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CIA Briefing Book on Egypt

for

Secretary Simon

and

Assistant Secretary Designate Parsky

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CONTENTS

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THE EGYPTIAN ECONOMY: CHARACTERISTICS AND RECENT PERFORMANCE

I. Background

Egypt is a country built out of two thin strands of water: the greatest, the Nile and its valley; the other the Suez Canal. The Nile was the cradle of Egyptian civilization and the only constant in its survival. Its waters support Egyptian agriculture which in turn provides the principal prop of the 36 million population in an area the size of Texas, and on a cultivated area more the size of Connecticut. That prop is devoted primarily to the production of export crops – particularly the finest extra-long-staple cotton – whose proceeds are used to purchase grain, capital equipment, and consumer goods. The valley's lavish production of rice, onions, and grain no longer feeds Egypt's burgeoning population, although agricultural exports (f.o.b.) still exceed agricultural imports (c.i.f.).

Industrial development in Egypt has been inextricably associated with its agriculture. Cotton provided the base for a textile industry, and the enormous need for fertilizer to sustain the multiple cropping in the valley was the spur for the development of the chemical industry. As the only Arab nation with a trained, skilled work force and with easy access to water transport, Egypt was the first Arab nation to develop a petroleum refining industry. Yet three generations after the beginning of industrialization, Egypt remains in a nascent industrial status, its early entrepreneurs dispersed by Nasirite socialism and its managers dulled by years of bureaucratic wrangling over investment allocation. It has added a budding iron and steel industry, expanded the capacity of established industry, and is beginning to expand into nonferrous metallurgy.

Egypt's initial foray into accelerated economic development under Nasir left it with an unmanageable foreign debt and a keen sense of frustration. Halted by financing difficulties in the early 1960s and by increasing pressure to secure a military solution to the Palestinian problem, Nasir subordinated Egyptian plans for economic growth to the more politically acceptable and the more easily financed military objective. Renewed acceleration of economic development, if financed in large part by foreign capital and directed in important measure by foreign entrepreneurs and managers, may expect greater success. The major new factors in the development equation are the huge amounts of Arab capital available to Egypt and the burgeoning Middle East market in which Cairo has always been an important vehicle.

Restoration of the Suez Canal will help Egyptian foreign exchange earnings. Its utility as a connecting waterway, however, has been drastically reduced with the growth in size of supertankers. Oil transit revenues, which provided the lion's share of income before the 1967 closure of the Canal, will be less in the future ($145 million per year) than they have been in the past (about $220 million in the last full year of operation). Nevertheless, the Canal remains an important Egyptian resource.

Egypt's other natural resources are small judged by those of its neighbors. Small discoveries of petroleum and natural gas have been developed and may be expected for the foreseeable future. They permit Egypt to be self-sufficient in energy and may even produce an exportable surplus should the Sinai fields be returned in the near future. Industrial growth at the rates projected by Sadat, however, will quickly develop a domestic market for such a surplus. There is limited prospect for expansion of the hydro-energy of the Nile. Indeed, much of the capacity of the Aswan facility cannot be exploited because of the seasonal character of the demand for irrigation water.

The overriding importance of the military establishment since the advent of the Israeli state has had profound economic impact. Although weapons have been obtained essentially without payments, the very magnitude of the modern weapons employed and their need for transport, set-up, training, and maintenance have imposed a large burden on the state. A Mideast solution that permits an early and sustained reduction in Egypt's military effort seems critical to orderly economic development.

II. The Nature of the Economy

The economy of the Arab Republic of Egypt is more advanced than that of any other Arab or African country, with the exception of South Africa. In ancient times the need to control the Nile imposed a high degree of economic organization and prompted an exceptional amount of technological innovation. Despite thousands of years of exploitation by a series of conquerors, the first stages of economic modernization occurred early in Egypt. As a result its economy is more diversified and more complex than that of its neighbors.

Agriculture has long been highly productive in Egypt, supporting a large number of people on a small amount of cultivable land. In the 19th century, when Egypt was still a part of the Ottoman empire, cotton culture and perennial irrigation of various crops were introduced in the Nile Delta. As control of the Nile increased, more water for summer irrigation became available. Double and triple cropping spread up the Nile. Other commercial crops -- rice, vegetables, and fruits -- were adopted, further divorcing agriculture from peasant subsistence. As commercial agriculture grew, elaborate crop rotation and extensive use of foreign commercial fertilizer became prevalent. Application of chemical fertilizer per acre in Egypt exceeds the rate in most other areas of the world. For decades, moreover, output per acre has compared favorably with that in many Western countries.

Modern industry also is not new. Industrialization was impeded until this century by the British administration's promotion of cotton culture and a trade program that included high duties on industrial raw materials and capital goods. Shortly before World War I, however, the first oil refinery in the Arab world was constructed at Suez. In the 1930s, little more than a decade after the British left, textile mills and other relatively large-scale manufacturing concerns began to appear. By 1958, the first steel mill in the northern part of the African continent opened at Hulwan.

Human resources are more highly developed in Egypt than in most developing nations. In the cities where the legacy of ancient Egyptian civilization persists, the upper and middle classes have always sought the best education available for their children. After the 1952 revolution, higher education was provided for hundreds of thousands of others in order to build a cadre for the military and the proposed new economic order. As a result of these policies, Egypt now represents a reserve of talent upon which the entire Middle East draws.

