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Chapter 5

The Administration of Foreign Trade and Foreign Exchange since 1961

Practically speaking, all exports and imports were taken over by government organizations or public enterprises in 1961. Since that time, the volume of exports and imports, prices, and all foreign payments have been the outcome of interaction between the Egyptian administration and the "world market." For a significant part of Egyptian trade and payments, the "world market" means the actions of the authorities of other countries, Communist countries in particular. The administration has, of course, been forced to operate within the constraints of the domestic supply situation, and domestic supply, particularly in agriculture, is to some extent still determined by market forces. Domestic demand, on the other hand, influences foreign trade and payments only to the extent deliberately permitted by the administration.

These circumstances make it difficult to describe the operation of the system. When everything is left to administrative discretion, only detailed studies made on the inside can disclose exactly which mechanisms or criteria are crucial for the decisions made. Unfortunately, we have not been in a position to study how the system functions from the inside, and with a single exception,[1] nothing has been published about it. Moreover, it is conceptually impossible to single out the impact of the nationalizations as separate from the effects of import, foreign exchange, and other controls. To a considerable extent foreign exchange allocation has been undertaken by the same ministries and organizations that administer the nationalized industries.

It is also clear that actual developments in foreign trade and payments should not be interpreted as simply revealing the preferences of the Egyptian authorities, for they did not always correctly foresee the consequences of

their decisions and may have based them on inadequate information. Miscalculation has certainly not been absent. And since much of Egypt's foreign trade has been on a bilateral basis, what has actually taken place may reflect the relative bargaining position of the countries involved rather than preferences. Complicating this issue is the fact that, intimately related to the problem of weapons deliveries, the Egyptian position vis-à-vis the Communist countries has become increasingly weak. To what extent these countries have taken advantage of the situation economically is hard to say. For political reasons they may even have been inclined to subsidize (rather than exploit) Egypt. It seems clear, however, that had weapons and loans been available to a larger extent from the West, Egypt's East Bloc trade would have been much more limited.[2]

ECONOMIC STAGNATION AND FOREIGN PAYMENTS COLLAPSE: 1964–1967

Table 5–1 shows some indicators of developments from 1963–64 to 1970–71. The GDP growth rate, which had been 6.4 percent in 1963–64, declined to 4.9 percent in 1964–65, to 4.4 percent in 1965–66, and finally dropped to 0.3 percent in 1966–67. While the outbreak of war in June 1967 may have lowered the growth rate for that last year somewhat, it can explain the complete stagnation of GDP only to a minor degree. With the war, the growth rate became negative; the closure of the Suez Canal (which normally produced some 4 percent of GDP), the occupation of Sinai, the evacuation and destruction of Suez, Ismaileya, and some minor towns, together with the destruction of some major industries, including oil refineries and fertilizer plants, brought about a fall in GDP by 3.1 percent.[3] In 1968–69 a recovery by about 6 percent took place, but it did little more than compensate for the fall in 1967–68. For the three years from 1966–67 to 1968–69, the GDP growth rate averaged only about 1 percent; per capita income must have fallen by about 6 percent during this period.[4]

It is usually assumed that it was the mounting foreign exchange crisis during 1965 and 1966 that brought development (in terms of GDP growth) to a complete stop around 1966–67—before the 1967 war. The foreign exchange crisis (which had been looming since 1961) became acute in 1965, when the United States abrogated PL480 sales of wheat, and Egypt suddenly had to purchase large quantities of wheat in convertible currency at a time when the exchange reserves were exhausted. The exchange crisis reached such proportions in 1965 and 1966 that Egypt was unable to fulfill contractual debt service obligations, got involved in short-term financing through European (particularly Italian) commercial banks at interest rates that even

TABLE 5-1

Economic Indicators, 1963–64 to 1970–71

Year (July 1–June 30)	Growth Rate (percent)		Production (1963–64 = 100)			Expenditure on GDP (% of GDP at current market prices)				Foreign Trade Deficit (−) or Surplus (+) (mill. £E)	Deficit on Current Account (−) (mill. £E)
	GDP	GDP, Excluding "Other Services"	FAO Index, Total Agricultural Production	Value Added at Constant Prices		Gross Investment	Public Consumption	Private Consumption	Foreign Balance		
				Agriculture	Industry and Mining						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1963–64	6.4	6.6	100	100	100	19.7	21.3	66.0	−7.0	−176.8	−126.0
1964–65	4.9	3.5	103	105	104	17.2	19.8	66.1	−2.5	−135.5	−119.5
1965–66	4.4	3.5	104	107	107	18.6	20.5	65.9	−5.1	−204.8	−96.2
1966–67	0.3	−0.5	103	104	108	15.5	19.7	65.8	−1.0	−115.2	−103.9
1967–68	−3.1	−5.5	107	108	102	13.5	22.7	69.6	−5.3	−99.3	−117.4
1968–69	5.9	6.1	117	109	114	11.8	23.9	67.8	−2.4	32.8	−118.7
1969–70	6.9	6.8	120	116	121	14.0	24.1	65.3	−4.1	5.9	−160.4
1970–71	4.8	3.6	118	115	134	14.2	25.8	66.9	−5.2	−61.2	−211.4

NOTE: Imports do not include delivery of military equipment, but the balance of payments on current account does include payments for such equipment. Public consumption probably includes payments for military equipment from abroad, and not deliveries.

SOURCES: Cols. (1), (2), (4), (5): Official estimates of Central Agency for General Mobilization and Statistics; estimates for 1959–60 to 1964–65 at constant 1959–60 prices; those from 1964–65 on, at constant 1964–65 prices. Both estimates are corrected for obvious flaws. Concerning the 1959–60 to 1964–65 estimate, see Bent Hansen in Vatikiotis, op. cit. In the estimate at 1964–65 prices, housing jumps up by more than 50 percent from 1966–67 to 1967–68. Since housing does not behave like that, particularly not at a time when houses are destroyed and about half a million people driven from their homes, we have assumed that housing in 1967–68 and 1968–69 increased by the normal 1–2 percent. "Other Services" consists mainly in government.

Col. (3): FAO, *Monthly Bulletin*, 1972 and 1974, No. 1, for averages of agricultural years. Overlapping of years makes year-to-year comparisons between cols. (3) and (4) difficult.

Cols. (6) to (9): CAGMS.

Cols. (10) and (11): *International Financial Statistics*, IMF, U.S. dollar values converted at the official rate of £E0.435 per U.S. dollar.

