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مطابع الاهرام - كورنيش النيل

Development of Egypt
Two Experiences and Three Scenarios
Ismail Sabri Abdallah
Prologue

This paper was written in the fall of 1977. It was commissioned by interfutures, a major study of «The Future Evolution of Advanced Industrial Societies in Harmony with that of Developing Countries» sponsored by the Organization of Economic Development and Cooperation. In fact the OECD decided on a Japanese initiative (1975) to carry on this study by a special team of high level experts. The permanent contributors, led by the eminent French economist and econometrician Jacques Lesourne, comprised 27 persons from OECD countries seconded by a host of consultants, including a few Third World citizens. Interfutures started its work in January 1976 and presented its Draft Final Report in June 1979. What incites the author to publish it without any addition or correction is the desire to get reactions on the validity of analysis. In the second place, I think that Egypt has gone through the «Mexican Scenario» (No. 1) in the 1980's and seems to enter now the Turkish one (No. 2). Lastly I would like the reader to know that originally this paper was written in French. The English version was produced by Interfutures staff.

INTRODUCTION

1.—The problems of Egypt's development are a particularly interesting field of study. Apart from the factors which give one of the oldest countries in the world a key position among what are sometimes called the young nations (its geographical position, population, Arab influence, etc.), there have been surprising changes in the last 25 years in the ideas and facts behind Egypt's development because it has moved, as it were, against

the current. Indeed at a time when Rostow's pamphlet, translated into many languages, was taken as the Bible on the subject, Egypt was nationalizing foreign enterprises instead of encouraging an inflow of capital as a vehicle of progress. It was also carrying out a wide redistribution of the means of production and of incomes instead of encouraging the growth of large incomes whose recipients were supposed to increase capital accumulation by their savings. In addition it embarked on a serious attempt to industrialize itself and to modernize agriculture without falling into the arms of the multinationals, while combining western technology and the socialist countries' technology as much as possible with an appreciable local contribution. Since 1974, on the other hand, while the orthodox concepts of growth have been sharply criticized for their unconvincing results and discussion has been raging on alternative approaches, Egypt has been returning via an often incoherent assemblage of measures to a policy of «laissez faire, laissez passer» which would make even Milton Friedman's mouth water. This is admittedly not unique in the Third World, but there are special features in the Egyptian situation. First, the transition from one policy to another is taking place smoothly by successive doses and without recourse, at least so far, to a coup d'état. Secondly, Egypt's previous experience did not lead to bankruptcy (with galloping inflation, unemployment, worsening of the situation of the middle classes, etc.) and the broad masses still think of it with nostalgia based on the memory of better days and not on any ideological fervour. Thirdly, for many reasons today's economic policy precludes embarking on one of those growth miracles which in some people's eyes justify inflicting physical and moral suffering on the majority of the population. One conclusion emerges, namely that the country is in precarious state of balance in which different policies may still be envisaged. Hence it would be quite insufficient to limit this study to what can be deduced from the confused political talk and incoherent socio-economic measures and to misname the result longterm strategy. Several options are still open, but none will come out of the blue. On the contrary, each option must have its roots in the development experience of this quarter of the century. Consequently it is necessary to discuss briefly the objectives, means and implications of each of Egypt's two

periods of modern economic history before planning possible future strategies. That is the explanation for dividing this study into two parts.

2.—Before concluding this introduction, however, a picture should be drawn of Egypt before 1952 and an attempt made to grasp the ideology of the rulers who emerged from the July revolution. Unless these two objective and subjective factors were combined, it would not be easy to understand the vicissitudes of our development and the ambiguity of the social reform projects proposed by Egypt's leaders.

Briefly, Egypt in the late 1940s was marked by the following features :

— Its economy was essentially *agricultural* (from 1 to 2 per cent of the working population was engaged in industry) and dominated by *cotton* (16 per cent of the cultivated area, 58 per cent of all agricultural output, 85 per cent of all exports in 1950 and the backbone of industrial activity : ginning, pressing, textiles and banking(1)).

— An undue concentration of *land ownership* on a rather small cultivated area (2.2 million hectares for a population of 20 million). The number of people owning 50 fedans (1 hectare = 2.5 feddans) was hardly more than 11,500, but they held 38 per cent of the land under cultivation. At the top of the pyramid were 60 landowners holding 5 per cent of all this land.

— *Foreign domination* took various forms; the entire banking system (except Bank Misr) and the insurance companies, foreign trade, energy, industry (the little there was) and the principal means of transport (except the railways) were in foreign hands.

(1) Even the money supply fluctuated during the year in line with cotton transactions. It reached its maximum in December (when the cotton was marketed) and its minimum in June after the previous year's harvest had been sold and before the first transactions in the current year's harvest had begun. See I.S. ABDALLA : «Monnaie et Structure Economique», Paris 1954.

— Despite one of the highest illiteracy rates (80 per cent), the country had made some progress in *education*. The modernization of a complex age-old bureaucracy together with the traditional desire of the lower middle class to climb the social scale by joining the civil service explains why there were three universities in 1950 and higher education for 40,000 students. This means that Egypt was not desperately short of an executive class, as most Third World countries were at that time.

The ideology of the «free officers» who took control in July 1952 could be summed up as a kind of «*nationalist empiricism*». Of middle class (and often lower middle class) origin, the new leaders had flirted with several political movements; bourgeois nationalism (the Wafd party), Islamic integristism (Mohammedan brethren) and Marxism. But the common characteristic which enabled Nasser to unite them and make their revolutionary project succeed in spite of their divergent ideologies was a sincere and even fierce devotion to national independence and a certain ideal of social justice. This lack of a coherent doctrine explains the disagreements (apart from personal rivalries) between members of the Council of the Revolution and also the many changes of course imposed on the new regime by Nasser's strong personality (2). By and large, the regime moved on from a short period (1952-55) of trying out a development policy based on private and foreign capital to another period marked by economic nationalism and the growing role of the State (1955-60) and then to a third period when the socialist option was proclaimed and measures were adopted which profoundly changed the economy and society, with varying success. However, whatever the main feature of each of these stages was, they cannot be kept completely distinct, because throughout all this experience there was a continuing determination to safeguard national independence and estab-

(2) Even when he tried to systematize his thoughts on socialist lines, Nasser wrote in the «National Charter of 1962» that empiricism or «trial and error» were essential to enable the pioneers, guided by the people's conscience and aspirations, to design the architecture of the new society.

lish social justice, thereby following an uninterrupted course which many writers have failed to see(3).

First Part

Two Tested Strategies

1. Growth with Redistribution

(1952 — 1973)

A. Growth :

All writers who have studied the performance of the Egyptian economy(4) Agree in stressing the high growth rate of the GNP between 1956 and 1966. Bent Hansen considers that averaged about 6.7 per cent. The years before that decade were marked by the repercussions of the Korean boom, the unwillingness of foreign and local capital to invest in a climate full of political hazards, and the still limited role of the State because of the lack of development projects worked out so far and the meager means of action at its disposal. The next few years (1967-1973) reflected effects of the military defeat, the loss of resources (including the Suez Canal and the oil in Sinai) and the burden of the military effort(5). Statistical data are not available for the years 1952-54, the first estimate of national income was for 1953 and appeared in 1955, and the National Planning Commission only just started to lay the foundations

(3) Any picture of a moment in Egypt's experience from 1952 to Nasser's death or even to the end of 1973 will make the would-be theoretical analyst neglect the factors of change and petrify a society whose dynamic for self-renewal sometimes acts spasmodically or in reverse. This true both of critical studies (Samir Amin : «L'Egypte Nasserienne», Anouar Abdel-Malek : «L'Egypte société (mimitaire...)» and of studies on Arab socialism.

(4) The most important are :

- Hansen and Marzouk
- Patrick O'Brien
- Robert Mabro.

(5) See the report prepared for the U.N.O. by the Institute of planning National (I.N.P.) : «Adverse economic effects resulting from Israeli aggressions and continued occupation of Egyptian territories», Cairo, July 1977, and also the report by the Secretary-General of the U.N.O. to the 32nd Session of the General Assembly last October, document A/32/204.

of a system of national accounts. On the other hand it is known that, although the growth rate was negative in 1967, it began to rise in the following year and averaged a steady 4 or 5 per cent in constant prices up to 1973. These figures are of course of not very impressive in themselves, but their importance will be better understood when one considers the overpopulation, the poverty of natural resources, the measures to transform the country and the pressures from abroad (Egypt suffered military attacks twice during this period, in 1956 and 1967). Rather than dwell on this famous but much criticized indicator, it would be more useful to break growth down into its component parts and briefly analyze them.

1. *Energy.* Egypt has no coal, so that its development depends on oil and hydro-electric power. The output of crude oil rose from 2.1 million tonnes in 1950 to 12.5 million in 1973, despite the loss of output from the Sinai oil field which in 1966 accounted for almost one half of Egyptian production (7.1 million tonnes). Meanwhile refining capacity increased in the same proportion and Egypt was not far from self-sufficiency in oil. But the most spectacular growth was in electric power, whose production rose from 991 million kwh in 1950 to 8,113 million in 1973, despite the destruction of the thermal power stations in the Canal zone and the marked slowdown in the output from other thermal power stations following the stoppage of the Suez refineries after bombing by the Israelis. It was the hydro-electric power station at the Aswan Dam (maximum output 10 Kwh) which provided the bulk of this clean and relatively cheap energy.

2. *Industry.* The idea that industrialization was the back bone of development (and not only of growth) was rooted in people's minds. Progress and modernity seemed inseparable from machinery and industrial technology. On the morrow of the 1919 Revolution (which gained recognition for Egypt as a formally independent power, but with «reserved questions» justi-

(8) Source : Ministry of Planning : «Indicators of Economic Growth 1960-1975» roneoed in Arabic. The author has revised the Ministry's figures downwards for technical reasons.

ying continued British occupation) the Egyptian bourgeoisie made a modest move towards industrialization whose keystone was a purely Egyptian bank for deposits and trade (Bank Misr). However, apart from a few measures of limited scope (a new customs policy, the establishment of a small industrial bank with mixed capital, etc.) the State did not take an active part in this field. The Second World War encouraged the birth of a not inconsiderable number of small and medium-sized industrial enterprises to remedy the shortage of certain manufactures which the War made it almost impossible to import. The same trend continued immediately after the War for the same reasons. Needless to say, this activity limited to the consumer goods industry (especially textiles, tobacco and other food industries which accounted for 60 per cent of total industrial production). It should be added that a controlling part was played by foreign residents in the country and that the plant and equipment was often bought second hand. Be that as it may, the number of industrial establishments employing wage earners (even a single workman) rose from 42,729 employing 92,921 persons in the census of 1976 to 78,037 employing 361,936 in 1984, i.e. an increase of 82.6 per cent in industrial establishments and of 289.5 per cent in wage earners. By way of comparison, the number of establishments had hardly changed at all during the previous ten years (1927-1937). The new regime, however, intended to throw its full weight into giving a new fillip to industrialization. The overall results by the end of the period included an increase in the processing industry's share of GDP from 9 per cent in 1950 to 24.2 per cent in 1973 and an increase in its share of exports from 1.9 per cent to 34.7 per cent, without counting the output of the mining and quarrying industry. Meanwhile the number of wage earners rose to over a million. Like most developing countries, the first stage in Egypt's policy (e.g. in the first five-year industrialization programme adopted in 1957) was to produce substitutes for imports. It was fairly easy to try to increase exports of manufactures in the mid-sixties by a pricing policy which tended to curb local consumption (especially of durables) and by giving directives to the State enterprises to promote exports. As is well known, the nature intended for the local market or for export, because exports are usually goods for satisfying a demand from rich or middle

classes whose lifestyle does not change much from one country to another. Consequently a change had to be made in industrial strategy and it was made at that same time as priority was given to the basic industries, led by metal-working and chemicals. However, the original feature of the experiment was something else. The country's industrialization largely escaped control by multinationals, vast nationalization schemes put an end to the activities of existing foreign enterprises; and with few exceptions the new industrialization projects were public owned. There were enough administrators and other senior executives to take the helm (sometimes at the expense of intensive training) of the nationalized or newly established enterprises. The «turn-key» formula was hardly used and Egyptian technicians and engineers were closely associated with the construction of the new plants from the conception of a project until it became operational. Nothing was to be imported which could be made locally. The managers and technicians had received a technical training on Western lines and then had to familiarize themselves with the technology of the Soviet Union and Eastern Europe and to find original solutions for pooling machinery of different origins, designing (and sometimes making on the spot) spare parts, etc. A strict account should include the value of the human capital thus trained and the value of the self-confidence acquired without any alarming slowdown in growth.

3. *Agriculture.* The priority given to industry was only a priority and agriculture was not sacrificed. Let us recall the distinctive features of agriculture in Egypt. there is hardly any rainfall and the life of the country depends entirely on the waters of the Nile. the mystery of Egyptian civilization and the continuity of a centralized State for 5,000 years depended on unceasing action to manage the river so as to spread its waters as far as possible over the valley and the delta and to prolong the irrigation season. Intensively cultivated land represents only 3.5 per cent of the total area of the country and could not support a population which increased by 73 per cent in 20 years. Consequently any serious effort to increase agricultural output must involve extending the cultivated area, or in other words changing the course of the Nile. it was this glaring necessity,

and not any kind of megalomania, which gave birth to the Aswan High Dam. In Nasser's eyes the value of this project was mainly its agricultural potential and for a long time energy was regarded as a by-product(7). The novelty of the project was the principle of a permanent reservoir, i.e. absolute control of the waters brought down by the floods so as to guarantee regular irrigation throughout the year and every year. Thus 700,000 feddans were switched from basin irrigation to perennial irrigation (providing an additional crop) and 1.3 million feddans could be won from the desert, especially where it borders on the delta. Unfortunately Israeli aggression has not allowed Egypt to enjoy all the benefits it expected. The forced curbs on investment after 1967 put a stop to land improvement and dangerously delayed the construction of the drainage network (an indispensable corollary of perennial irrigation) and the expansion of the production of chemical and organic fertilizers whose use was to be increased under the two-fold effect of more intensive cultivation and the partial loss of the alluvium. Nevertheless the cultivated areas increased by 16 per cent during the period, while the physical yield per feddan increased in proportions varying from 40 per cent (for cotton) to 79 per cent (for maize).

4. *Foreign trade.* The consequences of this development policy did not fail to show themselves in the country's foreign trade. They were seen in the pattern and directions of foreign trade and in the balance-of-payments deficit. As already mentioned, raw cotton accounted for 85 per cent of Egypt's exports in 1950 and, if one adds rice and onions, the percentage reached 94 per cent. The bulk of imports consisted of consumer goods; foodstuffs 22.3 per cent, manufactures 36.6 per cent and oil products 4.6 per cent. Items such as «machinery and apparatus», «transport equipment» and «other imports» are difficult to break down, but the manifest feebleness of the effort to industrialize leads one to conclude that the percentage of capital goods was

(7) Moreover the first plan for the project, as approved by the IBRD, included two stages, the construction of the actual dam and then the construction of the hydro-electric power station. The hazards of external financing made it very probable that the second stage would have been postponed until later or even until «calendes grecques».

pretty low. On the other hand in 1973 the Ministry of Planning's figures give : for exports, 59.9 per cent for all agricultural products, 54.7 per cent for industrial products and 5.4 per cent for oil products and mining products; for imports, 24.7 per cent for consumer goods (including 13.1 per cent for cereals and flour), 54.1 per cent for intermediate products and 21.2 per cent for capital goods. The directions followed by foreign trade underwent equally profound changes during the period. In 1950 the Western countries (the present OECD area) supplied 71 per cent of Egypt's imports (led by the United Kingdom with 21 per cent) and took 57.7 per cent of its exports (led by the United Kingdom with 29.2 per cent). The deficit with the occupying power was financed by claims on the United Kingdom which Egypt had accumulated during the Second World War, while the surplus with other countries financed the repatriation of the interest and dividends on the capital invested in Egypt. In 1973 the picture was very different. The Western countries supplied only 30.4 per cent of imports and their share of exports had fallen to 17.4 per cent. The chronic deficit was financed by multilateral or bilateral loans and by short-term borrowing (export credits and bank advances. Meanwhile the USSR and the East European countries became the main trading partners, supplying 40.7 per cent of imports and taking 58.3 per cent of exports. The surplus was not completely absorbed by servicing debts to those countries. Although there was a growing market for non agricultural products (textiles, footwear, furniture, domestic electrical appliances, wines and spirits, etc.) because the Egyptian public's consumption was increasing and was less sophisticated than in Western countries, Egypt continued to import from the United States and Western Europe for economic reasons (Plant and equipment already installed, a more familiar technology, etc.), Social reasons (tastes of the well-to-do consumers) and political reasons (the desire to diversify foreign trade). It should be added that «other countries», i.e. the developing countries (in particular the non-aligned group), increased their share of Egypt's foreign trade to 23.9 per cent of exports and 29 per cent of imports(8). Moreover,

(8) The bilateral payments agreements which official policy tended to favour covered more than 73 countries and were not limited to Eastern Europe, as is generally believed.

the balance-of-trade deficit was of the order of 28.7 million Egyptian pounds (i.e. 21 per cent of the total value of exports) in 1950 and rose to 191.3 million (52 per cent of the total value of exports) in 1973. There could be no clearer sign that the national economy had run out of steam and this point will be dealt with later.

5. *Social and cultural development.* Development efforts were not limited to increasing physical production and associated services. Education, health and housing were treated as objectives and not merely as means for improving productivity, so much so that the move to include these services in an overall coherent planning system was not made until the mid-sixties. As regards education, it should be pointed out that this policy was to include these services in an overall coherent planning system was not made until the mid-sixties. As regards education, it should be pointed out that this policy was in line with a long-standing popular aspiration, namely to better one self by obtaining access to education. Here are some figures. The percentage of children attending compulsory primary school (aged from 6 to 12 years) reached 75 per cent, i.e. over 4 million children, compared with 1.6 million in 1950, and was increasing at an average of 7.1 per cent per year. The number of children attending secondary school (aged from 13 to 18 years) rose from 250,000 to 1.7 million, while in higher education the number of students totalled 271,700 in 1973 compared with 40,000 in 1950. As regards health, the number of hospital beds more than doubled, rising from 35,740 to 77,078, of which 8,147 were in villages, without counting maternity hospitals and units for controlling endemic diseases. Egypt trains annually more than 3,200 doctors, 400 dentists and 890 pharmacists. One of the most important aspects of development in the country, although it is often ignored is the emancipation of women achieved by large-scale access to education and independent employment. This was nothing less than a revolution in the customs of a country with a rural and Islamic tradition. In 1973 women and girls were already filling one-third of the places in all educa-

tional establishments(9). In public sector and administration the principle of «equal pay for equal work» has the force of law.

B. Redistribution :

The most remarkable thing about Egypt's experience (1952-73) is that growth was accompanied by a sweeping redistribution of ownership of means of production and incomes. Before going into this two points should be made. The first point concerns motivations. The redistribution was a response to three distinct trends, even if they merged together in practice. First, there was the desire, especially after 1956, to free the national economy from all trace of foreign domination. Moreover, there had always been a longing for social justice, later to become a socialist movement which in turn sought to deprive the «reactionaries» of economic power. In addition, as planned development called for a more rational allocation of resources, the idea became established that resources allocation could only be made effective if the State played a leading part. The second point concerns the «gradual» approach and the rather original means of action which produced the eminently empirical and sometimes pragmatic policy of a government trying for the first time in 1962 to evolve an articulate doctrine, and this it did only by leaving some questions unanswered and allowing for a thorough revision in 1972. The first agrarian reform law was passed in September, 1952 and the last in July, 1969. The first nationalization took place in 1955 (Egypt's sugar refining company and its subsidiaries), taking the legal form of appropriation by the State of the company's assets in payment of

(9) i.e. 38 per cent in primary schools, 33 per cent in secondary schools and 29 per cent in higher education (ranging from 12.7 per cent in engineering schools to 55 per cent in arts faculties).

accumulated taxes. The last nationalization (this word having become part of the official vocabulary) took place in October, 1967 and applied to the wholesale trade. At first compensation was supposed to be paid for nationalization and expropriation, but later a law imposed a ceiling of LE 15,000 (for nationalization) and LE 30,000 (for seizure of total assets) or simply cancelled the indemnity (in the case of the landowners affected by the agrarian reform). Sometimes nationalization was only partial, affecting 50 per cent of the registered capital or consisting in transferring to the State the equity of anyone holding shares worth more than EL 10,000. The criteria applied were of different kinds, such as the importance of the sector (in the case of banks and mining resources), the nationality of the principal shareholders and the personal role of the head of a business in starting and expanding it. The principle laid down in the National Charter of 1962 was «control» by the people of the means of production and in theory this could take many forms. let us now turn to the main measures for effecting redistribution.