Despite a long headstart, Egypt remains a poor and far from modern state. With a GNP of about $8.5 billion and a population of 36 million, per capita income is less than $250 per year. Industrial development has been uneven, leaving the country with little capacity for producing capital equipment or for expanding industrial exports. Even after more than a decade of intensive effort at industrial development under the Nasir regime, agriculture still provides more than one-fourth of GNP and agricultural products account for more than half of export earnings. In rural areas, despite centuries of steady progress, output has barely kept pace

Production in Egypt

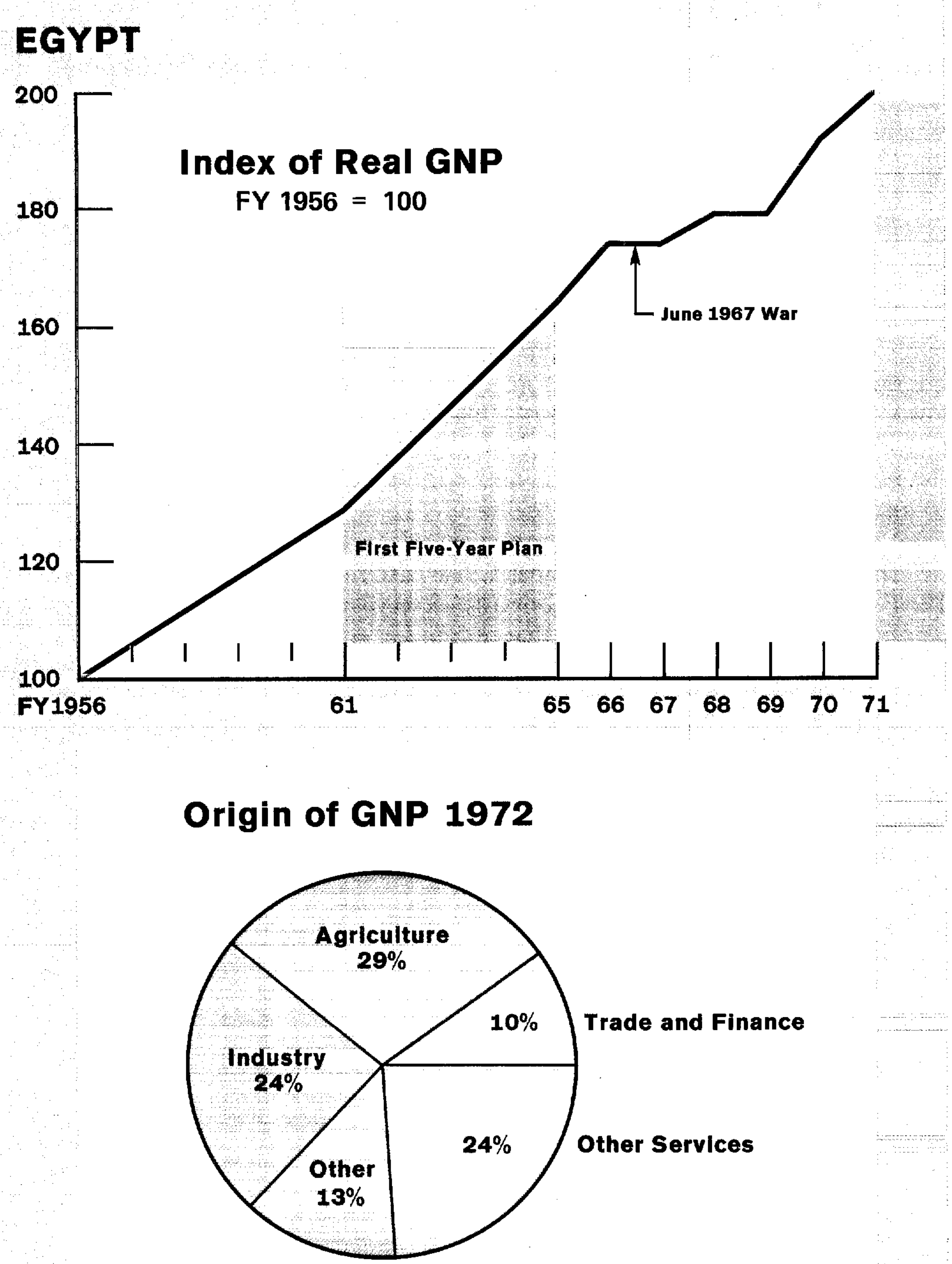
	1952	1971
	Thousand Tons[1]	
Major agricultural products		
Cotton (lint)	446	510
Vegetables	4,928	5,280
Fruits	894	1,685
Rice	517	2,681
Maize	1,506	2,342
Sugar cane	5,258	7,300
Major industrial products		
Iron and steel	78	431
Super phosphates	106	486
Nitrogen fertilizer	111	384 (FY)
Spinning and weaving	131	470
Portland cement	....	3,976
Generated electricity (million kwh)	992	7,995

1. Unless otherwise indicated.

with population growth, and incomes remain at or near the subsistence level. Industrial growth has failed altogether to keep abreast of urban migration and population growth. In the cities, massive unemployment has been avoided only by military recruitment, overstaffing in the state bureaucracy, and export of professional personnel and skilled workers to other Arab countries.

The Nasir government created today's economic institutions. Between 1952 and 1964 the government acquired all foreign-owned agricultural land and confiscated Egyptian holdings in excess of 100 acres. This land was then distributed to peasants and to landless agricultural laborers, firmly establishing the small farm as the dominant form of agricultural tenure and the small farmer as the principal recipient of rents in the agricultural sector.

Control of industry and finance was altered much more radically. A spate of nationalizations occurred in 1957, following the Suez crisis, in the course of which all property of British and French citizens was sequestered. During 1961-64, almost all other large industrial firms, all major banks, and most mining operations became wholly or preponderantly government-owned. By the end of the 1960s, less than 15% of all business firms were in private hands; private venture capital played a major role only in transportation, construction, and crude petroleum production. Almost all significant economic decisions were made by the central government. Even in the agricultural sector, government policy dominates private choice. Area planted, availability of water, and commodity prices, all are subject to government control.


EGYPT
Index of Real GNP
FY 1956 = 100
200
180
160
140
120
100
FY1956
61
65
66
67
68
69
70
71
First Five-Year Plan
June 1967 War
Origin of GNP 1972
Agriculture 29%
10%
Trade and Finance
Industry 24%
24%
Other Services
Other 13%

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Development and Growth

For a time the Nasir government succeeded in radically altering Egypt's economy. Output and industrial capacity grew rapidly from 1954 to 1965, largely because of the addition of new industries. Agricultural output increased more slowly. The favorable impact of land reform on individual incentives resulted in steadily rising productivity during most of the first decade under the Nasir government.

