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Program Paper

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54

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EC/O/69 - 137

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December 30, 1969

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U.A.R.: Country Program Paper

1. Attached is the draft Country Program Paper on the U.A.R. from the Europe, Middle East and North Africa Department (EC/O/69-137/1, dated December 30, 1969).
2. This paper will be discussed at the Economic Committee meeting scheduled for Wednesday, January 7, 1970, at 3:00 p.m. in the Board Room.

C. F. Owen

Attachment

Distribution

Members of the Economic Committee
Director, Deputy Director, Chief Division B, Area Department
Deputy Director, Projects
Directors, Projects Departments
Programming and Budgeting
Executive Vice President, IFC
Director, Department of Investments, Africa, Asia and
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EC/O/69 - 137/1
December 30, 1969

DRAFT

CONFIDENTIAL

COUNTRY PROGRAM PAPER

Europe, Middle East and North Africa Department

UNITED ARAB REPUBLIC

1969 Population (in millions)	32.5	<u>Bank/IDA Lending</u>		
1967 per capita GNP at factor cost (current prices)	\$ 160	<u>US\$ million</u>		
Current Population growth rate	2.5% p.a.	<u>1964-68</u>	<u>1969-73</u>	<u>1971-75</u>
Current Exchange Rate	LE 1 = \$ 2.30			
		Bank/	-	-
		IDA	-	174
		Total	-	174
		IDA		
		Credits		
		per capita -	3.9	5.4

Introduction

1. The work of the Bank in the U.A.R. has been characterized so far by a striking discrepancy between efforts and results. With the exception of the 1959 loan for the Suez Canal, which was connected with the Bank's other involvements relating to the Canal in the late 1950's, none of the repeated attempts to start lending operations reached an advanced stage until recently. In the early 1960's, unsolved problems of compensation for nationalized properties and later on the U.A.R.'s problems with creditor countries and the IMF prevented the Bank Group from lending to the U.A.R. The June 1967 war caused a further delay in establishing an active relationship. On the Egyptian side the memory of Aswan is still fresh and constitutes an element of doubt about the willingness of the Bank Group to contribute to Egyptian development. The Delta Drainage Project which is the result of concentrated efforts on both sides since late 1967 is at present held in abeyance pending positive developments in the rescheduling of the U.A.R. debt to the U.S. This paper is prepared on the assumption that it will be possible to start operations in the reasonably near future. The most important general conditions for continued operations are, first, the conclusion of the debt negotiations with the U.S., second, policies in the U.A.R. which at least maintain the present economic situation and prevent any deterioration and, third, sufficient stability in the Middle East as not to frustrate the realization of the benefits the Bank/IDA program is designed to achieve.

2. A November visit to Egypt to study recent economic developments and collect new data was cancelled in view of the uncertainty about the timing of the Board action on the Delta Drainage Project. Therefore, this paper is based essentially on the findings of the January 1969 economic mission which were reflected in the previous CPP dated April 2, 1969 and the Economic Report (EMA 10a) dated August 18, 1969. In the description of recent developments statistical information brought back by the recent IMF mission was used.

General Background

3. The uncertainties concerning the immediate future in the U.A.R. have continued during 1969. The relative quiet which existed during most of 1968 along the cease-fire line was replaced by continuous clashes. Major problems directly affecting economic life were the financial consequences of the continued closure of the Suez Canal (largely offset, however, by Arab assistance¹), the loss of the Sinai area with its oilfields and the increased border tensions.

4. Partly due to these large uncertainties, Egypt still does not have an economic plan which might be used as an indication of the economic objectives of the Government. The First Five-Year Plan (1960-1965) was to be followed by a Seven-Year Plan (July 1965 to June 1972). This plan was discarded because planned investments were found to be larger than could be financed. Instead, an Accomplishment Plan was drawn up for three years starting July 1967 but was also impossible to implement because of the June war. As a result annual programs were prepared. Recent information, however, indicates that a "Third Development Plan", which will cover the period from 1970/71 to 1974/75, is nearly ready. We expect that the economic mission scheduled for May 1970 will have an opportunity to study and evaluate this plan.

5. The internal political situation in the U.A.R. has continued unchanged with President Nasser's popularity showing some fluctuations but essentially remaining intact. On the whole, the Government seemed to be more in control of internal political developments in 1969 than in the preceding year. Whereas in 1968 there were for the first time since the founding of the Republic in 1952 some signs of open dissent (e.g. student demonstrations, clashes between workers and police in Helwan), the internal political situation was quiet in 1969. The major political events of the year were the reactivation of the Arab Socialist Union, the official and only political party

¹ This assistance includes receipts of \$98 million from Saudi Arabia, \$94 million from Kuwait and \$59 million from Libya.

organization, and the reconvening of the National Assembly after elections. In the course of these developments President Nasser's one-time heir apparent, Ali Sabri, generally considered pro-Eastern, lost his position and much of his prestige. More recently Anwar Sadat, known as a left of center politician, was appointed as a Vice-President. The significance of these changes for U.A.R. policies is not clear, but the fact of a smooth change at a high level of political leadership has some importance in itself. On the international scene, there are many indications that the once predominant role of the U.A.R. and President Nasser in the Arab world has diminished, although his image of leadership has been preserved to a surprising degree by his quick reactions to new situations created by more radical leaders emerging in other Arab countries. This situation implies the possibility of sudden shifts in policy, and this will probably be one of the main characteristics of political developments in the near future. It is difficult to speculate confidently about the future but it is safe to say that President Nasser still represents one of the least radical alternatives among the existing power groups in Egypt.