1. *Agrarian reform.* As a result of three agrarian reform laws which lowered the ceiling on individual ownership to 50 feddans (20 hectares), about one-fifth of the cultivated land was divided up among the landless peasants (an average of 3 feddans per family). Just before the first reform, land ownership was highly polarized; at the top were 11,500 persons (i.e. less than 0.5 per cent of the total number of land-owners) owning more than 50 feddans each and controlling some 38 per cent of the cultivated area. At the bottom were 94.3 per cent of all land-owners, with less than five feddans each (the working peasants) and controlling 33.4 per cent of the cultivated area. Today the top has disappeared and the bottom controls almost 60 per cent of all land under cultivation. As has already been mentioned, there was no compensation for expropriation. In addition, the beneficiaries needed to pay only 25 cent of the nominal price of their land and had 40 years in which to pay it. Furthermore, the law fixed the level of farm rents at seven times the amount of the land tax and, as the latter remained unchanged during the period in question, this measure amoun-

ted purely and simply to freezing farm rents (after reducing them). Lastly, State marketing of cash crops, accompanied by a system of loans to farmers (often in kind in the form of selected seed, chemical fertilizer, insecticides, etc.) managed by the State and the farmers' co-operatives, rid the peasants of the middle-men who had been amassing profits and charging usurious interest(10).

2. *The public sector.* Apart from some land which was improved by the State and farmed by a public undertaking, agriculture in Egypt remained mainly in private hands, but this was not so in other sectors of the economy, in which the State was to play a dominating part. The situation at the end of the period could be summed up as follows :

— *Banks and insurance* : A State monopoly.

— *Oil, mining and quarrying* : Public ownership was usual, but foreign capital was admitted up to 50 per cent and for a given period (usually 30 years) in oil enterprises exploiting discovered by foreign companies, if they held concessions and operated at their own expense.

— *Processing industries* : The principle was that basic industries should belong to the State. Public sector industry accounted for 65 per cent of all industrial production and for 94 per cent of the production of enterprises employing 20 persons more.

3. *Transport and communications.* Without invoking the principle of State monopoly, transport services by sea, rail and river, both urban and between towns, belonged to the public sector, while private enterprise continued to carry road freight (alongside public undertakings) and run taxis.

(10) Islam having prohibited lending at interest, money-lenders in the countryside concealed their transactions behind contracts for buying crops well before they were harvested, gathered or picked at 30 or 40 per cent below the market prices.

— *Foreign trade.* Only the State was allowed to import and it also handled exports of the products of State enterprises and of the main agricultural products. Meanwhile the private sector was allowed to export non-traditional products (fruit, vegetables, flowers, handicrafts, etc).

— *Domestic trade.* The wholesale trade was nationalized as were the chain stores and the principal crops. A chain of State shops handled about 12 or 15 per cent of the retail trade.

4. «*The rights of peasants and workmen*». By this is meant a set of measures for associating the masses with the management of affairs. The first requirement of the National Charter is that at least 50 per cent of the seats in any elected political assembly and municipal council including the National Assembly shall be reserved for peasants and workers. The second requirement is that the principle of joint management and profit sharing shall be applied in national enterprises. Each enterprise is managed by a board of directors consisting of a chairman (appointed by the Government) and eight members, four of whom are directly elected by the personnel and four are chosen by the Government from among the senior executives. In addition, 25 per cent of the profits must go to the workers in the form of direct payments, services in kind and contributions to the general services for all the workers in a group of enterprises. In the farmers' cooperatives (of which all farmers are members) 80 per cent of the managers must be poor peasants (farming up to five feddans).

5. *Other social measures.* To complete this account it should be mentioned that education is free, employment and a minimum wage are guaranteed, the workers enjoy trade union protection (except the right to strike), workers in towns have comprehensive social insurance, taxation puts a ceiling on incomes (standard income tax goes up to 90 per cent on incomes exceeding LE 10,000), the State fixed the level of rents and builds social housing, the prices of first necessities are kept relatively stable, etc.

But does this mean that everything was for the best?

Certainly not. Under Nasser a serious crisis began in 1966 which the War aggravated, while delaying the outbreak of social and political strife and the adoption of remedial measures. It is this crisis which explains the experience under Sadat.

II. No Return to «Laisser Faire» is Possible

(1974 - 1977)

A. The Crisis :

The performance of the years from 1952 to 1973, remarkable as it was, started in 1966 to show symptoms heralding an economic, social and political crisis. One cannot explain why development policy in Egypt has gone into reverse in recent years without first understanding the extent of the impasse and the economic and social factors which contributed to this and imposed decisive and painful choices which the regime had so far refused to make.

1. *Economic indicators.* The first Five-Year-Plan (1960-65), which was in fact an investment programme rather than a real plan, ended on some alarming notes. First, the *growth of consumption*, both public and private, exceeded all expectations and seriously reduced the rate of saving. From 89.7 per cent of GDP in 1959-60 the rate of consumption rose to 91.9 per cent in 1965-66. A facile interpretation of this development was put forward in 1966 by the proponents of the «classical» ideas regarding the famous vicious circle of growth in developing countries, namely that the improved living standards of the masses, in particular the redistribution of the national income, had increased mass consumption at the expense of capital accumulation. The remedy was therefore clear, namely to increase the prices of consumer goods, mainly by means of indirect taxation. However, this interpretation does not bear inspection in the light of the facts. First, during the period under study public consumption rose from 17 to 21.4 per cent, while private consumption fell from 72.7 per cent to 70.5 per cent. Here two observations should be made. The increase in public expenditure on consumption was due not only to the extension of public

services, but mainly to their high capital and operating costs(11) However, Egypt's involvement in the war in the Yemen explains the increase in military expenditure(12). If now one considers the trend in household consumption, one finds that the consumption of first necessities was increasing much less than of durable. For example, the consumption of cereals increased by 32.5 per cent and of cotton textiles by 26.5 per cent while the population increased during the same period by 16 per cent, reflecting a definite but by no means excessive improvement in the standard of living. On the other hand in the electric household appliances sector the number of refrigerators purchased increased by 352 per cent and of washing machines by 308 per cent. In addition, the workers were forced to save by the social insurance systems. Consequently one may conclude that it was middle class purchases which mainly explained the high level of private consumption.

Be that as it may, the fact is that the rate of accumulation of domestic wealth was falling; from 10.3 per cent in 1959-60 it dropped to 8.1 per cent. Here again there was a «class problem», because the contribution from small savers doubled between 1960-61 and 1965-66, rising from 24.3 per cent to 45.9 per cent. This «institutional» saving was partly compulsory and was effected by paying social insurance contributions; the excess of receipts over disbursements which was lent to the State by the social insurance funds rose from 12.8 per cent to 37.9 per cent of total savings.

Next came Post Office savings deposits, bank deposits and deposits with assurance companies, etc. The surplus handed over to the State represented 11.5 per cent and 8 per cent respectively on the dates stated. the second important item in national savings was the profits handed over by public undertakings to the State (37 per cent at the end of the period),

(11) Cost connected with the choice of technology and with types of services based on the Western model.

(12) This involvement was defensible as supporting «Arab revolutionary solidarity», but the method used was more like a costly classical military intervention than just support for the Yemeni liberation forces.

from which should be deducted the government's current deficit. Meanwhile the private sector (the whole of the agricultural sector, 35 per cent of industry, etc.) contributed to national savings at the rate of 18.6 per cent in 1960-61, but only 8 per cent in 1965-66. However, Egypt achieved a rate of investment of the order of 12.8 per cent of GDP in 1959-60 and 17 per cent in 1965-66. One can see at once that this rate was below the rate practised by countries which achieved rapid growth and that the «investment gap» was becoming dangerously wide. This state of affairs emerged clearly in the budget and balance-of-payments deficits and in their inevitable corollaries, domestic borrowing from the banking system and external indebtedness. In their turn these two things gave rise to inflation and to difficulties in obtaining supplies from abroad, especially of Intermediate products. Admittedly it is natural that the first stage in accelerated development should involved an external *Payments deficit*. When a «colonial» economy based on exporting raw materials and importing manufactures mainly for a privileged class changes over to a policy of industrialization and modernization, there is an immediate increase in the items «capital goods» and «intermediate products» in the imports column, whereas there are limits to reducing the volume of imported consumer goods; meanwhile a substantial increase in exports can only occur at the end of the running-in period for development projects and then only gradually(13). However Egypt, which had been living since 1947 with a persistent trade deficit (financed by sterling accumulated in London during the War), started its first Five-Year-Plan with a deficit equivalent to 18 per cent of the total value of its exports and by 1965-66 this percentage had become about 73 per cent. The current balance of payments showed a slight surplus at the beginning of the period (+ LE 4.5 million) and a serious deficit at the end (LE. 131.9 million). As for the budget deficit (which it is difficult to calculate exactly because the figures are so complicated), it could be seen in the rapid growth of the money supply. the

(13) For the structural nature of developing countries' foreign deficits and the inadequacy of the IMF's remedies for them see I.S. Abdalla «The monetary system and the new international economic order», *roncod*, Cairo, January, 1977.

notes circulation rose during the period under study from LE 192.4 million to 437.5 million (i.e. by about 44 per cent), while sight deposits in the banking system almost doubled. In the absence of a rate of inflation calculated by the competent authorities, the price indices (although often based on official prices and disregarding the parallel market) give an idea of the upward movement. The wholesale price index (1958 = 100) rose to 122 and the cost-of-living index reached 128.

Needless to say, Israel's aggression and occupation of Sinai inflicted losses of goods and resources on Egypt as well as a considerable loss of business opportunities. What was called in political language the «state of neither war nor peace» from 1967 to 1973 was in economic terms a state of war and peace at the same time. Indeed the country had to rebuild its military forces for a highly sophisticated war, while at the same time continuing its development effort, but without being able to impose all the hardships of a war economy on the population in the absence of hostilities(14). Suitable measures were taken to control public and private consumption by reducing certain State expenditure, raising taxes and imposing forced savings, etc., as a result of which the average annual growth rate of household consumption fell to 5.7 per cent from 8.6 per cent

in the previous six years. Meanwhile public consumption fell from 13.8 per cent to 10.7 per cent inspite of the increased military expenditure. In 1973, the year of the «October War», private consumption was about 64.6 per cent of GDP compared with 70.5 per cent in 1965-66, but public consumption reached a record 28.6 per cent, which was of course due to military expenditure.

Now one must look behind these global indicators to find the real imbalances which threatened the Egyptian economy. We have already mentioned an important one, the imbalance

(14) In connection with development it should be recalled here that the construction of the Aswan High Dam was completed in July, 1970 (three years after the defeat) without suffering any delay. During the same period, development projects as important as the iron and steel complex at Helwan and the aluminum complex were started.

between consumption and capital accumulation. It illustrates among other things the impact of the growth of the population. Starting at 2.74 per cent in 1952, the natural growth rate reached a maximum of 2.83 per cent in 1961, after which it began to fall off very slowly and unevenly to reach 1.99 per cent in 1973. There were structural reasons for this decline; the spread of education, the emancipation of women through access to education and independent employment, the extension of social insurance, etc., so that it should continue despite accidental fluctuations (such as the increase in the birth rate following the partial demobilization of the army in 1974-75). Nevertheless the full effects of the change will only be felt in the mid-eighties and meanwhile Egypt will have to feed, educate, house and look after the children born in the sixties. Apart from the demographic aspect, the problem of excessive consumption (compared with national output) amounts to the problem of the life-style of the wealthy classes and the impact of the Western consumer society on it, whereby the whole of society acquires a marginal propensity to consume which is often irrational(15), and in any case incompatible with the need to accumulate capital if there is to be rapid and sustained development. The (averaging 5.3 per cent from 1959-60 to 1973) compared with industry (7.8 per cent) and services (10 per cent). The consequences of this imbalance were serious; the supply of foodstuffs could no longer satisfy the growing demand from industrial and urban centers, whence the rise in the prices of these products and the steady increase in imports, especially of wheat, which worsened the foreign trade deficit; there was also a reduction in the agricultural surplus (e.g. rice) and in supplies of raw materials for certain industries (e.g. sugar refining). A third imbalance arose in industry itself, where the consumer goods industries were too numerous and diversified compared with the local production of intermediate products, so that industries

(15) This irrational behaviour of consumers in Third World countries is well known and appears in many guises. Take, for example, the order of priority which makes people buy a television receiver before installing sanitary equipment. Another example is the preference given blindly to imported products even when they are of lower quality than local products, and so on.

producing «import-substitutes» expanded and led to increase imports. There was a fourth form of imbalance, namely between investment and employment. While investment averaged an increase of about 9.9 per cent during the period from 1959-60 to 1973, employment increased at only 3 per cent, although many workers were taken on each year in excess of requirements. Lastly, there was the contradiction between the too rapid expansion of higher education and the illiteracy of more than 60 per cent of the population.

2. *Socio-political aspects.* Economic mistakes are often explained by the socio-political conditions which dictated the options for development policy and Egypt is no exception to this rule. Quite on the contrary. Having undertaken in the early fifties to renovate one of the oldest countries in the world with the twin objectives of natural independence and social justice at a time when world literature on development was dominated by the thinking of Rostow, the régime born of the 1952 Revolution was destined to encounter enormous difficulties. It had to suffer the negative effects of its own ideological ambiguity, as well as the new constraints laid upon it by the unforeseen effects of structural transformation measures introduced spasmodically. In fact the new régime was subject almost continuously to external and internal pressures. The external pressures were briefly as follows. First, the régime took over when the country was still occupied by British troops. No sooner had the new Government signed an agreement for the withdrawal of these troops in 1954 than it was asked to join the Baghdad Pact advocated by the United States, whose king-pin was the United Kingdom. Having refused to comply, Egypt saw its army humiliated by an Israeli raid on Gaza which enabled Israel to occupy the demilitarized zone (February, 1955). The United States refused to supply arms to Egypt until it joined the Baghdad Pact. When Nasser took the risk (which is no longer a risk) of buying Soviet arms, the Americans countered by withdrawing their offer to finance the Aswan High Dam. Egypt was looking for foreign currency and nationalized the Suez Canal Company, where upon Israel, France and the United Kingdom invaded its territory. The success of the revolution in Iraq, the prospect of a more «radical» regime than the Egyptian one

and the contradictions between Cairo and Baghdad made the Americans more conciliatory towards Nasser, but only for a time. In 1964 American pressure became stronger than ever; Egypt was to be given no more food aid. Then Saudia Arabia put forward the idea of an Islamic pact grouping together the countries opposed to the progress of «Arab nationalism» and «socialist» ideas. This confrontation terminated in Israeli aggression in 1967(16).

Inside the country the change in the social order, despite its pacific nature, created tensions and met with opposition, which was not surprising, but after the nationalization and expropriation measures of the early sixties the influence of the former wealthy ruling classes declined considerably. On the Other hand, these measures themselves and the effects of economic growth created new centres of resistance and social tensions. In rural areas the shortage of cultivated land meant that in spite of the drastic lowering of the ceiling on land ownership, the rich peasants (those who did not work the land themselves) owned 43 per cent of the land, whereas they accounted for no more than 5.5 per cent of the total number of landowners, not to mention the completely landless peasants. these «kulaks» soon filled the vacuum left by the eviction of the large landowners and came to dominate economic, political and social life in the villages. Thanks to their peasant status and the business knowledge which they had accrued in the service of their former masters, and taking advantage of family ties, they succeeded in monopolizing the elective posts and in dominating (sometimes acting through poor relations) the co-operatives, village councils and basic units of the Arab Socialist Union (the only political formation). Their children filled the higher education centres and provided the State and public sector with most of their executive and technical staff. A thrifty and dynamic class of people, these rich peasants succeeded both in improving productivity (being the first to make use of the facilities provided by the State) and in making large profits thanks to the scarcity

(16) The term «aggression» not only reflects the author's point of view, but is constantly used in the Resolutions of the United Nations General Assembly dealing with the situation in the Middle East.

of land and the rapidly increasing demand for agricultural products, especially foodstuffs. The clash between their interests and those of the national economy is an obstacle to the optimum use of that most scarce resource in Egypt, arable land. Needless to say, they threw their weight against any measure for enabling the most underprivileged peasants to benefit from the fruits of development. In the towns the decisive importance of the government machine and the extension of the public sector brought a «new class» (in the sense which Djilas gave to the term) into being, comprising the high officials and the managers of national enterprises. It should be said at once that the existence of good technicians and administrators was at first a benefit to Egypt and the reason for employing few foreign «experts», for the generally satisfactory management of the nationalized or newly established enterprises, for Egyptian self-confidence, etc. But the reverse side of the medal raised very serious obstacles to a positive development of the situation. First, these executives were of middle-class origin and educated on Western lines, and on the whole they were not in tune with popular aspirations. Moreover, they wished to enjoy their social and political status to the full, mainly by following a mode of life taken from their «colleagues» in the West(17). It is their influence which explains a curious slogan then current in the ruling circles to the effect that one should not «sacrifice the present generation for the sake of the happiness of future generations». Thus industrialization projects were chosen to please the middle classes, a typical example being plants for assembling consumer durables. Thirdly, the new class wanted the means of production to be privately owned. The ties between many of its members and the rich peasants, private building, contracting and sub contracting interests, etc. Often acted as additional sources of income which made it easier to acquire ownership of a villa, several taxis, a business, or some hectares of land for intensive cultivation (fruit trees, flowers, medicinal plants, etc.) In this way increasingly close ties were formed between rich peasants, big business, technocrats and

(17) They naturally found nothing attractive in the mode of life of their opposite numbers in Eastern Europe, whom they regarded as the victims of too egalitarian an incomes policy.

bureaucrats, who thereby became the upper class of the new society and played a very important political role. Now, this class as a whole, contradiction to the official objectives of the régime, wanted to develop capitalism and was fiercely opposed to any «radicalization» of the régime. Furthermore, many people in control were redundant bureaucrats multiplying in accordance with Parkinson's law to the detriment of the efficiency of public administration and the national enterprises. Here one should point out the special weight carried by Egyptian bureaucracy. To our knowledge Egypt is the only country in the world which has had a centralized government without interruption for 5,000 years. Moreover, the central government has always had control of the principal economic activity, namely agriculture(18). Consequently the civil service attracted those people who had qualifications and was also regarded as the main source of personal enrichment. The people's attitude towards this cumbersome unifying administration was ambivalent, because the administration was both a dispenser of benefits (water land, security, etc.) and an often implacable extortioner. In order to increase his share of goods and reduce the exactions on him, the peasant had practised «palm greasing» from time immemorial and had become particularly ingenious in devising techniques for circumventing laws and regulations (which were usually arbitrary). It was in this sociological context that the régime came down in favour of a «revolution from the top», i.e. the use of the government machine to change society, but this facile solution had serious consequences. First, the bureaucracy's traditional love of controls and red tape ended by imposing on the economy an excessive degree of State control which no planning system could justify. Secondly, the bureaucracy tried, as it always did, to stifle criticism by invoking the higher interests of the régime, launching the gravest accusations at its critics and, if necessary, inventing bogus conspiracies. Nasser's charismatic personality and practical achievements had won him immense authority and in the absence of political parties the ambitions of the privileged classes worked

(18) A consequence of the highly complicated irrigation system which can only be managed centrally. In addition the land was publicly owned until 1883.

through intrigues and clan warfare, endowing an already very personal authority with some of the features of a police state. It was natural that in such an atmosphere the principles of participation by the people proclaimed by the «National Charter», the constitution and the law could hardly produce their full effect. The masses were deeply attached to Nasser himself, but were constantly faced by the abuses of his lieutenants and the hostility of a bureaucracy which was jealous of its privileges and spread its tentacles over the administration, the public sector and the Arab Socialist Union. It was this two fold discontent, among the privileged classes who wished to continue their lucrative activities without impediment and among the masses who wished to put an end to undemocratic practices, which made it at first relatively easy for the country to slide towards the right after Nasser's death and then to steer a radically new course after the war of October, 1973.