The economic growth achieved by the Nasir regime was accomplished with insufficient regard for the costs involved or for the country's ability to pay. Unable to borrow abroad any longer by 1967, the government lowered investment outlays and restricted imports. The impact of these adjustments fell most heavily on the industrial sector, where output dropped sharply. Because of the government's rigid internal pricing policies, output of many agricultural crops also was cut back. Much lower investment in infrastructure as the Aswan Dam neared completion caused a decline in construction activity. Rising Suez Canal revenues and other gains in the service sector barely offset declining output elsewhere. In FY 1967, GNP failed to rise and per capita incomes declined.

In 1970 the Sadat regime inherited a battered and depressed economy. The 1967 war and its aftermath had seriously exacerbated Egypt's economic problems, depriving the country of assets that produced some 7% of GNP. Cut off from Western credit, saddled with growing industrial obsolescence, beholden to the USSR for arms, and confronted with the constant threat of renewed hostilities, the new government was able to tackle only the most immediate economic problems. During the interwar period as a whole the Egyptian economy stood still, with real output in 1973 only slightly, if any, greater than it was in 1966.

III. Egyptian Internal Finance

Egyptian finance is dominated by the state. In most activities, including banking, the government is the sole owner, and all operations are subject to the constraints imposed by a cumbersome state budgetary process. While this system has stifled initiative and reduced managerial efficiency in general, it has greatly facilitated financial planning. For example, the government has been able to repress much of the inflationary impact of social welfare and deficit financing schemes simply by controlling both prices and import levels.

The State Budget

The present format of the Egyptian state budget reflects the monolithic nature of the present economic order. The Egyptians inherited a simple fiscal structure from their British administrators, with state investment confined to a few public utilities and little but administrative operations funded through the state budget. The budget since has been expanded and revised to accommodate the emergence of Egypt as a socialist state. Even local government entities have lost much of their fiscal role, becoming mainly collecting and disbursing agents for the central government.

The first major post-colonial revision in the format of the Egyptian state budget occurred in FY 1959. It incorporated an "enterprise budget" into the traditional administrative budget. The purpose of the change was to reflect the financial operations of state firms that had been nationalized or sequestered in the wake of the October 1956 Suez crisis. New state enterprises and other nationalized firms subsequently have been added to this budget, vastly increasing its size. As a consequence of this change the budget now includes on the expenditure side all salaries and other current outlays in the ministries and state firms, as well as all investment in state enterprises. Revenues now consist not only of tax and other ordinary receipts, but also of earnings of state firms. The most important recent innovation in state finance was the creation, after the June 1967 war, of an Emergency Fund. The fund was financed by oil-rich Arab states and was to be used to cover military and other expenditures related to hostilities with Israel. It also provided a convenient blind for other financial activities that the Egyptian government did not want to detail in the conventional budget presentation.

The Egyptian government has always been reluctant to reveal much about the implementation of the state budget. Until 1973 a substantial portion of the planned budget was published each year. It appeared, however, in a wide variety of inconsistent formats, many of which seemed almost designed to confuse. Actual expenditures have never been published. Only small bits have been released to the IMF and IBRD after long lags. In 1973, after changing from a fiscal (1 July - 30 June) year to a calendar year presentation, the Sadat regime announced that even the planned budget would no longer be published. This move probably was designed to avoid revelation of military outlays as well as to avoid too complete an account of Egypt's expenditures to its Arab benefactors. Now that financial pressures on Sadat have been reduced, more budgetary candor may be forthcoming.[1]

Banking System

The banking system consists primarily of government-owned institutions. At the time of the revolution, Egypt had a relatively modern banking system owned mostly by foreigners or wealthy Egyptians. The system then consisted of a *de facto* central bank and 27 commercial banks. Following the nationalization of the Suez Canal Company in 1956, foreign banks were "Egyptianized." The law initially required that all banks be transferred to Egyptian nationals or to public entities, but in 1961 the banks were taken over by the government. Until recently the proscription against foreign-owned banks was relaxed only to permit pan-Arab banks to operate in Egypt. Since the October war, however, the Sadat regime, as part of a general economic liberalization, has again opened the door to government-approved Western branch banks in Egypt. A preliminary agreement with Chase Manhattan Bank has already been reported.[2]

Money

The monetary unit of Egypt is the Egyptian pound (£E), made up of 100 piasters, each in turn divided into 10 units called milliemes. The official parity of the Egyptian pound has remained at US $2.872 since 1949, when it was devalued in line with the pound sterling. A *de facto* devaluation occurred in 1962, after which all official transactions took place at about $2.30 to the Egyptian pound. The buying rate was raised to $2.55 to the pound in 1973, effectively revaluing the pound for official transactions in spite of a contrary recommendation from the IMF.

In practice the official pound rate is only applied to Egyptian private citizens purchasing pounds with foreign exchange in Egypt. Almost all Egyptian commodities moving in foreign trade are either bartered or priced in dollars or pounds sterling and paid for in convertible currency. These foreign exchange receipts are made available to state entities to pay for imports. For internal accounting purposes, various exchange rates are used depending on the priority of the enterprise involved. For many years, both diplomats and tourists in Egypt have received preferential buying rates for pounds. The latest foreign exchange innovation is a plan to create a parallel free currency market available to foreign visitors. In this market, pounds could be acquired at the rate which they bring in such financial centers as Beirut where they bring only about half of the official rate.

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IV. Egyptian Foreign Trade

Egypt is heavily dependent on foreign trade[3] because of its severely restricted resource base. Most mineral resources essential to modern industry are lacking. In Egypt's almost rainless agricultural sector, both arable land and known water supply are fixed in the short to mid-term. These rigid constraints have inspired Egypt to concentrate increasingly on the production of high-value commercial crops to be exchanged on the international market for other agricultural commodities, industrial inputs, and consumer goods.

Despite considerable economic diversification over the years, Egypt's export trade remains dominated by extra-long-staple cotton, marketed both as fiber and as manufactured textiles. As the world's largest producer of long-staple cotton, Egypt exercises considerable control over prices. Since the mid-1950s this power has been enhanced by access to East European markets in which Egypt sells lower grades of this cotton regularly and dumps surplus supplies of the top grade cotton when demand in the West is weak. Egypt is also the world's third largest exporter of rice. Dehydrated onions and citrus are other important exports.

