CENTRAL INTELLIGENCE AGENCY

Directorate of Intelligence

EGYPT: ECONOMIC PROSPECTS THROUGH THE YEAR 2000

A Research Paper

31 December 1987

This paper was prepared by a contractor with the Office of Near Eastern and South Asian Analysis. Comments and queries are welcome and may be addressed to the Chief, Arab-Israeli Division, NESA

25X1

EGYPT: ECONOMIC PROSPECTS THROUGH THE YEAR 2000

25X1

Summary

Egypt's deep-seated economic difficulties probably will not cause an unraveling of the society by the year 2000, but they almost certainly will prevent the generation of economic momentum and higher living standards. Rapid population growth will offset substantial gains in industrial facilities, modern technology, and human skills. Egypt will have to run fast merely to keep even with the demands of its expanding population, its sizable military establishment, its deteriorating infrastructure, its frustrated young people, and its international creditors.

The most likely scenario--with perhaps a 75-percent chance of occurring--is a pragmatic middle-of-the-road coping with economic problems. This coping scenario would reflect a blend of Egypt's entrepreneurial spirit, its bureaucratic obstructionism, and its time-honored cultural and religious practices. Major elements in the economy would fit into this scenario as follows:

--Population will expand from 52 million in 1987 to 71 million in 2000, thus absorbing most of the government's

25X1

25X1

energies in providing food, housing, education, and jobs for the 1 million people added every eight months. This population growth of 2.5 percent over the next 13 years would preempt practically all of the anticipated GNP growth of 3 percent. Although the government urges religious leaders and the media to explain the need for smaller families, it cannot itself launch an activist antinatalist program because of the opposition of Muslim fundamentalists.

--The administrative <u>bureaucracy</u> of some 3 million persons will continue to resist reformist proposals for streamlining regulatory procedures and privatizing a broad range of economic activity. The bureaucracy will remain a place to park many of the educated and half-educated young persons who have no good alternative employment.

--The administration of Mubarak and his successors in this period will manage to live with, but not solve, the problems of a crumbling <u>infrastructure</u> of water and sewage systems, roads and public transport vehicles, housing, the electric power supply, and the telephone system. Projects financed by USAID and the World Bank

25X1

will continue to prop up Cairo's efforts to keep support services at a tolerable level.

--The armed forces, which serve as the ultimate hidden buttress of the regime, will require gradually increasing resources to build up military industry, purchase expensive modern weapons, and maintain, if not enhance, the perquisites of military personnel. These bedrock requirements should take a fairly constant 10 to 15 percent of GNP.

--In agriculture, population will continue to press against the essentially fixed supply of land and water. Historically a major food exporter, Egypt now imports 60 percent of its food and this percentage will slowly grow over the next decade as: (a) agricultural output grows at about 2 percent annually, somewhat less than population; and (b) standards of consumption gradually rise. The financially strapped and bureaucratically constipated government will at best be able to effect only a fraction of the reforms needed in agricultural procurement prices and the crop mix. A five-year drought in the Nile catchment area has caused an alarming drop in the water level of Lake Nasser, behind the Aswan High Dam. This

Declassified in Part - Sanitized Copy Approved for Release 2013/12/12 : CIA-RDP06T00412R000707230001-1

presumably is a temporary situation but, if the drought continues, the authorities will have to cut the flow of irrigation water substantially by early 1989.

--Industry will present a mixed picture of entrepreneurial initiative in medium and small ventures and sluggish state operation of large-scale companies. Foreign capital will not be readily available because of the more attractive investment opportunities in other Third World countries. Managers will experience continued difficulty in getting foreign exchange for needed industrial equipment, spare parts, raw materials, and technology. Output will expand on average by perhaps 3 to 5 percent.

--Sadat's dramatic "infitah" (opening to the West) policy has increased the importance of foreign exchange earnings in a nation that imports $10 billion in goods but exports only $4 billion and that has to service a $40 billion external debt. The annual gap is made up approximately as follows: $3 billion in worker remittances coming back in official channels; $1 billion in Suez Canal tolls; $1 billion in tourist receipts; $2 billion in U.S. support; and large intermittent grants and credits from oil-rich Arab nations, the World Bank, and the IMF. The coping scenario envisions these sources of assistance as a force normally pushing the economy toward the middle, i.e., the funds will generally increase under emergency conditions and dwindle under less pressing conditions.

An alternative <u>unraveling scenario</u> stands a much smaller chance of occurring, perhaps 15 percent. This pessimistic scenario would develop against a background of a stagnant economy and a weakened government that could no longer honor the "social contract" of minimum food supplies at low prices and other welfare benefits. The proximate cause of the unraveling might be major riots touched off by an injudicious government announcement of cuts in food subsidies or a harrangue in the marketplace by a fundamentalist preacher or a final victory by Khomeini in his war with Iraq. As the unraveling gathered momentum, all or some of the following developments might take place:

--a growing resort to unofficial and/or illegal markets to obtain necessities, marked increases in prices, and a rush to convert financial assets into dollar form.

--a further chilling of the investment climate, affecting both local businessmen and foreign firms and bringing large new projects to a halt.

--a sharp drop in tourist numbers and revenues.

--an upsurge in religious fundamentalism within Egypt, a revival that could rend the fabric of law and order and spread to other Arab countries.

--a rekindling of hostility between Egypt and Israel.

--a reluctance on the part of the United States to continue the $2 billion annual package of economic and military assistance;

--an opening of opportunities for Soviet initiatives in Egypt.

--a growing dilemma for the Egyptian armed forces, which cannot lightly discard many years of training on and integration of U.S. equipment.

--and, at some stage, the replacement of the present regime with a new military regime of fundamentalist leanings.

Under this scenario, the resilience and adaptibility that characterized the coping scenario would be lost, at first gradually, then perhaps with a rush. Individuals and groups would face more privations, challenges, and uncertainties than they could handle. The confidence of the populace and the military establishment in the regime would wane as it too became overwhelmed by new problems and uncertainties. As people became mutinous at the loss of income, status, and psychological certainty, the effects would be felt in lower production in agriculture, industry, and services. The whole infrastructure of the economy and society--barely maintained under the coping scenario--would suddenly appear grossly inadequate to an aroused people.

A second alternative momentum scenario, with perhaps a 10 percent chance of occurring, would most plausibly have its source in some combination of higher oil earnings, worker remittances, tourist revenues, Suez tolls, and foreign aid. This added inflow of foreign exchange would depend on favorable international developments largely beyond Egypt's control. Such positive developments are more likely to originate in the fluid conditions of the international capitalist market than in the highly constrained domestic Egyptian economy. Once started, however, the process would rapidly lead to self-reinforcing changes inside Egypt:

--With additional funds available for industrial raw materials, agricultural chemicals, and transport vehicles, the economy quickly could put its considerable idle capacity to work and realize some of the gains from new technology.

25X1

--The government would have more manuever room for implementing economic reforms, for example, adjusting farm procurement prices, reducing controls over business, and moving more vigorously to substitute gas for oil in the domestic economy.

--Both domestic entrepreneurs and foreign companies would sense a more promising environment for profits and for long-term investment.

Cairo could take advantage of a probably fleeting opportunity to make the most critical reforms and to shore up its shaky finances. Or Cairo could fritter away the opportunity in, say, billion-dollar outlays for new military equipment and for overambitious land reclamation projects. (Table 1 compares the three scenarios in outline form.)

The United States wants a friendly, prosperous Egypt closely tied to the U.S. economically, as well as politically and militarily. The U.S. hopes Soviet influence will be minimal in the Mid-East in general and Egypt in particular. Related U.S. objectives are the maintenance of a secure oil supply to Western Europe and Japan and the preservation of Israel as a close ally at peace with Egypt.

25X1

The U.S. $2 billion annual subsidy to the Egyptian economy does not give Washington a vise grip on Cairo's policy. U.S. aid will always have surprisingly little clout because of:

--the political restrictions on Cairo in embracing U.S. suggestions;

--the ineffectual aid "absorbing mechanism" represented by Egypt's bloated bureaucracy;

--the institutional constraints hobbling the U.S. aid "disbursing mechanism"; and

--the sheer magnitude of the economic task itself, particularly the inexorable advance of population.

U.S. aid by itself cannot produce an independent self-sustaining Egyptian economy by the year 2000. Rather, U.S. aid will help feed the additional people, rehabilitate important parts of the infrastructure, and support the moderate acquisition of modern weapons. This limited view of U.S. aid fits comfortably into the middle-of-the-road coping scenario.

The Soviet Union enjoyed a prominent position of influence in the Nasser era of Arab socialism, only to lose its influence under Sadat and his turn to the West. Moscow lacks the funds, the technology, and the administrative flexibility to compete with Western and Arab sources of economic support. Furthermore, the Egyptians have a deep personal dislike for the Russians. Only in the event of the unraveling scenario would Cairo likely solicit large-scale support from Moscow.

25X1

Table 1 (in Summary)

EGYPT: ALTERNATIVE ECONOMIC SCENARIOS, 1988-2000

Item	Unraveling Scenario	Coping Scenario	Momentum Scenario
Background	Crescendo of popular unrest and takeover by a military leadership with strong fundamentalist leanings	Mixture of good and bad economic events and continued ability of government to adjust to these events	Increase in oil earnings, worker remittances, and Suez revenues, which gives government maneuver space
Reconstruction of Economy Along Western Lines	Comes almost to halt as Western ties and support diminish	Proceeds unevenly on pragmatic basis	Picks up pace, with higher per capita net investment
Economic Role of Government	Recentralization on emergency basis	Sluggish bureaucratic management	Sponsoring of new initiatives
Environment for Investment	Disappearance of private initiatives in modern sector	Multiple obstacles to moving projects forward	Substantial reduction in obstacles to new ventures
Infrastructure	Near chaos in supply of utilities and maintenance of transport	Nip-and-tuck efforts to keep utilities and transport operating	Input of large resources; bottlenecks, as new demands on services arise

----

(continued)

25X1

25X1

Item	Unraveling Scenario	Coping Scenario	Momentum Scenario
Stability of currency	Foreign exchange drought and domestic hyper-inflation; new government controls	Movement toward unified exchange rate; domestic price pressures	Smoother movement toward unified exchange rate; ongoing price pressures
Support from United States	Rapid drop-off in willingness to make large grants	Continued support at $2 billion annual level; emergency supplements	Willingness to consider support of new long-term projects
Relations with Israel	Rekindling of hostility	Cautious economic and political relations	Room for somewhat easier relations
Attitude of Egyptian Military	Dilemma: cannot lightly discard years of training with and integration of U.S. equipment	Supportive of regime; enjoying an absolute budget priority at current level of outlays	Moderate pickup in military modernization projects
Average GNP Growth	Perhaps 1 percent	Perhaps 3 percent	Perhaps 5 percent

Note: The unraveling scenario draws heavily on Charles Waterman, "What If Mounting Economic Woes Led to Egypt's Unraveling?" Christian Science Monitor, 25 July 1986.