B. The so-called «Open door» Policy :

1. *A process and a keyword.* This change of course was made in stages during a vast campaign for throwing the responsibility on Nasser's policy in the sixties for all the real or imaginary misfortunes complained of by this or that social class. At least to begin with, the authorities did not place themselves officially at the head of this campaign and they sometimes even deplored its excesses, although justifying them in the name of freedom of expression. Thus the instruments which prepared public opinion for the changes were plays, films, books, newspaper articles, isolated statements in Parliament, etc. The «socialism» of the preceding period was described as synonymous with «administrative» imprisonment, sequestration of goods, excessive alignment with «atheistic communism», an unjustified break with the West and its advanced technology, the suppression of all private initiative and a split with the Egyptians' moderate Arab brethren and their fabulous wealth. In a word, it had been the spread of poverty under a repressive régime which had led the country to its bitter defeat in 1967. When in practice a stop was put to «administrative» imprisonment and especially when the war of October, 1973 broke out, the authorities won genuine popular support thanks to which

they could begin to introduce radical measures which changes economic and social policy in line with ideas which until 1971 had been completely taboo. Here again there was no really coherent strategy, but it is easy to see, behind the economic measures and recent statements by the President of the Republic and his principal collaborators, a number of basic ideas which formed a kind of ideology. First, there was the rehabilitation of the efficiency of private enterprise compared with the public sector. Then there was the belief in the concept that any activity deemed profitable by a business man was necessarily profitable for the national economy, whence the uselessness of planning or even of defining national priorities. Worse still, as the State should not be in charge of production and as the Egyptian bourgeoisie was rather weak, only massive investment by Arabs and foreigners could get the country out of its economic quandary without making the well-to-do classes sacrifice their consumption. To attract this investment, Egypt had resolutely to court the West and the Arab countries which were well-disposed, turning away ostentiously from the USSR and the socialist countries and burying the «phraseology» of anti-imperialism, progressions and socialism. The keyword in Arabic for this ideology is «infitah», which is usually translated by «open door policy», but conjures up, more than its translated versions do, the idea of obtaining outside help to add to one's own efforts. The chosen process of change excluded any abrupt break which might trigger off a violent popular reaction. For the same reason it was not possible to proceed at once, as was done in some Latin American countries, to liquidate the national enterprises or greatly reduce employment. An attempt to stop subsidizing prices for certain commodities led in January, 1977 to the worst riots which the country had known for decades and the measure had to be canceled at once. This state of affairs goes some way towards explaining why today's economic policy is so incoherent and we shall now discuss the main components of that policy.

2. *Arab and foreign investment.* It is curious how little the governments of the Third World learn from past experience. Without a thought for the role played by foreign investment in the countries which have relied heavily on it (Brazil, Mexico,

Taiwan, South Korea, etc.) and turning a deaf ear to the international debate on multinational firms, the Egyptian Government places an astonishingly blind trust in foreign enterprises as the only source of capital and technology and extols the benefits of «Arab and foreign» investment. In order to advance as fast as possible along this road to salvation it passed the most «liberal» law of its kind (especially after the 1976 amendment). First, all sectors of economic activity are thrown open without restriction to foreign capital. The Act contains no guarantee for domestic industry (public or private) and reserves no sensitive sectors to Egyptian nationals. Secondly, it draws up no list of priorities for projects or sectors. Permission to invest is granted automatically as soon as the broad details regarding capital and production seem satisfactory. The advantages granted are the same for a steelworks as for an import-export agency. Thirdly, these advantages are excessive; total exemption from tax on industrial and trading profits for a period ranging from 5 to 15 years, tax exemption for the salaries and wages of all foreign personnel and exemption from income tax (whose rates are to be drastically reduced under the Bill presented by the Government to the People's Assembly) for individual shareholders up to 5 per cent after deduction of schedular taxes (unpaid). Finally, the Government foregoes its sovereign rights, since enterprises containing some foreign capital escape exchange control and all controls on foreign trade. Needless to say, these enterprises are not obliged to comply with the 1961 Act which stipulates that the personnel of every joint stock company shall be represented on its board of directors. In addition to these advantages there are the free ports where foreign capital is completely free from control. This policy was started in Port Said, which has become a free port, and is to be extended to the whole of the Suez Canal zone. In addition, a factory could be declared a free port, wherever it is situated in the country. However, this extremely liberal policy has had very disappointing results, as might be expected, because the rich Arabs are mostly «rentiers» and not entrepreneurs; to induce them to invest in productive activities, serious projects should have been worked out which could have overcome the doubts of their western consultants and interested them in the output of these projects and not only in the profits from them. the legal

concessions encouraged them only to invest to some extent in real estate (and its natural extension, building hotels to be managed by international chains), thus aggravating land speculation. The resulting considerable rise in the prices of building had made the housing crisis insoluble. As regards the multinational firms, it is well known that the recession and unemployment in the OECD countries are hardly encouraging them to increase their investment. What interested them at the beginning was to recycle petrodollars through Arab investment in Egypt which would bring them profitable orders for plant and technology. However, Egypt's economic stagnation and the attitude of the Gulf countries in favour of using their capital as a magnet to attract manpower and of establishing new industries in the desert have led to turning the multinationals away from Egypt. No industrial enterprise of importance has been financed by foreign investment. In the few cases where foreign companies participate in industry, a domestic enterprise has been transformed into a joint venture in which foreign participation is limited mainly to the value of supplies of know-how and the use of a trade mark. On the other hand, the activities of foreign companies have increased in number, if not in cash contributions, in the tertiary sector led by banking and import-export business. This move towards the tertiary sector is also found among Egyptian businessmen and their Arab partners. Once economic growth was deliberately left by the State to private initiative in a country particularly poor in natural resources, it was bound to move from the secondary sector to activities which were more profitable in the short term.

3 *The «liberalization» of foreign trade.* The first target of the businessmen's pressure groups close to the Government was the regulation of foreign trade. In view of the unsatisfied demand for Western consumer goods, including gadgets, there were attractive prospects of profit in this sector, so that «infitah» began there. In assessing the desirability of this policy one should remember the disturbing balance-of-payments deficit at the end of 1973 and the fact that, as the war had not led to a rapid settlement of the conflict with Israel, the constraints on the Egyptian economy remained unchanged. Thus the Government opted for liberalization in an economic situation which

would normally call for controls. the new policy began modestly by setting up a «parallel» foreign exchanges market. This enabled private persons to acquire funds transferred by Egyptian working abroad or changed by tourists (at a so-called incentive rate), or earned by exports of so-called nontraditional products (flowers, vegetables, handicrafts, etc.) and to use them to import products for productive purposes listed by an Order of the Ministry of Economy. the volume of transactions in this market in 1974 did not exceed 10 per cent of foreign trade, but in 1975 the Government authorized a new type of transaction under the curious name of «imports without transfer of foreign exchange». these imports were financed by compensation deals using the transferable assets of Egyptians working abroad and funds spent by tourists from oil-producing Arab countries. The rate of exchange for such transactions was below the rate on the parallel market and before long these imports became a form of «parallel foreign trade» which the authorities do not even record statistically. The third stage was when the Government decided, at the request of the IMF, to apply the parallel market rate to all exports (except cotton, rice, oil and Suez Canal earnings) and all imports(19) (except wheat, edible oils, sugar, fertilizer, insecticides and expenditure by diplomatic missions). Since 1977, customs duties and the foreign element in public investment have been calculated at the same rate. Thus the Egyptian pound has in practice been devalued and there disadvantages of a measure which devalues the national currency by 43.9 per cent(20) in relation to the dollar. Moreover, a law passed in 1976 authorized foreign exchange dealings through banks without control by the Central Bank. In addition, any enterprise which obtains a foreign currency addition to its capital even from an Egyptian, is allowed free use of its foreign currency earnings. Likewise enterprises in the public sector have been given the right to use their export earnings directly for financing their imports. In such conditions it is clearly impossible to allocate foreign currency at national level in the

(19) In 1977, 72.9 per cent of all imports were to be paid for at the new rate.

(20) The official rate of exchange is LE 1 = US \$ 2.56. The new rate is LE 1 = US \$ 1.43.

optimum way and obvious that the consumption of the well-to-do and middle classes, stimulated by advertising and the display of wealth, will deprive investment projects of the resources they require.

4. *Role of the private sector in Egypt.* When Nasser announced his sweeping nationalizations in July, 1961, he justified them on economic grounds and not only on social and political grounds. For example, the results of the first year of the Five-Year-Plan showed that the private sector had not made the productive investment foreseen by the Plan. On the other hand it had succeeded, by means of contracts for supplies, building and contracting, subcontracting, etc., in extracting considerable sums from the public sector. The weakness of Egyptian capitalism was notorious; there was no industrial tradition worthy of the name and very little financial experience. The predominance of the public sector from 1961 to 1973 was not calculated to strengthen the spirit of enterprise or the liking for risk-taking, so that it was to be expected that Egyptian businessmen would use their great freedom in recent years to move at once into the sectors they knew well; real estate and land speculation, commerce, import-export business and its derivatives such as packaging and bottling, and expensive foodstuffs (meat, poultry, fruit, etc.). Furthermore, the invitation to Arab and foreign capital involved swelling the ranks of «intermediaries» whose earnings were of doubtful legality. Free foreign and domestic trade, selling flats and representing foreign companies have become highly lucrative activities which in practice escape taxation, so that the system works to the detriment of productive activities. Indeed, building even a small factory takes much longer, usually yields less profit and saddles the owner with labour and tax problems. In order to enable the private sector to play a positive role in development, steps would have to have been taken to define the fields in which its operations would have been effective and desirable, to have projects worked out by government departments for it, to support it with loans, to train its personnel, to supply it with raw materials and intermediate products, and to market its output. Mere «laissez faire» in an underdeveloped economy does not automatically bring the famous «entrepreneur class» into being. In recent years State

intervention in Egypt took a turn which discouraged «businessmen» from becoming real entrepreneurs.

5. *Balance sheet of an experiment.* It is well known that Egypt is at present struggling with tremendous economic difficulties. The press keeps writing about them and «friendly» powers and international organizations worry about them. At the meeting in Paris in May, 1977 of the «Consultative Group» formed by the World Bank, the vice-president of the Bank announced that an unprecedented effort had obtained about \$ 5.4 billion worth of external finance for Egypt for that year and then spoke gloomily about the outlook for 1978. It will therefore be useful to close this chapter with some figures for the results of the open door policy.

(a) *Investment and growth.* Owing to inflation and the de facto devaluation of the Egyptian pound, the figures for investment are confusing. The Ministry of Planning gives two versions :

Gross investment at current prices

Gross investment at current prices :

<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976²¹</u>	<u>1977²¹</u>
500	734	1,194	1,194	1,543

Gross investment at 1975 prices⁽²²⁾.

<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977²¹</u>
		1,328	1,115	1,474

(in LE million).

Be that as it may, it should be noted that the increase in 1974 is partly explained by the worldwide rise in prices, which made its full impact in 1975. A considerable part of investment in 1975 (about 28 per cent of the total) was for reconstructing the Suez Canal zone and was financed almost entirely by

(21) Projected magnitudes in the Plan. An estimate of actual investment is not yet available.

(22) At the official rate of exchange.

Arab and international aid. In 1976, however, gross investment declined, while in 1977 it should slightly exceed its 1975 level. Thus it is clearly stagnant. Here two points should be made. First, despite the open-door policy the private sector (local, Arab and foreign) is still making a very small contribution : 6.6 per cent in 1975, 7.9 per cent in 1976 and 7.6 per cent in 1977(23). By way of comparison, the local private sector accounted for 7.9 per cent and 12.1 per cent of total investment in 1965-66 and 1973 respectively. The conclusion is evident; the open-door policy has neither induced the local bourgeoisie to invest much nor attracted a massive inflow of Arab and foreign capital. Secondly, the proportion of investment in the production of goods has declined in favour of services. From 59.4 per cent in 1973 this proportion fell to 45.1 per cent in 1977. Moreover, the official order of priority for public investment is infrastructure, housing etc., and industrialization is no longer one of the State's main concerns. Meanwhile the growth rate of GDP does not fully reflect the falling off of investment. The explanation of the discrepancy is to be found in a number of accidental factors such as massive reconstruction expenditure in 1975, the reopening of the Suez Canal and the recovery of the Abu Rhodeis oil fields in Sinai.

(b) *Consumption and saving.* As the war of October, 1973 did not bring peace, military expenditure could not be much reduced. However, the Government behaved, and encouraged everyone to behave, as if better times had come at last and one could now loosen one's belt(24). It was therefore natural that in spite of additional resources, in particular the Suez Canal and oil from Sinai, the share of consumption in GDP remained very high. From 92 per cent in 1973 it rose to 99.4 per cent in 1975. A remarkable fact was that public consumption exceeded its exceptional level in the war year (27.1 per cent) and, despite partial demobilization, reached 29.9 per cent in 1975. Things

(23) Estimates by the Ministry of Planning, the Ministry of Economy and Economic Co-operation merely gives the total for the projects approved by it and for projects planned.

(24) See statement by the Prime Minister, Mamdouh Salem, to the People's Assembly in May, 1975.

improved in 1976, when the rate of total consumption was 90.7 per cent. It is true that pressure from Egypt's sources of finance made the Government bring down public consumption to 25.5 per cent, but the return of private consumption to almost its 1973 level (65.2 per cent and 64.9 per cent respectively) concealed a serious deterioration in the living standards of the masses and to some extent even of the middle classes. To realize this one need only remember how the consumption of luxury goods by the wealthiest class exploded thanks to the liberalization of imports and the growth of the population. Actually inflation redistributed real incomes to the detriment of all wage earners (despite the rise in average nominal wage rates) employed by the Government and the public sector. As regards the masses who, whether in rural or urban areas, have no regular employment, their condition is worsening and bordering on dangerous, chronic malnutrition, not to mention the state of their housing, transport facilities, health or clothing. The fact that the rate of saving has declined so far without unduly distributing the authorities is explained by the latter's mentality mentioned above; «the country» has made a maximum of sacrifices and can now only rely on Arab and foreign capital.

(c) *Budget deficit and money supply.* This laxity is seen especially in the central government budget. Its deficit increased from 29.9 per cent of total revenue in 1973 (a record compared with previous years) to 35 per cent in 1974 and 61 per cent in 1975, after which it decreased to 48 per cent in 1976. But one should note that the relatively smaller deficit in 1976 is largely explained by the doubling of customs revenue as a result of liberalizing imports and calculating duties on the basis of a 43.9 per cent lower rate of exchange. Treasury (short-term) borrowing from the banks rose from LE 183 million in 1973 to a maximum of LE 800 million in 1975 and then levelled off at about LE 500 million in the next two years. The inflationary effect of this requires no proof and its extent is clear from the growth of the money supply. Here are the Central Bank's figures :

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Note circulation	777.2	947.6	1155.6	1387.8
Sight deposits	<u>427.6</u>	<u>555.2</u>	<u>706.7</u>	<u>851.1</u>
	1204.8	1502.8	1862.3	2238.9
Time deposits	432.2	616.8	703.2	974.5

These figures show that total means of payment expanded by 85 per cent in three years. No increase in production or trade justified this, the printing press alone increased the note circulation by 78.6 per cent, while sight deposits almost doubled. (99 per cent.) Meanwhile quasi-money increased by 125.5 per cent, bringing the rise in the total of liquid funds on the market to 96.3 per cent. The size of the budget deficit, the inflationary nature of certain public expenditure (especially military expenditure), the focusing of demand on consumer goods, the de facto devaluation of the Egyptian pound, etc. were all domestic factors which belied the Government's claim that inflation was imported. There are no official figures available for measuring the rate of inflation. The published price indices are not valid, as we have already pointed out. Nevertheless the cost of living index (basis 1966-67 = 100) rose to 127.7 in 1973 and 174.2 in 1976, i.e. only 27.7 points in seven years compared with products group, the figures are 120.8 in 1973 and 209.9 in 1976. Instead of taking the traditional action to control inflation, the Government chose a policy of granting tax exemptions, reducing direct taxation and increasing indirect taxation while proclaiming its firm intention to stem the rise in prices. There were already fiscal, economic and social policy defects in the Egyptian budgetary system, but their effects had not been too serious during the preceding period when nationalization's, expropriations, the dominating role of the public sector and the attempts at planning had given the State much greater powers(25). Under a government which has solemnly promised

(25) Direct taxation in Egypt dates from 1939 and copies the French system of that time with some variants. It is based on schedular taxes on various categories of income, together with a progressive surtax on total revenue already subject to a proportional schedular tax. The system does not apply to agricultural or real estate profits, which consequently escape tax altogether. Moreover, the tax on industrial and commercial

not to attack private property again and has made encouragement of private enterprise the keystone of its economic policy, taxation should have resumed its role as an instrument of State intervention. Instead, as already mentioned, the law granted full tax exemption to Arab and foreign investment on the ground that such investment brings in foreign currency. However, the local private sector was not long in obtaining similar concessions. Finally all new investment, whether private or public, was exempted from tax. Other reliefs were to be granted on all kinds of pretexts; relief for small tax payers, for interest on time deposits, etc. As was to be expected, this policy led to a reduction in the share of direct taxes in total current government revenue (excluding transfers of profits from public undertakings) of from 23.4 per cent in 1973 to 17.7 per cent in 1976. By way of comparison, customs revenue more than doubled during these three years from LE 205.1 million in 1973 to LE 570 million in 1976.

(d) *External deficit.* The liberalization of imports was bound to increase the trade deficit, because hitherto the demand for the consumer society's goods gadgets had been curbed. In 1973 Egypt's exports paid for 60.3 per cent of its imports, but in 1976 they paid for only 42.6 per cent, although the value of wheat imports had fallen considerably as a result of lower world prices. The origins and nature of the deficit are explained better by the geographical distribution of trade than by its customs classification. The E.E.C., the United States and Japan accounted for 85 per cent of the deficit, because Egypt bought 58.8 per cent of its imports from these countries, but they took only 28.4 per cent of its exports. While the huge deficit with the United States (LE 244.2 million worth of imports against LE 23 million worth of exports) was partly financed by food aid, most of the deficit with the OECD countries as a whole was financed by shortterm credits whose extent, as we shall see presently brought the country in 1977 to the brink of

profits is not a tax under common law; it applies only to the activities listed in the relevant Act and then only if these activities are performed on a regular basis. Evasion is greatest in the general income tax, the revenue from which has never exceeded LE 3 million.

bankruptcy. By way of comparison, imports from the Soviet Union in 1976 were no more than 5 per cent of total imports, where exports to that country formed 23.2 per cent of the total. Egypt's trade with Eastern Europe as a whole was in balance (LE 125.2 million worth of imports against LE 123 million worth of exports). Apart from that and despite the marked improvement in invisible earnings (Suez Canal dues LE 121.7 million in 1976, tourist expenditure, transfers by Egyptians working abroad, etc.) (26), the current balance-of-payments deficit is LE 593 million, or 36 per cent of total current earnings. In national accounting terms the external deficit increased from 5.6 per cent of GDP in 1973 to 21.7 per cent in 1975. The Government had hoped that an inflow of Arab and foreign capital would remedy the situation, but we have already pointed out how small was this inflow. Moreover, the proliferation of foreign and partly foreign banks, far from providing the national economy with additional foreign currency, instead diverted large sums from the Egyptian market to foreign markets. The balance sheet for all these institutions together on 31 st March, 1977 shows that their capital was only 8 per cent of all their resources on that date. Meanwhile local deposits (much of which came from the public sector) accounted for 57.7 per cent and debts to the local banking system for 18.2 per cent. A major part of their resources (49.8 per cent) was deposited abroad. The second item in order of importance was short term lending to the public banks for financing imports. Thus the only course left to Egypt by its open-door policy was to borrow. The appeal for direct investment had been «justified» by the desire not to borrow any more abroad (27), but in practice the

(26) According to the World Bank these transfers increased from \$ 86.3 million in 1973 to \$ 336 million in 1975. This sharp increase, which is continuing, was not due to the de facto devaluation of the Egyptian pound, but rather to the increased number of emigrant workers. The slowing down in the pace of development and sharp increase in the cost of living make Egyptian emigrate, while the affluence and ambitious investment programmes of the oil-producing countries with their relatively high wages attract immigrants. However, this unorganized exodus is depriving Egypt of the executive and skilled manpower which was its main asset, but without solving the unemployment problem as a whole.