Because of the heavy dependence on outside sources for both consumer and producer goods, Egypt has only limited control over the volume of imports. Since most food for urban consumption is imported, population growth and urbanization have impinged relentlessly on the size of the import bill. Moreover, quickened economic growth will reinforce the upward surge in the volume of imports until capital and intermediate goods industries are more fully developed.

Reducing imports requires particularly difficult economic and political decisions. Any reduction in the quantity or quality of consumer goods imports causes immediate dissatisfaction in politically sensitive urban areas. On the other hand, restricting the flow of imported industrial inputs leads to urban recession. During foreign exchange crises in the past, the Egyptian government, after initially limiting luxury goods imports, generally has resorted to restrictions on investment, preferring to cope with eventual stagnation and obsolescence rather than to risk the immediate ire of the urban masses.

The geographic pattern of Egyptian foreign trade has fluctuated widely over the last two decades. Traditionally, Egypt traded almost exclusively with Western Europe, but under Nasir, barter trade with Eastern Europe and other LDCs became increasingly important. The growth in barter trade stemmed mainly from the availability of concessionary credits either in the form of long-term, low-interest loans from the USSR and Eastern Europe or in the form of sizable "swing balances" allowed under bilateral trade agreements. These markets also provided an outlet for Egyptian manufactured goods, surplus agricultural products, and other items that could not easily or profitably be traded in the West. The share of bilateral trade has begun to shrink recently, principally because high cotton prices in the West have inspired the Egyptians to divert shipments that previously would have been earmarked for the USSR.

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V. External Economic Relations

As a result of the excesses of the Nasir regime, Egypt has accumulated more than $1.5 billion in external economic debts. Because of this debt overhang, Cairo was for many years almost totally dependent on handouts of Arab aid to cover a current account deficit that exceeds half a billion dollars.

When the socialist government came to power in 1952, Egypt's external finances were in good order. Cotton exports and invisible earnings were adequate to finance imports. Foreign debt was minuscule and foreign exchange reserves amounted to almost $1 billion.

Egypt's external economic position changed rapidly under the socialist government. Nasir's decision to promote simultaneously long-term economic growth and a broad program of social welfare inflated demand for both capital and consumer goods imports. For a time the mounting import bill was financed by rising exports of agricultural products and by reduction of reserves. By the end of the 1950s, however, Egypt had begun to borrow heavily in the West and, to a somewhat lesser extent, in the East.

Implementation of the First Five-Year Plan (1960-65) greatly accelerated the pace of foreign borrowing. By 1962, external debt was almost $1 billion, compared with a GNP of less than $5 billion and annual export earnings (goods and services) of about $500 million. By 1965, interest payments alone were absorbing 25% of foreign exchange earnings.

Even before the Five-Year Plan was completed, it became clear that Egypt would be unable to service its mounting foreign debts. The favorable early impact of the land reform program began to fade, reducing agricultural export growth well below initial government expectations. Egypt's newer manufacturing industries, moreover, were failing to achieve savings in foreign exchange outlays. Because the Plan had not been designed and implemented carefully, unexpected gaps in industrial production had to be filled with imports. The new industries, heavily dependent on imported inputs, could amortize foreign exchange investment costs only at near-capacity production levels. A high level of output could not be maintained, however, because of the inefficiency of Egypt's state bureaucracy and the haphazard plan implementation that left newer industries dependent on an outmoded economic infrastructure.

As early as 1963, Egypt began to have difficulty meeting the short repayment schedules and high interest rates on its foreign commercial bank obligations. After a series of defaults, acceptable debt-consolidation and rollover agreements were concluded with most banks in December 1966, effectively transforming Egypt's overdue short-term obligations into medium-term indebtedness. By the time the Five-Year Plan was concluded in 1965, Egypt was already seeking relief from longer term obligations. Rollover agreements were concluded in 1966 with all major Western creditors except the United States. Of these agreements, only the French, which had allowed considerable additional debt accumulation, was honored. Egypt used the 1967 war with Israel as a pretext for new debt negotiations, most of which were not concluded until 1969 or 1970. The aftermath of these debt negotiations was a complete cessation of net capital inflow from the West. Moreover, the Aswan High Dam had been completed, and repayments to the Soviet Union almost certainly were as large or larger than greatly reduced aid drawings.

The 1967 war with Israel further restricted Egypt's financial options.[4] Closure of the Suez Canal, loss of the Sinai oilfields, and reduction in the tourist trade led to foreign exchange losses of more than $250 million annually. Annual subsidies from Saudi Arabia, Kuwait, and Libya, agreed to at Khartoum in October 1967, were provided to replace these losses. Egypt was thus placed at the mercy of its Arab neighbors at a time when it was already completely beholden to the USSR for arms. 25X1

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[redacted]

VI. Status of Egypt's Arms Acquisitions

Moscow has been the source of about 90% of Cairo's arms purchases. More than $3.1 billion worth of Soviet arms have been provided,[5] of which two-thirds have been delivered since the 1967 war, and $400 million since 6 October 1973.

Egyptians arms procurement since the 1967 war has centered around one primary objective – regaining the Sinai. Soviet refusal to supply advanced weapons systems that might challenge Israel's technological superiority led to Sadat's expulsion in 1972 of most Soviet military advisers and technicians and all Soviet combat units stationed in Egypt. Although Sadat's action reduced the Soviet presence, it did not end the flow of Soviet arms. The T-62 medium tank was provided in increasing numbers, and the BMP combat infantry vehicle and SU-17 and SU-20 fighter-bombers were introduced after the Soviet expulsion. Contracts covering the supply of the Scud surface-to-surface missile system and the MIG-23 Flogger swing-wing interceptor apparently also were concluded. The Soviet resupply effort begun in October 1973 accelerated Egyptian arms modernization as those units hardest hit in the fighting were reequipped with the most modern armored equipment and antitank weapons being exported by the USSR.