25X1

CONTENTS

		Page
Summary		2
Section I.	Introduction	16
II.	The Economy's Productive Resources	20
III.	The Inherited Economic System	31
IV.	Dealing with Major Problems Through 2000	53
V.	Three Alternative Economic Scenarios, 1988-2000	73
VI.	Significance for the United States	82

Tables

Table 1.	Egypt: Alternative Economic Scenarios, 1988-2000	12
Table 2.	Egypt: Basic Economic Facts	15
Table 3.	Egypt: GNP and Population, 1950-2000	18
Table 4.	Egypt: Economic Policy Positions, 1952-1987	45

Boxes

Box A.	Egypt: Brief Chronology, 1952-1987	30
Box B.	Egypt: Major Objectives in 1987-1992 Plan	47
Box C.	Egypt: Economic Reforms Urged by Outsiders	50
Box D.	Egypt: Class Structure in 1980s	71

Appendix

Appendix A.	Egypt: Notes on GNP and Other Statistics	88

25X1

Table 2

EGYPT: BASIC ECONOMIC FACTS

Area: 1 million square kilometers (387,000 square miles, equal to Texas and Arizona combined)
Arable area: 4% of total area (along Nile River and in Nile Delta)
Cultivated area: 2.5% of total area, all irrigated

Population: 52 million (1987); growth rate: 2.8%; literacy: 45%
Religion: 90% Sunni Muslim; 10% Coptic Christian
Largest cities: Cairo, 14 million people; Alexandria, 4 million people

Government: military-rooted republic since revolution of 1952
Dominant leader: Hosni Mubarak, b. 1929, president since October 1981

GNP: $36.4 billion (1987); $700 per capita
Defense outlays: 10% to 15% of GNP
Defense manpower: 500,000 men
Currency: Egyptian pound; widespread use of U.S. dollar
Exchange rate: multiple rates; market rate of 2.2 Egyptian pounds equal 1 U.S. dollar (1987)
Inflation rate: 25% (1987)
Foreign debt: $40 billion (1987)

Natural resources: oil and gas, iron ore, phosphates, limestone, and other minerals
Industrial output: textiles, foodstuffs, petroleum, chemicals, construction materials, machinery, armaments
Agricultural output: cotton, grains, clover, fruits, vegetables, meat

Exports: about $4 billion annually; oil, cotton, textiles
Imports: about $10 billion annually; foodstuffs, machinery and technology, fertilizers
Foreign Aid: $2 billion annually from the United States; sizable sums at intervals from oil-rich Arab nations; support from World Bank and IMF
Worker Remittances: $3 billion through official channels, with another $3 to $6 billion through non-official channels
Suez Canal earnings: $1 billion annually
Tourism earnings: $1 billion annually
International memberships: UN, IMF, World Bank, GATT

25X1

Section I

INTRODUCTION

This report examines the prospects for stability and growth in the Egyptian economy over the next 13 years, 1988-2000.

Section II describes the economy's natural resources, population and labor force, capital plant, and technology. Section III deals with the inherited economic system, which is a complex mixture of time-honored traditions, bureaucratic socialism, and free-wheeling markets; the section notes the different economic strategies of Nasser, Sadat, and Mubarak. Section IV considers the prospects for expansion in the major sectors of the economy to the turn of the century. Section V compares three alternative scenarios for the economy in 1988-2000: a pessimistic unraveling scenario, a middle-of-the-road coping scenario, and an optimistic momentum scenario; this section ties the economic reform tasks facing the government to the chances for the appearance of each scenario. Section VI considers the significance of the entire analysis for the United States. Appendix A explains the deficiencies in Egyptian economic statistics and the derivation of the estimates of total and per capita national output, 1950-2000, in Table 3.

25X1

A number of tables and boxes bring together key information on these various topics.

25X1

25X1

Table 3

EGYPT: GNP AND POPULATION, 1950-2000

Year	GNP (bil 1986 $US)	GNP Change (percent)	Population (mil midyear)	Population Increase (percent)	GNP Per Capita (1986 $US)
1950	7.68	---	21.198	---	360
1951	7.86	2.3	21.704	2.39	360
1952	8.02	2.1	22.223	2.39	360
1953	8.17	1.9	22.755	2.39	360
1954	8.39	2.7	23.299	2.39	360
1955	8.52	1.5	23.856	2.39	360
1956	8.32	-2.3	24.426	2.39	340
1957	8.64	3.9	25.010	2.39	350
1958	9.00	4.2	25.608	2.39	350
1959	9.57	6.3	26.220	2.39	360
1960	10.23	6.9	26.847	2.39	380
1961	10.63	3.9	27.523	2.52	390
1962	11.42	7.4	28.173	2.36	410
1963	12.39	8.5	28.821	2.30	430
1964	13.03	5.2	29.533	2.47	440
1965	13.54	3.9	30.265	2.48	450
1966	13.77	1.7	30.986	2.38	440
1967	13.55	-1.6	31.681	2.24	430
1968	13.69	1.0	32.338	2.07	420
1969	14.48	5.8	32.966	1.94	440
1970	15.13	4.5	33.574	1.84	450
1971	15.66	3.5	34.184	1.82	460
1972	15.97	2.0	34.807	1.82	460
1973	16.54	3.6	35.480	1.93	470
1974	17.30	4.6	36.216	2.07	480
1975	18.75	8.4	36.952	2.03	510

(continued)

25X1

1976	20.16	7.5	37.737	2.12	530
1977	21.61	7.2	38.680	2.50	560
1978	23.58	9.1	39.755	2.78	590
1979	25.51	8.2	40.916	2.92	620
1980	27.42	7.5	42.239	3.23	650
1981	29.50	7.6	43.717	3.50	670
1982	31.21	5.8	45.122	3.21	690
1983	32.80	5.1	46.427	2.89	710
1984	34.34	4.7	47.765	2.88	720
1985	35.37	3.0	49.133	2.86	720
1986	35.37	0.0	50.525	2.83	700
1987	36.43	3.0	51.930	2.78	700
1988	37.52	3.0	53.348	2.73	700
1989	38.65	3.0	54.778	2.68	710
1990	39.81	3.0	56.219	2.63	710
1995	46.15	3.0 av.	63.557	2.48 av.	730
2000	53.50	3.0 av.	71.169	2.29 av.	750

Note: For methodology, see Appendix A.

25X1

Section II

THE ECONOMY'S PRODUCTIVE RESOURCES

This section briefly describes Egypt's land and other natural resources; its people and their skills; the extent and variety of its capital plant; and the general level of its technology and management.

A. Natural Resources

Egypt occupies a large squarish chunk of land in northeast Africa, all essentially desert except for the 4 percent of the territory lying along the Nile River and in the Nile Delta. This vital 4 percent enjoys fertile soil, constant sunshine, and practically 100-percent irrigation; the result is multiple crops and notably high yields by Third World standards. Approximately 95 percent of the Egyptian people live in this green area, one-third in the valley, two-thirds in the delta, including Cairo.

At present, the vast expanse of Egyptian desert contributes to GNP mainly through the oil and other mineral industries. Future possibilities--such as solar energy, nuclear power (at isolated sites), construction materials, and industrial parks (on the fringes of arable land)--lie largely outside the time frame of this report.

25X1

Only 2.5 percent of the land area (out of the available 4 percent that is arable) is under cultivation because of the competition for land for industrial, military, governmental, and housing facilities. Each year urbanization takes 50,000 acres out of cultivation, or nearly 1 percent of existing farmland. The government has embarked on ambitious schemes to reclaim land from the desert at a roughly similar rate. U.S. and World Bank economists disagree with this policy, citing the enormous cost per acre of reclamation, the low productivity of reclaimed marginal land, and the cost-effective alternative of increasing the cultivation and yields of existing land. Further improvements in plant breeds, fertilizer application, and water usage can raise some yields to two or three times current levels. As described in Section V, the rationalization of the price structure in agriculture is critical for the exploitation of Egypt's agricultural possibilities.

Like the arable land, the supply of water from the Nile constitutes a vital resource in essentially fixed supply. The completion of the Aswan High Dam in 1971 has proved a mixed blessing. The Dam has (a) regularized the flow of water, both seasonally and annually; (b) increased the opportunities for multiple-cropping; (c) provided a substantial new source of electric power; and (d) created a vast new Lake Nasser with recreational and fishing resources. At the same time it has (a) forced tens of thousands of people to move

25X1

25X1

from their ancient villages; (b) deprived the Nile farmland of the annual deposit of rich silt, with the result that farmers must apply costly fertilizers to the land; (c) added to the salination of delta cropland and hence complicated the process of flushing and draining the land, with the consequent need for large-scale investment in drainage facilities; (d) decimated the sardine fishing industry off the Nile Delta; and (e) increased the incidence of schistosomiasis (a debilitating snail-carried disease) in downstream areas.

A presumably temporary problem has been the alarming drop in the water of Lake Nasser caused by five years of drought in the catchment area. Output in the electrical turbines already has dropped by 20 percent. The authorities will have to cut the flow of irrigation water substantially by early 1989 unless conditions improve.

Ideally, land and water resources should provide a Third World country with a substantial food export surplus to exchange for modern machinery and technology. Egypt possesses excellent food production resources but has become a major food importer. The problem is population, the subject of the next sub-section.

B. Population

In thousands of years of history the population of old Egypt had ranged between 2 and 5 million people. Then in the nineteenth and

25X1

twentieth centuries the introduction of the European agricultural, industrial, and medical revolutions destroyed the balance between human fertility and mortality. The population shot up as follows:

Year	Population
1800	2.5 million
1850	5 million
1900	10 million
1950	20 million
1987	52 million
2000 (proj.)	71 million

From now through the remainder of the century Egypt will add on average 1 million people every eight months. Because of urbanization and education the annual rate of increase will fall from two and three-quarters percent to two and one-quarter percent, but the absolute gain will rise slightly on the expanding base. (Table 3 presents estimates of Egypt's population, 1950-2000.)