(27) As if the repatriation of dividends and capital (guaranteed by law) would have been a lesser burden than the debt service.

debt contracted by Egypt in 1976 and 1977 amounted to 40 per cent of its total previous indebtedness. By the end of 1976 Egypt's total foreign indebtedness(28), amounted to some \$ 7,188 million, including \$ 1,759 million due mainly to European socialist countries. The amount of short-term debt, \$ 1,176.3 million, is particularly disturbing. Debt service took 38 per cent of the value of exports, which was the highest percentage in the Third World(29). In addition, 1977 was heralded as a deficit year and the January riots had made the Government retreat in face of the IMF's demands to reduce the deficit by making large increase in the prices of consumer goods. Thanks to an extraordinary effort, Egypt was able to borrow abroad some \$ 5.4 billion for 1977, of which \$ 1.5 billion was for covering its short-term debt service payments. However, nothing essential had changed in the Egyptian economy and, if the ruling classes are placing their hopes in oil production, an increase in the Suez Canal's traffic following its reconstruction, tourism, etc., it should be noted that all these things are planned for the 1980s. For the present Egypt has to face its immediate difficulties by making clear political choices and accepting their full consequences. Shilly-shallying and compromises only worsen the situation. the IBRD's latest report is rightly entitled «Egypt in Transition». The question is now, a transition in what direction and with what strategy? This brings us to the need to examine the possible scenarios.

Part Two

Three Scenarios for the Future

A. Basic Needs :

Whatever social policy options are taken in Egypt, its leaders will have to fika up to number of basic needs that anyone looking into the country's long-term future must see as vital

(28) Sums drawn and not merely contracted for.

(29) See World Bank : Debt Tables, 1977.

requirements. Widely differing ways of dealing with them may, of course, be contemplated and the merits of each approach discussed at length but none will be feasible unless the solutions found in these specific areas fail to operate. These basic needs are as follows :

1. *To reduce the food deficit.* Egypt's food imports (mainly grain, oils and fats) accounted for about 22.3 per cent of its total imports and were equivalent to over 65.2 per cent of the value of its exports. The growth rate rules out the possibility of any monetary solution. Wheat imports went up from 2.3 million tonnes in 1973 to 2.9 million in 1976, closely followed by the increase in flour and corn imports. In 1976 wheat and flour imports totalled the equivalent of 3.63 million tonnes of wheat, whilst home production totalled about 2 million tonnes so that Egypt is dependent on other countries for two thirds of its daily bread. A comparison between the natural population growth rate and the growth rate for food production points to a steady and relatively steep increase in this enormous food deficit. Apart from the question of national policy with regard to this dependence, it is difficult to see how the country could find necessary resources to buy abroad everything it will need to feed a population which is now nearly 40 million. On the contrary, everything points to a worsening balance of payments and higher priced and rarer food. In other words, regardless of the political bent of the country's leaders, a speedy improvement in agricultural production and productivity, particularly with regard to food, is essential. The social policy options would simply vary in the ways they proposed to do this. Obviously, these choices would make a difference to the effectiveness of the way in which the food problem is solved but policy-makers could not just ignore it.

2. *Industrialization* . It must, however, be recognized that agricultural and rural development will not be enough to make Egypt self-sufficient in food. The smallness of the area farmed and the almost complete absence of rain were referred to at the beginning of this study. At this point it may be added that the maximum flow rate of the Nile - the country's only source

of water(30) - has been calculated and that the maximum surface area that could be farmed, even using the most advanced irrigation technologies, is limited. Another physical constraint is the area of land that is available for farming on viable economic terms. At all events, it is vital to «reclaim» any land purpose. Otherwise, the growth of built-up areas and towns will steadily continue to reduce the area farmed which, today, is not even 2.3 million hectares for a population of over 36 million(31). This ratio between population and farmland therefore has to be improved. Even so the country will have to import part of its food requirement, particularly if the standard of living is to rise. To pay for these imports it has to be in a position to generate a surplus in its trade balance for manufactured goods. For Egypt, therefore, industrialization is a question of survival. Whether the primary object be exports, substitution of imports or satisfying the whole population's basic requirements is a matter of ideology or politics, but the country has to industrialize in order to be able to export more industrial products than it has to import so that the surplus can be used to finance the food deficit. In addition, since the country is poor in natural resources but rich in manpower that could swiftly acquire every kind of technical and other occupational skill, the industrialization process should therefore aim at making the best possible use of human resources and therefore concentrate on those industries in which, locally, the value added is highest. There is not point in dwelling on alternatives to industrialization which, in Egypt's case, are quite unrealistic. Even the most optimistic forecasts do not anticipate that the country will ever earn vast surpluses from oil exports-the figure is 50 million tonnes in the early 1980s for a population of 40 million. A widened Suez Canal and the Suez-Alexandria pipeline (Sumed) will never yield more than 8-10 per cent of the GNP and tourism, whose real profitability is by no means certain, can hardly be the answer for such a vast populations.

(30) The irrigation potential through the use of artesian wells bringing up underground water in certain desert areas is not yet known with any exactness but everything suggests that the contributions it is likely to make will be marginal.

(31) The annual loss of farmland to urban development is estimated to be 4,000 hectares.

3. *Better use of the national territory.* For thousands of years the Egyptians have been living on only about 3 per cent of their land - the Nile Valley and Delta. One of the oldest races to go in for sedentary farming, they have striven throughout their long history to make the most of their only source of water to extend the area they could form into the desert surrounding them but these efforts were halted in the south by the chains of hills enclosing the valley and in the north by the lack of water during most of the year. The exceptionally fertile soil and a relatively small population (only 9 million at the end of the 18th century) made Egypt a rich country that was always envied by its nomadic neighbours and empires further afield. The growing population, the diversification of economic activities (and in particular the advent of industry) and the changing lifestyle (urbanization, particularly in the Cairo and Alexandria areas) are now threatening the country with suffocation. The «inhabited» part of Egypt has an extremely high population density (nearly 692 people for square km in 1976 as compared with 142 in 1897). An even more serious feature is the encroachment of urbanization and non-agricultural activities on farmland, robbing agriculture of the most fertile areas, reclaimed land being of lower quality. The most reliable forecasts indicate that the population will have doubled in the early part of the next century (around 2010). If the present pattern holds, the Cairo areas will have a population of 15 million and the area of farmland lost will be far more than all that current projects will have reclaimed from the desert. In the «development community», therefore, it is generally predicated that this «second Egypt» will have to find its home outside the Nile Valley and Delta. Several settlement areas have already been identified where multi-sectoral development potential would make infrastructure costs acceptable. first there is Sinai, excluded from development plans up to the 1967 war for false military strategy reasons. The peninsula has mineral and oil resources and significant agricultural potential. Fishing and tourism are other possibilities. Next there is the area around Lake Nasser agriculture, fishing, transport, tourism, mineral resources and a natural harbour on the Red Sea). The north-west coast has fine beaches and some farming potential. In addition, electrocution in the vast Quattara depression could

supply Egypt with more hydro power than the Aswan Dam, to say nothing of the possibility of finding oil. The south west, lastly, has some big phosphate deposits and agricultural potential with well-water irrigation. The survival of the country will very much depend on exploiting these areas. Here again, there are various social policy options ranging from the kind of resettlement that Brazil has embarked upon in the Amazon and a voluntary movement of pioneers building a «new life», but it would be wrong just to do nothing about this need for regional development.

4. *Arab co-operation.* Proximity, the common culture, the diversity and complementary of resources (farm land in the Sudan, mineral wealth in Morocco, Algeria and Tunisia, oil in many countries, capital surpluses in the Persian Gulf, skill and manpower in Egypt, etc.) and the intensive contact across frontiers over the last two decades are some of the reasons why no development strategy in Egypt can afford to ignore the «Arab co-operation» aspect. There is a reciprocal attraction between the factors of production that are irregularly distributed in the area. A complex institutional framework already exists to promote co-operation - the Arab League and its specialized agencies, the Council for Arab Economic Unity, «multinational» enterprises in the real sense, a development bank and a monetary fund - and then there are the various development funds set up by the oil countries with money to spare. Egypt's position in the Arab world is of the highest importance. It is strategically placed between North Africa and the Middle East, its population (one-third of the Arab nation) is a vast market, it has a considerable potential of management grades and engineers, etc. Obviously, the nature and extent of Arab co-operation will be a political decision and could be at different levels according to the affinity between the regimes in power. In some cases it could be enhanced through the agency of transnational companies and their local partners. In other cases, regimes with their sights set on leadership will endeavour to tighten the economic links over which they have any power. In short, this area has all and everything in its favour for a successful experiment in collective selfreliance. However one

sees the future, Egypt is bound to strengthen its economic relations at least with certain «sister countries».

These basic needs must be included in any scenario for the future, but a scenario is primarily defined by the social and political options of its authors, whether these are explicitly stated or below the surface and clothed in economic terminology. As we saw in the first part of the study Egypt has undergone a revolution at the socioeconomic level and not just a change of political power. In the 1960s, the trend of development in the direction of the masses was thwarted by the action and influence of the rich. In the present decade, the trend towards a market economy was stifled by hesitation in the face of the formidable task of getting rid immediately of all the inherited structures and relationships. Any scenario for the future, therefore, must decide on its options in the light of the revolutionary experiment. This means that three scenarios (and only three if internal coherence is considered important) are possible : undoing freezing or continuing the revolution).

B. Scenario 1 : Undoing the revolution :()*

1. *Instituting a market economy.* The 1952 revolution, as we have pointed out, fairly quickly opted for greater state intervention in the management of the national economy. As years went by, the measures taken built up into a closeknit fabric of legislation and regulations which, effective or not, form a coherent system. If the State is to institute a market economy it cannot just resort to a negative «Laisser faire» policy, which would merely add the defects of liberalism to those of State control. What is more it has to be remembered that Egyptian capitalism has a mediocre history particularly in the modern sectors that should be the mainsprings of economic growth and industry in particular. The changeover to a market economy would therefore call for positive and systematic action by the State and this the contradiction implicit in this option for most Third World countries. Unlike what happened

(*) This might be called the Turkish scenario after the liquidation of Kemalism started in 1945.

intervention - not the opposite - on the part of the authorities. In Egypt this intervention would have to aim at nothing less Undoing the Egyptian revolution cannot be just a question of establishing themselves in the various sectors of the economy. than creating a class of capitalist entrepreneurs capable of canceling nationalization or expropriation measures. The length of time that has elapsed since the measures were taken and the large number of enterprises set up by the State and of the extensions, changes and mergers it has put into effect, the disappearance of the previous owners (through death, departure from the country, changeover to other activities, etc.) political reaction, and so on, would all combine to make such a policy futile and inoperative. Instead, this scenario would have to provide for promoting the rapid emergence of a new capitalism - and this could well be feasible. The basic material for this bourgeoisie already exists : technocrats who have acquired knowledge and experience in the management of public enterprises, wealthy bureaucrats, big merchants and real estate promoters with vast amounts of cash at their command, and big farmers who cannot develop their purely agricultural activities further because of the legal ceiling on land ownership. What is lacking is that these people do not own any production plant and facilities in other sectors of the economy. What would be needed is both to refloat their «original assets» and to provide them with opportunities for investment paying an immediate return in order to encourage them to set up new enterprises in these sectors. The ideal way, as things stand, would be to transfer viable public enterprises to them on very attractive terms, i.e. at a reasonable price payable by installments. Thereafter, the State would have to continue to encourage them through suitable tax, credit, wage and price policies. In addition, the State would have to embark on the necessary investment to give them the infrastructures they need such as ports, roads, railways, telecommunication, etc., and to finance industries that are necessary but not economically viable(32). But although

(32) Trends in Brazil since 1964 show similar features. See study by Paul Singer and Bolivar Lamonnier : Brazil : Growth through inequality in «Another development, Approaches and strategies» edited by Marc Nefin. Dag Hammarskjöld Foundation, Uppsala, 1977.

turning a large part of the public sector over to private enterprise is a necessary condition for instituting a market economy it is not sufficient since its success will depend on reversing all the economic and social policies that - in theory or practice - have so far prevailed. An example is the policy aimed at preventing any increase in average wages by freezing prices, and even by granting subsidies. Another illustration is the ban on unwarranted dismissal and participation in profits and management in return for the ban on strikes. the same applies to the policy for increasing employment (and in particular the automatic employment for all university and technical college graduates) which is deemed to be necessary for «social peace» and to prevent any increase in wages. Lastly, the policy banning imports of anything that can be produced locally could not just be replaced by indiscriminate liberalization of imports because the new bourgeoisie would need customs protection, etc. These are only a Few examples of a pyramid of measures fitting, with varying success, the socialist trend and which would have to be repealed, revised or replaced in full awareness of the possible repercussions. Instituting a market economy, therefore, implies global and systematic action which would tend to undo everything that had been done under Nasser. Let us now look at the answers that this scenario would afford to the objective problems identified in the first section of this part.

2. *Agriculture and food.* In this scenario, the mainspring of agricultural development would have to be the «modern farm», of a reasonable size, mechanized and combining several activities. Nothing could justify going back on the agricultural reform and returning the land to its previous (often absentee) owners. All that would have to be done would be to do away with the land ownership ceiling and since the market mechanisms normally act in the direction of concentration, this would be helped even more if the State provided the necessary credit. As regards enlarging the area under cultivation, joint ventures with international «agri-business» would be a possibility provided that the State paid for the costly infrastructure (irrigation, drainage, transport, etc.). However, in view of the relative scarcity of land, it is likely that basic crops like wheat, corn, beans, etc., would be sacrificed to more profitable crops (fruit

and vegetables for export, flowers, and so on). Any increase in agricultural production would not therefore reduce the country's dependence on others for food. the future of cotton would be a serious problem because prices yielding profits for growers comparable with those from other crops would be ruinous for the local textile industry and even affect exports.

3. *Industry.* In all probability this scenario would result in a steep increase in the number and size of assembly firms helped, firstly, by links with the transitional companies (the latter's involvement taking various forms) and, secondary, by access to neighbouring Arab markets (probably via Arab share holdings in the firms concerned). The same would apply to construction material firms which would have a big local and Arab market. There would probably also be some expansion in the country's traditional light industries such as textiles and footwear. The last possibility is that the State would find itself having to finance certain basic industries requiring large scale capital investment but offering mediocre return, e.g. iron and steel. However this may be, the main problem would be the need to keep unit labour costs down in order to sustain investment : a freeze on nominal wages as inflation pushes wages up to the desired levels, stricter work discipline, preferential use of capital intensive technologies, mass lay-offs of redundant State or public sector workers in order that the surplus of manpower keeps down average wages etc. Industrial production would, of course, be designed for export and to substitute, at least in part, those imports of consumer goods going to the rich and middle classes.

4. *External relations.* This scenario clearly implies a large measure of integration in the world market. With the country's economic and financial situation being so bad at the outset. its requirements in terms of foreign capital would be all the greater. Oil surpluses in the region cannot, of themselves, supply the answer. The point is, that with this scenario, the transnational companies (and the banks in particular) would play a decisive part in routing Arabic capital to Egypt (banking transactions between branches and subsidiaries established in the area, «trilateral» enterprises etc.). In theory of combined resources of Egypt, Saudi Arabia and the Sudan could create

a new Brazil in the Middle East, a prospect which would certainly attract the transnationals. Obviously there are too many difficulties in the way of such a union, but some form of common market could be contemplated. Apart from capital input, the transnational companies would dominate because they would be supplying the plants, replacement parts, and above all, the technology. They would also have a significant role in selling products (made with their trade marks) on export markets. Lastly, the Brazilian example shows that the success of such a scenario itself causes a considerable increase in the foreign debt and to meet the increasing foreign currency requirement attempts would be made to build up income by developing a «service economy». The country's exceptional tourism resources would probably make this priority for the State and for foreign and local investors. The facilities which the State would not fail to provide would lead to the kind of exploitation of the physical and cultural environment that would cause irreparable damage(33). Certain officials and businessmen have already openly indicated their wish to see Cairo take the place of Beirut as a capital market and as the «shopping centre» of the Middle East.

An analysis of the political conditions in which this scenario might be feasible does not come within the scope of this study and we shall therefore confine our comment to stressing how difficult it would be to reduce suddenly the standard of living of large strata of the population, surprises essential social benefits, and encourage blatant inequalities in income in a country where limitations on property ownership and income have already been introduced and where the active population has been brought up from childhood on ideas of equality and dignity for its most disadvantaged members. It is therefore to be feared that the social price of this scenario would be a dictatorship of the South-American kind. Furthermore, an unsatisfactory settlement (or no settlement at all) of the conflict in the Middle East and the political movements hostile to this kind

(33) Already, a Hong kong company has obtained a concession on the plateau of the Pyramids at Giza.

of strategy which are (or may one day be) in power in the Arab countries would strengthen internal resistance. Nevertheless, we shall refrain from evaluating the changes of this scenario, both as regards its implementation and its results since any judgment would have to be subjective.

C. Scenario 2 : Freezing the revolution : ()*

This scenario is based on a de facto scraping of the socialism option (on the ground of efficiency, the need to mobilize private and foreign resources, some different type of strategy, and so on) although the State would not, for all that, discard its direct responsibility for accelerating economic growth and working for «social justice» (so that social and political stability may be maintained. While it would therefore mean reconsidering and revising the policies of the 1960s it would not mean that they would have to be completely jettisoned. On the other hand it would also mean reviewing the liberalization measures taken since 1974.

1. *A mixed economy.* This middle-of-the-road strategy would be a variously satisfactory amalgam of the controlled planning and market economy systems. One of its salient features would be the retention of the decisive, if not dominant role, of the public sector. Admittedly, some small enterprises could be handed over to private shareholders but big new firms would be set up by the State in those fields having little attraction for private capital though deemed to be essential for economic growth. On the other hand, discarding the socialism option would open the door to combinations of private and public capital in mixed economy companies. Similarly, public enterprises would be able to share in joint ventures with Arab or foreign capital. so the public sector would continue to be the main (but more privileged) instrument of state intervention. At the same time systematic policies to develop a dynamic private sector would be introduced. Public enterprises, instead

(*) Its perfect model is Mexico under the rule of the Institutional Revolutionary Party (PRI) for more than 60 years.

of competing with private enterprise activities, would be designed to stimulate them by supplying energy, raw materials and intermediates. The role of the State in promoting the private sector would not stop there. It would help it by providing capital (mainly in the form of loans), reserving some government contracts to the sector, protecting the local market, subsidizing exports, etc. The State might even give technical assistance. The relevant State departments could possibly produce feasibility studies, give advice on the choice of technology, and provide information about the wording of technology transfer contracts. Again, the point is that a straight «laissez faire» policy would not be sufficient to create a go-ahead and effective capitalist system, otherwise underdevelopment would have disappeared of itself when political independence was achieved. A specific foreign trade and exchange policy would help to channel sums wasted today in trade and consumer goods towards productive activities. The State probably also try to involve transnational companies in its activities. On this last point, the State, for its part, would want to ensure that such companies «contribute to national development» but at the same time to minimize the «secondary effect» of their involvement. Probably the accent would be placed on their technology input rather than on their capital contribution. Making the most of national resources and protecting local industry would probably be essential to the concerns of the authorities. However this may be, the number of joint and trilateral ventures would increase steeply. Lastly, this mixed economy would fit in very well with guideline planning on the French model. As soon as the private sector has become really involved in productive development activities it would feel the need for efficient statistical, economic and social research and forecasting services and not being able to finance them itself it would ask the State to provide them.