TABLE 5–2

Money Supply, 1962–1968

Year End of	Price Indexes (1962=100)			Money Supply, M_2[a]			Counterpart of Change in Money Supply (mill. £E)				Net Foreign Assets minus Clearing Accounts
		Wholesale Prices			Increase						
	Cost of Living	Food-stuffs	Industr. Mat. and Prod.	Total (mill. £E)	(mill. £E)	(%)	Net Foreign Assets, etc.[b]	Net Claims on Government[c]	Claims on Private Sector	Claims on Specialized Banks	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1962	100	100	100	629.2							−0.1
					118.9	18.9	−32.5	120.5	26.0	4.7	
1963	102	100	102	748.1							7.6
					115.9	15.5	−25.7	114.7	12.0	14.9	
1964	114	110	105	864.0							−6.3
					59.7	6.9	−17.3	69.7	8.5	−0.8	
1965	127	124	110	923.7							−22.8
					14.8	1.6	−65.4	101.5	−4.9	−16.4	
1966	133	141	111	938.5							−77.8
					45.3	4.8	−26.1	64.5	−8.9	15.8	
1967	132	153	113	983.8							−101.9
					32.0	3.3	−13.7	4.9	44.4	−3.6	
1968	—	147	116	1,015.8							−103.1

SOURCES: Cols. (1) to (3): *Economic Bulletin*, various issues; cols. (4) to (11): *International Financial Statistics*, IMF, various issues.

a. Includes time and savings deposits with banks and Post Office Savings Bank deposits; does not include government and semigovernment deposits.

b. Net foreign assets (including gold) *minus* clearing and other accounts in £E, U.S. counterpart funds, and IMF accounts.

c. Including capital, reserves, et cetera (since all banks are government-owned).

TABLE 5–3
Imports, 1963–1968
(mill. £E)

	1963	1964	1965	1966	1967	1968
Foodstuffs	113.6	119.8	110.2	126.1	137.7	91.9
Other consumer goods	42.2	33.8	45.3	47.0	32.3	28.9
Raw materials	133.9	153.2	168.1	175.8	106.3	100.5
Capital goods	98.5	107.6	92.3	117.0	67.9	68.3
Total	398.4	414.4	405.8	465.4	344.3	289.6

SOURCE: *Economic Bulletin*, National Bank of Egypt, 1970.

the Khedive Ismail would have found immodest, and had to ask for moratoria from both West and East.

The payments crisis was a financial matter, of course, but it could have been expected to lead to a reduction of imports. This was not the case, however. From 1964 to 1966, total commodity imports remained at a very high level in relation to GDP (see Chart 1–1), increasing by 12 percent over the two years, which should have been sufficient for sustaining the growth rate at a level of 6 percent. Not only is it surprising, therefore, that the authorities were able to increase imports in the face of the desperate payments situation, but also that production suffered from the payments crisis when imports were actually on the rise.

Before discussing this matter in some detail, we want to emphasize that other factors did, in fact, serve to dampen the GNP growth rate from 1964 to 1967.

Both agriculture and industry stagnated, but in both cases exogenous forces were at work none of which can be traced back to the foreign exchange crisis. Agriculture experienced very good crop years from 1962 to 1964, and this helped to create the rather high growth rates of GDP in that two-year period. From 1964 to 1966, however, the yield of cotton fell by about 20 percent. There was a little "green revolution" in corn, with yield increasing by about one third. Nevertheless, corn being a much less valuable crop than cotton, agricultural output and value added stagnated, albeit at a relatively high level, from 1964 to 1967. In industry, oil production (extraction as well as refining) fell because certain wells began to run dry, a circumstance that also tended to create stagnation in the total exports of manufactured products other than textiles during these years (Table 5–4). The same happened with manganese. In addition, the slowdown in agricultural output alone would have tended to create stagnation in industries processing agricultural products, such as cotton ginning and pressing, flour milling, canning, and sugar refining.[5]

TABLE 5–4
Exports, 1963–1968
(mill. £E)

	1963	1964	1965	1966	1967	1968
Cotton						
Raw	121.0	166.6	146.2	143.4	121.6	121.1
Yarns and fabrics	32.9	31.8	47.0	47.9	47.6	52.4
Rice	19.5	30.4	19.8	21.2	29.8	44.9
Other agric. products	15.2	14.6	14.5	15.3	16.2	13.7
Crude oil and oil products	20.0	20.9	16.8	15.3	9.1	7.5
Cement	1.2	1.0	2.0	2.3	1.9	5.1
Other	5.6	5.8	5.5	5.1	5.5	6.5
Total	226.8	234.4	263.2	263.1	246.1	270.3

SOURCE: *Economic Bulletin*, National Bank of Egypt, 1970.

However, these factors can, at best, only partially explain the stagnation of industrial production.

The foreign exchange crisis could have worked directly on industrial production through a decline in imports of raw materials, parts, and machinery, and through greater maldistribution of the production requirements actually imported. However, the total value of imports of both capital goods (including transport equipment) and raw materials continued to rise through 1966, as shown in Table 5–3. Raw materials imports rose by about 15 percent and capital goods and transport equipment, by about 9 percent, (in value terms) from 1964 to 1966, while industrial value added at constant prices rose by only 3 percent from 1964–65 to 1966–67. Relevant import price indices are not available, but international raw materials and capital goods prices did not rise markedly during these four years. A unit price index for total Egyptian imports rose by 3.3 percent from 1963 to 1965,[6] while the IMF's import price index for less developed areas rose by 3 percent from 1963 to 1967.[7] It seems clear that imports of both raw materials and capital goods increased much more than industrial production in real terms.

Moreover, data are available which point in the direction of higher stocks of industrial raw materials and parts during this period. Table 5–5 presents value figures for inventories in state-owned industrial enterprises. Nothing is known about the inventory valuation principles applied, but finished products are presumably at current prices, and raw materials and spare parts, at ingoing prices. It is not clear how goods in process—if at all included—have been classified. Two comparisons with inventory values have been made, one

TABLE 5–5

Inventories in State-Owned Industrial Enterprises

	1964–65		1965–66		1966–67	
	(mill. £E) (1)	Percent of Total Output Value (2)	(mill. £E) (3)	Percent of Total Output Value (4)	(mill. £E) (5)	Percent of Total Output Value (6)
Finished products	56.2	6.6	77.9	7.6	100.3	9.4
Raw materials	84.1	9.8	112.9	11.0	107.2	10.0
Spare parts	29.8	3.5	34.5	3.4	39.6	3.7
Total inventories	170.1	19.8	225.3	22.0	247.1	23.1
			Index Numbers			
Total inventories, value	100	—	132.4	—	145.3	—
Industry and mining, value added at constant prices	100	—	102.5	—	103.2	—
Wholesale prices, industrial materials and products	100	—	103.1	—	107.1	—

SOURCES: Value of inventories: Cols. (1), (3), (5), *Follow-up and Appraisal Reports for the First Five-Year Plan*, Ministry of Planning, Cairo, for the years indicated in the tables. Cols. (2), (4), (6), our calculation—Cols. (1), (3), and (5) divided by total output value in industrial enterprises with ten workers and more; 1964–65 and 1965–66, from *Economic Bulletin*, N.B.E., 1970; 1966–67, obtained by applying percent increase of "Value of Industrial Production" (undefined) for averages of 1965–1966 and 1966–1967 in *Yearbook, 1969*, Federation of Industries, Cairo, p. 10, to the 1965–66 figure for output value in industrial enterprises with ten workers and more.

Industry and mining, value added: *Economic Bulletin*, N.B.E., 1971, No. 4.

Wholesale prices: *Economic Bulletin*, N.B.E., 1970, end of calendar year figures.

with total output value in enterprises employing ten workers and more (which must include practically all state-owned enterprises but also some private ones) and the other with total value added at constant prices in industry and mining (which includes all private industrial enterprises and handicrafts).

Compared with total output value, there was a clear relative increase in total inventory value from 1964–65 to 1966–67, whereas during the first five-year-plan period, 1960–61 to 1964–65, there had been no change in relative inventory value.[8] Almost the whole (relative) increase was in finished products, although relative value of inventories of both raw materials and spare parts showed a slight increase, too.