The Soviet arms supply relationship has weakened considerably in recent months. Since the disengagement agreement on the Egyptian front, Sadat has felt less of a need for dependence on the Soviets. In mid-April, following a deterioration in relations between Moscow and Cairo, the Soviets stopped arms deliveries and Sadat publicly announced a program to diversify Egypt's sources of arms. Cairo subsequently sent arms purchasing missions to Western Europe and expressed interest in obtaining Mirage and Jaguar aircraft, the Rapier surface-to-air missile system, and a wide range of support equipment ranging from trucks to electronics.

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Despite mutual antagonism, neither Sadat nor the Soviets want a total break in relations. Sadat needs Soviet arms and spare parts to maintain a credible military posture to bring about a final peace treaty. Moscow would like to protect its use of the port of Alexandria and needs a viable relationship with Egypt during the Geneva peace negotiations to check the ebb of its position in the Middle East.

By June, Soviet-Egyptian relations, at least on the surface, were beginning to improve, high-level Soviet-Egyptian meetings appeared to be in the wind, and the resumption of Soviet arms deliveries seemed a possibility. Sadat will continue to attempt to diversify his arms inventory by the introduction of sophisticated Western weapons systems, but this will require a long-range program over part of which he will of necessity be dependent on the Soviets. Moreover, diversification

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will depend on continued availability of Arab funding because cash payment or short-term credit almost certainly will be involved.

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VII. American Firms in Egypt

US firms are not and never have been heavily involved in the Egyptian economy. Before the 1952 revolution, French and British interests owned most of the financial and industrial assets in Egypt. Although little pre-revolutionary stigma is associated with US firms, entry into Egypt's highly socialized post-revolutionary economy has been difficult. US firms are represented by marketing offices in Egypt, established to sell such products as movies, cosmetics, and pharmaceuticals, commodities in great demand but in short domestic supply.[6] US oil companies who own most assets in the petroleum sector jointly with the Egyptian General Petroleum Corporation are an exception to this pattern. Thus far, US firms have invested more than $500 million in Egyptian oil production and marketing, and another $200 million in investments has been scheduled.

After the October war, interest in US firms soared because of the good press our diplomatic efforts received, Egyptian respect for US expertise, and the cost advantages offered by the devalued US dollar. Engineering contracts were awarded in quick succession to Bechtel Corporation (for the SUMED pipeline) and to Murphy Pacific Company (for clearing the Suez Canal). Discussions also were held with the Chase Manhattan Bank about establishing branches in Egypt and with Sheraton hotels about construction of new tourist facilities. This euphoria slowed abruptly in April 1974, when the Bechtel Corporation withdrew from the SUMED contract. Temporarily, at least, this action discouraged Egyptian authorities from offering other large contracts to US firms.

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VIII. Politics in Egypt: A New Atmosphere, New Burdens

The October 1973 war brought changes of revolutionary proportions to Egypt: changes in Egypt's image of itself as a leader among Arab countries and as a significant force among world nations; changes in President Sadat's image as a domestic and an Arab leader; and, most important, changes in Egypt's foreign and domestic policy orientations. The changes have been happy ones, evoking in the Egyptians a sense of pride that is both self-satisfying and absolutely necessary for the sustenance of the new policies Sadat is pursuing. The changes carry with them methods of operation that are unfamilar and in some cases unwelcome to the bureaucratic, administratively inflexible government apparatus that runs the country.

Political Change

Sadat was seldom taken seriously before the war, either by his own people, by other Arabs, or by the world at large -- something he never loses an opportunity to point out now that the situation has changed. He lived in Nasir's shadow, and his inability to match Nasir's flair or to reverse Nasir's defeats, despite persistent promises to do so, made him a subject for jokes even among those who had not been enamored of his predecessor.

The war has given Sadat proper title in his own right to the leadership of Egypt and of the Arab world. The Egyptians, whatever the facts of the military situation, believe they have won a military victory, and this has given Sadat a certain freedom to set policies for Egypt and for the Arabs that he could not have carried off before. Without the restored sense of self-respect the war brought with it, Sadat could not have pursued negotiations with Israel, could not have improved his ties with the United States, and could not have shifted his concentration from war to reconstruction.

Sadat believes that he has won for Egypt the right to be considered the political equal of other nations -- of the Israelis with whom he is negotiating, of the superpowers on whom he now looks as partners rather than as sponsors, and of the states that offer investment promises for Egypt's reconstruction program. This self-confidence is a new sensation for Sadat, and he is prepared to capitalize on it. He will gauge his relations with other states according to their readiness to deal with him on equal terms. He regards the investment market that Egypt offers -- to say nothing of the political benefits that cooperation with Egypt provides -- as a fair trade-off for assistance in the one area, economic and technical development, where he recognizes that Egypt still lags.

Sadat is not without opposition, and potentially serious opposition, from Arabs who believe that he has conceded too much to Israel and turned his back on the Arab "battleground" to concentrate on Egypt's narrow domestic interests. He also faces opposition, less serious but potentially disruptive, from Egyptians who

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fear that he is moving too fast toward the United States and is abandoning Egypt's economy and thus its political freedom to Western capitalists.

Sadat often admonishes the Egyptians to rid themselves of the "complexes" that have characterized and hindered Egyptian policy in the past. His admonitions are at once a sign of his own confidence in Egypt's ability to pursue its domestic and foreign policies on its own terms, and a recognition that others in Egypt do not share his self-confidence. To those who fear that closer ties with the United States will mean subservience to Washington, Sadat points out that Egypt must adapt itself to international changes, to detente in particular, and need no longer fear that good relations with either superpower signifies that Egypt is cast in the mold of client state for that superpower. In a similar vein, to those who fear that foreign investment will mean a return to foreign colonialist domination, Sadat emphasizes that he does not intend to give the economy over to foreign control despite Egypt's resort to external financing and to foreign technical expertise. Although not so directly stated, Sadat's admonitions apply as well to the fears of other Arabs that he is giving up the struggle with Israel too easily.

Flexibility and adaptability have become the cornerstones of Sadat's policy, domestic and foreign, since the war. Egypt's military and negotiating successes have enabled him to overcome his own "complexes" about dealing with Israel and about Egypt's ability to deal on equal terms with the rest of the world. His principal task at present is to overcome the rigidity and extremism that prevent other Arabs from following him readily.