2. *Industry.* In view of the limited nature of the country's agricultural resources in relation to total population and the rural population in particular it would be normal, in this scenario, to make industrialization the first priority. The experience of the fifties and the sixties introduced a large section of the population to industrial activity and enabled many people to be trained as management staff, engineers and skilled work-

ers. The country's mineral resources, though poor are far from being fully exploited. Oil prospects suggest there will be no energy shortage; on the contrary, there would be opportunities for a petrochemical industry. In a mixed economy it would be easier to raise additional capital and to acquire new technology. In addition to the industries that have now become traditional (textiles, food building materials and so on) the advent or growth of basic industries like metals, electro-chemicals and petrochemicals could also be expected. Assembly and packaging firms could then be gradually integrated into a relatively coherent industrial structure. This is particularly true for the engineering industries but it also applies to others (such as pharmaceuticals, for example). This pattern of activity could go on for a number of years without any fear of major social conflict. workers in the public sector would retain their basic benefits and those in the private sector would receive considerably higher wages offsetting the end to co-management and the ban on unwarranted dismissal. The private sector's main resource for achieving substantial profits in spite of higher average wages would be capital-intensive production technologies and in any case the magnetic pull of «advanced technologies» is widespread in the third-world, particularly among its engineers and chief executives. Probably industrialization would fall into the classic «expert-oriented and import-substitution» pattern(34) and would have little to do with satisfying basic requirements. A last point is that the rate and volume of industrial growth would, in the final resort, depend on export possibilities. Some measures of co-ordination - and also joint ventures - would be necessary to export to Arab markets. East of access to markets in the industrialized countries would depend on the way the recession develops and the results achieved in the north-south dialogue.

3. *Agriculture.* The risk in this scenario, is that agriculture would become the «poor relation» of growth or to pub

(34) We have already shown that the type of product is generally the same whether production is intended for consumption by the privileged minority or for export.

it another way, its Achilles heel. the close links between industry and rich farmers would prevent any systematic development of real farming co-operatives. At the same time, the concern for social peace and the political refusal to repudiate the revolution would prevent very small farms being taken over by the larger ones. In addition, the number of people leaving the land and swelling the ranks of the workless would prevent the industrial boom from increasing wages to any large extent. On the other hand, rich farmers would use their influence to obtain inputs to improve productivity : better seed, fertilizer, insecticides, tractors, etc. This in itself would open up a market for certain local industries and a kind of economic duality could well take shape. Just like the modern sectors and traditional or «informal» sectors that co-exist in towns, rural Egypt could have two types of agriculture : one being relatively modern and featuring high productivity and the other carried on by poor farmers (tenant farmers, share-croppers or small holders) and left behind by progress. this is what happened in Mexico where major technological projects did little for poor farmers(35). A similar phenomenon occurred in India during the «green revolution»(36). Any enlargement of the agricultural areas would be marginal and confined to the areas near the Delta. On the other hand, it is possible that some food industry firms would reclaim the land that they need for industrial crops provided the State made itself desponsible for providing the irrigating water infrastructure. In all probability the food deficit would continue to give cause for alarm and the real gamble in this scenario is that industry would have to export enough to offset not only its own requirements of imported products but also the country's grain imports

4. *Regional development.* A natural feature of this type of scenario is that it would be ambitious and therefore the country

(35) See : C. Hewitt de Alcetra : «Modernizing Mexican Agriculture : Socioeconomic implications of technological change 1940-1970. United Nations Research Institute for Social Development, Geneva, 1976

(36) A. Eugene and W. Flinn : «Green Revolution technology : Structural aspects of its adoption and its consequences». UNRISD, Geneva, 1975.

might be expected to be prepared to tackle some major problems like the need for a new approach to regional development. As regards tourism, which is always believed to be a rich source of foreign currency, the State might well bear the cost of exploiting the north-west coast or the shores of the Red Sea. Oil and ore would give the authorities reason to undertake major projects for developing the Sinai - at least in part. Combined contributions from the State, the World Bank, Arab Development Funds, Arab and foreign capital and capital from the private Egyptian sector could be used for an integrated development programme for the far south (around Lake Nasser).

5. *International relations.* The fact that there would still be a large public sector would not impede Arab co-operation. The Persian Gulf countries - the moderates among the moderates - all have big public sector. One might almost say that the private firms that exist there were, as it were, fathered by the State. In an economy based almost exclusively on oil royalties, the State - as distributor of this income - is the source of all wealth(37). Oil activities are kept in the hands of the State. The State sets up big firms and deliberately makes way for private shareholders who acquire those shares by means of the royalties they have, in one way or another, received. Private enterprise draws most of its profit from trade with the government and the public sector. The events offending the leaders of these countries in Nasser's time were the nationalization and the socialist propaganda. If all that stopped, their apprehension would cease and Egypt would not have to align itself totally and completely on the Saudi Arabian position. This means that it could also co-operate with other Arab countries like Syria and Iraq or even Algeria. In any case, this scenario implies an active government role in promoting international co-operation and not just removing obstacles to the free movement of the factors of production. The main tool in this co-operation would thus be the multinational firms in the proper

(37) It might almost be described as de-nationalization. Oil, a national resource if ever there was one, is converted into financial assets which in their turn, are distributed in the form of private wealth.

sense, in other words a firm whose capital belongs to several States. This would not, of course, exclude other forms of firm with shares distributed in several Arab countries and belonging to persons and corporations in the private or public sector, as the case be. A second probable trend would be a resumption of trade with the socialist countries of Europe. Markets in East Europe, and particularly in the USSR, could very well absorb industrial products that were difficult to market in the West. In return, Egypt would have to import certain capital goods (the public sector would make itself responsible for this although, prior to nationalization, private firms had not hesitated to «buy Russian». The relatively low price of consumer goods exported by East European countries would guarantee them a significant share of the market among the middle classes who could not afford to buy goods from the West(38). Nevertheless, these more balanced trade relations would do nothing to alter the fact that the Egyptian economy would, objectively, be more and more integrated into the economies of the centre. Any nonsocialist development of a country on the periphery integrated it more into the centre. Any integration of this kind implies a dominant-dependent relationship. On the other hand, there are degrees of dependence and it seems to us that in this scenario there would be a lower degree of dependence than in the previous one.

One last brief word on the social policy aspect. We feel that this scenario could be implemented without recourse to an excessively authoritarian regime. The retention of the public sector and certain social benefits, the economic growth that would be possible and its spin off, the policy line accenting both national interests and social justice, and the national economy being managed in a way that could make the authorities credible above all in the eyes of the executive and engineer grades, would all broaden the social basic of the regime and release it from too frequent a need to take exceptional and harsh measures. In the extreme case, a powerful political party could bring

(38) The Soviet «LADA» car is a significant illustration of this point. It is even being sold on West European Markets.

together representatives of all social classes benefiting from this policy and monopolize power by providing for the changes in government teams itself without being too bothered by the existence of a few small opposition parties. In this connection, the Mexican example makes an interesting study. Once again, we shall refrain from passing any judgment on this scenario, its ability to promote overall development, its chances of survival and the kind of income distribution it would lead to.

D. Scenario 3 : Continuing the Revolution :

In this scenario, it is a question of overcoming social policy constraints and correcting the technological and economic decisions that resulted in freezing development since the end of the 60s. It seems clear to us that only a strategy based on the principles of selfreliance and satisfying basic requirements could work. But just repeating these terms like a new catechism is not enough; putting them into material effect raises specific problems which have to be identified, analyzed and solved. The Nasser experiment contained elements - some-time in embryonic form - of this strategy that has now become fashionable in intellectual circles although not everyone is in agreement on its practical content. The most salient feature, in agreement on its practical content, the most salient feature, in any view, is the redistribution of production resources and income and the conviction that development is an overall phenomenon in which economic growth is a part - but by no means the whole - and that therefore it cannot be generated spontaneously by the free play of market forces. All of this was present to some extent in the Nasser experiment : far-reaching structural reform, a reduction in the inequality of income, concern for social and cultural progress, etc., but clearly in the absence of a coherent analytical approach, the policy necessarily lacked consistency and boldness. Continuing the revolution means raising it to a higher level, thanks to better knowledge of the practical problems and an overall long-term view ensuring coherence in the answers found for them. It is in this light that we will now review the «basic needs» listed at the opening to this section but in an order that is more in line with the strategy on which this scenario is based.

1. *Re-drawing the map of the country.* Misuse of language should not cause us to forget that the word strategy covers a number of actions spanning a relatively long space of time(39). Development, understood as the process of renewal of a society as a whole needs several decades to run its course. Although our knowledge and resources do not allow us to forecast with sufficient certainty or to act effectively over so long a period, a development strategy worth of the name needs to have a time horizon of 15-25 years without running the risk of any major error provided, of course, that society has mobilized all available resources to ensure that the strategy is sound and realistic. Unfortunately, the number and complexity of present problems in the present and cease to be aware of time as past experience(40) or foreseeable future(41). In the case of Egypt, a look at the long-term show immediately the need for the speedy development of new settlement areas or for what is called here «re-drawing the map of the country». This implies turning new resources to account that are not used today. In addition, the work required would absorb a great deal of manpower at all levels of skill. thirdly, it would help toward a gradual reduction in the density of the rural population, an essential condition for successful agricultural development. It would thus slow down the runaway growth of large towns with all this implies in the way of costly infrastructure investment. The effort required would, of course, be enormous and its financial cost would be prohibitive if it were based on the latest technologies. The choice of suitable techniques and the motivation of the population as a whole and of those working in the development regions in particular would be the factors on which the success or failure of this kind of venture would depend. Experience in the building of the Aswan High Dam teaches us some valuable

(39) The term of taken from military science. According to von Clausewitz's classic definition, strategy is the art of winning a war whereas tactics is that of winning battle. So the time scale is different.

(40) How else can one explain that a country that has nationalized foreign firms in order to bring colonial exploitation to end sees its salvation, a few years later, in the return of these same firms.

(41) Which explains the over-ambitious plans and extravagant contracts approved by certain OPEC countries in the euphoria of 1974 and their present indebtedness.

lessons in this respect. There would also be much to learn from the Chinese, Vietnamese and Cubans.

2. *Integrated rural development.* Two notions which have to be thrown out if the most is to be got from Egyptian agriculture are, firstly, that based on American experience according to which progress must be aimed at the disappearance of peasant farmers in favour of big, wholly-mechanized farms and the replacement of villages by small provincial towns(42), and and secondly, the idea which prevailed for a long time in the USSR according to which industry is the mainspring of progress and therefore has to be given absolute priority, with agriculture inevitably following in its wake. We cannot repeat the experiment of American industrialization to solve the agricultural question nor can we count on the «trickling down effect» to overcome social inequalities. The setbacks in Soviet agriculture show that a systematic policy is necessary for rural reform; residual action is not enough. In Egypt, therefore, it has to be recognized that there will be urban and rural areas existing side by side for the next few decads. That being so, they have to be developed together to make work in agriculture pay as well as work in industry or commerce and rural life comparable with that in urban centres in terms of the social services that are provided. In this way production and productivity could be increased in agriculture and at the same time population movements confined to the labour mobility that is strictly necessary for the country's harmonious development. This means, in the first place, that the workless and the under employed would have to be mopped up. The new development regions would do this. A second objective would be the gradual elimination of wage-earning work, in other words of landless peasants and the farmers employing them. With hard-working peasant-farmers, co-operatives could be successful even if individual ownership were retained and the distribution of land would not be perfectly equitable. The success of the co-operative movement would facilitate mechanization and rational crop choice in rela-

(42) In the United States, as is known, there are only «townships», no «villages», and the population working in agriculture is only just over 4 per cent of the total.

tion to soil quality and water availability. In this way it would be possible to optimize the use of arable land and the water of the Nile at the national level. Thirdly, it would be essential to diversify economic activities in the rural areas by having small-sized firms upstream and downstream of agriculture but also by setting up agribusiness complexes. Educational health, cultural and information services should be tailored both in content and staff, to suit their rural context and be comparable to those provided in towns. rural housing should meet the minimal conditions for an acceptable standard of living. However, none of this will be achievable or credible if the rural population is not freed of bureaucratic control. the keystone in this plan for rural development - Without which no agricultural development is possible - would be the «rural community» in which all the members would take an effective part in decision making, day-to-day management being in the hands of a freely elected body open to continuous examination by the general public. This is the real hub on which self-reliance and participation must turn. Free to take its own decisions, the community must also assume responsibility for them. there is not more favourable framework to stimulate people's imagination and initiative and to mobilize their energies so as to overcome difficulties with the resources to hand, reduce costs and improve productivity. Also, it is easier to form an opinion on questions concerning the management and life of a community of this type than on the state budget. In this way, participation could become a day-to-day reality and the rural community a school for training citizens capable of acting at the level of the district, the regional and the country as a whole. Lastly, the reclaimed land in the new regions could, apart from extending the farming area, provide test benches for agronomic research and types of production organization. This would help Egypt to reduce its food deficit, supply agricultural raw materials for its industry and export agricultural products in optimum quantities. The socio-economic structure would no longer be an insurmountable obstacle in the way of this objective as it is at the moment.

3. *What form industrialization?* Here we feel that the first need is to answer a number of questions before starting

off on a path which may not have any pitfalls but at the same time may not lead anywhere. The first question is *for whom* should industry produce? The answer to this question will help to decide *what* to produce and *how* and *where* to produce it ?. In this scenario, the priority for industry must be to meet the requirements of the mass of the population. this means producing in large quantities and at the lowest possible price because the potential market is vast and consumers' incomes low(43). What is wanted, therefore, is to muster every possible resource, promote «cottage» industry, encourage in-home work in order to make use of idle time (agricultural workers during the off-season, housewives, etc.), use simple, labour-intensive technologies in some cases and more sophisticated technologies in others when this enables productivity to be improved to the for export because making industries aim the satisfaction of basic requirements for relatively cheap products in no way rules point where cost prices are radically reduced, etc(44). This approach would clearly create far more jobs than importing the most modern machinery and would therefore generate the necessary purchasing power to buy industrial products. Another point is that it would help to disperse industrial activities throughout the country and avoid aggravating the distinction between industrial and rural areas. Priority would also go to industries processing local raw materials. the self-reliance principles implies the rational utilization of all available resources. Depending on the quality of the raw materials and development requirements, goods would be produced for local consumption or out the manufacture of quality products. For a start, the Lorezo curve will never be a straight 45 line, however much inequality is reduced (Egypt is not China) and so the demand from relatively high-income consumers will also have to be met. Again,

(43) As an example, the Ministry for Supply estimates the market requirements for ordinary cotton cloth (the official prices for which are kept below production cost) at 600 million metres. whereas the quantity actually produced has never actually exceeded 250 million and the total production capacity for cotton cloth of all kinds is 750 million.

(44) «Cottage» industry could make a useful contribution to the supply of cotton and knitted cloth but the artisanal footwear industry earns more by producing luxury goods so that, for general consumer requirements, the use of machinery and leather substitutes is necessary.

as we have already pointed out, the country will have to export manufactured goods in order to import capital goods, intermediates and food. Its exports will have to go in two different directions : towards the other countries in the Third World where cheap products would have nothing to fear from competition on the part of the industrialized countries, and also to the markets in the industrialized countries and their extension (privileged classes in the Third World) in the form of quality products designed to satisfy this type of demand. Next, once the consumer goods industries and their technologies, and the scale of production in each case have been defined, their requirements in terms of capital goods and intermediates could be determined. In that way, the choice and scale of the different basic industries would be decided primarily in relation to the requirements of arise and would have to be resolved on the basis of making optimum use of local resources, including manpower in relation to the concrete requirements of downstream operations and in accordance with the country's positive cultural values. It should be noted that the above sequence is not an order of priority for investment placing light industry (consumption) in front of heavy industry (capital formation). Instead it is a planning exercise which would use economic mathematics to simulate this industrialization scheme to give optimum allocation of resources. Basic requirements would not be satisfied to the detriment of capital formation because continuous economic growth is necessary to meet those requirements - which have to more than those necessary for bare subsistence.

4. *Building a scientific and technological basis.* As will no doubt have been observed, this scenario implies that Egypt has to rid itself of any idea of copying a model. Development thinking itself has to be inventive and extremely sensitive to the country's concrete realities and the hopes of its people based on a knowledge of the facts. The «self-reliance» principle implies the need to inventory and evaluate all available and potential resources and the alternative uses that could be made of each of them individually. From a critical study of planning techniques and development indicators, a methodology should be worked out for defining local realities and opening the door to democratic participation, the preparation and implementation

of the plan and the supervision of its execution(45). The institutional framework for production still remains to be defined and new forms of organization might emerge. For one thing, the industrialization policy referred to above implied the existence of a large number of medium and small-sized firms, but state ownership is warranted only in the case of enterprises on a national scale. Other forms of social ownership would therefore have to be considered (ownership by regions, communes or co-operatives) possibly with a specific role for a capitalist sector. In another study we criticized the technological dependence that imported techniques often implied and their often unsuitable nature(46). Selection and adaptation of imported technologies, improvement in traditional techniques and the invention of new technologies are all essential for the success of this scenario. The scope and scale of the necessary scientific and technical research can be seen. Fortunately, Egypt has a wealth of senior grades and scientists. Defining a national science and technology policy, involving scientists deeply in the development task, motivating them and stimulating their creativity both as research scientists and as free and responsible citizens would be the most profitable investment the country could make. Not only would this provide original answers to its specific urban development problems but in addition the country would achieve that self-confidence that is essential for independent development.

5. *External relations.* Once again we would repeat that self-reliance is not synonymous with self-sufficiency. Certainly, the scenario we are considering would mean a reduction in the volume and «strategic» importance of trade between Egypt and the advanced industrial countries. To begin with, the mobilization of national resources, the deliberate spurning of consumer society life-styles and the high-principled motivation of the

(45) See I.S. ABDALLA : «Development Planning Reconsidered» in «Surveys for Development», J.J. Nossin, Editor, Elsevier, Amsterdam, 1977.

(64) I.S. ABDALLA : «Appropriate Techniques and National Technological capacity in Third World countries». A study prepared for the OECD Research Project INTER FUTURES.

population would help the country to do without heavy borrowing from abroad. In addition, production structures and the choice of suitable technologies would considerably limit recourse to multinational companies as suppliers of machinery and technology. The latter would be admitted to the country only exceptionally and with the necessary guarantees. With the object of diversifying its trade partners (so as to have more freedom of action) and balancing its trade (a further guarantee of independence), Egypt should acquire its capital goods and intermediate products at least as much from the countries of East Europe as from the Western markets. On the other hand, commerce with Third World countries would form a bigger share of foreign trade. To these countries, Egypt could export cheap consumer goods in exchange for imports of raw materials or other cheap consumer goods. To the extent that some of these countries would have introduced a similar strategy, the possible trade spectrum would broaden permitting a real division of labour, the Arab world would continue to the preferential framework for co-operation of all kinds, not limited to the attraction of oil capital. fully committed to a strategy of self-reliance, Egypt would perhaps offer fewer attractions for the wealthiest Arabs but, on the other hand, nothing provides a greater reassurance to potential trade partners than a healthy economy.

There is not need to say that this latter scenario has the author's personal preference, but it would be wrong to underestimate the difficulties and opposition that it would encounter. The difficulties are all the greater in that its success would depend essentially on the active participation of the population at all levels of decision. A leader with charisma, surrounded by an élite and both dedicated to the interests of the people could win the enthusiastic allegiance of the masses, but only a truly democratic framework could engender and stimulate the active participation of free and representation we now have to bring democracy of participation into being. this may seem utopian, but real development is a plan for society and utopias have always been the «sciencefiction» that has preceded the birth of any new society.

COMMERCIAL INTERNATIONAL BANK (EGYPT) S.A.E.

A CASE STUDY IN CAPITAL MARKETS

DEVELOPMENT AND PRIVATIZATION IN EGYPT

APRIL 1990 — SEPTEMBER 1993

Adel A. El-Labban

I. Historical Perspective

The purpose of this paper is to describe and document Commercial International Bank's («CIB» or the «Bank») capital restructuring plan which spanned a period of over 3 years from April 1990 to September 1993. This exercise involved a fundamental re-alignment of the Bank's capital and shareholding base. It also set in place the framework for a new phase in the Bank's history following its initial establishment and operations as a joint venture and the subsequent full National Bank of Egypt («NBE») ownership phase. The importance of this plan also lies in its positioning CIB to become Egypt's leading financial institution by providing the necessary capital funding to implement its ambitious growth plans. The exercise involved several pathbreaking transactions; Egypt's largest privatization sale to employees, the largest public share offering in the local market and International Finance Corporation's («IFC») largest initial investment in a financial institution worldwide.

The importance of these financial transactions will be fully explained in this paper as they raise significant opportunities for the future course of Egypt's capital markets development and privatization process.

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To clarify the process of thought and planning which preceded and determined the parameters of the capital restructuring plan, CIB's situation in mid-1990 must be understood.