In physical terms, inputs of raw materials and consumption of spare parts can be expected to change roughly in proportion to physical output and value added at constant prices (unless there is strong pressure on capacity, in which case at least consumption of parts might increase more than proportionately); and inventories need not increase fully in proportion to current inputs. Value added at constant prices in the industry and mining sector increased by 3 percent from 1964–65 to 1966–67. Wholesale prices for industrial materials and products increased by 7 percent. Assuming that this price index can be used for deflating the values of both raw materials and spare parts, and identifying increase of real value added with increase in physical output, one finds a sharp rise in real inventories relative to real output, not only of finished products but also of raw materials and parts. There is admittedly more than one snag in this argument. Presumably, production increased more in state-owned enterprises than in small private enterprises: raw materials allocations discriminated clearly in favor of state-owned enterprises. And the assumptions about prices may be misleading. Nevertheless, it would take a very strong discrepancy in the relative increase of production in public and private enterprises, or a shift in relative input and output prices, to upset the conclusion that relative inventories of raw materials and parts increased somewhat during the years in which the growth rate of production slowed down. Certainly, it is beyond a reasonable doubt that relative inventories of finished products increased substantially during these years.

Data for individual industries also point to the accumulation of excessive inventories of spare parts. The cement industry, for example, which experienced an increase in production from 2.0 million tons in 1960 to 2.3 million tons in 1965–66, at the same time showed an increase in consumption of spare parts from £E5.12 million to £E6.15 million (this nominal increase may have implied a certain fall in real terms), while inventories of spare parts rose from £E2.10 million to £E4.99 million.

Thus, looking at the *totals* of imports and inventories of raw materials and parts, there is nothing there to help us understand the stagnation of industrial production during the period of the foreign exchange crisis. Totals, how-

ever, tell us nothing about distribution between enterprises. There may be plenty of inventories—of the wrong things. Indeed, the simultaneous occurrence of inventory surpluses and commodity shortages is a well-known phenomenon in the centralized economic systems of the Communist countries. Would it not be natural for something similar to take place in Egypt, and perhaps even more so in Egypt than in a Communist country? Also, enterprises may have been stockpiling in anticipation of shortages.

Be that as it may, nothing is easier than giving examples of shortages leading to unintentional production curbs during these years. In 1965–66 superphosphate production declined because of insufficient supplies of pyrites and sulphur (both imported). Production of rubber tires declined from July to December 1966 because of the shortage of imported raw materials.[9] During these years, the newspapers—which are often quite outspokenly critical of the lower levels of government—contained reports of extraordinary accumulations of import goods in the customs warehouses in Alexandria. Moreover, the durable consumer goods industries were severely affected by deliberate curbs on imported components; automobile assembling is the outstanding example. Thus, there is little doubt that behind the apparently satisfactory import and inventory totals there were, indeed, commodity and sectoral shortages that exerted an adverse effect on production.

A striking feature of Table 5–5 is the sharp absolute and relative increase in inventories of finished industrial products. In a market economy this would normally be interpreted as a sign of slack demand. In a controlled economy it might just mean that a lot of unsaleable rubbish is piling up. But although domestic purchasers certainly preferred imported goods (apart from cotton textiles, where Egyptian quality is superior), there is no indication that they would have chosen to abstain from all buying when only domestic products could be obtained. We have, then, the last possible explanation of the industrial stagnation: measures to curb private demand and investment were taken as of 1964–65. Since the situation was one of repressed inflation, however, it is difficult to find clear indicators of total demand ex ante.

Let us first consider money supply as a demand indicator (Table 5–2). The expansion in money supply, including quasi money (in the terminology of the IMF), slowed down rapidly during 1965 and 1966. After spurts of 19 percent in 1963 and 15 percent in 1964, the increase was only 7 percent during 1965 and less than 2 percent during 1966. The corresponding figures for increases in GDP at current market prices were 12, 18, 9, and 4 percent. Thus, while some excess liquidity may have accumulated during 1963 (and earlier), during the following three years liquidity in the private sector showed a relatively declining tendency. These developments in the money supply do not exclude the possibility that some deflationary pressure may have emanated via the private sector during 1965 and 1966.

The course of money wages points in the same direction. While annual wages increased from 1963–64 to 1964–65 by 17 percent in agriculture, by 9 percent in industry, and by 5 percent in services, the corresponding increases during the following year were only 4, 3, and 0 percent. Real wages in agriculture rose slightly during these two years, but those in industry and services fell. Developments in private profits are not known.

The composition of national expenditure, measured as a percentage of GDP at current market prices (Table 5–1, columns 6 to 9), permits some further conclusions. The characteristic feature of national expenditure from 1963–64 to 1966–67 is that gross investment (including stock changes) shrank from 19.7 to 15.5 percent of GDP, while the foreign deficit fell from 7.0 to 1.0 percent of GDP. Of the improvement by 6.0 percentage points in the foreign deficit, 4.2 percentage points was financed (in real terms) by a decline in gross investment; fixed gross investment even fell as much as 5 percentage points. Gross investment thus occupies a central place in explaining events. The remainder of the improvement in the foreign deficit is related almost exclusively to the share of public consumption, while private consumption by and large kept its share.

Before analyzing the demand situation, we sound a word of caution concerning the improvement in the foreign deficit noted above. A glance at col. 11 of Table 5–1 shows that the deficit in foreign *payments* improved less during the same period. Apart from the deficiencies of the statistics, this apparent contradiction is most probably explained by the fact that the computation of the foreign deficit for the national expenditure estimates is based on commodity and services *deliveries* in foreign trade (with the exception of weapons), whereas the foreign payments deficit is a deficit on *payments*. The difference would then be the well-known phenomenon of leads-and-lags in foreign payments, and it is crucial for understanding the payments situation. From around 1963 to 1966, payments abroad were postponed as the foreign exchange situation became increasingly strained; when, therefore, purchases and deliveries of imports were cut down after 1966, payments continued to run at a high level for some time because deferred payments fell due and could not be postponed. The alleviation of the payments situation was thus a prolonged process and did not occur instantaneously with the reduction of imports.

The diminution in the share of gross investments partly reflects the government's deliberate policy of reducing investment expenditure; the Mohieddin cabinet felt that expenditure on investment could safely be reduced without detrimental effects on real investment in the sense of capacity creation.[10] The reduction of investment expenditure goes far in explaining why a domestic slack should appear with little or no immediate improvement in the balance of payments in terms of capital goods deliveries, and why the effects on imports tended to lag behind the domestic measures of demand management.

In the year 1964–65, the decision of the government was not to embark upon any new investment projects, only to finish projects already started. Since at the start of an investment project (particularly in industry and electricity) expenditures are usually concentrated on construction, shifting to machinery and equipment only later, and since construction is an activity using domestic materials—whereas machinery and equipment are largely imported into Egypt—it follows that a decision to cut investments by refraining from starting new projects leads to a drop in construction activity and, hence, in the production of building materials, while capital goods imports continue and may even rise for some time. This time pattern is well-known in developed countries and is clearly discernible in Egypt for these years. In real terms construction activity (measured by value added) fell by 5 percent from 1964–65 to 1966–67, while capital goods imports increased by 8 percent during the same period.[11] To some extent the development was fortuitous, since the Aswan High Dam project happened to pass from the construction phase to the installation of generators and transmission lines around 1965. In terms of money value, fixed investment remained constant from 1964–65 to 1966–67; in real terms it probably fell, but in terms of finished capacity it may quite well have increased in line with the government's intentions. Not until 1967 did capital goods imports fall, but then the fall was very dramatic (to less than two thirds), and now real investment fell to a very low level.[12] For the years we are interested in—1964 to 1966—the investment policies thus created a domestic slack without alleviating the strain on the balance of payments.