Administrative Change

Sadat also faces administrative problems of a largely mechanical, yet complex nature. Egypt's government apparatus is an overstaffed, overly centralized bureaucracy with built-in inefficiencies and little experience in policy planning. It needs revamping before it can effectively pursue the tasks of reconstruction and domestic economic revitalization.

During most of the recent past, Egypt's foreign and domestic policies were formulated largely on an ***ad hoc***, almost haphazard basis. Sadat began to see the benefits of comprehensive foreign policy planning as he prepared for the war. The prospect of heavy foreign investment and large-scale development in the aftermath of the war has now forced him to consider the need for similar planning and more efficient implementation in the domestic sphere. Where planning and carrying out foreign policies is essentially a one-man show in Egypt, domestic policies depend to a large extent for their design, implementation, and acceptability on the collective will and on the efficiency of a massive bureaucracy.

Sadat recognizes the problems involved and has taken the first steps necessary to overcome them. He recently established specialized national councils to draw up long-range policies in the fields that most closely concern development and reconstruction; these include councils for production and economic affairs, public services and social development, and education and technology. Sadat and First Deputy Prime Minister Hijazi also envision streamlining the implementation process by delegating greater responsibility to lower levels of each ministry and at the same time reducing the proliferation of small, overlapping agencies.

Recognizing the administrative problems that plague the government and following through on corrective measures, however, are two very different things; and Sadat and Hijazi face an uphill battle. They must fight a cumbersone and well-entrenched bureaucracy that extends beyond the government to the state-owned corporations that will participate most directly in reconstruction programs. They must force change on a change-resistant apparatus; and the process, if it is ever to be accomplished, will require years.

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IX. Sadat's Economic Policies

Sadat's economic policies are directed toward the goal of maintaining an economic growth rate of 7% - 10% a year during the next decade. This would double GNP and provide a growth in per capita income of at least 4% a year. He hopes that his program of economic liberalization will be the driving force for this unprecedent growth by revitalizing Egypt's small private sector and by attracting foreign venture capital.

Sadat's program of economic liberalization was begun in 1971 when an omnibus foreign investment law was enacted that liberalized tax laws, provided investment guarantees, and eased most of the restrictions on business management and the movement of money. With the exception of the Arab International Bank little progress had been made in implementing the program before the October war. Egypt's cumbersome state bureaucracy had been slow to establish the necessary administrative machinery, but the most serious impediment was the constant sabre rattling by the Sadat regime which scared off most foreign capital.

The central mechanism of Sadat's liberalization program is the Free Zone concept. Free Zone status can be accorded to an area or to an organization, entitling it to all of the benefits of Egypt's revamped foreign investment code. Thus far a large tract in or near Alexandria has been designated a Free Zone area, and most of the reconstructed Suez Canal area is expected to become a Free Zone.

As Sadat's new policies are implemented, the state economic sector almost certainly will shrink. Initially, the Sadat regime attempted to create the new private sector by selling off unprofitable state firms, but this scheme was rejected by the assembly. The same objective may be accomplished indirectly. The new investment code entitles state firms to Free Zone status whenever a joint partnership is formed with a foreign investor. Most of the Egyptian General Petroleum Company is already entitled to escape state control by means of this provision, and other firms almost certainly will be eligible in the future.

X. Egypt's Economic Prospects

Egypt's economic prospects are greatly improved as a consequence of the October war. [redacted] 25X1 non-military aid from Arab sources [redacted] 25X1

25X1 [redacted] raised extraordinary receipts in 1973 to more than $850 million. Only a small amount of these funds was used to offset war-related damages and inconveniences, and none was spent for arms. The extra 1973 receipts have permitted Egypt to repay its most pressing foreign debts, greatly enhancing Cairo's credit rating, and will enable Egypt to finance its most urgent imports through mid-1975. The post-war disengagement will allow the Suez Canal to be reopened and the SUMED pipeline to be constructed as planned. For the next five years or so, revenues from these two sources alone should be ample to finance the normal increment in demand for consumer imports stemming from urbanization, rising per capita incomes, and population growth.

Over the longer term, Sadat's ambitious economic plans will produce sizable current account deficits.[7] Even a reasonably efficient investment program designed to achieve a 7%-10% per annum growth in GNP could entail a current account deficit of $500 million to $600 million annually over the next 6 years and a cumulative deficit of about $3 billion.

The magnitude of state borrowing that will be necessary over the next several years will depend on a number of uncertain factors. Revamping and expanding Egypt's old and inadequate economic infrastructure will require considerable state investment. The state will also need to relieve the most critical production bottlenecks created by irrational past investment policies. To forestall criticism of too rapid economic liberalization, the Sadat government will seek a sizable state equity in new industrial projects. In the event that the Sinai oilfields are regained, the prospective external deficit on state account could be partly offset by earnings from crude oil exports. Continuation of the annual $190 million Arab subsidies would enable the state to meet two-thirds of its prospective new public sector investment commitments without further foreign borrowing and without Sinai oil. Under no circumstances, however, would Egypt be able to retire a significant amount of external official debt until 1980 or later.

Prospects for financing the current account deficit appear to be good even if Arab subsidies are discontinued and assets on Sinai are not regained. At the present time, about $1.6 billion in foreign aid -- mostly from Iran, the IBRD, the United States, and Japan -- has been approved or is being seriously proposed. In addition, almost $3 billion in venture capital is being proffered, mainly from Arab sources. Together these amounts more than equal the cumulative deficit now being projected.

While sufficient foreign funds to finance economic development should be available, political and economic considerations could make it difficult for Egypt

25X1 [redacted]

to take full advantage of this opportunity. To gain access to private funds on a large scale, Egypt must open up its economy to private enterprise and substantially reduce bureaucratic controls. There will be strong resistance to such a change both from Egyptians with a socialist ideology and from vested interests. At the same time, there is strong opposition in Egypt to large-scale foreign ownership of Egyptian assets and an unwillingness to permit a high degree of Egyptian dependence on any single foreign country. The Sadat government for example, refused to permit Kuwait to acquire control of the SUMED pipeline. If necessary, Egypt will forgo considerable funds to prevent what it considers to be a danger of undue foreign influence.