Egypt is steadily losing the social glue of the extended family living passively for generations in one village, town, or city, because of:

--The extensive rural to urban movement, especially to the two great cities of Cairo (now 14 million people) and

25X1

Alexandria (now 4 million people), and the fracturing of family connections.

--The employment abroad of as many as 3 million men, which entails the long absence of the family head, the increased feminization of the Egyptian family, and the destabilizing of patterns of family discipline and lifestyle.

--The failure of an overcrowded and increasingly secularist educational system to reinforce family values as in the past.

--The absence of meaningful jobs for the 450,000 young people entering the labor force each year, together with the greatly inflated expectations of the younger generation; for example, the waiting list for government jobs for university and secondary school graduates is now five years, with only one-third of the graduates able to find other jobs before their number comes up.

--The permanent emigration of a large part of the most highly educated and ambitious males, those staying behind being vulnerable to recruitment into radical groups.

25X1

Psychologically and politically, Egypt cannot and will not introduce a birth control program that will appreciably cut back population growth by the year 2000. For one thing, male status depends largely on virility as evidenced by the number of children. Also, with government and private social security entirely inadequate, children represent a reliable prop in old age. And given the near-subsistence living of the bulk of the population, sexual congress often is the only pleasure open to a man and his wife. The moderate Muslim leaders, but not the fundamentalists, can accept a government policy that openly discourages large families through education, propaganda, and even the provision of birth control devices. President Sadat once told his wife that he could not move decisively on the population problem because of fundamentalist opposition.

As the long-time center of Arab culture and education, Egypt has traditionally supplied teachers and technical people to the whole Arab World. A large number of Egyptians have demonstrated commercial and financial talent, as witnessed by the energizing of the entrepreneurial class under Sadat's "infitah" (open door) policy. Indeed, one professor of economics at the American University in Cairo notes that members of the new infitah class are "much more conscious of the value of time, have more respect for manual labor, and much greater admiration for modern technology." The willingness of other Arab countries to employ more than 2 million Egyptian professional people, craftsmen, and manual workers also attests to the high economic potential of much of the population. Population growth has undermined these strengths, multiplying the numbers of people who are lethargic, time-serving, fatalistic, and not only useless from the point of view of production but also an increasing drain on Egypt's scarce resources.

Egypt's land yielded a substantial food surplus with the 20 million people of 1950 and might even today if the government had adopted appropriate agricultural policies. Egypt now must import 60 percent of its food for a population of 52 million. The government will find that most of any growth in GNP will be eaten up by the 19 million people added by the year 2000.

C. Capital Plant

By Third World standards, and Arab standards in particular, Egypt has an extensive and varied capital plant of an increasingly modern cast.

In agriculture, the irrigation and drainage system has undergone substantial expansion and modification, attributable both to pressures from population growth and the completion of the Aswan High Dam. On-going investment in storage facilities, transport systems, and food-processing plants form part of the continued expansion of agricultural capacity. Primitive methods of irrigation and cultivation still exist, especially in outlying areas.

In industry, Egypt possesses broad-based plant and equipment that give the potential for rapid expansion of capacity and output. The economy boasts substantial capacity for the production of textiles, petrochemicals, steel, aluminum, motor vehicles, electric power, construction materials, processed foods, trainer aircraft and drones, tanks and artillery, small arms, telecommunications equipment, and the simpler types of factory equipment. Almost all of the output of heavy and military industry comes from 350 public sector companies. The existence of much outmoded Soviet-built capacity and socialist mismanagement of many large industrial firms dilute Egypt's industrial strength.

As for "infrastructure"--those portions of capital plant furnishing general support to agriculture, industry, the government, and the populace--Egypt has a large, semi-modern complement of roads and railroads, ports, power lines, school buildings, hospitals, water and sewer systems, and housing. Much of this infrastructure has been crumbling since 1952, however, under the impact of the population explosion, inadequate maintenance, the using up of resources in preparation for war, and the subsequent physical damage from war.

D. <u>Technology and Management</u>

A noted historian of Egyptian affairs speaks pessimistically of Egypt's huge problems in expanding education, e.g., the worsening of standards in the rush for more teachers and buildings, the small attention paid to independent study as opposed to rote learning, the social and job expectations associated with a certificate or diploma, and the politicalization of the higher level student body. This historian joins those other observers who see the dissipation of Egypt's very real strengths under the impact of population growth and political conflict.

Many valuable technological ties ended with the 1952 seizure of power by the Free Officers, the subsequent confiscation of British and French industrial properties, and the departure of Greek and Italian craftsmen and technicians who kept going the day-to-day machinery of economic life. The turn to the Soviet Union and its satellites during the Nasser regime distanced Egypt still farther from valuable on-going technological developments.

Today, Egypt is repairing its technological fences, through joint ventures with Western governments and corporations, extensive training of its students abroad, and generally closer ties to international markets for technology.

Some parts of Egyptian management get high marks, notably the management of the General Egyptian Petroleum Company and the Suez Canal Authority. Most other state firms suffer from an unseasoned management, a surfeit of petty tutelage by an overstaffed bureaucracy, and insufficient motivation of the working force.

25X1

Box A

EGYPT: BRIEF CHRONOLOGY, 1952-1987

1952: the nationalist revolution of the Free Officers organization led by Nasser and the establishment of independence after 2,500 years of foreign domination.

1967: the disastrous military defeat by Israel

1970: the death of Nasser and the accession to power of Sadat

1973: the Arab sense of "triumph" in their fourth war with Israel; and the concomitant oil price revolution

1974: Sadat's establishment of the "infitah" (open door to the West) policy

1979: the peace treaty with Israel and Egypt's alienation from the other Arab states

1981: the assassination of Sadat and the succession of Mubarak to the presidency

1987: the May debt restructuring agreement with the International Monetary Fund; and the November reintegration of Egypt into the Arab world

[End of Box A]

25X1

Section III

THE INHERITED ECONOMIC SYSTEM

The Egyptian economic system stands today as an inefficient amalgam of:

--Commercial capitalism with its strong ties to international markets in goods and technology and with its myriad enterprises in trade, finance, industry, agriculture, and services.

--Bureaucratic socialism with its massive administrative and regulatory bureaucracy, its skeletal five-year economic plans, and its array of publicly owned firms in banking, heavy and military industry, electric power, and transport.

--Arab traditionalism with its old-style village and small town activities and its fundamentalist constraints on moving too deeply into public ownership or Western ways.

A. Cultural and Political Elements

The economic system of any particular nation-state bears the marks of its political and cultural history. In the case of Egypt, one British observer identifies three major themes:

--the continuity of Egyptian society from ancient times, even though foreign rulers dominated the country for the 2,500 years prior to 1952.

--the shaping of the Egyptian outlook through the interwoven forces of the Muslim religion and the Arabic tongue, beginning in the seventh century.

--the intensified clash today between the values of an older Egypt and the social and technological values of an awakened Egypt; this clash leads to ambivalence in the leaders as they choose new social-political philosophies and new international partners and to emotional dislocation in the masses of people as they react to the onslaught of technology and untested values.

Noting that Egypt's contemporary socioeconomic profile conforms to the profile of most Third World countries of similar size (e.g., Iran, Mexico, Nigeria, and Indonesia), a second observer cites such common features as "overpopulation, rapid demographic growth, unchecked rural-urban migration, oversized urban centers, mounting demands on services, strained infrastructure, deficit in the balance of payments, foreign debts, inflationary pressures, maldistribution of wealth, and sociopolitical unrest..." This concise portrait of

Declassified in Part - Sanitized Copy Approved for Release 2013/12/12 : CIA-RDP06T00412R000707230001-1

the negative side of Egypt's situation needs balancing by consideration of Egypt's formidable strengths, as presented in Section II and other parts of this report.

B. Ownership of Productive Resources

The ownership of the factors of production in Egypt lies in both public and private hands. The government owns (a) the large industrial firms, which make up most of heavy and military industry; (b) transportation and port facilities; (c) the commercial banks; (d) the irrigation and drainage system; (e) the radio, television, telephone, and postal systems; and (f) educational and health facilities of any size. The government also has a dominant ownership position in large joint ventures with foreign firms. Private individuals own many medium-sized and essentially all small-sized businesses, which predominate in the light, food, and service industries. Well-to-do individuals also share in the ownership of joint ventures with foreign firms.

Since the 1950s, when the Nasser regime destroyed much of the power of the rich landowning class by limiting private farms to 100 acres, small and medium landowners predominate in rural areas; the rich have at least partially evaded limitations on land holdings through subterfuge, e.g., the registration of land parcels in the name of relatives.

25X1

C. Locus of Decision-Making

Since the revolution of 1952, Egypt's three ruling presidents have continued the ancient pharaonic tradition of leadership. This tradition holds that the ruler must be strong both in exacting the obedience of his subjects and in taking care of their basic needs.

The Egyptian government under the president's direction makes the macroeconomic decisions as to the proportion of national income going for defense purposes, the scale of food and housing subsidies, the authorization and scheduling of major investment projects, and the use of foreign exchange. Cairo shares with Washington decisions over the use of the annual $2 billion in U.S. aid and complains that it should have a stronger voice in the employment of these funds.

One conspicuous instrument of the central regime's decision-making power is the five-year economic plan. The current plan extends from fiscal year 1987/88 through fiscal year 1991/92, the Egyptian fiscal year starting on 1 July. The Egyptian five-year plan promises much more in government control over the economy than it delivers. Indeed, the plan has evolved as little more than a guideline for major investment projects, even though it purports to set the level of GNP growth, the national product mix, the pattern of foreign trade, and the main lines of technological development.

25X1

The identity of other decision-makers reflects the diverse public/private character of the economy: managers of major public enterprises, joint ventures, and private business firms; senior military officers; private landowners, village headmen, money changers, master craftsmen, and local entrepreneurs; and foreign capitalists and managers. The "old rich" and "the new infitah class" make decisions involving, for example, investment opportunities and the import of luxury consumer goods. Tradition continues to play a major role in decision-making, both in the behavior of owners and managers and in the conduct of petty enterprises.