The available data on public and private consumption are less helpful. Public consumption data (and the foreign deficit) may include payments for military equipment acquired from abroad, but certainly not deliveries (otherwise something much more dramatic would have taken place from 1966–67 to 1967–68, when the Soviet Union replaced a very substantial part of the army's equipment); this fact distorts the size of all shares, and most of all that of public consumption. Moreover, the only available expenditure data (Table 5–1) are at current market prices, which are particularly deceptive for a comparison between public and private consumption shares for this period. About two-thirds of public consumption consists of government wages and salaries, which were kept unchanged (in principle, at least) from 1964 to 1967, while prices for consumer goods increased much more than other prices, by about 30 percent from the end of 1963 to the end of 1966 (Table 5–2, columns 1–3). The almost unchanged share of private consumption at current market prices thus hides a substantial decline in real terms. The share of public consumption in real terms, on the other hand, must have declined far less, and probably even increased somewhat from 1963–64 to 1966–67. How

this shift in the composition of real demand affected private production and the balance of payments is difficult to say a priori, but it stands to reason that it must have tended to reduce demand for domestically manufactured products and perhaps strained the balance of payments. For public consumption consists of direct labor services to a much larger extent than does private consumption; and the Egyptian government, involved in the Yemen War at that time, probably had a relatively high propensity to import (even disregarding heavy military equipment, included here only insofar as payments are concerned): the army procurements of food, an important import item, and of other imported goods probably increased rapidly.

It is more difficult to gauge the shifts in income distribution in the private sector and their effects on demand for domestically produced manufactures and import goods or exportables. It is beyond a reasonable doubt that private sector income distribution shifted strongly in favor of labor during the 1961–1963 period, when nationalizations, Arab socialism, and other policies of the Nasser regime dominated the scene (see Chapter 4). But from 1964 on the picture is less clear. The rise in the cost of living was largely the result of public enterprise pricing, and to that extent did not serve to increase private profits. Some increases in producer prices in agriculture did take place, however, and black market profits probably became more widespread. It seems possible, therefore, that from 1964 to 1967 there was, indeed, a shift back in favor of private profits. There is some evidence that terms of trade between agriculture and manufacturing shifted in favor of agriculture from 1964 to 1967, with the peasantry tending to consume more food, textiles, and fuel, and little else. How shifts in income distribution within the private sector generally affect the demand for domestic products and the balance of payments ex ante is not obvious. The effects may go either way.[13]

Possibly all of these factors must be brought into the picture to explain fully the stagnation of industrial production. Industries processing agricultural products tended to stagnate because agricultural crops were mediocre. Durable consumer goods industries declined because supplies of imported components were deliberately cut down. Private sector liquidity stopped increasing, generally dampening private demand. Building materials industries suffered from the change in public investment policy and a decline in residential building. The shifts in the composition of demand may, at least temporarily, have affected the balance of payments adversely. On top of all this, the growing complexity of controls and the increase of red tape generally created imbalances and obstacles to production, inter alia through increased maldistribution of available imports. However, to quantify the individual impact of all of these factors does not seem feasible.

A final problem to be considered is the coordination of domestic demand management measures with foreign trade and exchange policies. Through

1963–64, a high degree of coordination was possible insofar as the two key ministries—the Treasury and the Ministry of the Economy (in charge of foreign trade and banking, including the central bank)—together with the Ministry of Planning (a body without any real importance), were gathered under the same minister. Thereafter, these three ministries were headed by three different ministers, and coordination of policy may have suffered from this change. Coordination between ministries has always been a weak point in Egyptian government, and it became worse during these years when the president lost contact with domestic realities and his interest was almost exclusively directed toward foreign affairs.[14] It must not be excluded from our consideration, either, that, at the same time as the Treasury embarked upon an honest attempt to mop up purchasing power, the foreign trade authorities continued to consider it their main task to secure higher commodity imports regardless of the foreign exchange position. Pressures from other ministries and the natural tendency under a control system for enterprises and authorities to ask for more than is really needed may have contributed to keeping the issuance of licenses at too high a level.

The deficit in the balance of current payments during these years was largely with Western Europe and the United States and therefore a deficit in convertible currency. Payments vis-à-vis Communist countries were almost balanced (Table 5–6). Trade with the latter yielded a surplus averaging almost £E20 million during the years 1961 to 1966, but this surplus was by and large used for covering payments for deliveries of military equipment from, and debt service to, the Communist countries. Between one-half and two-thirds of total imports continued to be purchased from Western Europe and the United States (the Communist countries being unable to supply wheat, to take one important item), and during the years 1963 to 1966 the trade deficit with these countries was on the order of £E150 to £E200 million. About half of this deficit was covered by revenues from the Suez Canal. The remainder had to be covered by credits and, apart from some long-term development loans and PL480 counterpart funds (until 1965), this meant short-term commercial credits.

Contacts with the IMF led the latter to present in 1966 a "background stabilization plan" which, among other steps, involved a rise in the foreign exchange rate by about 40 percent, as well as certain price and tax increases and a lowering of subsidies on consumer goods. The Mohieddin cabinet seems to have agreed to the stabilization plan; some further price and tax increases were actually implemented to reduce private consumption and investments were further curtailed. But the president considered the devaluation proposal as an intolerable interference in Egypt's economic affairs, and it led to the resignation of the cabinet. At this time there seems to have been a clash between president and cabinet about policy in general, and the Yemen War in

TABLE 5–6

Distribution of Foreign Trade by Area, 1961–1968

Year	Exports			Imports			Trade Balance (mill. £E)		
	Total (mill. £E) (1)	Eastern Europe (%) (2)	Western Europe and America (%) (3)	Total (mill. £E) (4)	Eastern Europe (%) (5)	Western Europe and America (%) (6)	Total (7)	Eastern Europe (8)	Western Europe and America (9)
1961	168.9	40.5	30.9	243.8	23.6	50.9	−74.9	10.9	−79.9
1962	158.3	38.7	35.4	301.0	24.2	56.7	−142.7	−11.5	−114.7
1963	226.8	44.3	31.5	398.4	18.7	64.0	−171.6	25.7	−183.2
1964	234.4	45.1	30.1	414.4	19.1	62.9	−180.0	26.7	−190.0
1965	263.2	48.7	25.2	405.8	22.7	55.2	−142.6	37.1	−157.8
1966	263.1	51.7	19.9	465.4	25.7	55.1	−202.3	16.4	−204.1
1967	246.1	50.3	23.5	344.3	43.5	37.1	−9.2	−26.0	−70.0
1968	270.3	49.5	20.8	289.6	40.4	42.4	−19.3	15.4	−66.6

NOTE: Based on customs statistics. Except for 1963 and 1964, "aid" (see Note, Table 1–5) is not included. No military equipment is included in the import figures.