CIB, was incorporated in August 1975 as the Chase National Bank Egypt. It was Egypt's first Law No. 43 joint venture bank established under the then Open Door Economic Policy. The founding shareholders were National Bank of Egypt and the Chase Manhattan Bank («CMB») which owned 51% and 49% of the equity stock respectively. CMB acted as the managing shareholder by virtue of a 10 year management and technical services agreement which expired on September 11, 1985.

Despite the Bank's success over the years, CMB decided in 1987 for a variety of internal reasons to liquidate its investment in CIB. The Chase Manhattan Bank shares were purchased by the National Bank of Egypt which became the owner of 99.9% of the Bank's shares in June 1987. Minor residual shareholdings were held by different NBE and Commercial International Bank (as the Bank was re-named) staff funds to comply with the minimum number of shareholders legal requirement so as to ensure the continuance of the Bank as a separate legal entity from its parent.

Following Chase's departure, the Bank changed its name but did not change its fundamental business strategy of catering to the wholesale banking needs of private Egyptian and multinational companies. During this period, NBE adopted a very constructive hands-off approach in terms of management. It monitored its investment at the strategic level through the Board of Directors and effectively delegated executive management to CIB's senior staff members. This proved to be a very successful policy as the Bank continued to improve its excellent earnings growth thereby firmly demonstrating its credentials as a successful example of «technology transfer» in the post-Chase era. NBE also publicly stated from the outset its desire to dilute its equity interest and restore a broader based shareholding structure to the Bank.

The period from mid 1987 to early 1990 was a period of consolidation in which CIB initially defended and subsequently expanded its market share establishing in the process its own corporate culture and identity as a leading local bank without any foreign share capital or management involvement.

II. Capital Restructuring Plan

By early 1990, the stage was set for change and the first practical steps to effect the capital restructuring plan were initiated. CIB's starting point was to determine its business objectives which would be achieved and financed by the projected capital structure.

It is important, at this juncture, to highlight that the start of this planning exercise preceded Egypt's Economic Reform Program which was signed in May 1991. It was initiated in a very regulated banking environment in which the monetary authorities and prevailing trade legislation defined the room for growth of banking activities. As the regulations decreed healthy spreads on lending operations in local currency and high fees on trade transactions, profitability was a function of wholesale growth which necessitated capital support. Growth was also predicated on access to scarce foreign currency resources which required a boarder branch network to attract foreign currency transfers from retail clients and incoming tourism.

Following the execution of the Economic Reform Program sponsored by the International Monetary Fund in mid 1991, a series of wide ranging economic policies were implemented which radically transformed the domestic banking scene. These measures basically de-regulated local currency funding and lending operations, liberalized the domestic foreign exchange markets and eliminated the fixed rate tarification of banking services.

As a result, traditional banking products (loans and documentary import credits) witnessed rapidly declining margins due to increased competition in the de-regulated market en-

vironment. This created greater pressure for additional bank capital as the wholesale growth of traditional products was rendered more urgent to compensate for their deteriorating margins. Secondly, the Government of Egypt's new policy of encouraging the Egyptian capital markets and eliminating entry barriers to the insurance business led CIB to formulate a three axis business strategy to create Egypt's first diversified financial services group.

In addition to its existing banking franchise, CIB decided to acquire a significant minority stake (up to the 40% legal maximum limit) in a diversified investment company and in an insurance company. The choice of these specific areas was based on identified cross synergies with CIB's banking activities and on their anticipated returns. Accordingly, a further need for additional capital resources was identified to finance CIB's equity investments in these new affiliated companies.

To successfully implement this strategy, CIB needed to ensure the motivation and stability of its manpower resources and to inject the required capital to support its expansion in the wholesale corporate and trade finance markets as well as its proposed investments in new affiliates, branches and product development.

PHASE I :

Employee Privatization

The first requirement of manpower motivation prompted senior management to recommend to the Board of Directors a number of new personnel and compensation policies including the divestiture by National Bank of Egypt of a portion of its shares in the Bank to the employees of CIB. A second portion of CIB shares was simultaneously allocated for sale to its own employees as a continuation of an already existing NBE internal policy to compensate its staff by offering them the opportunity to acquire shares from its existing portfolio of investments.

The initial goal was to sell 10% of the outstanding shares (i.e. 150,000 shares at the time) to the employees of both banks in equal amounts.

NBE Board of Directors approved the first transaction on September 25, 1991. The approval was obtained in the context of a 3 phase plan to restructure CIB and increase its paid-in capital to LE 500 million. The plan was formulated by CIB and submitted to NBE to obtain its approval for the initial phase which involved the sale of its shares to the employees of both banks. The pricing exercise was conducted by a joint CIB/NBE team in November, 1991 and was based on the adjusted CIB book value as of December 31, 1990 with an element of discount applied for reasons described below.

CIB's Board of Directors approved the rules for the first employees share purchase transaction on February 20, 1992. These rules attempted to achieve a fair balance between the interests of the seller (National Bank of Egypt), the buyers (employees of CIB) and the institution itself (CIB). The essential parameters of the share sale were :

(i) Voluntary participation. No employees were obligated to purchase shares. Accordingly, it was agreed to price shares at a limited discount and to provide financing terms for the majority (90%) of purchased values so as to enhance their attractiveness and increase staff participation.

(ii) Widespread distribution. For a variety of motivational and other considerations, a broadly based distribution approach was structured. Shares were accordingly offered as follows :

Tranche A : A maximum number of shares for each CIB staff category as indicated :

(Maximum No. of Offered Shares)

— Assistant Manager & above	100
— Supervisor, Senior Supervisor & equivalent	80

— Senior Clerk & equivalent	70
— Clerk & equivalent	60

Financing to purchase these shares enjoyed a very subsidized rate of interest of 5% p. a. to stimulate maximum employee participation.

Tranche B : A descending scale of incremental share entitlements based on rank and performance rating as follows :

	<i>(Maximum No. of Offered Shares)</i>		
	<i>Commendable</i>	<i>Fully Satisfactory</i>	<i>Satisfactory</i>
General Manager	1500	1000	500
Deputy General Manager	1250	750	400
Assistant General Manager	1000	500	300
Senior Manager	750	400	250
Manager	500	300	200
Assistant Manager	400	250	150
Senior Supervisor & Supervisor	300	200	125
Senior Clerk	200	150	70
Clerk	100	75	60

This scale was structured to ensure widespread distribution as well as the employees' ability to repay shares from projected bonuses and salaries. The applicable interest rate on the share purchase financing was initially set at 18% p. a. and reduced to 12% p.a. in November 1992.

Non-clerical staff were excluded from the program given their more restricted value added to the Bank's performance and the limited available number of shares offered by NBE.

(iii) Maximize motivational impact. To achieve this goal, a 10% downpayment was mandatory (5% with submission of share purchase application to be increased to 10% of value of actually allocated shares). Secondly, the distribution system was structured in a descending order of seniority and merit (performance rating). Thirdly, share ownership was restricted to full payment of share value and completion of a mandatory period of service (up to June 30, 1994 for Tranche A shares and to June 30, 1995 for Tranche B shares). Fourthly, any participating staff member would forego 75% of all future bonus income and share distributions until full payment of outstanding share loans. Any employee resigning from the Bank or wishing to withdraw from the program was obligated to resell allocated shares to the Bank at the original purchase price i.e. absorbing all interest costs incurred.

Finally, the element of interest subsidy in the share financing loans was restricted to a small discount from prevailing commercial interest rates.

Accordingly, the element of equitable balance of interests of the various parties to the transaction was achieved as follows:

For NBE :

Although the offered share price involved a discount to estimated market value, its motivational impact on CIB employees would enable NBE to recoup its price concession through the enhancement of the value of its remaining shares during the mandatory employee service period. Every employee shareholder would actively seek to enhance CIB's performance and its share value to maximize eventual personal gains and in the process benefit NBE.

For Employees :

A unique opportunity to access premium shares at a discount with a subsidized financing option was created. More senior and meritorious performers had the option of acquiring

more shares without restricting the ability of junior staff to share in the offered securities. The service period tie-in was reasonable in length for the employees to be able to repay loans from anticipated income and for the motivational impact of share ownership to be reflected in the Bank's results.

The voluntary nature of the program enabled staff members to evaluate the potential advantages of participation against the cashflow strains of reduced earnings and the burden of the initial cash downpayment.

For CIB :

Mandatory service period and cashflow repayment implications ensured seriousness of participants thereby maximizing the motivational impact. Widespread distribution avoided any staff animosity to the exercise.

The first tranche of CIB employee shares (75,000 shares) was offered for sale on February 24, 1992 for a period of 29 days. Subscriptions for 158,584 shares were received from 544 employees. Subscribing CIB employees represented 77.7% of the total eligible employees. The other portion (75,000 shares) sold to NBE employees was also oversubscribed.

Accordingly, an additional second tranche of 5% of outstanding shares (75,000 shares) was offered by NBE to CIB employees and to its staff members on an equal basis. A subsequent third tranche of also 5% of outstanding shares was allocated entirely to the NBE staff members after the exhaustion of the eligible CIB staff demand. NBE had over 8,000 employees as compared to CIB's 1087 employees at the time. As of April 1992, the employee share ownership reached 7.5% which, together with the NBE staff members' 12.5% equity stake, represented 20% of CIB's total outstanding shares (300,000 shares). The balance continued to be held by NBE. The total number of shareholders increased to 2886.

In late 1992, a final additional 10% equity stake (250,000 shares after CIB's capitalization of reserves which increased

the paid-in capital to LE 250 million in June 1992) was offered on an unequal basis to the employees of both banks. 20% of this fourth tranche was allocated to CIB employees while the remaining 80% was offered to the NBE staff members. A similar distribution scheme was implemented for CIB staff members with two changes. First, the cash downpayment was eliminated to reduce the financial burden on employees. This was acceptable for this final tranche as the vast majority of eligible staff members were already shareholders and as the other restrictions in terms of sale and repayment continued. Secondly, the price was increased from LE 150 to LE 190 per share incorporating a discount to real price but reflecting the enhanced value of the share which had considerably increased in value since the initial assessment conducted for pricing the earlier tranches.

In December 1992, the final shareholding structure became NBE 69.9%, NBE employees 20.5%, CIB employees 9.5%, employee funds 0.1%. CIB's total shareholders increased to 4873.

The success of the employee share purchase program in terms of the number of participants, the total number and value of sold shares and its impact on the performance of the Bank whose profits increased from LE 60 million in 1990 to LE 75 million in 1991 to LE 96 million in 1992 is attributable to its above described structuring elements which fairly balanced the interests of the various involved parties. It should be highlighted that the indicated 60% increase in net profits over this two year period was achieved under recessionary economic conditions and in a more competitive banking environment following the deregulation of the local interest rate and currency exchange markets and the relaxation of import regulations in 1991 and 1992.

Although this phase of the capital restructuring plan did not generate new funds to increase the Bank's capital base, it complemented and solidified CIB's efforts to develop, motivate and retain its human resources which, together with the Bank's reputation, are considered by senior management to represent its main assets.

*PHASE II**Capital Increase through Profit Retention :*

The importance of the absolute size of available capital resources increased in the post-1991 deregulated banking environment which substantially eroded lending margins for local currency operations and reduced the profitability of trade and bonding products. Accordingly, a larger capital was needed to support the quantitative expansion of CIB's loan and contingent asset portfolios required to maintain and improve the Bank's profitability.

Furthermore, the greater perceived opportunities for profitable investment banking and insurance activities created by the Government of Egypt's new economic policies accelerated the Bank's need for additional capital funds.

To support the capital requirements of CIB's business objectives, the Bank adopted a policy of progressive capitalization of retained earnings and reserves to increase paid-in capital. This was complemented by low dividend payments in 1990-1992 in which cash dividends of only LE 30 million, representing 13% of generated profits during the period, were paid to shareholders. The dividend payout ratio was only slightly increased in 1992 to accommodate the debt repayment needs of the employee shareholders on their share financing loans.

CIB's ability to execute such restricted dividend payments was assisted by NBE's unique situation. As a public sector bank, it lacked for regulatory reasons the ability to internally invest its achieved profits, including any dividend income received from CIB. Accordingly, the controlling shareholder was willing to accommodate CIB's capital expansion plans by retaining the bulk of generated profits so long as adequate returns on the increased equity funds were achieved. The Bank averaged a 21% annual return on equity («ROE») from 1982 - 1992. In the last 3 years, ROE was 20.8% in 1990, 21.9% in 1991 and 23.6% in 1992.

Retained profits were progressively capitalized to ensure the long term stability of the Bank's funding base and to obtain tax relief on the additional paid-in capital thereby hedging achieved profits.

The Bank's authorized capital was increased from LE 150 million in 1990 to LE 500 million in 1992. Paid-in capital was increased from LE 50 million in 1987 to LE 75 million and subsequently to LE 150 million in 1990, entirely through internal sources of funds. A further capitalization of reserves and retained earnings increased paid-in capital to LE 250 million in 1992. The employee shareholders benefited from the bonus share issue associated with the last paid-in capital increase to LE 250 million effected in mid 1992. It however impacted only the first tranche of employee shares (300,000 shares) generating an additional 200,000 bonus shares for CIB and NBE staff shareholders.

PHASE III

Capital Increase through the Injection of New Capital Funds

The Bank's business plan, as amended in the post-1991 deregulated environment, identified the immediate need for LE 300-400 million in additional capital to support growth and diversification objectives. An additional LE 100-200MM need was projected, on a contingency basis, for 1995/1996 depending on the rate of mobilization of the initial capital increase.

CIB's stated strategic objective was accordingly formulated to fully cover its authorized capital of LE 500 million by 1995 at latest, thereby becoming Egypt's first private bank with an LE 1000 million net worth including the proceeds of the newly raised capital and its associated share premium.

The following possibilities for raising additional capital were considered :

— Internally sourced growth through the capitalization of retained earnings. Assuming normalized annual net profits avail-

lable for distribution ranging from LE 80-120 million per annum and a dividend pay-out ratio of 40-50%, accumulated profit retentions would need 5-10 years to provide the initial capital increase required by CIB. This would delay the implementation of the business plan and could result in CIB missing a key opportunity to establish itself as Egypt's dominant private sector bank and to develop its new lines of business.

It should be noted that this analysis factored a very conservative profitability scenario and a substantially higher than historic dividend payout ratio. This was done to adjust for the employee (and potentially other) shareholders' dividend requirements as well as NBE's possible increased appetite to bolster its profitability in the deregulated market environment.

Accordingly, this option was only retained as a complement to a more direct externally sourced capital raising strategy.

— Capital increase funded by existing shareholders. This option was rapidly discarded as the current privatization and dilution of public ownership trend eliminated NBE's ability, as a public sector bank, to participate in such exercise. Furthermore, the limited resources of the remaining employee shareholders precluded any significant contribution on their part.

— Capital increase through a private placement to new shareholders. In many ways, this was the preferred option for CIB which had operated as a closed shareholding company since its inception. This approach however suffered from a number of drawbacks :

1.—Difficulty of identifying and concluding transactions with the desired configuration of investors for the required capital amounts within a reasonable period of time.

2.—Absence of any strong interest by major OECD banks in a significant bank equity investment in Egypt. Direct contacts and approaches coordinated through the International Finance Corporation («IFC»), an early identified investor, failed to identify strategic potential bank investors with acceptable systems and technology.

3.—Loss of tax advantages on dividend distributions and stamp duty exemptions associated only with a public offering as per Capital Markets Law No. 95 for 1992. A shareholding company with 30% of its issued capital raised through a public share issue covered by at least 150 subscribers and maintaining a future ongoing shareholding base of the same minimum number of shareholders would be exempted from the 1.2% annual stamp duty tax on shares calculated on the par value of paid-in capital and from all personal income taxes on dividends distributed to Egyptian individuals.

Given CIB's rapidly expanding paid-in capital base and the large number of individual shareholders, the absence of these tax and stamp duty advantages was a key factor in the Bank's evaluation of this option.

— Capital increase through a public share issue. This option would enable CIB to combine the advantages of the private placement by pre-marketing selected institutional investors and would increase the probability of securing the entire required capital by tapping the retail demand base. A public share offering was also considered to be more positive for future secondary market share trading due to the expected more diversified shareholding base and the visibility associated with such an issue if successfully launched and covered. Additionally, it provided Egyptian individual shareholders with the previously indicated tax advantages and would relieve the Bank from its annual stamp duty payments on the paid-in capital.

Its main drawback was its novelty. It was an untested transaction as Egyptian companies had not completed any share sale of similar magnitude on a public offering basis. The second critical drawback was its visibility which rendered any actual or perceived failure (e.g. failure to rapidly cover and oversubscribe the issue), a serious embarrassment to the Bank with potentially very negative consequences for its reputation. Finally, to obtain the tax exemptions associated with a public issue a number of shares at least equal to 30% of our total issued shares should be offered, (i.e. a minimum number of 1.07 million additional shares based on the then outstanding 2.5 mil-

lion shares), this implied a transaction of unprecedented magnitude. The option of fragmenting the process into two successive issues within a 2-3 year period was discarded for timing, logistical and capital requirement considerations.

In addition to these factors, CIB's internal assessment of the public's general demand for shares was that it suffered from widespread ignorance and deep rooted suspicion. The Egyptian stock market had been dormant for over 30 years. The older generation (60 years or older) which may have owned shares pre-1961 had suffered from the socialist laws of that period which nationalized most existing enterprises of any size and failed to adequately compensate shareholders. The younger generation (50 years or younger) had very limited opportunity to purchase local shares which were rarely available or represented profitable investments. Their exposure to securities transactions was also clouded and soured by the failure of the various Islamic investment companies and funds in the mid 1980s.

Another concern was the delay in the issuance of the Executive Regulations of Law No. 95 of 1992. These regulations, outlining the procedures to be employed for effecting a public share issue, were only released in April 1993 (approximately 10 months after the issuance of the law itself).

Given the above concerns and constraints, the Bank had to tread very carefully. The Board of Directors authorized in principle a public share issue in December 1992. Its final approval was subject to a well structured marketing campaign and a positive share demand assessment which would ensure to the fullest extent possible a safe launch and a rapid subscription if not oversubscription. As Law No. 95 of 1992 imposed a minimum 10 day offering period, it was considered very important that the issue be at least fully covered within this period.

To comply with the terms of this mandate, two preliminary steps were taken :

(a) A marketing study was commissioned in February 1993 from CIB's media consultants to assess retail share de-

mand. The scope of the study covered both CIB's general recognition factor with the public and specific client attitudes. It also analyzed, through a wide sample of Class A & B consumers, their knowledge of and appetite for equity transactions.

The results of this study were mixed. Although predictably lagging behind the major public sector banks with large branch networks, CIB was ahead of its peer group in terms of general name recognition due to its earlier successful mass media campaigns (particularly anti-drug messages). Client reaction was also positive both within and outside the Greater Cairo area.

In terms of share and public subscription issues, a general distrust and lack of understanding was very clearly identified. The study also highlighted that the retail base demand was primarily driven by dividend yield and restricted to Class A & B consumers due to economic considerations. Future capital appreciation was not a key factor for determining share attractiveness and hence placement potential with retail investors.

(b) CIB also retained the UK office of Touche Ross in February 1993 to conduct a comprehensive share valuation exercise based on CIB's November 30, 1992 financials.

In addition to being needed for our Board of Directors' final approval to price the issue, an independent reputable third party share value confirmation was required for discussions with potential core institutional investors particularly non-resident entities.

Touche Ross were selected after receiving and reviewing presentations from another international auditing firm. CIB's selection criteria were based on quality of assigned personnel, previous experience and related costs.

This was the only phase of the overall exercise in which foreign consultants were used.

A price range of LE 300 to LE 350 per share was derived by Touche Ross using the adjusted book value and discounted cashflow techniques.

Based on the above marketing and pricing inputs, a detailed placement strategy was drafted with the associated implementation timetable. Its fundamental parameters were as follows :

1. Pricing

Board of Directors' approval was obtained to price the issue at LE 260/share representing a 20% discount to the mean share valuation price determined by the external valuation firm. The discount, proposed by senior management, was driven by the following considerations; unprecedented absolute size of the issue (\$ 116 million equivalent), generally unfavourable investment climate in the first half of 1993 due to terrorist attacks on tourism and finally the importance of share appreciation in post offering secondary market trading. The last concern was extensively discussed as senior management placed a high premium on creating a satisfied shareholders base with an appetite to support the Bank in its future capital expansion plans.