Only a small fraction of government employees and private citizens participate in decisions of any consequence. Many households live so close to the margin that choice among alternatives has little meaning.

D. Implementation of Decision-Making

Internally, Egypt's mixed economy employs a variety of bureaucratic channels, private markets, and social traditions to implement economic decisions. Externally, national and international organizations and global commodity and financial markets are the main instruments of implementation and reflect Western economic practice.

Declassified in Part - Sanitized Copy Approved for Release 2013/12/12 : CIA-RDP06T00412R000707230001-1

25X1

Every observer of the Egyptian scene sees the deadweight bureaucracy as a major hindrance to the implementation of economic decisions and to the general energizing of the economy. These observers characterize the bureaucracy as "bloated," "over-staffed," "venal," "incorrigibly corrupt," and the like. The government has meaningful work for only a fraction of public employees and lacks funds to pay 3 million bureaucrats adequately. The general result is a tremendous amount of idleness and makework, unending delays, a nearly universal susceptibility to bribes, and considerable moonlighting.

Even though the president can set the tone of economic policy and make strong economic decisions, he faces a major constraint in the ability of the bureaucracy to slow down the implementation of his decisions. In general, the leader often must go with the tide; he can do little in the short run to change Egypt's vast poverty, or the instinctive venality of officials, or the deep-seated religious animosities.

E. <u>Paramount Role of the Military Establishment</u>

Power in the Egyptian politico-economic system since the revolution in 1952 has rested ultimately on the armed forces. Behind a civilian facade, the top layer of government has the confidence and support of the military establishment. Military spending at a slowly

25X1

increasing level has an almost absolute priority. The government must provide sufficient resources for adequate military pay and gradual acquisition of modern weaponry.

The top government echelon values military strength as necessary to deal with unsettled conditions in the Middle East, to hold domestic factions in check, and to symbolize Egypt's importance as a proud nation-state. Furthermore, the armed forces makes a positive contribution to the economy in building bridges and sewer lines, running factories that produce both military and civilian goods, and training people in basic technical skills. Finally, the armed forces with their 500,000 men and the public security forces with their 300,000 men constitute valuable sources of employment in this underemployed nation.

F. Dollarization of the Economy

Even more so than most other Third World countries, Egypt depends on the Western market economies for food, machinery, technology, and financial support. This dependence runs counter to currents of Egyptian nationalism, Arab regionalism, and Muslim fundamentalism.

One major consequence has been the dollarization of the Egyptian economy to the extent that the dollar serves as a practically equal companion money to the Egyptian pound:

--The international oil market, the major source of Egypt's export earnings, uses dollars as its unit of account and medium of exchange.

--Expatriate Egyptian workers typically draw their pay in dollars and channel great sums back into the economy by both official and non-official channels.

--Suez Canal revenues also come largely in dollars.

--Tourists often pay in dollars, and the government collects as many of these dollars as possible through hotels and other tourist facilities.

--Individual Egyptians hold tens of billions of dollars in their savings and business accounts, both in Egyptian and foreign financial institutions.

--The bulk of Egypt's foreign aid receipts are in dollars.

--Businessmen, money changers, and black market operators within Egypt often carry out their transactions in dollars.

--The virulent inflation of domestic prices, in recent years increasing from 15 percent to 25 percent annually, encourages Egyptians of all ranks to deal in dollars and thus reinforces the above tendencies.

25X1

G. Drain of Rent-Seeking Behavior

Another major characteristic of the Egyptian economy is rent-seeking behavior--the process whereby individuals strive to earn incomes from exploitation of a good in fixed or short supply rather than from expanding the existing supply of goods. Many Egyptians seek incomes as go-betweens with foreign firms, speculators in currencies, sub-leasers of scarce housing or land, bureaucratic toll-collectors and influence merchants, or re-sellers of rationed goods. In some of these instances, the person indeed performs a useful economic service in facilitating transactions that raise community well-being. In too many cases, however, the activity is a rake-off, adding neither to the stock of products nor to the level of individual satisfaction.

Meantime, the nation as a whole rents its Suez Canal to shippers, its pyramids to tourists, its oil deposits to foreign countries, its workers to the Gulf States, and its geo-strategical position to the major powers. Again, while some of this activity clearly raises both national income and product, it frequently lacks the technological push associated with modernization and economic momentum. Indeed, rent-seeking ventures promise the most lucrative and immediate returns when, as often is the case, they do not involve large

25X1

investment in plant and technology or close association with the government bureaucracy. Finally, rent-seeking proliferates in an overpopulated society of shortages, subsidies, and massive underemployment--like Egypt's.

Rent paid by Egyptians to other Egyptians within the economy does not in itself raise national product, certainly not when the rent is a simple pay-off. Rent paid by outsiders such as foreign governments and tourists, on the other hand, adds to Egyptians' command over goods and services, hence to national product.

H. Social Contract Between Rulers and Ruled

The Egyptian politico-economic system has remained stable since 1952 largely because of the observance of an implicit social contract between rulers and ruled:

1. Of prime importance in the social contract is the supply of cheap food and other necessities to the populace through massive government subsidies. The cost to the treasury of the food subsidy has risen to an estimated $7 billion per year. In January 1977, serious riots in Cairo and other cities erupted after President Sadat announced cuts in subsidies for food. He had to rescind his order immediately. Subsequently, the government has had to move cautiously when reducing subsidies, for example, by juggling the quality and

weight of bread. Because of the 15-25 percent domestic inflation, fixed nominal prices for necessities mean lower real prices over time and thus higher real subsidies. The mass of people, however, see the prices in terms of current piastres, not the economist's real piastres, and object to rises in nominal prices even when justified by inflation.

2. Ever since Nasser saw education as the key to Egypt's modernization, the government has moved to eliminate illiteracy and has made free education up through the university level an important plank in the social contract. Up to recently the goverment had even promised jobs in the public sector to all high school and college graduates. Moved by personal ambition, encouraged by public policy, and prodded by their parents, young people have flooded the educational system. The schools have unsuccessfully struggled to find enough qualified teachers and have turned out masses of ill-educated persons. About 450,000 young people enter the labor market each year, with only a fraction of this number leaving the labor market in the older age brackets. The waiting line for the employment of college and secondary school graduates now contains five classes. The authorities expect these young people to get other jobs while waiting but only one-third are able to find jobs compared with two-thirds of the people a few years ago.

25X1

3. Implicit in the social contract is the provision of minimum housing, water and sewerage, medical care, and other family support items that form part of the society's infrastructure. Government officials conceded some time ago that the economy was short 1 million housing units and will be short 3.6 million in the year 2000, and they were understating the problem. (Other sections of the report deal with the crumbling of the infrastructure and the government's efforts to prevent further deterioration.)

The ancient pharaonic tradition called for the ruler to see that the people enjoyed a minimum level of goods, but Nasser greatly enlarged that commitment under the banner of Arab socialism. Although not a part of the basic social contract, Sadat's infitah policy constituted a de facto commitment to the well-to-do, i.e., the provision of considerable latitude to make money outside the socialist constraints, both at home and abroad. This permissive attitude seems necessary to reap the advantages of the opening of the West and to retain the services of at least part of Egypt's best and brightest. Indeed, the vitality of Egypt's own entrepreneurs rests largely on their proven ability to deal with or perhaps circumvent the venal bureaucracy. Another aspect of the government's implicit contract with the well-to-do is a certain liberalization of foreign trade which permits the newly rich to import luxury consumer goods.

25X1

An extended version of the social contract might also include the guarantee to the military of a certain minimum allocation of real resources and an implicit arrangement with foreign creditors to maintain a respectable facade of honoring debt obligations.

I. Changes in the Rules of the Game Since 1952

Once firmly established in office, Nasser embarked on his own personalized brand of Arab socialism: (a) nationalizing the banks, oilfields, and large industrial facilities; (b) drastically curbing the power of the large landowners through land redistribution; (c) seeking Soviet aid and building up a large Soviet-style administrative and planning bureaucracy; (d) rapidly expanding Egypt's capacity to produce basic industrial materials; (e) greatly raising the expectations of the rank-and-file through welfare measures that included price controls, subsidies, rationing, and free education; and (f) devoting perhaps one-third of the national product to military purposes.

His successor Sadat, after leading a "triumphal" crossing of the Canal in 1973: (a) instituted the "infitah" policy of expanded trade and technology contacts with the West; (b) encouraged private investment in both the domestic and foreign arenas; (c) initiated a peace accord with Israel, thus easing the military burden; (d) replaced the USSR with the United States as Egypt's superpower

25X1

patron; and (e) subordinated egalitarian policies to the needs of the entrepreneurial class. He could do little about the burdensome legacies of a bloated bureaucracy and inflated welfare expectations.

Mubarak has held to the economic course bequeathed by Sadat--at a reduced pace. His caution reflects the end of the oil bonanza, his wish to return to the Arab fold without upsetting the U.S. alliance or disturbing the peace with Israel, and the constraints posed by the continued poverty of the masses of the people and an upsurge in Islamic fundamentalism. He has sought out practical remedies and has tried to dampen the unrealistic expectations of the populace.

Table 4 lists these and other comparisons of the economic policies of Nasser, Sadat, and Mubarak.