SOURCE: *Economic Bulletin*, N.B.E., 1970.

particular. Mohieddin seems to have insisted upon a termination of the Yemen War as the only way of improving the economy.[15]

DEVELOPMENTS AFTER THE 1967 WAR

The outbreak of war with Israel in 1967 changed the picture in several respects. The immediate consequence was a sharp increase in imports (excluding military equipment) from the Communist countries, with exports to them remaining almost unchanged. But after 1968 the tendency was reversed, to a fall in commercial imports from and a strong increase in exports to these countries, obviously to cover payments for military equipment. The deficit vis-à-vis Western Europe and the United States in 1968 was cut down to £E66 million, which was more than covered by the transfers received from other Arab countries as compensation for the loss of revenues from the Suez Canal. The reduction of the deficit with Western Europe and the United States was accomplished exclusively through a substantial reduction of imports from these countries. Thus, in 1968–69 Egypt, for the first time since World War II, found herself with a trade surplus.[16]

Beginning with that year, however, GDP started recovering. The growth rate was 5.9 percent in 1968–69, 6.9 percent in 1969–70, and 4.8 in 1970–71. Agricultural production played an important part in the recovery, and it would seem that the returns from the Aswan High Dam began to materialize at that time. From 1967 to 1969, the FAO index of total agricultural production rose by 12 percent. The uptrend continued over the following two years at a slower rate, with an increase of little more than 4 percent, but, the overall increase for the five-year period from 1966 to 1971 did reach about 25 percent, or some 5 percent per year. By comparative standards this is quite a substantial rate of growth for agriculture. It should also be recalled that the normal growth rate of Egyptian agriculture had been about 2½ percent; the additional 2½ percent per year, therefore, was almost certainly the result of the High Dam. Since the dam had originally been expected to increase total agricultural output by some 20 percent, this means that almost two-thirds of the expected increase (12½ percentage points out of 20) had materialized by 1971. Fertilizer shortages related to the destruction of some industries and the decline of imports may have inhibited faster agricultural growth in these years, notably because the High Dam itself meant a strong increase in fertilizer requirements.

More important from our point of view is the fact that industrial production recovered, too, despite the destruction of important industrial plants. After a decline in 1967–68 of 5 or 6 percent in industrial value added, an increase of 12 percent in 1968–69 brought industrial production 5 percent above the pre-1967 War level. Since this recovery took place in the face of

capital goods and raw materials imports in 1967 and 1968 running at only two-thirds of the average for 1965 and 1966, it is hard to believe that supplies of imported capital goods and raw materials could have been the decisive factor in limiting industrial growth during the years immediately *before* the war.

THE ADMINISTRATIVE SYSTEM[17]

Initially, the nationalizations of 1961 changed little in the formal setup of exchange and trade controls. Exchange control continued to be supervised by a Supreme Committee for Foreign Exchange, set up by the Minister of the Economy. Laws, decrees, and instructions issued by the latter were implemented by a Director of Exchange Operations. Technical problems were left to the Central Exchange Control attached to the Central Bank of Egypt.

Commodity exports were controlled by a special Export Board. In principle, they continued to be free of licensing, and, as mentioned earlier, some exports of fruits and vegetables actually remained in private hands. However, most foreign sales were now handled by public enterprises, and exports of cotton could take place only through the intermediary of the Egyptian Cotton Commission.

All imports required licenses by the Import Control Office. Imports were largely effected through state organizations, which initially had to apply for licenses to import. Government departments could import directly, but state import organizations as well as industrial firms had to submit applications to the appropriate ministry, which scrutinized each application in relation to the foreign exchange budget (see below) and forwarded it to the Import Control Office. The imports of industrial firms were limited to their own requirements of raw materials, parts, and equipment. Thus, there was no scope left for imports by private traders, and as of August 1963, the right of private industrial firms to import directly was also abolished.

Import licenses were issued within the framework of the foreign exchange budget, drawn up by a Supreme Committee with members from the Central Exchange Control, the Cotton Commission, and representatives from the ministries of Industry and Planning. Initially, the Supreme Committee was only expected to evaluate the foreign exchange budget estimates prepared by the other exchange control authorities, but after 1962 it was directly in charge of the allocation of foreign exchange. The intent was to keep imports within the limits of export performance and the availability of foreign loans, and to coordinate the allocation of foreign exchange with the expenditures under the overall government budget, which included the gross expenditure and revenue of all state-owned enterprises from 1962 on.

The allocation process developed roughly as follows: In January the Foreign Exchange Office of the Ministry of the Economy sent questionnaires

to the various state organizations and firms, requesting details about their production requirements for imported raw materials and capital equipment for the next fiscal year. On the basis of these questionnaires a foreign exchange budget was drawn up after extensive bargaining between the various authorities and organizations. The allocations were made according to the type of goods to be imported, the type of currency required for payment, and the method of settlement. Allocation of foreign exchange to an importer was accompanied by an import license, and the import transaction was initially carried out by the licensee. However, import licenses became superfluous, since private traders and private industrial firms (beginning with 1963) were not allowed to import. Licensing was therefore abolished as of October 1964.

In October 1964 the economy was divided (administratively) into a number of major sectors. Each was allotted a total amount of foreign exchange by the budget of the Supreme Committee, but it was left to the authorities (ministries) at the top of each sector to determine the detailed allocation within it. These authorities also determined whether imports should be made directly by themselves or left to the (state-owned) import organizations. A special bank was attached to each sector to take care of the technical matters pertaining to import payments. These changes implied a certain degree of decentralization of the allocation system, with the aim of placing the responsibility for investment, production, and import decisions with the same authority.

Within the framework of the annual budget, the foreign exchange allocations to the main sectors were first made on a weekly basis by a special Interministerial Committee. The total amount allocated each week equaled the actual exchange earnings of the previous week *minus* foreign debt obligations and other payments for invisibles falling due in the following week.

A system as myopic as that could hardly be expected to work in a satisfactory way. For instance, it would seem to link sectoral allocation of foreign exchange to the seasonalities of exports and debt servicing, but how this, in turn, affected allocations within the sectors is not known to us. The system was changed in the following year—1965—to one of less frequent periodic allocations, but operated on the basis of the same kind of simple arithmetic as that of the weekly system. A step in the direction of increased centralization was taken later, when it was decided that a central financing committee should meet periodically to decide upon import transactions recommended by the sectors for the period under consideration and within the given, periodic foreign exchange allocation. The intention was obviously to permit appraisal of the relative need for foreign exchange among the various sectors. It should be added that the annual foreign exchange budget continued to set fixed annual quotas for each particular sector, but what precise relation the foreign exchange budget had to the periodic allocations of foreign exchange and import approvals is not clear.

In regard to import priorities little was changed after the nationalizations

of 1961. The Ministry of Defense had top priority along with the Ministry of Supply (in charge of basic foods). Next in line came raw materials, machinery, and parts. How allocations were made within the main sectors during the period of decentralization in 1964 and 1965 is not known, though the priorities were probably largely the same. It is clear, however, that actual allocation was greatly influenced by bargaining among parties of unequal bargaining power, and that all kinds of imponderabilia, from ministers' whims and personal favoritism to baksheesh, played their role.