Independent verification of the recommended issue price (LE 100/share par value and LE 160/share incremental premium) was obtained from our local external auditors to comply with the requirements of Capital Markets Law No. 95 for 1992.

2. Number of Offered Shares

This decision was governed by two key considerations :

(a) Needed capital increase in value terms to support business objectives.

(b) Requirement to offer at least 30% of issued shares in a public offering.

The second condition imposed on CIB a minimum target of selling 1.07 million shares which if added to the existing 2.5 million shares would represent 30% of the total issued capital of 3.57 million shares.

The decision to sell 1.5 million shares was based on the need to rapidly grow the Bank's activities and on the favourable initial results of the share marketing plan described below. This number of shares would also enable CIB to maintain the minimum requirements for a public offering shareholding company status (and associated tax advantages) even if it increased paid-in capital to its maximum authorized level of 5 million shares.

The decision was also affected by the possible launching of other share offerings by public sector entities in the course of the announced Government of Egypt privatization plans at the time. If successful, these issues could siphon liquidity and destabilish higher performance criteria for CIB to be able to sell its shares. If these other offerings were unsuccessful, the negative market backlash would hit CIB's issue. Accordingly, it was deemed important to pre-empt such issues to the extent possible and to cover our entire capital requirements in a single transaction.

3. Timing

As previously outlined, the decision to undertake a public issue was taken in principle in December 1992 prior to the issuance of the Capital Markets Law's Executive Regulations which govern the approval, mechanics and reporting requirements of a share offering. Accordingly, the Bank's timing plans in the first quarter of 1993 were based on an assumption that the Executive Regulations would be issued by June 30, 1993 and in a format enabling it to proceed with and complete a public issue within a 90 days period as the maximum targetted completion date was December 31, 1993. The regulations were actually issued in April 1993.

A September 1993 issue launch became the earliest possible date through the following process of elimination. First,

the Bank decided that fiscal 1992 full year audited results were needed for marketing purposes as CIB had achieved record profits of LE 96 million with an ROE of 23.6%. This eliminated the first six months of the year as the CIB Ordinary General Shareholders Assembly meeting which ratifies the previous year's financial results is typically held in June every year. The months of July and August were considered but excluded as holiday months in Egypt and abroad. This rendered the month of September the first suitable date in the year.

4. Share Placement Plan

The marketing plan was formulated and approved in early 1993 to provide sufficient time for implementation and thereby ensure the highest chances of success for the issue.

The Bank's target was to pre-place at least 80% of the offered shares on a committed basis prior to launching the public issue.

Marketing efforts, accordingly, covered the widest range of potential subscribers broken down as follows :

(a) Institutional investors. CIB's primary focus was on visible reputable non-resident entities with banking or financial credentials. A key consideration was to initiate early contacts to accommodate the time span of the decision making process of these entities and their need for frequent consultations.

Demand from OECD entities was very weak. Limited interest was expressed by the Gulf banks. Demand by multinational and pan Arab financial and investment companies was stronger.

Serious discussions started with IFC in early 1992 culminating in their approval to underwrite 200,000 shares for a total value of \$ 15.5 million representing their largest initial investment in any bank worldwide. Significant subscriptions were raised from The Arab Investment Company («TAIC»), Arab Petro-

leum Investments Co. («APICORP») and different emerging growth funds. Marketing was conducted through verbal presentations and discussions with senior management.

(b) Large local and foreign corporate and individual investors. Discussions were also initiated in early 1993 with this group of investors and were restricted to a limited number of key potential investors. To assist our marketing, the «Club of 50» concept was conceived. 50 potential investors were approached to subscribe 10,000 shares or more each. This approach was very successful raising 449,500 shares from investors, representing 20% of the total funds raised and 30% of the offered shares.

Marketing was also conducted through verbal presentations and direct marketing by CIB's senior management.

(c) Retail Demand. This market was segmented into two categories :

i. CIB's inhouse client base.

The Bank's retail depositors, numbering over 100,000 accounts were targetted as a first priority as their customer profile (predominantly mid/high income professionals and businessmen) and their greater identification with the Bank increased the chances of their positive response and participation in the issue.

To emphasize their special link to the Bank, a direct mail campaign advising of CIB's planned issue and extending a personalized invitation to participate was used.

ii. General Public

Given the marketing survey's confirmation of the public's ignorance and suspicion of share transactions, a saturation mass media campaign was structured to ensure maximum public exposure to the issue.

This effort was broken down into three stages :

1.—Reinforcement of CIB's overall corporate image by emphasizing its relationships with highly visible corporate accounts. This lasted from mid May to mid July 1993 and was considered as part of the Bank's annual advertising campaign.

2.—Emphasis on the Bank's profitability during the period mid July to mid August 1993. These advertisements focused on CIB's sustained profit trend over the past 5 years and its record 1992 profits of LE 96 million. This segment of the campaign represented a complete divergence from the Bank's earlier media approach which had not focused on profitability.

In 1993, the profit focus was critical to address the identified concern of potential subscribers with dividend returns which are contingent on achieved profitability.

3.—Direct invitation to subscribe from mid August to mid September 1993. The last advertisement was on September 12, 1993, the launch date of the public issue.

These advertisements re-inforced the profitability of CIB, the attractiveness of its shares and provided the necessary logistical details (subscription locations, minimum subscription amounts, share prices etc.).

As described, the first phase of the campaign constituted the annual general advertising and image building efforts the Bank. The second and third phases were directly geared to support the public issue. The former by emphasizing profitability and the latter by direct invitation to subscribe.

Advertising covered both television and newspapers : 53% of the available budget was allocated to newspapers, 45% to television and 2% to direct mail. Limited advertisements were placed in regional newspapers with a high concentration of mid/high income Gulf Arab readers (2% of overall budget). The high outlays in written material media expenditure (newspapers and direct mail) were driven by the key priority to reach and convince Class A & B consumers who had been earlier identified as the crucial potential subscriber group by the Bank's marketing consultants.

The initial phase of the campaign was mostly television concentrated. The second and third phases involved the usage of more written material to re-inforce our message and provide the Class A & B consumers, as well as the general public, with written details of the subscription and its venues.

The key date in the media campaign was the shift from the first to the second phase. This was triggered by the Capital Market Authority's («CMA») approval of CIB's offering memorandum which was obtained on August 19, 1993 (submitted on June 23, 1993). According to Law No. 95 of 1992, share placement efforts could only commence after submission of an application to the CMA. Until approval, marketing could only use the material in the share placement application after highlighting that CMA approval had not yet been obtained.

Accordingly, the marketing plan for the final stretch (second and third phases) could only start after CMA approval had been formally received. The first phase and direct mail campaign to CIB's depositor clients were launched upon submission of our application.

The uncertainty with regards to the CMA's approval and its timing forced the Bank to slightly extend the first phase beyond its originally estimated end date as the entire campaign was structured as an integrated effort which had to sustain its continuity and momentum even at the expense of incremental costs.

4. Other Structuring Issues

Several other changes in the structure of the issue were recommended to and approved by the CIB Board or Directors to facilitate its sale to subscribers :

(a) Minimum Subscription Amount :

The minimum subscription amount was reduced to 10 shares to encourage retail demand. This decision was extensively debated due to the higher ongoing administrative costs associated

with a large base of small investors as well as the possible subscribers' congestion during the subscription period in CIB's branches which could result from such a reduced minimum investment level. The concern for immediate full share coverage and oversubscription however prevailed.

(b) Share Currency :

The shares were offered in Egyptian Pounds or foreign currency («FCY») equivalent. This was geared at attracting non-resident investor demand which could only invest in foreign currency paid shares. Foreign investors also typically preferred payment in FCY as such shares are both quoted and receive their dividend payments in FCY. The dual currency share issue also enhanced demand by Egyptian investors capable of subscribing in either currency and seeking to exploit potential arbitrage opportunities.

This decision was facilitated as CIB, since inception, had a dual currency capital by virtue of its original joint venture structure involving the Chase Manhattan Bank, a non — resident shareholder.

As the timing of the issue corresponded with an ongoing local currency surplus situation for CIB (and other Egyptian banks), structures were explored to incorporate a preference for FCY subscriptions in terms of share allocations if the issue was oversold. This was not approved by the CMA as it would create a bias in the treatment of subscribers thereby contradicting the essential legal character of a public issue transaction namely complete equality between all subscribers.

A dual currency issue structure with pre-set limits for each type of share was acceptable to CMA. This however posed a marketing problem if any of the two issued share categories was not fully covered. In such a case, an excess in a certain share currency category would not be available to complete the deficit in the other category. Accordingly, the dual currency structure, as well as a more restrictive 100% FCY issue,

were discarded given CIB's main focus on guaranteeing full coverage rapidly.

(c) Share Financing

Several potential subscribers requested margin lending facilities to purchase the offered shares. This request was declined by the Bank due to the following reasons :

i Legal difficulties in using CIB shares as collateral for any extended loan.

ii. Marketing considerations. The extension of credit facilities by the Bank to encourage share subscriptions would be immediately perceived as a sign of weakness by the market. The entire selling approach was based on the scarcity and uniqueness of the offered shares.

(d) Diluted Subscriptions :

The International Finance Corporation and other large investors expressed a desire to ensure their full allocation of all subscribed shares. CMA, for the same reasons expressed in (c) above, refused any preferential formula for any subscriber in terms of share issue allocations. Accordingly, it was agreed to cover any deficit in allocated shares due to oversubscription through a direct sale by NBE of additional shares from its existing equity stake at the issue price prior to the start of secondary market trading in the new issue shares.

(e) Undersubscription :

Despite its low probability of occurrence, the situation of undersubscription was also considered and related contingency plans were formulated. By law, two possibilities exist in such a case. Either the public issue is cancelled and proceeds returned to investors or an Extraordinary Shareholders General Assembly meeting is held to consider increasing the capital by the raised proceeds. This can be implemented subject to the approval

of all newly subscribing shareholders and of a majority of existing shareholders. Given CIB's pre-determined capital needs and to avoid the embarrassment of a cancelled subscription due to insufficient demand, the used share subscription applications included a blanket agreement clause by all investors to accept the decision of CIB's Extraordinary Shareholders General Assembly if it decided to increase paid-in capital by available raised funds.

6. *Legal, Administrative & Organizational Considerations :*

A team of CIB's Electronic Data Processing («EDP») Financial Controls Operations executives was formed to prepare the necessary procedures and application forms covering the subscription period, the registration of capital and refund of any excess amounts.

A very detailed on-line computer reporting system providing the key details of the subscribed amounts and the relevant breakdowns was designed and proved very useful in terms of CIB's daily monitoring of the performance of the issue on an aggregate and branch level.

Secondly, all involved personnel in CIB's 16 branches were briefed on the marketing aspects of the issue and provided with replies to anticipated standard subscriber queries. Operational procedures were also explained and logistical details to handle the anticipated subscribers' inflow were organized. Staff back-up was provided from the Head Office and senior management was available on a round-the-clock basis to answer questions or handle any emergencies.

In this context, the Bank decided to coordinate with the National Bank of Egypt in accepting subscriptions through its branch network (approximately 350 branches) which extends to areas where CIB has no physical presence. Applications were all directed to the NBE Investment Department which daily transferred them to a designated CIB branch (Birgas Branch) for processing.

CIB's Legal Department was also requested to effect the necessary amendments to the Bank's Articles of Incorporation to prepare for its expected post-issue open shareholding structure. Existing restrictions on share transactions in terms of corporate approvals were eliminated and other adjustments implemented. These changes were approved by CIB's Extraordinary Shareholders General Assembly which convened in June 1993.

III. CIB Public Share Issue

By late August/early September 1993, the stage was set from a marketing and organizational perspective to launch the public share issue. Shares totalling 1,401,176 had been firmly committed, broken down as follows : 490,000 shares from institutional investors, 449,500 shares from the Club of 50 and 461,676 shares from CIB's retail base. Funds had been received or were in process of transfer to the Bank for these subscriptions.

As the issue had aroused considerable public interest and investor support, CIB was now in a position to implement its Board of Directors mandate of proceeding with a 1.5 million public share issue at a par value of LE 100/share with an LE 160/share premium subject to a high certainty of full coverage within the minimum ten day offering period and a strong potential for oversubscription.

The public share issue was launched on Sunday September 12, 1993. In compliance with CMA requirements, its initial announcement had been placed in the Al Ahram and Al Akhbar daily newspapers on August 25 and 26, 1993 respectively. CMA objected to the first announcement which had unintentionally failed to highlight the exact text of the approval necessitating a last minute adjustment to the Al Akhbar announcement. These announcements were required, by law, at least 15 days before the start of the issue to ensure full visibility and access to the offered shares by all potential subscribers.

An associate economics editor in the leading Al Ahram daily newspaper, launched a scathing direct attack on the issue in his weekly economic commentary page on Saturday September 11, 1993 (the day preceding launch). The essence of the attack, as presented in a number of interrelated articles was :

(a) CIB had misrepresented its achieved 1993 results by quoting a 23.6% rate of return on invested equity. The actual rate was only 8.5%. p.a.

(b) Interest rates on local currency Treasury bills had stopped sliding and were stabilizing around the 14% — 15% rate (i.e. were more attractive than potential share yields).

(c) Bank privatization and capital increases, in general, were undertaken to salvage undercapitalized and non-performing banks.

The entire page was structured to raise doubts as to the integrity of the Bank and its senior management, to question the profitability and returns of an investment in its shares and to promote alternative safer and more profitable investments in Treasury bills given the problem linked implications, in his view, of share issues by banks.

Given Al Ahram's widespread distribution and credibility, a serious situation emerged necessitating immediate damage control to avoid a negative impact on demand particularly on the retail side. Senior management visited Al Ahram's Chairman on the same day who agreed to print the next day a very strong CIB reply clarifying the correct facts and bluntly accusing the writer of ignorance or ulterior motives. Al Ahram's Chairman also agreed to front page coverage of the public issue results.

Extensive contacts were also undertaken by senior management during September 11 and 12, 1993 with all key institutional

investors to clarify matters and prevent any dilution or cancellation of their commitments. All branch and corporate marketing personnel were briefed on the situation to be able to address concerns.

The share issue was launched, as planned, on Sunday September 12, 1993. CIB's reply appeared in the Al Ahram newspaper on the same day. Demand was very strong in the first two days as the major institutional funds started flowing in, then gradually tapered down until the final day when the balance of institutional funds were transferred. The reason for this skewed demand pattern is that subscribed funds are non-interest bearing and treated equally in terms of allocation priority so long as paid during the subscription period. Accordingly, several large subscribers waited effectively until the close of the public offering period to transfer their subscriptions thereby maximizing the utilization of their funds until the final deadline. The Al Ahram newspaper episode also led some subscribers to delay their decision until the overall market response to the issue became clear.

The following table summarizes the total number of shares subscribed and the number of subscribers during the 10 day subscription period :

<u>Day</u>	<u>No. of Shares Subscribed</u>	<u>No. of Subscribers</u>	<u>Cumulative Subscribed Shares</u>
Sept. 12, 1993	686,771	1566	686,771
Sept. 13, 1993	363,808	594	1,050,579
Sept. 14, 1993	178,738	770	1,229,317
Sept. 15, 1993	99,498	620	1,328,815
Sept. 16, 1993	153,037	516	1,481,852
Sept. 19, 1993	97,825	402	1,579,677
Sept. 20, 1993	144,142	359	1,723,819
Sept. 21, 1993	191,672	319	1,915,491
Sept. 22, 1993	102,642	346	2,018,133
Sept. 23, 1993	232,097	488	2,250,230

An Al Ahram first page article was published on Tuesday September 14, 1993 citing that over 80% of the shares had been sold amid an excellent market response.

Internally, the flow control in the branches for the retail demand and the tracking of major investor funds worked very smoothly. This was directly attributed to the several months of hard work and planning which preceded the issue as well as the commitment and dedication of all staff members.

The EDP program also functioned perfectly and provided updated detailed on-line information on the results of the subscription, enabling senior management to effectively monitor and control the situation.

The subscription period were not marked by any significant events except that two unfavourable press articles were written by the economic editor of the daily Al-Gomhouria newspaper. No response was made by CIB as very favourable press coverage was simultaneously obtained from several regional newspapers and from international press services.

Given the early oversubscription, the Bank decided to close the issue after the passage of 10 business days from its launch. The choice of business versus calendar days was based on conservatism given the ambiguity of the «days» definition in the Capital Markets Law's Executive Regulations. This decision effectively lengthened the issue for two days. CIB also decided to publicly advertise the closing date which is not a legal requirement. Both decisions reflect its concern with ensuring the full transparency of all subscription operations and CIB's strict adherence to mandatory requirements so as to avoid any possible challenges to its procedures by the CMA which could jeopardize the desired tax advantages.

The issue was closed at the end of business on Thursday September 23, 1993. Positive coverage of its results were highlighted by Al Ahram newspaper in its front page on the following day. Several other complimentary newspaper articles followed.

The results of the issue can be summarized as follows :

2,250,230 shares were sold to 5980 subscribers. Total proceeds were LE 585 million (equivalent) representing a 50% oversubscription rate. The shares were 57.6% subscribed in Egyptian Pounds and 42.4% in foreign currency. The largest subscriber was IFC with 200,000 shares. As a result of the oversubscription of the issue, 66.7% of subscribed shares only were allocated to each shareholder.

The contribution of the Bank's different branches in terms of share subscriptions was as follows :

<u>Branches</u>	<u>Number of Subscribed Shares</u>	<u>% of Total Subscribed Shares</u>
<u>Cairo Branches</u>		
Giza (Head Office)	869,951	39%
Birgas	216,687	10%
Nasr City	175,178	8%
Hoda Shaarawy	134,983	6%
Zamalek	124,966	5%
Mohandessein	82,152	4%
Heliopolis	80,365	3%
Maadi	23,487	1%
Grand Mall	6,782	-
Sixth of October	3,080	-
Mostorod	535	-
Subtotal	<u>1,718,166</u>	<u>76%</u>
<u>Delta & Port Said Branches</u>		
Sultan Hussein	200,424	9%
Port Said	197,608	9%
Tanta	83,445	4%
Manshia	28,985	1%
Roushdy	21,602	1%
Subtotal	<u>532,064</u>	<u>24%</u>
Total	<u>2,250,230</u> *****	<u>100%</u> *****

The breakdown of proceeds by number of subscribed shares was as follows :

<u>Size of Subscription</u>	<u>No. of Subscribers</u>	<u>% of Total Subscribed Shares</u>
10 - 500 shares	5593	19.0%
501 - 1000 shares	178	6.8%
1001 - 5000 shares	158	18.4%
5001 or more shares	51	55.8%
	5980	100.0%

Total number of subscribers with 5,000 or more shares were 69 institutions and individuals, contributing 59.8% of total generated.

In terms of the composition of the 5980 public issue subscribers by nationality, 98.3% were Egyptian and 1.7% were non-Egyptian (multinational, Saudi, Lebanese, Palestinian, Syrian etc.). The latter however contributed 27.6% of the total share proceeds with Egyptian subscribers covering the remaining 72.4%. This disproportionate share of non-resident subscribers was due to the large commitments made by institutions such as IFC, TAIC and APICORP among others. In terms of the legal nature of subscribers, individuals covered 62% of the sold shares and corporates/institutions the balance of 38%.

An objective evaluation of these results demonstrates the success of CIB's marketing strategy :

1.—The strategic objective of raising the required funds (LE 390 million) was easily achieved within the minimum 10 day subscription period despite a generally unfavourable economic environment compounded by adverse press coverage at a critical pre-launch time. Healthy oversubscription was realized with a 150% coverage ratio which was in line with the Bank's expectations. CIB had estimated an oversubscription of 25 - 50% based on the desired short subscription period, the results of

pre-placement marketing efforts and the absolute magnitudes involved given the large issue size required for capital and tax considerations.

2.—Large pre-marketed anchor investors (institutional and Club of 50) contributed 41.7% of total proceeds i.e. 62.6% of the offered shares minimizing CIB's market exposure risk.