25X1

Table 4

EGYPT: ECONOMIC POLICY POSITIONS, 1952-1987

Item	Nasser	Sadat	Mubarak
Period in Power	1952-1970	1970-1981	1981-1987
Leadership Style	Charismatic, Emotional	Dramatic, Introspective	Technocratic, Cautious
Economic Philosophy	Bureaucratic Socialism	Open Door Policy	Stable Mixed Economy
International Ties	Soviet Socialist Bloc	Western Market System	Western Market System
Position in Arab World	Militant Leader	Pariah (since Camp David)	Gradual Reconciliation
Ownership of Resources	State Entities	State and Private	State and Private
Economic Decision-Making	Bureaucratic Hierarchy	State and Private	State and Private
Decision Implementation	Bureaucratic Hierarchy	Trend toward Market	Trend toward Market
Foreign Aid	From Soviet Bloc	From U.S. and Arabs	From U.S. and Arabs
Agricultural Policy	Land Redistribution	Limited Investment	Limited Investment
Industrial Policy	State-Sponsored Rapid Growth	Market-Sponsored Rapid Growth	Moderate Growth
Educational Trends	Nationalistic, Populist	Technical, More Elitist	Technical, More Elitist

----

(continued)

Declassified in Part - Sanitized Copy Approved for Release 2013/12/12 : CIA-RDP06T00412R000707230001-1

25X1

Item	Nasser	Sadat	Mubarak
Population Control	Secondary Issue	Secondary Priority	Rising Priority
Infrastructure	Neglected in Rush	Emergency Patchwork	Emergency Patchwork
GNP	Ups and Downs	Oil Bonanza	Slow Advance
GNP/Capita	Slowly up	Major Rise	Leveling Off
Income Distribution	Decided Leveling	Less Egalitarian	Less Egalitarian

25X1

Box B

EGYPT: MAJOR OBJECTIVES IN 1987-1992 PLAN

In the Government Policy Statement presented to the People's Assembly on 16 November 1987, Prime Minister Sidqi declared that the government hopes to implement many ambitious economic programs during the 1987-1992 five-year plan, as follows:

1. Agricultural Sector
   a. Raising annual production more than 80%.
   b. Attaining self-sufficieny, except in wheat and corn.
   c. Reclaiming 150,000 acres.

2. Industrial Sector
   a. Raising production 42%.
   b. Attaining self-sufficiency in most consumer goods.
   c. Emphasizing production of industrial tools, spare parts, and export goods.
   d. Renovating especially the armament and textile branches.

3. Oil Sector
   a. Increasing oil output by 5.6%; doubling gas output.
   b. Pressing exploration for oil and gas.
   c. Substituting gas for oil in all possible domestic uses.

4. Electricity Sector
   a. Boosting power generation capacity by 3,529 megawatts,

or by roughly 40%.

b. Pushing coal-generated and nuclear-generated power.

5. <u>Transport and Communication Sector</u>

a. Renovating 1,000 km of railway track and completing double-tracking of lines in Upper Egypt.

b. Building 376 km of new roads, converting 399 km from one lane to two, and constructing nine bridges.

c. Increasing telephone lines by 465,000, to 2.1 million.

d. Raising port capacity by 8.2 million tons, or 27%.

e. Upgrading four airports into international airports.

6. <u>Tourist Industry</u>

a. Completing new luxury hotels.

b. Streamlining administration, security, and training.

7. <u>Construction and New Communities</u>

a. Building roads, water systems, and desalinating plants in Sinai, the northern coast, the High Dam lake area, Cairo, and other expanding areas.

b. Completing first phase construction of four new cities.

8. <u>Housing Sector</u>

a. Constructing one million housing units, 900,000 in urban areas and 100,000 in reclaimed areas, with 630,000 for low-income families.

25X1

9. Public Utility Sector

   a. Increasing the volume of pure drinking water by 44%, with half of the increase in Cairo.

   b. Augmenting substantially the capacity of sewer systems throughout the country.

10. Social Services Centers

   a. Raising the number of hospital beds from 96,700 to 115,700.

   b. Funding new museums and theatres.

   c. Ensuring basic education for all children and expanding educational programs on radio and TV.

   d. Strengthening the network of vocational training and social rehabilitation centers.

   e. Building or refurbishing 361 mosques and commissioning 300 new Islamic libraries.

   f. Erecting 40 youth centers, as well as new sports facilities.

11. Employment

   a. Providing 2.1 million new job opportunities.

[End of Box B]

25X1

Box C

EGYPT: ECONOMIC REFORMS URGED BY OUTSIDERS

Economist observers from Western and international organizations, who stand above the daily struggle of Egypt's leaders to reconcile mutually unattainable economic objectives, urge the government to make the following reforms:

1. Unification of the exchange rate between the Egyptian pound and the U.S. dollar: The process of unification has received a considerable boost from the IMF agreement of May 1987, with a gradually increasing number of transactions taking place at or near the international market rate.

2. Introduction of higher real interest rates within the domestic economy: The government has found it politically inexpedient to set interest rates at a high enough level to ensure a positive rate of return over and above the 25-percent inflation rate.

3. Reduction of subsidies on domestic energy consumption and the vigorous substitution of gas for oil in domestic use: The government in recent years has raised the domestic price of key petroleum products from about one-tenth to one-fourth of international prices and has made a partial start on constructing pipelines and modifying equipment to accommodate the use of gas.

25X1

4. Cut in domestic budget deficit: Because of built-in commitments to important interest groups and the inability of the government to firm up tax collections, the budget deficit has continued at a high level.

5. Restraints on bank lending, as part of a general effort to curb inflation: The recent cap on bank lending (part of the IMF pact) has touched only one part of the inflationary process; prices are advancing at an even faster clip, and the trend toward the use of U.S. dollars continues.

6. Reduction of food and other consumption subsidies and an increase in agricultural incentives: The government, remembering the great riots of January 1977 touched off by Sadat's announcement of subsidy cuts, has proceeded cautiously in trimming subsidies, e.g., by juggling the quality and weight of the subsidized loaf of bread. The government lacks the financial means to raise agricultural procurement prices and farmers' incomes as a stimulus to output.

7. Reduction in bureaucratic controls and interventions: The old observation of one eminent observer still holds: "It is this obstructionist monster of the state machine with its red tape, lethargy, and choking legalism which has impeded a faster rate of foreign capital flow into the country." Efforts to reduce the size of the bureaucracy will run aground on the vested interests of

25X1

incumbents and the practical need to provide government employment for secondary school and college graduates.

8. <u>Systematic rationalization of all laws that affect domestic and foreign entrepreneurs</u>: The laws include commercial law, trademark and patent law, labor laws, import-export regulations, banking and securities regulations, foreign exchange regulations, and income and other tax laws: Revision of these laws has proceeded slowly on an ad hoc basis; systematic and timely rationalization is unlikely.

9. <u>Restraints on consumerism</u>: The government has taxed and has licensed imports of luxury consumer goods without, however, substantially reducing the ostentatious lifestyle of the new infitah class or curbing lower middle class appetites for radios, TVs, refrigerators, and better housing.

Addendum: These outside observers recognize the overriding importance of Egypt's large and growing population as the key barrier to economic progress. Yet they do not, certainly not in any advice offered under official auspices, urge draconian antinatalist policies on a government that lacks the power to administer even mild restraints.

[End of Box C]

25X1

Section IV

DEALING WITH MAJOR PROBLEMS THROUGH 2000

This section describes the likely outcome of government and private efforts to deal with the major problems of the Egyptian economy through the year 2000. It identifies the problems that probably will grow, those that will remain at about the same level of intensity, and those that will diminish. It addresses the issue of the likely effect of the fundamentalist religious revival on economic affairs. Implicit in the discussion is the thesis that Mubarak and his successors will have to devote most of their energies to keeping things from getting worse; they will lack the administrative drive, the political opportunities, and, above all, the economic resources needed to delay present satisfactions in order to reap the long-term advantages of added investment.

A. Exploding Population: The Problem No One Can Do Much About

A rise in population from 52 million today to 71 million by the end of the century appears an inevitable feature of the socioeconomic background. The rapid growth of population will adversely affect developments in all the other problem areas addressed in this report. The central government nonetheless cannot

25X1

seriously contemplate an overt antinatalist program that would consume administrative energies in a fruitless effort and that would stir up fundamentalist unrest to no purpose.

Prime Minister Sidqi in his lengthy 16 November 1987 Government Policy Statement to the National Assembly devoted a cautious paragraph to the population question, as follows:

> There is no doubt that confronting the population problem is essential. Only then can efforts toward development produce effective results in raising the standard of living. As mentioned in the previous government statement, our brothers, the religious ulema and preachers, should shoulder a big responsibility in resolving this problem. Furthermore, the mass media and the various information campaigns can and should play an extremely important role in changing social behavior by advocating small families.

B. <u>Huge Bureaucracy: A Place to Park Redundant Labor</u>

In his second term acceptance speech of 12 October 1987, President Mubarak stated that "the ministries, state institutions, public economic establishments, and public sector" employ about 6 million workers and that the government sector had added 892,000 new jobs in the past 5 years. Of the total, perhaps 3 million are in the administrative bureaucracy itself, with each member, according to Cairo nightclub opinion, performing on average only 27 minutes of useful work each day.

With an estimated 450,000 entrants to the labor force each year, hopes to trim the bureaucracy seem futile. The government does well to waste little energy in raising the productivity of redundant bureaucrats or in preventing their moonlighting on other jobs. The regime presumably will do what it can to promote alternative employment opportunities in the private sector and foreign countries.

One drawback to the existence of this bloated bureaucracy is a built-in resistance to government measures for streamlining the regulatory process or for privatization of the economy. The bureaucracy does not choose to participate in any dismantlement of the public sector.

C. Crumbling Infrastructure: Efforts to Keep Abreast of the Game

The strategy and degree of success of the government in dealing with the crumbling of the infrastructure will vary widely from sector to sector:

--A recently opened French-built subway line in Cairo will carry several hundred thousand commuters each

25X1

day in a system with just six stations; this is an important step in keeping Cairo's commuting problem within tolerable limits.

--Water and sewerage problems are a stark reality in a country with a fixed and already overstretched water supply; the government gives high priority to fixing these national plumbing problems in cooperation with West European and North American contractors; large sums advanced by the World Bank and USAID go for this purpose.

--Land, materials, and incentives are wholly inadequate to keep the housing shortage from worsening; in the face of a situation where millions are homeless, one observer notes the amazingly large number of empty and half-finished housing around Cairo; well-to-do people are holding housing and apartment units for their children and friends, since the amount of rent forgone under government controls is quite small and since tenants cannot be readily removed; investors supposedly abandon projects from a combination of rising costs and pessimistic revenue prospects; and the number of homeless living in Cairo's great

25X1

cemetery, the City of the Dead, has grown to a million.

--Contracts with Western companies are beginning to make palpable improvements in the notoriously inefficient telephone system.

--With the doubling of per capita GNP since 1952, the more than doubling of welfare outlays and popular aspirations, and government efforts to broaden educational opportunities, the staff and facilities of Egypt's educational system have gradually deterioriated in quality; well-to-do people hire private tutors, and a private educational net has sprung up to prepare students better for higher rungs on the educational ladder; meanwhile, the government faces the problem of strengthening vocational training to support the technical upgrading of industry and agriculture.