It should also be emphasized that construction of new plants financed through special arrangements with foreign sources and, of course, purchases of weapons fell outside the foreign exchange allocation system just described.

No information is available on the import requests of the various sectors and the extent to which they were satisfied, but we have compiled a partial list of quotas actually allocated by the Foreign Exchange Budget to the ministries and government authorities in the fiscal year 1963–64 (Table 5–7). The

TABLE 5–7

Foreign Exchange Quotas Allocated to Various Ministries and Organizations in the Fiscal Year 1963–64

(mill. £E)

	Total	Convertible Currency	Inconvertible Currency
Ministry of Industry (raw materials, industrial equipment, spare parts)	105	76	29
Ministry of Agriculture (seeds, pesticides, agric. equipment, livestock)	14	12	2
Ministry of Supply (wheat, tea, coffee, fertilizer, sugar, etc.)	105	27	78
Ministry of Housing (steel and electrical equipment, drainage and sewage requirements)	7	3	4
Transportation	4	3	1
Pharmaceutical Organization	14	13	1
Petroleum Authority	28	22	6
Agricultural Organization (fertilizer and seeds)	4	3	1
Total	281	159	122

SOURCE: M. S. Mourad and F. Moursy, *The Foreign Exchange Budget and the Exterior Financing of Development*, Cairo, 1967, pp. 206–208.

total amounts to £E281 million (67 percent of all imports), which exceeds exports for that year (£E238 million) by roughly the service surplus (£E45 million). However, to these import allocations one should add capital goods imported in implementation of the investment program for new plants, as well as imports of consumer goods (such as woolen textiles, furniture wood, appliances, and automobiles) allocated directly to government agencies. Moreover, to the £E135 million deficit on current account in 1963–64, foreign payments obligations on capital account amounting to £E54.6 million should be added. Against this, foreign loans of £E148.1 million were available (including £E75.5 million under PL480), leaving an overall deficit of £E41.5 million. This deficit, maintained at that level until 1966, had then to be covered ad hoc by short-term credits and postponement of foreign debt service obligations. The Supreme Committee, thus, does not seem to have had the authority to balance its budget, and lack of power in negotiating with ministries and organizations may have confronted it with an impossible task.

APPRAISAL OF THE SYSTEM'S PERFORMANCE

Any attempt to appraise the performance of the administration of foreign trade and exchange after 1961 runs into two basic problems. Information about the actual working of the administrative machinery is scarce and may not really be sufficient to evaluate what was going on. In any case, a standard of comparison has to be chosen, and it is not obvious what this standard should be. Before proceeding, therefore, we have to make up our minds in this regard.

The information we have been able to collect about the administrative machinery summed up above does not amount to much more than a crude outline of the organizational setup. We could have added some more details of the same type, giving lists of state-owned trade agencies and organizations, et cetera, but this would hardly contribute to answering the basic question of how the machinery worked and how well or badly it performed. Indeed, such detail might help prejudice the analysis; for there is probably a tendency to assume that the larger a bureaucratic machinery is, given the problems to be solved, the worse it works. But that does not necessarily follow. Bureaucratic machinery may have an optimal size and may thus be too small, too. Moreover, with any system there is a concomitant bureaucracy. Even the "market forces" have their office employees and the less-than-perfect markets have many of them. It is only in abstract theory that perfect market forces as such do not use up resources and do not depend for their performances on the capabilities of these resources.[18] Once it has been decided, therefore, to replace private enterpreneurship with state ownership and not to depend on market forces, the bureaucracy of the market forces has to be replaced by

another allocative machinery, another bureaucracy. The mere fact that the new bureaucracy is larger than the old one does not prove that the new system is less efficient.

Connoisseurs of Egyptian bureaucracy may, at this point, smile and ask whether these are not fairly superfluous rites in the name of academic objectivity. After all, would anybody acquainted with Egyptian bureaucracy be in doubt about the answer? The authors, who have long personal experience with Egyptian bureaucracy, do not suffer from illusions in this regard[19] but feel, nevertheless, that some caution is warranted. First, there is a clear tendency in the economics profession, particularly in the United States, to take it for granted that any market system, however imperfect, is better than any other system. Second, private enterprise and market forces in Egypt were never perfect; they performed only reasonably well under the umbrella of a government that was always at their disposal and ready to bail out losers, be it through protective measures, support in the cotton futures market, or otherwise. In the case of Egypt (as anywhere else, of course) the choice is between (highly) imperfect systems, and we do not think that it is obvious a priori which one is preferable.

These considerations lead us directly to the basis of comparison. The reader will already have understood that we do not think that a system should be condemned just because it demonstrably fails to imply a perfect theoretical Pareto optimum or convergence toward such an optimum. No existing system is known to succeed in that unfailingly. The only basis of comparison that makes sense is the hypothetical performance of a realistic alternative system that could conceivably operate in Egypt. We know of at least one such system —that which preceded the one introduced in 1961. To choose that system as a basis of comparison has the great advantage that we do not need to hypothesize about its possible performance: we know what it was. Hence, we shall simply compare performance during the two five-year periods 1956–1961 and 1962–1967, and see which period made the better showing. The objection might be raised that the transition to the present system already began in the first of these two periods: important nationalizations took place in connection with the Suez War (nationalization of the canal itself, with a number of British- and French-owned companies, particularly in the field of finance); the purely domestic Misr Bank, the center of the Misr concern, was nationalized in 1960; and, in general, government activities in investments were increasing during the entire period. Hence it might be more interesting to go further back in time when private entrepreneurship was still unchallenged. Disregarding the immediate postwar years when the economy was still dominated by war controls, their dismantling, and the recovery of the economy, this would lead us to take as our point of reference the period from around 1948–49 to 1955. However, we shall refrain from this choice, mainly because

this period is dominated by the Korean boom and post-Korean recession and therefore can hardly be termed characteristic of the private enterprise system.

The Balance of Payments Deficit.

We emphasize first that the extraordinary increase in the balance of payments deficit after 1961, with the subsequent payments collapse, should not be taken as proof, or even as an indicator, of the inferiority of the present system. It was the logical, direct result of the ambitious targets for economic policy formulated by the government during the years 1960 to 1962, as we already noted in our discussion of the 1962 devaluation. The five-year plan of 1960–61 to 1964–65, Arab socialism, and the involvement in the Yemen war implied targets for gross investments, private consumption and public consumption far beyond the expansion of GNP. It is not clear whether this was understood by those who set these targets. Indeed, it is by no means clear whether target setting during these years was performed with any consideration of the problem of consistency. The men who pushed the first five-year plan and its investment targets (El Boghdady and El Kaisouni, among others) were not the same individuals as those who pushed for Arab socialism, with its consumption effects (Ali Sabri and his entourage). Also, the rise in defense expenditure may have been an unexpected consequence of the Yemen war (which was the president's personal responsibility and was initially expected to be brief and painless), much as the increase in U.S. defense expenditure in 1966 came unexpectedly as a consequence of the escalation of the Vietnam war. Furthermore, the president, upon whom the ultimate decisions about these matters rested both formally and de facto, may not have been correctly informed about the implications of these ambitious targets. Given the targets, however, the "system" had no choice but to increase the payments deficit and do its best to finance it.