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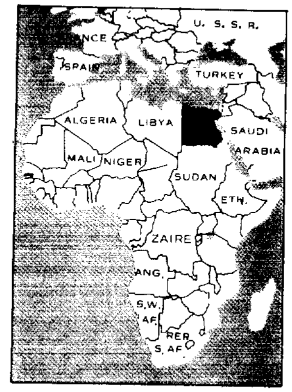
FACT SHEETS ON EGYPT



LAND:

386,200 sq. mi. (including 22,200 sq. mi. occupied by Israel); 2.8% cultivated (of which about 70% multiple cropped); 96.5% desert, waste, or urban; 0.7% inland water

Land boundaries: 1,570 mi. (1967), excludes occupied area 1,534 mi.

WATER:

Limits of territorial waters (claimed): 12 n. mi. (plus 6 n. mi. "necessary supervision zone")

Coastline: 2,140 mi. (1967), excludes occupied area 1,340 mi.

PEOPLE:

Population: 36,418,000, average annual growth rate 2.2% (7/70-7/72)

Ethnic divisions: 90% Eastern Hamitic stock; 10% Greek, Italian, Syro-Lebanese

Religion: (official estimate) 94% Muslim, 6% Copt and other

Language: Arabic official, English and French widely understood by educated classes

Literacy: around 40%

Labor force: 8 to 12 million; 45% to 50% agriculture, 10% industry, 10% trade and finance, 30% services and other; serious shortage of skilled labor

Organized labor: 1 to 3 million

GOVERNMENT:

Legal name: Arab Republic of Egypt

Type: republic; under presidential rule since June 1956

Capital: Cairo

Political subdivisions: 25 governorates

Legal system: based on English common law, Islamic law, and Napoleonic codes; permanent constitution written in 1971; judicial review of limited nature in Supreme Court, also in Council of State which oversees validity of administrative decisions; legal education at Cairo University; accepts compulsory ICJ jurisdiction, with reservations

Branches: executive power vested in President, who appoints cabinet; People's Assembly has little actual power (serves mainly for discussion and automatic approval); independent judiciary administered by Minister of Justice

Government leader: President Anwar Sadat

Suffrage: universal over age 18

Elections: elections to People's Assembly every 5 years (most recent October 1971); presidential elections every 6 years (next scheduled in 1976)

Political parties and leaders: political parties banned except for the government-sponsored sociopolitical grouping, Arab Socialist Union (ASU)

Communists: approximately 500, party members

Member of: AAPSO, Arab League, FAO, IAEA, IBRD, ICAO, IDA, IFC, IHB, ILO, IMCO, IMF, ITU, OAU, Seabeds Committee (observer), U.N., UNESCO, UPU, WHO, WMO, WPC

ECONOMY:

GNP: $8.5 billion (1973 est.), $240 per capita; slow decline in per capita income since 1970 (C)

Agriculture: main cash crop -- cotton; other crops -- rice, onions, beans, wheat, corn, barley; not self-sufficient in food, but agriculture a net earner of foreign exchange

Major industries: textiles, food processing, chemicals, petroleum, construction, cement

Electric power: 4,555,000 kw. capacity (1972); 8 billion kw.-hr. produced (1972), 230 kw.-hr. per capita

Exports: $839 million (f.o.b., FY72); raw cotton, cotton yarn and fabric, rice; also crude petroleum, onions, potatoes, chemicals, cement (C)

Imports: $1,279 million (c.i.f., FY72); foodstuffs, machinery and equipment, fertilizers, woods (C)

Major trade partners: EC countries, U.S.S.R., and other Communist countries (C)

Aid:
economic -- Communist countries, $2.1 billion in credits through 1973; U.S., $1,017 million in credits and grants through FY72 (diplomatic relations and aid suspended June 1967); sizable credits from international agencies, West Germany, Italy; large grants from Libya since 1969; $250 million annual subsidy from Arab states while canal is closed;
military -- Communist countries, about $3.5 billion through 1973

Monetary conversion rate: 1 Egyptian pound=US$2.54 (selling rate); 0.394 Egyptian pound=US$1 (selling rate)

Fiscal year: calendar year, beginning in 1973

COMMUNICATIONS:

Railroads: 3,358 mi.; 570 mi. double track; 15 mi. electrified; 2,976 mi. 4'8 1/2" gage, 156 mi. 3'3 3/8" gage, 226 mi. 2'5 1/2" gage

Highways: 29,000 mi.; 5,190 mi. paved, 7,130 mi. gravel, crushed stone, and improved earth, 16,680 mi. unimproved earth, additional 1,150 mi. (mostly paved) in territory (Sinai) occupied by Israel

Inland waterways: 2,100 mi.; Suez Canal, 100 mi. long, temporarily closed to navigation because of sunken vessels; normally used by ocean-going vessels drawing up to 38 ft. of water; Alexandria-Cairo waterway navigable by barges of 500-ton capacity; Nile and large canals by barges of 420-ton capacity; Ismailia Canal by barges of 200- to 300-ton capacity; secondary canals by sailing craft of 10- to 70-ton capacity

Freight carried: Suez Canal (1966) -- 242 million tons of which 175.6 million tons were POL

Pipelines: crude oil, 185 mi.; refined products, 390 mi.; natural gas, 30 mi.