D. Expensive Military Establishment: Political Bedrock

One sacrosanct commitment of Egypt's resources--amounting to 10 to 15 percent of GNP--is the support of the military establishment of approximately half a million men. In an age of alienation,

25X1

frustrated expectations, and erosion of traditional social controls, army support stands as the ultimate strength of the regime. The government is attempting to boost the loyalty of the army through new housing and other benefits for the officers and stepped-up training for enlisted men that can mean a better job upon discharge. The switch from Soviet to U.S. and French arms has resulted in a hodgepodge of equipment, and the process of gradually modernizing the army's weapons will require some increase in the military budget through 2000. The major restraints on the military will be on the pace at which it can buy foreign weapons and simultaneously improve its material perquisites. Already officers are grumbling at what they see as an erosion of their perks.

The Egyptian army performs useful work on roads, bridges, telephone lines, and other contruction projects. According to a Wall Street Journal article of a year ago, army farms annually produce 60 million eggs, 13.5 million tons of red meat, and thousands of tons of fruits, vegetables, and dairy products. One-third to one-half of the output of army factories consists of civilian products, such as diesel engines, pumps, and desalination equipment.

E. Inadequate Foreign Exchange Earnings: Striking a Balance

Egypt will need ever-increasing amounts of foreign exchange, mainly U.S. dollars, to pay for: food; industrial equipment,

Declassified in Part - Sanitized Copy Approved for Release 2013/12/12 : CIA-RDP06T00412R000707230001-1

technology, and raw materials; and increasingly complex and costly weapons. Recently, imports of goods have run at $10 billion per year, exports of goods at only $4 billion. Furthermore, Egypt faces an annual $4 billion outlay for paying interest and principal on its $40 billion external debt; ongoing negotiations with creditor nations, under the IMF umbrella agreement of May 1987, are stretching out these debt service obligations. Items that will help fill the gap between foreign exchange income and outgo are:

--$3 billion annually in worker remittances coming through official channels (another $3 billion to $6 billion flows in through unofficial channels, outside the government's statistics); these payments likely will dwindle over the next decade, more or less rapidly depending on oil prices and the policies of Arab Gulf states in hiring foreigners.

--$2 billion annually in U.S. military and economic support.

--large sums from oil-rich Arab nations on an irregular basis, totaling roughly $1 billion in 1987.

--important sums advanced by the IMF and World Bank on soft terms; these advances normally postpone, rather than reduce, Egypt's foreign exchange difficulties.

25X1

--$1 billion in Suez Canal fees, an amount apt to climb gradually over the long run.

--$1 billion in annual tourist earnings; Egyptian tourist officials optimistically expect this figure to reach $3 billion in the next decade; in any case, a substantial increase will occur if Egypt retains its political stability and relations with other Arab countries continue to improve.

Oil earnings will depend in part on unpredictable movements of price, which could put annual earnings from petroleum and petroleum products between, say, $1 billion and $2.5 billion. As to volume, Egypt's oil production can remain at 900,000 barrels per day with reasonably good fortune but probably will not top that figure. Of this amount, 300,000 b/d goes to pay the oil companies and 400,000 b/d goes for domestic use, leaving 200,000 b/d for export. As population and GNP rise, domestic demand for oil will rise at least in proportion, or, say, from 2.5 to 3.0 percent per year. Egypt is taking steps to counteract this increase in domestic demand by the substitution of domestically produced gas.

F. Widespread Dollarization: Restrained by Nationalistic Sensitivities

Because of Egypt's multiple exchange rates, its 15- to 25-percent annual inflation, its substantial price subsidies, and its extensive international economic ties, widespread dollarization will remain a salient feature of the economy. Oil earnings, worker remittances, tourist expenditures, large investment projects, foreign aid transfers, and even a substantial share of domestic financial assets will continue to bear a dollar label. Egypt's sensitivity to its national sovereignty will inhibit further dollarization on the official level but will not prevent its continued advance on the business and household levels.

G. Agriculture: More Food Imports Likely

According to World Bank economists, Egypt was able to boost agricultural output by an estimated 3.5 percent a year in the 1970s because of the initial impact of the Aswan High Dam on irrigation, acreage, and the introduction of high-yielding varieties of crops. Growth in the 1980s, however, fell by more than one percentage point because of:

--The government's failure to provide an adequate incentive for farmers to produce, especially those crops in which Egypt enjoys a pronounced comparative advantage.

25X1

--The annual loss of 1 percent of the cultivated area to urbanization, possibly offset in quantity, though not in quality, by the reclamation of other land.

--The decline in some crop yields due to increased salination and inadequate drainage, in part the result of altered conditions brought about by the Dam.

--Labor shortages in some farm areas attributable to rapid migration, especially of those males with the most education and the highest technical skills.

--Institutional weaknesses in applied research, extension services, and marketing.

Despite these unfavorable factors, gradual improvements over the next decade in fertilizer application, plant strains, cultivation methods, and water usage should enable Egypt to achieve 2-percent annual growth in the agricultural sector. Changes in government policy on agricultural procurement prices and farm incomes, if properly carried out, could lead to much higher agricultural growth rates. However, a financially strapped government acting through a bureaucratic labyrinth almost certainly will not adapt, let alone implement, more than a fraction of the necessary measures.

25X1

Egypt, which now imports 60 percent of its food, almost certainly will be importing an even greater proportion in the year 2000. The loss of "food security" since World War II poses a political issue which the government lacks the means to resolve.

H. Industry and Construction: Building on a Broad, Variegated Base

Recent visits to a dozen small and medium industrial enterprises near Alexandria gave two U.S. Embassy officials a new appreciation of the ability of Egypt's entrepreneurs to surmount bureaucratic barriers and economic obstacles. Each businessman had his own particular mix of satisfactions and complaints. Among the latter are the delays in getting licenses and permits, the uneven and unfair application of the tax system, the frequent interruptions of the electric power supply, shortages of certain types of skilled labor, and the difficulty of obtaining foreign exchange for purchase of vital machinery and raw materials. These problems no doubt will continue through the year 2000; they will impinge on private businesses in an individual pattern, depending on the products and connections of the firm, and they will continue to test the resiliency and adaptability of entrepreneur and manager.

The large state-owned industrial businesses face a different set of problems, especially in their adjustments to international

25X1

market conditions and absorption of modern technology. The General Egyptian Petroleum Company and the Suez Canal Authority will continue to benefit from competent management, accumulated experience, and assured markets. Other state-owned businesses suffer from tangled administration, loose discipline, and an ill-trained and ill-paid labor force. Some, like the state steel and aluminum companies, have built-in technology that makes them voracious consumers of energy in an era where oil output must earn foreign dollars and where government price policy improvidently encourages household consumption of energy. Many will benefit from a sheltered and expanding domestic market, especially if they can obtain foreign exchange needed for equipment, technology, and raw materials.

The construction branch of the Egyptian economy will experience a brisk demand for its services over the next decade, e.g., in expanding industrial capacity, implementing programs for reclamation of land and higher yields in agriculture, building new housing and tourist facilities, and playing a lead role in the constant refurbishment of the infrastructure. Construction activity will involve crafts ranging from primitive village brick-making to the skills of electrical engineers at Aswan.

The industrial and construction sector should move fitfully ahead on a broad and variegated basis, building on an already

25X1

substantial base. Annual growth in real output ought to fall in the 3-5 percent range, but this admittedly is a guesstimate based on the qualitative observations of foreign observers and not on research into available quantitative information.

I. Services: Tied to Growth in Population, Industry, and Agriculture

The outlook for support services, especially those based on masses of unskilled urban labor and locally produced raw materials, is a major bright spot. These services will both support the operations of and share the fortunes of industry, mining, construction, agriculture, the tourist sector, and households, especially those households propped up by remittances. With cautious encouragement of privatization and foreign investment under Mubarak, services will help create the alternatives to joblessness or public employment that the masses of newly fledged labor so desperately need.

In the financial sector, the rise of the popular Islamic investment companies, which pay generous dividends on shares in a variety of business ventures, has been the most spectacular institutional development of the 1980s. In some cases at least, these appear to be fair-weather companies that cannot maintain their high dividends for long and that will shortly add to the government's already full plate of problems.

25X1

J. Fundamentalist Revival: Constraint on Policy Initiatives

Economic and political frustrations and the powerful cultural currents from the West have led a considerable number of Egyptians to turn to Islamic fundamentalism. Many of these activists are young have-nots; others are representative of the best and brightest students in the university network. Until now, the fundamentalist movement has not appreciably disturbed economic affairs, although it restrains the pace of secularization and westernization in Egyptian society.

If Egypt were to institute the strict Islamic code of behavior, the following adverse economic developments would follow, some immediately, some gradually:

--A disruption of business transactions based on interest payments, which are anathema in the Islamic code, and the adoption of makeshift alternative arrangements for credits, probably along the line of profit-sharing.

--A sharp drop in tourism, with the halt to the public flow of liquor and to the public appearance of bikini-clad women.

25X1

--A reduction in agricultural efficiency, as Islamic inheritance laws would divide already small parcels of land into still smaller holdings.

--A further erosion in educational standards, as perhaps two hours of schooling per day would be lost in mathematics, the sciences, and other modernizing studies; on the other hand, the adoption of the Islamic code conceivably could bring better discipline and more serious study to offset this re-allocation of time.

--A loss of output from many of the highly skilled women in Egypt's labor force, as women returned to traditional menial employment.

--A final blow to already remote prospects for a strong antinatalist policy in this century.

A recent Wall Street Journal article explains how Mubarak is trying to contain the fundamentalist revival without undue resort to force. His assets, according to the article, are: (1) the 500,000-man army; (2) the 300,000-man central security forces, which maintain internal security; (3) an emergency law under which suspects can be held for two months without charge; (4) a strong margin of

25X1

support in parliament; and (5) widespread admiration within the populace for his integrity.

His liabilities, according to the article, are perhaps even more formidable: (1) the exhaustion of the Egyptian treasury, in contrast to the fundamentalists' ability to fund hospitals, schools, daycare centers, and even some housing; (2) the hobbling of administrative initiatives by "a hopelessly corrupt bureaucracy"; (3) the demeaning reliance on $2 billion annually in U.S. aid, which still isn't enough; (4) the growth of influence within the army and police of militant fundamentalists; and (5) the ability of the fundamentalists to assassinate and terrorize, i.e., to set the rules of the game.