The dangers of this policy were comprehended at the lower levels of government at an early stage, and the Treasury as well as the Central Bank tried to get messages through to the president in this connection. Whether these did not reach him, he did not take notice of them, or whether he thought that he would be able to continue playing off the United States and the Soviet Union against each other[20] and thus obtain financing beyond what the Treasury and the Central Bank thought realistic or justified is not known. As long as the two powers agreed to play the game, the payments problems were overcome. But when first the Soviet Union, in 1964 (when Khrushchev refused to postpone High Dam loan payments), and one year afterwards the United States (abrogating PL480 sales) backed out, the potential inconsistency immediately became an established fact and targets had to be sacrificed.

While thus the balance of payments policy turned out to be entirely un-

realistic and the export performance, against this background, entirely inadequate for financing the import requirements of the economy at a satisfactory rate of growth, these are failures for which the top decision makers rather than the administrative system as such should be blamed.

Given the public sector's expenditure targets and the government's wage, tax-subsidy, and exchange rate policies, any system would run into balance of payments difficulties. Whether it would have been possible under another and better allocation system to realize the general expenditure targets at lower balance of payments deficits, either by maintaining production increases at lower import levels or, at given levels of imports, by increasing production and exports is another matter. This is largely a matter of production efficiency, the problem we are turning to now.

Resource Allocation.

Productivity data certainly point to inefficiency in production. While productivity per man-hour in industrial enterprises with ten employees and more increased by 4 percent per year from 1952 to 1960,[21] and faster in the second than in the first half of this period, there does not seem to have been any increase at all in industrial labor productivity after 1961.[22] To some extent the decline in labor productivity may reflect overemployment created first by the government's employment drive of 1961 (yet another ambitious policy target related to Arab socialism), when public enterprises were forced to employ workers beyond their needs, and after 1965 by the slack in demand which, as in any other system, tends to create labor redundancies. However, the increasing complexities of the bureaucratic system, deterioration of management, commodity shortages, and disciplinary difficulties—all directly or indirectly related to the change in the system—probably did much to keep down labor productivity. And if these circumstances had harmful effects on labor productivity, it stands to reason that they also had harmful effects on the productivity of other inputs, including imports.

There is the further question whether the *composition* of domestic production became more or less suboptimal during the 1960s—the allocation problem of neoclassical theory.[23] Did explicit and implicit price distortions increase or decrease? This matter will be discussed in some detail in the following chapters on agriculture and industry. A clear answer is difficult to give, however, because we are confronted not only with direct price distortions and trade controls—which certainly did increase—but also with government interference with domestic production patterns. Our tentative conclusion on the basis of the following chapters is that resource allocation in both agriculture and manufacturing industry deteriorated during the 1960s.

The problem is closely related to that of the *level* of foreign trade, or,

given the deficits, the level of exports or imports. In Chapter 1 (Chart 1–1) we presented exports and imports as percentages of GDP at current market prices. The important feature in the present context is the clear downward trend of exports in relation to GDP from the time of the Korean boom until around 1963; from that year on the level is approximately constant.

Before World War II, exports seem to have been about 15 or 16 percent of GDP. Immediately after the war the percentage was low, but it recovered quickly. After the high export prices of the Korean boom years had subsided, the export level in 1952 was about the same as before World War II. From then on the share was shrinking until 1963 (the very low levels of 1961 and 1962 should be disregarded here, since they were the result of the cotton crop failure in 1961). The gradual (cyclical and structural) depreciation during the 1950s (Chapter 3) was clearly insufficient to stop, let alone reverse, the downtrend in the share of exports. In that respect the system after 1961 actually performed better—at least it stopped the downward trend. But by then exports had reached a very low level, and it was partly the rise in cotton and rice prices on the international markets that halted the decline. A volume index for exports shows an increase of 40 percent from 1956 to 1960 and of only 25 percent from 1960 to 1966. The corresponding unit value index fell by 6 percent between 1956 and 1960 and rose by 10 percent between 1960 and 1966.[24]

Assuming the level of exports in 1952–53 (the same as before World War II) to have been about optimal under free trade, given the deficits, the falling level of exports during the 1950s could have only been optimal if the concurrent downward trend in imports had been optimal. The fact that import licensing gained in importance during this period and commodity shortages began to appear is probably sufficient corroboration of the hypothesis that imports were running at an increasingly suboptimal level. In addition, some ill-advised import substitution took place in manufacturing (the steel works in Helwan being the most important example), but the removal of export taxes in agriculture and the increasing evasion of area controls (Chapter 6) worked in the opposite direction. All things considered, our judgment is that the optimal level of imports in 1961 as a percentage of GDP, given the deficit, may have been about the same as, or even higher than, in 1952–53. It follows that exports were running at too low a level in 1961 (even disregarding the cotton crop failure).

The roughly unchanged level of exports after 1962–63 was accompanied by an increase in the balance of payments deficit and a sharp rise in imports. If now, starting from an optimal situation with balanced foreign payments, the government decided to run a balance of payments deficit, imports should have increased and exports decreased (unless there were inferior goods), at least measured as a percentage of GNP. Since exports were not lowered when

imports soared from 1962 onwards, the export level, ceteris paribus, must have become less suboptimal. The development of exports by commodity groups points in the same direction; (see Table 5–4). The government's export efforts during the 1960s were concentrated on rice and cotton textiles. The expansion of rice production and exports was certainly a move in the direction of better resource allocation (Chapter 7), and so was probably the expansion of textile production (Chapter 8). The fall in the export of other manufactured goods was mainly the consequence of the exhaustion of oil wells. However, despite these efforts, it seems pretty clear that the level of exports was too low during the whole period of the 1960s, even granted the size of the deficits. If that is true, there must also have been some loss of efficiency, and with better resource allocation the targets could have been fulfilled at a higher level of trade with a smaller deficit.

In conclusion, the economic system is not export-oriented; exports are simply viewed as necessary to pay for imports. Neither have exports been designated as a specific target supported by a planning machinery, nor have they been actively promoted abroad. Indeed, they have often served as a buffer to domestic supply fluctuations. The adaptation of domestic products to foreign specifications, particularly with regards to packaging and grading, has been virtually nonexistent, and only recently have some efforts been made in this direction.[25] This deficiency may be odd for an economy long based on exports of cotton, but even here there are strong indications that export promotion has not been pursued thoroughly and has often succumbed to considerations of self-sufficiency, diversification, and equitable income distribution.

Problems of Foreign Exchange Administration.

The changes made in the foreign exchange allocation system in 1962, 1964, 1965, and 1966 reflect all the difficulties such allocation systems face.

Although, to work rationally, a system must be comprehensive and cover all sources of demand and supply, Egypt's foreign exchange allocations to defense and new plants and other projects remained outside the system even after 1962, while orders from the top could always supersede existing allocations.