Ports: 3 major, 8 minor

Merchant marine: 45 ships (1,000 GRT or over) totaling 208,400 GRT, 275,500 DWT; includes 5 passenger, 32 cargo, 8 tanker (C)

Civil air: 16 major transport aircraft

Airfields: 159 total, 79 usable; 69 with permanent-surface runways; 42 with runways 8,000-11,999 ft., 21 with runways 4,000-7,999 ft.; 2 seaplane stations

Telecommunications: second best system of coaxial and multiconductor cables, open-wire lines, and radio communication stations in Africa; principal centers Alexandria and Cairo, secondary centers Al Mansurah, Ismailia, and Tanta; 365,000 telephones; 5.1 million radio and 600,000 TV receivers; 12 AM, 1 FM, and 26 TV stations

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Egypt: Value and Distribution of Total Imports, by SITC Categories, 1971

	Total	Food and Live Animals	Beverages and Tobacco	Crude Material (Except Fuels)	Mineral Fuels, Lubricants, and Related Materials	Animal and Vegetable Fats and Oils	Chemicals	Manu-factured Goods	Machinery	Trans-portation Equip-ment	Miscel-laneous Manu-factured Goods	Commod-ities n.e.s.
		0	1	2	3	4	5	6	71 & 72	73	8	9
	Million US $											
Value	1,140	198	23	64	78	53	117	152	354		14	87
	Percent											
Distribution	100	17	2	6	7	5	10	13	29		1	8
United States	6	....[1]	....	....	....	3	1	....	1	....	....	....
Canada	1	1		....			....	....	....	....		....
Japan	1	....		....			....	1	....	1	....	....
United Kingdom	4	....	....	....	....	....	1	1	2	3	....	
West Germany	9	1		....	....	....	1	1	3	....	....	....
France	6	3	....	....	....	....	1	1	....	1	....	....
Italy	5	2		....	1		1	....	....	....	....	
Other Western Europe[2]	8	1	....	....	....	....	2	1	3	....	....	....
Soviet Union	33	....		2	4	1	....	3	10	5	....	7
Other	27	10	2	3	1	1	3	5	2		....	....

1. A leader entry (....) indicates a negligible amount of imports.
2. Excluding data for Greece, Ireland, Portugal, and Turkey.

Egypt: Value of Significant Imports from the United States and the West, 1971[1]

Million US $

SITC Categories	Commodities	Imports From (1) United States	(2) United States, Canada, Japan, France, United Kingdom, Italy, West Germany	(3) Column 2 + Other Western Europe
041	Wheat		2.1	2.6
044	Corn	2.3	2.3	2.3
046	Wheat flour	....[2]	53.1	54.3
048	Cereal preparations	0.5	0.5	0.6
081	Animal foods	1.3	1.4	1.7
121	Tobacco	1.0	1.1	1.1
122	Tobacco manufactures	0.8	1.0	1.0
332	Petroleum products	0.6	16.7	19.5
411	Animal oils and fats	11.0	11.4	11.6
421	Vegetable oils and fats	18.5	18.9	19.5
561	Manufactured fertilizers	....	3.5	3.7
599	Chemical materials, n.e.s.	1.4	10.1	26.1
	Of which:			
599.2	Pesticides	0.1	4.5	N.A.
678	Iron and steel tubes and pipes	0.5	6.2	6.4
	Of which:			
678.2	Seamless steel tubing	0.3	4.0	N.A.
711	Non-electrical power generating machinery	1.6	9.1	13.2
717	Textile and leather machinery	0.2	6.6	11.3
719	Non-electric machinery, n.e.s.	4.5	24.9	29.0
	Of which:			
719.2	Pumps and centrifuges	1.9	8.6	N.A.
724	Telecommunications apparatus	0.3	6.9	12.9
732	Road vehicles	1.4	47.5	48.3
	Of which:			
732.1	Passenger vehicles (non-bus)	0.1	10.4	N.A.
732.3	Trucks	0.2	18.3	N.A.
732.8	Bodies, frames, and other vehicle parts	0.6	16.7	N.A.
734	Aircraft	1.4	3.2	3.4
	Of which:			
734.9	Aircraft parts	1.4	3.2	N.A.

1. No total or data for "all other suppliers" can be derived, because the other trading partners of the Arab states do not publish trade data at this level of detail.
2. A leader entry (....) indicates a negligible amount of imports.

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Egypt: Balance of Payments[1]

Million US $

	FY 67[2]	FY 68[2]	FY 69[2]	FY 70[2]	FY 71[2]	FY 72[2]
A. Merchandise						
Exports, f.o.b.	607	583	707	800	823	839
Imports, c.i.f.	-953	-890	-883	-1,088	-1,221	-1,279
Trade balance	-346	-307	-176	-288	-398	-440
B. Services						
Receipts	402	134	154	171	171	195
Suez Canal dues	219	....	....	....	....	....
Other services	183	134	154	171	171	195
Payments	-239	-184	-214	-252	-262	-281
Total (net)	164	-49	-59	-81	-91	-86
C. Unrequited transfers (net)	69	192	288	320	272	281
D. Balance on current account (A + B + C)	-113	-164	52	-49	-216	-244
E. Nonmonetary capital						
Drawings on medium- and long-term loans	230	128	176	249	349	400
Repayments on medium- and long-term loans	-126	-134	-244	-267	-331	-282
Other capital (net)	54	55	34	61	-14	29
Total	158	48	-33	43	4	147
F. Net errors and omissions	6	-8	7	-6	-25	16
G. Total (D + E + F)	51	-124	26	-12	-237	-81
H. Allocation of SDRs	....	....	....	25	20	22
I. Total (G + H)	51	-124	26	13	-217	-59
J. Monetary movements						
Foreign exchange (increase -)	-121	80	-6	16	159	54
Payments agreements	22	29	-2	-17	59	2
Other	60	5	3	4	-1	3
Total[3]	-51	124	-26	-13	217	59

1. Converted throughout at the rate of £E 1 = US $2.30.
2. Ending 31 June of designated year.
3. Negative entry denotes a balance-of-payments surplus, a positive entry a deficit.

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COMMUNIST MILITARY AID TO EGYPT

Million US $

	Extended			Drawn		
	Total	USSR	Eastern Europe	Total	USSR	Eastern Europe
Total	**3,531**	**3,135**	**396**	**3,516**	**3,120**	**396**
1956-66	1,439	1,160	279	1,315	1,045	270
1967	200	175	25	175	170	5
1968	100	100	....	115	100	15
1969	87	50	37	102	90	12
1970	657	650	7	677	640	37
1971	415	400	15	361	350	11
1972	170	150	20	283	250	33
1973	463	450	13	463	450	13
1974	....	....	....	25	25	....

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Economic Activity