One bitter Egyptian, quoted in the article, asked how the fundamentalists propose to solve the country's major problems:

> Can they get us money from the international banks or other countries without interest? Can they cancel the peace accord with Israel and throw this country back to war? Can they shut down the tourist income by imposing their liquor and dress rules? Can Egypt take it? I don't think so, and people will see that for themselves. The support will melt away.

25X1

For the future, the fundamentalists add to the problems of Mubarak and his successors by narrowing the already small room for policy manuever and by consuming the administrative attention that ought to go to programs with the potential to spur economic growth. At the same time, their growing social welfare activities help ease the strain on government resources.

K. Soviet Return to the Arena: Not Likely

The Soviet economic presence in Egypt, nurtured by Nasser and ended by Sadat, will not revive in the next decade except under the unlikely circumstances of a complete unraveling of Egyptian society. The innovative political-economic policies of Sadat and the cautious continuation of these policies by Mubarak have reinforced economic and psychological ties to the West, especially the United States.

The Soviets do not possess the means to subsidize Egypt at the level maintained by the United States and Egypt's Arab brethren, who in November 1987 ended Egypt's political ostracism. Moscow, already overcommitted at home and in Afghanistan, Cuba, and Africa, has to contend with near-zero growth in its own economy and internal divisions over economic policy. Moscow lacks the ties to the international market, the modern technology, and the administrative flexibility normally provided by the West as a matter of course in dealings with Egypt. Another substantial handicap is the personal dislike Egyptians have for Russians.

25X1

L. The Evolving Economic System: Three Currents

The three broad elements in Egypt's eclectic economic system probably will fare as follows through the year 2000:

--Capitalism will move gradually ahead, in an uneven pattern as domestic and foreign entrepreneurs take advantage of a rising GNP, a somewhat better climate for investment, and a more realistic system of foreign exchange.

--Socialism will continue mainly as is, with large welfare outlays and a massive bureaucracy as "societal givens" and with little privatization of public firms. (Mubarak believes that wholesale privatization would lead to intolerable price increases for the poor.)

--Traditionalism, assuming the fundamentalists do not take charge under an unraveling scenario, will retreat slowly under the impact of education, technology, and Western cultural influences.

25X1

Box D

EGYPT: CLASS STRUCTURE IN 1980s

Upper-Upper Class: government ministers and vice ministers; provincial governors; leaders of the national assembly; chief judges; multi-millionaire financiers, traders, industrialists, and property owners; general officers of the armed forces and internal security forces; top-rank religious leaders; highest educational and scientific authorities; heads of a few pre-revolutionary families of impeccable social standing.

Lower-Upper Class: government bureau chiefs and senior rural and urban officials; members of the national assembly; senior judges, lawyers, and physicians; millionaire businessmen; senior managers of leading state enterprises and joint business ventures with foreign firms; field grade military and police officers; leading religious figures, academics, and scientists; large landowners; heads of families of next-to-top social standing.

Upper-Middle Class: senior government clerks; ordinary college-educated professionals; medium-scale businessmen; company-grade military and police officers; well-to-do master craftsmen.

25X1

Lower-Middle Class: low-paid public and private white-collar workers with secondary education; small-scale businessmen; skilled craftsmen and technicians, including operators of complex industrial, agricultural, and transport equipment; village headmen; small landowners; non-commissioned officers in military and police.

Upper-Lower Class: unskilled manual workers in industry and transport; propertyless workers in agriculture; street vendors and entertainers; porters, draymen, and runners; domestic servants; military and police recruits.

Lower-Lower Class: the lumpenproletariat of surplus slum dwellers; landless underemployed villagers; petty criminals; the destitute and the outcast.

Note: This listing assumes that families derive their socioeconomic status from the position of the senior male. The listing is impressionistic, tentative, and subject to modification by better informed observers.

[End of Box D]

25X1

Section V

THREE ALTERNATIVE ECONOMIC SCENARIOS, 1988-2000

This section discusses three alternative economic scenarios for Egypt in the 13-year period 1988-2000. The discussion does not go into the details of Egypt's major economic problems or prospects for individual economic sectors, which previous sections have addressed. Table 1 in the summary provides a quick overview of the three scenarios.

A. The Middle-of-the-Road Coping Scenario

The centrist coping scenario reflects the traditions and temperament of the Egyptian people, both rulers and ruled, which have given this nation-state the ability to absorb changes and challenges, sidestep conflict, and adapt to adversity. These characteristics have generated today's stabilizing tendencies of interwoven vested interest groups, proven adjustment mechanisms, and strong balancing forces:

--vested interests: the military; the bureaucracy (hierarchical, overstaffed, slow-moving); the well-heeled upper business community of private capitalists, merchants, industrialists, and

25X1

intermediaries; the skilled managerial and technical people active in both public and private enterprises; the prosperous farmers/landholders; and the centrist religious leaders, professors, and editors.

--adjustment mechanisms: the social contract under which a strong central government retains its mandate so long as it compels obedience and takes care of the minimum needs of the ruled; the bargaining and back-scratching among organizations and individuals; the safety valves of emigration and expatriate jobs; and the existence of alternative economic choices offered by official, private, black, and international markets.

--balancing forces, which keep activity close to the middle: the ability to defer payments and to live off capital and credit until the storm passes; the existence of private social traditions to this effect, most notably the extended family, the village, and the religious community; the build-up of welfare supports since 1952; and the availability of aid from the United States, fellow Arab countries, and the IMF and World Bank in time of emergency.

25X1

On the economic front, unusually stable growing conditions in agriculture presage a fairly constant growth rate of 2 percent; this rate could be much higher if reforms were forthcoming in the agricultural price structure. Industrial and construction activity depends on a wide variety of enterprises, products, and markets, some of which will prosper and some fail, with most continuing to struggle along. The reforms advocated by foreign economists (presented in Box C) likewise will appear in piecemeal fashion but the government will not sacrifice existing political stability for anticipated economic efficiency. Mubarak's success in ending Egypt's ostracism in the Arab world, without disturbing the alliance with the United States or the cold peace with Israel, adds to the centrist atmosphere.

The Mubarak regime thus has been able to hold the country together, i.e., contain the religious militants, play even-handedly among the superpowers and neighboring states, and obtain a little economic breathing room through the IMF agreement of May 1987. With an exhausted treasury and the array of problems described in Section IV, the president has small prospect under this coping scenario to sponsor perceptible gains in Egypt's per capita output and productive facilities. Population growth and minimum repairs to the infrastructure will eat up the 3-percent growth expected from the economy.

This scenario implies piecemeal success in carrying out economic reforms, perhaps in the following pattern:

--considerable success in unifying exchange rates.

--partial success in reducing the subsidization of energy prices, encouraging the privatization of the economy, reducing the most onerous bureaucratic roadblocks to investment and production, and cutting the rate of inflation.

--little or no success in reducing the cost of food subsidies, adjusting the structure of agricultural prices, trimming the budget deficit, closing the foreign exchange gap, and stemming the tide of consumerism.

In an interesting alternative view, an Italian think-tanker has flatly rejected the centrist thesis of the present report:

> The Egyptian economy is on a razor edge...On the one hand, it might enter the [virtuous] circle characterized by high wages and growing investments and be in a position to exploit the country's great structural resources. On the other hand, it might fall into a vicious circle characterized by a rapidly growing population and become

too involved with its immediate problems to be able to devote sufficient resources and political energies for insuring its long term growth.

B. The Pessimistic Unraveling Scenario

The pessimistic unraveling scenario starts with the notion that the influx of Western goods, technology, and ideas--combined with a population explosion in an already overcrowded land--causes awkward dislocations in traditional patterns of family and social life. Individuals and groups face more challenges and uncertainties than they can comfortably handle. The government, operating through a corrupt and slothlike bureaucracy, appears less and less competent in honoring the social contract. While some individuals profit handsomely from opportunities for new deals, the great majority of people grow mutinous at the loss of income and status and at their increased psychological uncertainty.

The economy sputters along at 1 percent growth. Oil export earnings fall as the government's efforts to substitute gas fall behind schedule and as low domestic prices for oil-related products remain only one-fourth of international prices. Inflation edges up above 25 percent, and would-be investors shift into dollar assets and foreign business ventures. Workers return from overseas employment

25X1

and can find no jobs or jobs at only a fraction of their old pay. Interruptions in utility and transport services perceptibly worsen.

After the situation has deteriorated, say for two or three years, an injudicious act by a government official in a major city, or a harrangue to a market crowd by a religious zealot, or a final Khomeini triumph in his war with Iraq touches off major rioting. The situation unravels; the regime falls; and a newly energized group of military officers with fundamentalist leanings takes over. Then follows:

--an end to efforts to restructure the economy along Western lines.

--a chilling of the investment climate, affecting both local businessmen and foreign firms and bringing large new projects to a halt.

--a rekindling of hostility between Egypt and Israel.

--an upsurge of religious fundamentalism within Egypt, which spreads to other Arab countries.

--a reluctance on the part of the United States to continue the $2 billion annual subsidy.

25X1

--an opening of opportunities for Soviet initiatives in Egypt.

--a dilemma for the Egyptian armed forces, which cannot lightly discard many years of training on and integration of U.S. equipment.

This version of a downside scenario brings to front stage the Muslim fundamentalists, who call for a puritanic Islamic state purged of Western cultural and economic influences. Two other opposition groups that could contribute to an unraveling are: the Nasserites, who urge a return to Arabism, state socialism, and non-alignment, and the Marxist leftists, who advocate close ties with the USSR and a centrally planned economy.

Given the deterioriation of the domestic economy as sketched above, the economic reform programs would grind to a halt for lack of resources and government authority.

C. The Optimistic Momentum Scenario

The most likely starting point for the momentum scenario is some combination of greatly enhanced dollar revenues from remittances, oil, tourism, Suez canal fees, and foreign aid. This inflow of extra dollars, coupled with an end to the drought in the Nile headwaters, would immediately increase the economy's ability to

25X1

use its considerable idle capacity, modernize capacity in all sectors through stepped-up domestic and foreign investment, and accommodate an increasing number of the prescribed economic reforms. GNP growth under these conditions would spurt to perhaps 5 percent on average, and room would open between available resources and population to enable the regime to factor long-run elements into its economic moves.