Foreign exchange budgets, indispensable for administrative exchange allocation, have been in existence since 1957. The budgets seem to have systematically overestimated foreign exchange availabilities in relation to requirements. One reason may have been the lack of comprehensiveness, but inadequate forecasting methods may also have been at fault. The survey method, apparently the major forecasting device, does not work well when the surveyed enterprises, organizations, and authorities know that their answers will have direct consequences for themselves: the requirements will tend to be

overstated. Although the budget may try to adjust for such a bias, doing so correctly requires long experience with the survey method in this particular field. The tendency for imports of raw materials and parts, and inventories of such inputs, to increase more than production (for which we have given some evidence) could be a consequence of this kind of bias in the surveys. It is more difficult to know how replies to questions about future foreign exchange earnings would be biased. Exaggerated statements could be expected from enterprises and organizations if the import allocating authorities were known to discriminate in favor of foreign exchange earners—which, in fact, they probably were. Management may also have a personal career interest in drawing up a rosy picture of the future. With upward biases in both requirements and expected earnings, it is easy to imagine a situation where excessive import licenses are issued and unexpected foreign exchange shortages arise.

Under such circumstances it is tempting to supplement the annual foreign exchange budget with a primitive "cash flow" system by which any dollar is allocated at the moment it is earned but never before. The weekly allocation system adopted in October 1964 came close to a completely synchronized earnings-allocation system. Such a system is foolproof in the sense that it does not allocate more than has been earned, but only if it is comprehensive—which this system was not. In addition, it rules out all possibility for optimal allocation over time, at least if it is applied at all stages of allocation. And it does not, of course, solve the problem of allocation between users. If, for instance, the weekly allocations simply applied the proportions of the annual allocations in the budget, by the end of the year all users would have received the same x percent of their annual allocations; this is not necessarily a rational way of adjusting the annual budget. The change to a system with less frequent "cash flow" allocations in 1965 was obviously a compromise between annual budgeting and mechanical synchronization.

It appears that improvement in Egypt's exchange allocation administration partly hinges upon the development of better forecasting methods for demand and supply of foreign exchange. The short-term forecasting methods used in highly developed countries could presumably be adapted for this purpose. But it should be emphasized that, even under free trade, exports and imports tend to be difficult to forecast and that, even with the best possible forecasting methods, a substantial foreign exchange reserve may be indispensable as a shock absorber. Certainly, forecasting trade with Communist countries gives rise to special problems that, we think, nobody has tackled so far.

Centralization versus decentralization was another problem encountered in Egypt during these years. The decentralization move in 1964, when the economy was divided into sectors that were allotted lump sums of exchange to be allocated within an individual sector by the sector's own authority, was

clearly undertaken to enable each sector to coordinate its decisions in regard to production and allocation of both domestic and imported inputs. But this system left open the problem of coordination among the various sectors, which probably explains the switch back to centralization in 1966 whereby the individual sector's detailed allocation of its overall quota had to go back to the central organ for approval. The government may have hoped to combine the advantages of centralization and decentralization in this way; the paper work must certainly have increased.

One of the basic shortcomings since 1961 in the Egyptian system is that it has never succeeded in formulating clear, simple, operational allocation criteria to replace those of private profit maximization, be it in long-term investment planning or in short-term commodity allocation. Hence the vacillation between centralization and decentralization. It would probably help greatly if the government could formulate such criteria—and stick to them; they might come close to private profit maximization, and, if so, the whole problem of relying upon price mechanisms to a larger extent than at present would naturally have to be reconsidered.

Our discussion in this section is not very conclusive. It does, however, indicate that—even apart from the basic targets—the administrative systems after 1961 were less efficient than the earlier system in the areas of production and imports. In exports the performance may have been better, although it was far from satisfactory. The possibilities of substantial improvements in the present administrative system are evident. Given such improvements, it is not clear to us which system would prove superior in the long run, particularly if weapons purchases continue to necessitate substantial trade with Communist countries.

NOTES

1. M. F. Mourad and F. Moursy, *The Foreign Exchange Budget and the Exterior Financing of Development,* Cairo, 1967.

2. This view pervades Nutting's discussions of Nasser's foreign policy. See A. Nutting, *Nasser,* London, 1972.

3. Excluding the sector "Other services," which mainly consists of government (including defense), the growth rate was −0.5 percent in 1966–67 and −5.5 percent in 1967-68.

4. Excluding "Other services," the fall in per capita income averaged about 3 percent per year, or 9 percent for the three years 1966–67 to 1968–69.

5. But this was not true of the cotton textiles industry. After a bad cotton crop the government has always preferred to let exports of raw cotton suffer rather than the textiles industry. The crop failure in 1961 is the clearest example of this policy.

6. *Statistical Indicators for the U.A.R., 1952–1965,* Central Agency for General Mobilization and Statistics, Cairo, 23 July 1966, p. 97.

7. IMF, *International Financial Statistics*, 1968.

8. *Follow-up and Appraisal Report for the First Five-Year Plan*, Ministry of Planning, Cairo, 1967, pp. 119–143.

9. Federation of Industries, *Yearbook*, Cairo, 1967, p. 209.

10. According to the Minister of the Treasury, Nazih A. Deif, in conversation with one of the authors in 1965.

11. The increase of 8 percent in capital goods imports is in value terms, but even allowing for some price increase it seems likely that capital goods imports rose in real terms.

12. Capacity creation may not have fallen—the completion of the Aswan High Dam during 1969–70 added enormously to capacity in electricity.

13. D. L. Chinn, "Effects of Income Redistribution on Economic Growth Constraints: Evidence from the Republic of Korea," *Economic Bulletin for Asia and the Far East*, Vol. 13, No. 1, United Nations, ECAFE, June 1972, pp. 61–76.

14. Nutting, op. cit., Chapter 15.

15. Nutting, op. cit., p. 381.

16. In terms of customs statistics. The surplus is actually smaller because a small part of the accumulated imports at ports of entry were released under the "temporary admission" procedure, whereby imported goods can be withdrawn from customs without payment of duties (and entry into the custom statistics) to relieve port congestion. Duties would be collected (and imports recorded) at a later date. On a payment basis, however, there is a substantial deficit (£E77 million), in a steady uptrend in subsequent years, reflecting increasing payments for armament deliveries after the 1967 war.

17. This section depends heavily upon the annual reports of the IMF on exchange regulations, and Mourad and Moursy, op. cit.

18. So-called information theory is, however, beginning to reform abstract theory at this point.

19. See, for instance, B. Hansen, "Economic Development in Egypt," in C. A. Cooper and S. S. Alexander, eds., *Economic Development and Population Growth in the Middle East*, New York, 1972.

20. Nutting, op. cit., pp. 374–76, seems to imply that the abrogation of U.S. aid was largely the result of Nasser's actions rather than a deliberately designed policy on the part of the Johnson administration. But this is irrelevant for our problem, since the policies we are discussing were launched during the time of the Kennedy administration.

21. B. Hansen and G. Marzouk, *Development and Economic Policy in the U.A.R. (Egypt)*, Amsterdam, 1965, p. 143.

22. See Chapter 4, Table 4–3; and George Abed, "Industrialization, Employment Growth, and Economic Development (with Special Reference to the Case of Egypt)," Ph.D. dissertation, University of California at Berkeley, 1972.

23. In the preceding paragraphs we suggested that the actual production point might be below the production frontier. Here we are concerned with the question whether the best point on the frontier has been chosen.

24. L. E. Preston, in association with K. Nashashibi, *Trade Patterns in the Middle East*, New York, 1970, Appendix (by K. Nashashibi), p. 78.

25. Exports of citrus fruits have increased from negligbile amounts to over 100,000 tons solely as a result of standardization and packaging.

Part Two

Protection, Controls, and Competitiveness in Egyptian Agriculture