3.—Retail demand (10 - 1,000 shares) contributed 25.8% of total proceeds of which 65% approximately was sourced from CIB branch network clients. This highlights the effectiveness of the mass media campaign and of the direct sourcing strategy to the CIB retail client base. Furthermore, subscriptions between 10 - 500 shares, generated 19.0% of the proceeds, supporting the low subscription minimums set.

4.— Egyptian corporate/institutional demand was predominately concentrated in closed shareholding companies or partnerships included in the Club of 50. CIB's marketing efforts had intentionally not aggressively pursued local insurance companies or pension funds due to their public sector ownership or affiliations.

5.—Approximately 14.8% of the issue was purchased in foreign currency by Egyptian individuals and institutions in addition to the 27.6% foreign currency tranche committed by non-resident subscribers. This supported CIB's decision to proceed with a dual currency issue as structured without adopting pre-set limits on the shares denominated in either currency or opting for a 100% foreign currency issue as total demand for a 100% foreign currency issue, although respectable, was insufficient for covering the entire issue.

6.—The performance of the Bank's branches reflected the results of the earlier market survey. The 5 non-Cairo based branches contributed 23.6% of the subscribed shares i.e. 35.4% of the issue. This percentage is better understood if the impact of the large non-resident institutional investors such as IFC and of shares sold through the NBE network is excluded as

their contributions were all routed through the Bank's Head Office Giza Branch and Birgas Branch respectively. Both these branches are Cairo based. The adjusted percentage contribution of the non-Cairo based branches was approximately 32% of the subscribed shares.

7.—CIB's marketing arrangement through NBE generated 139, 422 shares representing 6% of the total subscribed issue. No operational problems were faced as these share subscriptions were all centralized through NBE's Investment Department and directed to CIB's Birgas Branch.

8.—Arab individuals demand was predictably weak as CIB did not conduct any extensive marketing of the Gulf countries to solicit individual participations. This response was also affected by the then prevailing boom in bank shares in Saudi Arabia which reduced the relative attractiveness of CIB's issue.

A very important result of the public share issue was the dilution of NBE's shareholding to 43.8%, thereby relinquishing outright majority control of the Bank for the first time since its inception and effectively privatizing CIB.

Following the closing of the issue, necessary subscription data including subscribers' details, number of subscribed and allocated shares and currency breakdown of shares sold was prepared and sent to the CMA on October 5, 1993 within the 15 days post-closing time limit established by the Executive Regulations. CMA approval of subscription procedures and results was obtained on October 20, 1993. A newspaper announcement was placed in Al Ahram on October 23, 1993 advising subscribers of the success of the issue and their allotted shares. Reimbursed amounts totalling LE 195 million were re-credited to CIB clients' accounts or paid by certified cheques to all other subscribers. Reimbursed amounts were in the same currency as the original subscriptions. For FCY subscribers, the same exchange rate prevailing at the subscription date was applied.

The articles of incorporation of the Bank were amended, following GAFT's approval, to reflect the increased paid-in capital and the shareholding structure. An updated commercial registration reflecting our increased LE 040 million paid-in capital was completed on December 5, 1993.

Temporary share certificates were released in April 1994 to enable the new subscribers to start trading their shares.

Conclusion

CIB's capital restructuring exercise is most vividly summarized by its numerical dimensions. In 1990, CIB's paid-in capital was LE 50 million. In 1993, it reached LE 400 million. The Bank's networth base increased from LE 312 million to approximately LE 863 million over the same period.

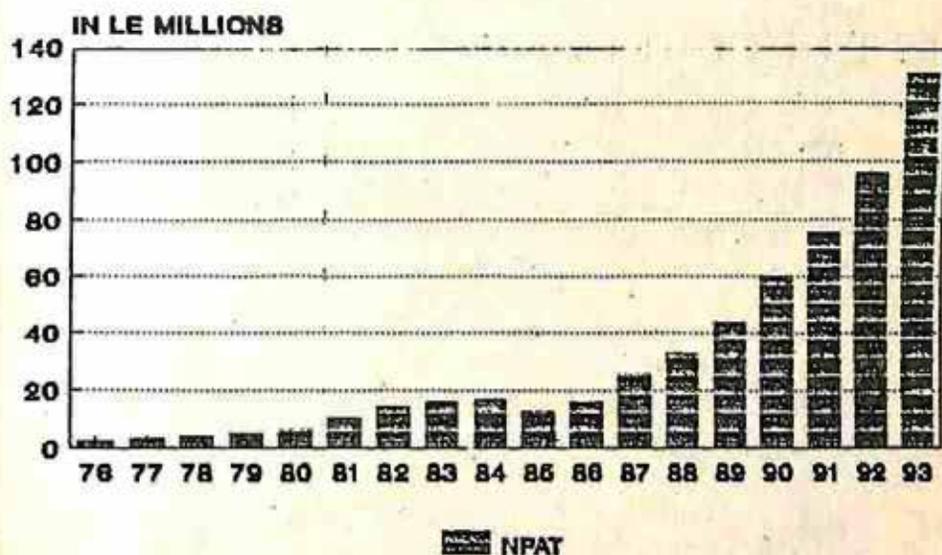
Equally striking has been the growth in its shareholder base from 2 shareholders in the Chase National Bank Egypt era to just 4 shareholders during the CIB closed shareholding phase to 10,853 shareholders at the close of the public issue. These include approximately 559 CIB employee shareholders, 4310 NBE employee shareholders and 5980 new subscribers in addition to the National Bank of Egypt and the employee funds. As a result, CIB was transferred in less than 3 years from a closed shareholding company to Egypt's most broadly held open shareholding company.

The Bank's capital raising exercise was also characterized by the diversity of techniques employed. It initially involved the progressive capitalization of reserves and retained earnings to increase paid-in capital from LE 50 million to LE 250 million. This overlapped with the sale of 550,000 shares (excluding bonus shares) to the employees of CIB and NBE for a total value of LE 92.5 million representing Egypt's largest privatization sale transaction to employees. The plan finally culminated in an LE 390 million very successful public share issue which represented the single largest capital markets transaction undertaken on the Egyptian stock exchange since its inception. Both

these transactions are pathbreaking and hopefully precedent setting for Egypt.

In the course of this exercise, NBE's shareholding interest was reduced from 99.9% to 79.9% in April 1992 to 69.9% in December 1992 to its post-issue level of 43.8% thereby completing the effective privatization of the Bank through a structured and integrated plan which generated the necessary capital and staff motivation to achieve the Bank's ambitious growth plans and to position it to become Egypt's first truly diversified financial services holding company. For the first time since the inception of the Bank, NBE had relinquished outright majority control of CIB through a unique strategy which can assist other public sector banks and companies to proceed along the road of privatization in a balanced, profitable and visionary manner.

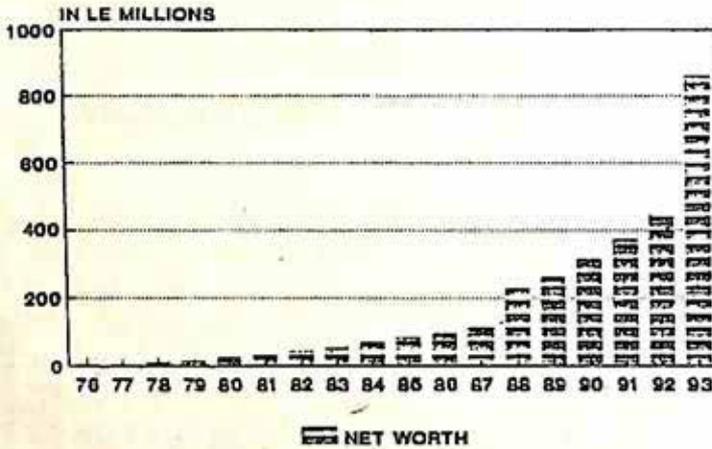
NET PROFITS AFTER TAX PROVISION



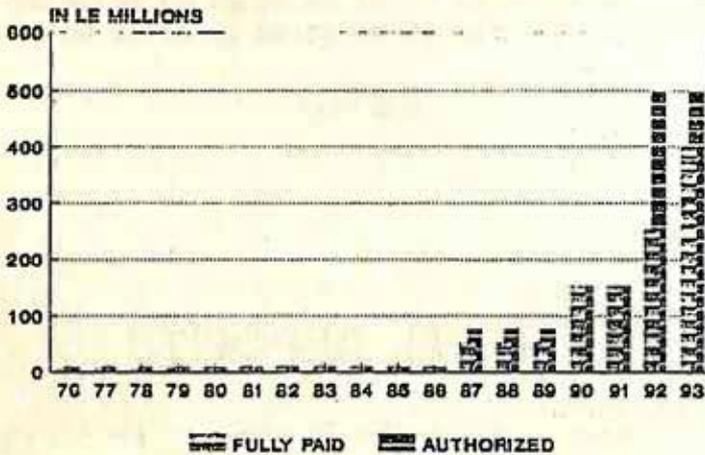
TOTAL DEPOSITS



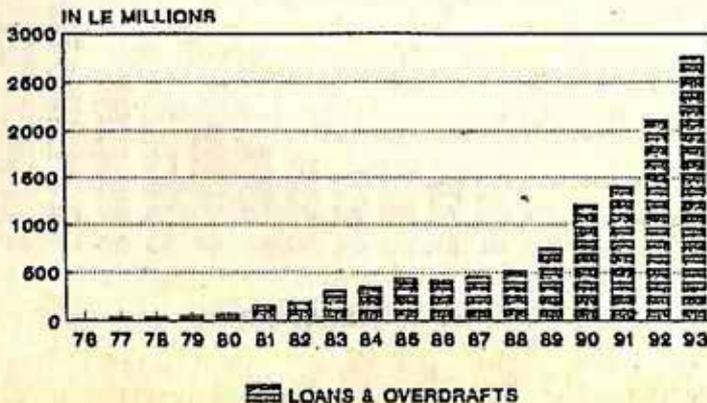
NET WORTH



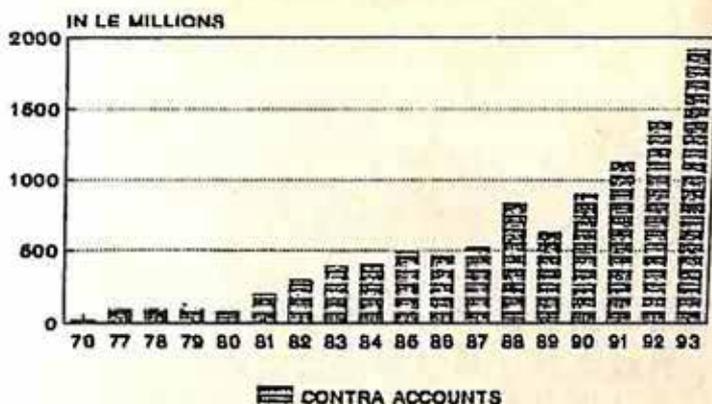
CAPITAL FUNDS



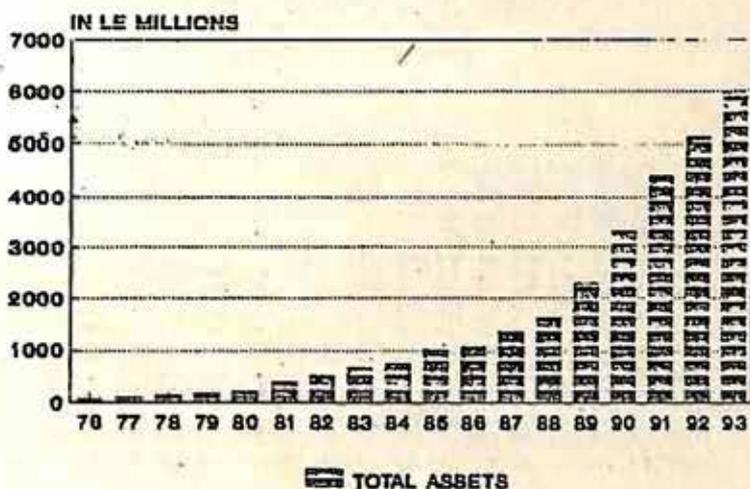
LOANS & OVERDRAFTS



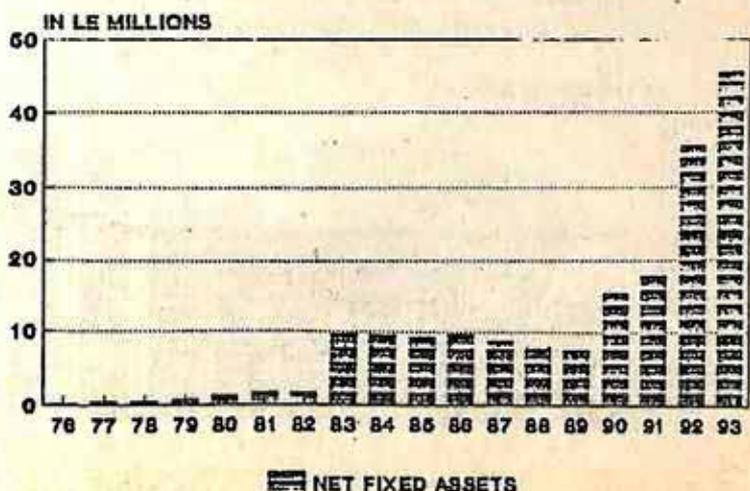
CONTRA ACCOUNTS



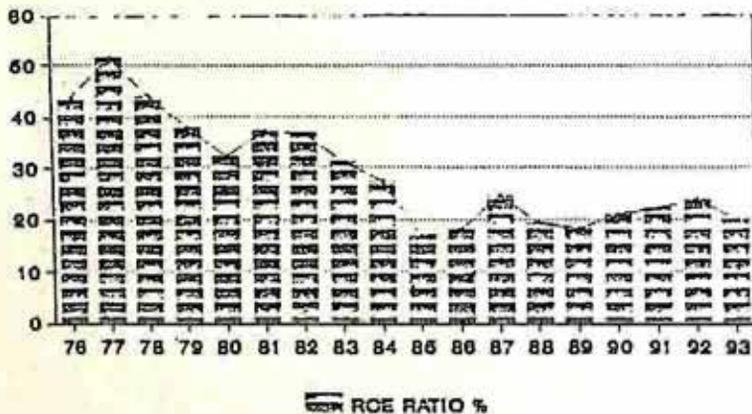
TOTAL ASSETS



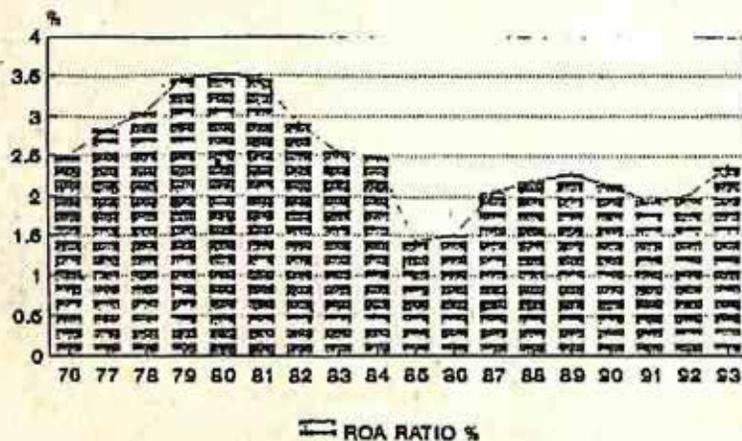
NET FIXED ASSETS



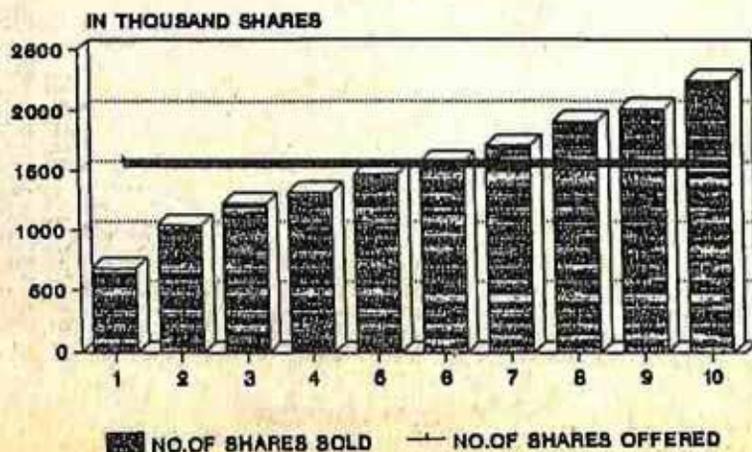
RETURN ON EQUITY RATIO (ROE)



RETURN ON ASSETS RATIO (ROA)

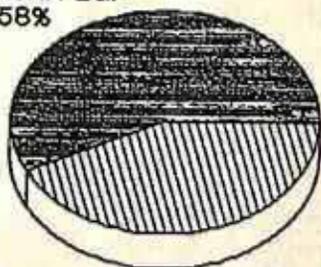


DAILY SHARE SUBSCRIPTIONS SEP.12 TO SEP.23, 1993



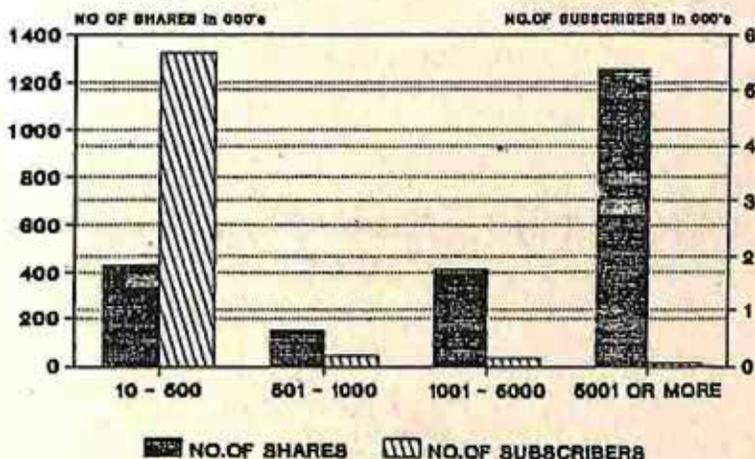
BREAKDOWN OF SHARE ISSUE PROCEEDS BY CURRENCY

SHARES IN EGP
58%



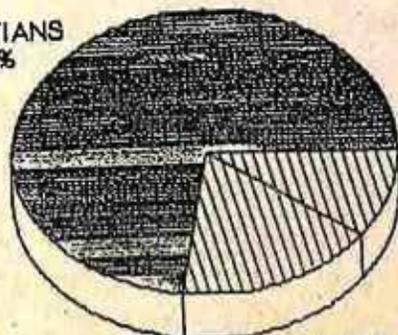
SHARES IN USD
42%

BREAKDOWN OF SHARE ISSUE PROCEEDS BY SUBSCRIBERS & SIZE OF SUBSCRIPTION



BREAKDOWN OF SHARE ISSUE PROCEEDS BY NATIONALITY

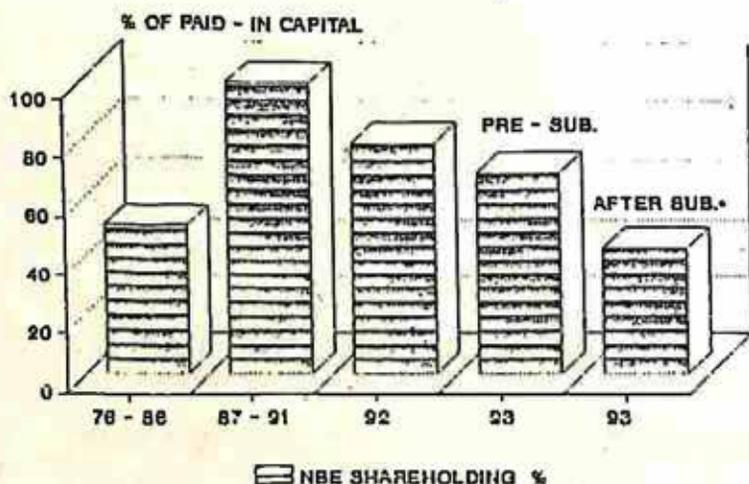
EGYPTIANS
73%



OTHERS
10%

ARABS
17%

EVOLUTION OF N B E OWNERSHIP

CIB SHAREHOLDING STRUCTURE
DEC.31.1993