The shape and durability of the economic advance under the momentum scenario would depend on the size and duration of the extra dollar inflow, the perception of investment risk in Egypt by foreign and local businessmen, and the regime's skill in dealing with success. Cairo would possess a unique opportunity to press ahead vigorously with, say, some priority projects for the refurbishment of infrastructure, or Cairo could fritter away the opportunity in, say, billion-dollar outlays for new military equipment and for ill-advised land reclamation projects. Egypt, admirably steeled in handling adversity, does not always deal so well with success. Accordingly, momentum may disappear early, and the economy may return to the coping centrist position.

D. <u>Percentage Chances of Each Scenario's Occurrence</u>

The discussion in this section suggests that the coping scenario is far and away the most likely of the three with perhaps a

25X1

75-percent chance. The unraveling scenario, at 15 percent, probably is more likely than the momentum scenario at 10 percent.

E. Relationship of the Scenarios to Egypt's Economic System

The coping scenario envisions a gradual modernization of the economy, with a continued slow shift to market determination of the "what, how, and for whom" of production. The unraveling scenario fits in with a move back away from privatization toward increased governmental and religious control over the allocation of resources. The momentum scenario employs the same general system of the coping scenario but with a greater tempo in the privatization, dollarization, and modernization of Egypt's economy.

Section VI

SIGNIFICANCE FOR THE UNITED STATES

This section examines the significance of likely Egyptian economic developments in 1988-2000 for the United States. It sketches the importance to U.S. policy of maintaining close ties with Egypt, the role of the large-scale U.S. aid program, and the necessity for negotiation, compromise, and more sober expectations on the part of both nations.

A. Prime Importance to the United States of a Friendly Egypt

The United States wants a stable, friendly, prosperous Egypt closely tied to the U.S. economically, as well as politically and militarily. The U.S. hopes Soviet influence will be minimal in the Mid-East in general and Egypt in particular. Related U.S. objectives are the maintenance of a secure oil supply to Western Europe and Japan and the preservation of Israel as a close, democratic ally at peace with Egypt.

For the Egyptian economy, the United States would like to see continued modernization, steady increases in living standards, and the further integration of Egypt in the international market system.

25X1

These bread-and-butter objectives parallel the objectives of Egypt's government and populace, with the exception of small minorities of fundamentalists who would sacrifice modernization in the Western mold for Islamic traditionalism and Marxists who would look to Moscow for political guidance and economic support.

While most Egyptians share these U.S. hopes for the betterment of their own economy, they remain hostile or indifferent to some of the broader U.S. objectives, e.g., the preservation of a strong Israel.

B. U.S. Annual Aid of $2 Billion as Focal Point

The United States stepped up its aid to Egypt as a reward and reinforcement for Sadat's bold peace initiative, beginning with his trip to Jerusalem in November 1977 and culminating in the signing of the Egyptian-Israeli peace treaty in March 1979. The two signatories together now receive more than half of U.S. aid disbursements. Annual U.S. aid currently amounts to:

Recipient	Military Aid	Economic Aid	Total
Egypt	$1.3 bil	$0.8 bil	$2.1 bil
Israel	$1.8 bil	$1.2 bil	$3.0 bil

Sadat, however, overpromised the Egyptian people a new era of peace and rising living standards. He shared to some extent the exaggerated Egyptian conception of the United States as a source of vast wealth, which Washington could readily tap to help Egypt surmount its economic problems.

A knowledgeable U.S. foreign service officer, in writing about the failure after 1979 to realize Sadat's "peace dividend," has this to say: "Unless a determined attempt [is] made to curb the expansion of the government bureaucracy, cut government subsidies, eliminate official corruption, and control the growth of Egypt's population, real economic progress [is] impossible." He goes on to note that the U.S. government cannot pry reforms out of the Egyptian government, and points out that, even if it could, large-scale reform would generate intolerable political unrest.

A second U.S. observer recently stated that the impact of U.S. aid will far fall short of its potential because of the political restriction on Cairo in embracing U.S. suggestions, the ineffectual "absorbing mechanism" represented by Egypt's bloated bureaucracy, the institutional constraints hobbling the U.S. "disbursing mechanism," and the magnitude of the task itself.

Continued U.S. support of the Egyptian economy at the $2 billion level thus will not produce an independent self-sustaining economy by the year 2000. Rather, U.S. aid will serve the less ambitious purpose of enabling the Egyptian economy to accommodate 19

25X1

million more people under essentially the same socioeconomic conditions that exist today. Specifically, U.S. aid will continue to help feed the people, rehabilitate important parts of the infrastructure, and support the moderate acquisition of modern weapons. This limited view of the impact of U.S. aid fits comfortably into the middle-of-the-road coping scenario of the previous section. As part of that scenario, the U.S. government can expect calls for emergency aid whenever other sources of foreign exchange falter.

C. Lowered Expectations, Negotiation, and Compromise

President Mubarak has cooled the dangerously inflated popular expectations created by Nasser under the banner of Arab socialism and by Sadat under the infitah policy and the accord with Israel. Furthermore, he has practically completed his task of restoring Egypt to the good graces of other Arab states, while maintaining friendly relations with the United States and the cold peace with Israel. Finally, he has broadened his options with cautious overtures to the USSR.

The Egyptian government and people now realize that U.S. aid is not a cure-all for their economic difficulties but that Egypt cannot do without the aid. To some extent, the Egyptians are forthcoming as a friendly ally and genuinely appreciate the aid. At

25X1

a deeper nationalistic level, the Egyptians dislike their dependence on the U.S., wish to have more control over the use of the aid, and resent their inability to influence U.S. policy toward Israel on their behalf. On the other side, the lessons of the Nasser and Sadat eras should have demonstrated to Washington that massive aid does not give the U.S. a vise grip on Egyptian policies even in the economic sphere. The longer aid continues, the more it becomes an on-going fact of life, i.e., it already has become a normal expectation for the Egyptians and an on-going overhead cost for the Americans. From a cynic's standpoint, the Egyptians are renting their political goodwill and their strategic location and may soon ask for a rise in the annual rent payment.

The future of U.S. aid flows to Egypt rests on the validity of major assumptions made for this report, especially continued peace with Israel, and on the outcome of negotiations between Egypt and the United States on the size, the mix, and the timing of the aid program. Even though Egypt has committed itself to a welfare state it can ill afford, the United States can only suggest and advise, not dictate. Mubarak and his successors must steer a course between jeopardizing the American aid connection and appearing to be lackeys of the U.S. government. Washington perhaps can find some comfort in the fact that most Egyptians find the dependency relationship with the United States far more palatable than one with the USSR.

25X1

D. Positive Effect on Private U.S. Economic Interests

U.S. economic ties to Egypt benefit private American business firms, in industry (including military industry), agriculture, mining, communications, transport, and science and technology. A few major joint ventures probably will come on stream over the next decade, further benefiting U.S. business.

25X1

Appendix A

EGYPT: NOTES ON GNP AND OTHER STATISTICS

A. Inadequacy of the Egyptian Statistical System

Egyptian statistics suffer badly from the paucity of data in most primary-level firms, incomplete collection of data, the tortuous routing and massaging of data in the bureaucratic maze, and the slow dissemination of final statistics. Moreover, the price structure contains so many subsidized consumer prices, artificial procurement prices, and gray market prices as to defy meaningful aggregation. Finally, and perhaps of most importance, the 15-25 percent inflation rate of recent years precludes the calculation of accurate real values from the pound values alone.

The bureaucrats responsible for drawing up the five-year plan lack adequate data for most planning purposes and in effect do little more than draw up a list of major investment projects for the next plan period. The plans for the various economic sectors are mutually inconsistent, calling for an aggregate level of investment resources several times the amount available in the economy. Box B, which summarizes the overambitious goals of the 1987-1992 five-year plan, provides illustrations of the unrealistic and uncoordinated nature of Egyptian economic planning.

25X1

ale government-owned enterprises, especially those in as of the economy, have comparatively good accounting sable data. Thus, foreign trade data accurately depicts ; that go through official channels.

: <u>Estimates of GNP in Table 3</u>

he Egyptian statistical authorities publish annual estimates (Gross Domestic Product, which counts national output on a aphical basis, as opposed to GNP, which counts national output ne basis of the nationality of the owners of the factors of duction involved); these estimates are in Egyptian pounds. ecause domestic prices in pounds have increased from 15 percent to 25 percent in recent years, the correction of "current pounds" to "constant pounds" requires major numerical adjustments. If honest men do not know the rate of inflation within a range of, say, 3 percentage points, they cannot distinguish real GNP growth of 2 percent from real growth of 4 percent; but the uncertainties in the inflation rate probably are more serious than 3 percentage points. Accordingly, a World Bank report may present in a table Cairo's official estimate of a sturdy 7-percent real growth while providing an accompanying text of economic difficulties that suggest a considerably lower actual growth rate of, say, 2 or 3 percent.

The GNP series in Table 3 does not purport to be the result of a study of basic statistical sources and individual economic sectors. Rather, the series comes from the piecing together of information on growth in scattered years, taken from secondary sources in English. The author of the present report designed the series to meet the following reasonable conditions:

(1) Per capita GNP in 1986-87 is 700 U.S. dollars, as estimated by the World Bank; other estimates vary widely, from about $500 on the low side to about $1,100 on the high side; most of these other estimates purport to be Gross Domestic Product (GDP) rather than GNP.

(2) Per capita GNP has doubled since the Free Officers revolution in 1952.

(3) GNP fell in the war years of 1956 and 1967.

(4) The highest rates of GNP growth came in the years after the 1973/74 oil price revolution.

(5) The year 1986 saw zero growth because of lower oil earnings, the plunge in tourism, and other economic setbacks.

(6) The rate forecasted for 1988-2000 (3 percent) should reflect the argument in the text about the high likelihood of a middle-of-the-road coping scenario for the economy.

C. The Estimates of Population in Table 3

In contrast to the rough-hewn GNP estimates, the estimates for population in Table 3 are close to the mark. These estimates came from the U.S. Bureau of the Census. Table 3 presents both the population and the GNP figures in more digits than are statistically significant in order to facilitate calculation of rates of change.

D. Other Estimates in the Report

Some of the other estimates in the report, such as Egypt's oil production, come from the dollarized international trade area and are accurate. Other figures such as the 3-5 percent growth rate forecast for industrial output in 1988-2000 are informed guesses.