6. For many years the political situation has had a pronounced effect on economic developments in the U.A.R., for example on the amount of military expenditures and consequently on the resources available for investment and other development expenditures. Military expenditures in Egypt have already reached very high levels. Important balance of payments factors are also politically sensitive. Among the major ones are the earnings from the Suez Canal and tourism, and the assistance from the richer Arab countries. To these must be added for the future the rate of utilization of the prospective Suez-Alexandria pipeline and the marketing of the increasing oil production.

A. Country Objectives

7. The U.A.R. Government has committed itself to establishing a form of socialism. But what is referred to as "Arab socialism" is not a clearly defined concept. This and the fact that we have yet to see the new development plan makes it difficult to identify and quantify the country objectives. In the present political situation military considerations seem to have an overriding importance. Although largely assisted by other Arab countries, continued increases in defense expenditure show that substantial resources are being diverted away from economic development.

8. Egypt is a country with a serious population problem. The annual rate of population increase is 2.5 percent. There is overall only 0.078 of a hectare of arable land per person as compared with 0.6 hectares in the

United States and 0.5 hectares in Turkey and Yugoslavia. Even the ratio of 0.138 hectares per person in the rural areas is considerably below the figures for the whole population in the United States, Turkey and Yugoslavia. There is also a high level of unemployment. The 1968 estimate was 1 million or about 13 percent of the work force. Population pressure is therefore a basic factor to be taken into account in any long-term planning, and the formulation and implementation of an effective population policy is thus of utmost importance. Several government announcements and the establishment of a population program are signs of recognition of the problem but it has not yet been attacked forcefully. In view of the limited availability of land, policies will have to be geared on the one hand to creating new employment possibilities in sectors other than agriculture and on the other hand to increasing yields per acre, particularly by improving drainage conditions and by reclaiming new lands. Although average yields in Egypt are among the highest in the world, wide variations in different districts show that there is scope for improvement. The present policy of the government of emphasizing capital intensive heavy industries is not entirely consistent with the need to create additional employment.

9. In establishing and realizing development objectives, the role assigned to industry and industrial development strategy will be a central factor. Industry has played a leading role in the development strategy in the U.A.R. since 1957 when the first industrialization plan was launched. The U.A.R. has already developed a relatively diversified industry, which provided about 22 percent of GDP at factor cost and compared with an agricultural contribution of about 30 percent in 1967/68. The composition of industrial investment in the next few years will largely be determined by the need to complete already-started projects (e.g. the Helwan steel mill), excess electric power capacity, and the sources of external financing available. The objective in the medium term will have to be a reorganization of the sector to increase the efficiency of existing production capacity. The reorganization of industry, which is largely controlled by the public sector, has been under discussion for some time. The immediate need is to decide on a course of action and to implement it.

10. During the last three years the Government has made some efforts to improve the balance of payments situation but during this period the net inflow of capital (apart from the Arab assistance) has been limited and its terms have been hard. The establishment of external economic relations which will result in larger amounts of capital inflow on softer terms is an important country objective. Apart from political factors, the amount of economic assistance the U.A.R. will be able to get from the Eastern European countries will probably be delimited by the composition and the size of the bilateral trade agreements entered into as related to the U.A.R.'s investment

needs. The U.A.R. can sell a large part of its produce for hard currencies and the first question will be how much of this she is prepared to sell to the Eastern bloc instead. Furthermore, the investment goods which the Eastern bloc is prepared to export to Egypt (steel mills, for example) may fit the U.A.R.'s needs to only a limited extent. The failure during 1967/68 and 1968/69 to increase Eastern assistance even when credits from the Western countries were at their lowest levels may be interpreted as a sign that the limits are narrow. Egypt has tried to improve the availability of credits from the Western sources by a series of rescheduling operations, but while these arrangements have served to re-establish her credit, they have so far only increased the outflow of capital and the accumulation of medium term debt.

Medium-Term (1975) Macro Economic Prospects

11. The U.A.R. economy has been going through a process of readjustment since the June 1967 war which will have a bearing on medium-term prospects. The economic slowdown which started in 1965/66 continued until 1967/68. Per capita income in constant terms declined between 2 to 3 percent per annum in 1966/67 and 1967/68. There were, however, some positive developments during this period, particularly improvements in the management of public finance and the balance of payments. A substantial improvement in the fiscal situation of the Government occurred in 1966/67. Both the current account deficit and the overall budget deficit were substantially reduced. In 1967/68 the current account deficit of the central government was kept at the same level as in the previous year, but savings of enterprises declined to a greater extent than that accounted for by the closing of the Suez Canal. This, together with a decline in foreign credits and the curtailment of borrowing from the Central Bank, resulted in a substantial cut in public investment which fell below the 1962 level, which was already low.

12. In 1968/69 the economy started to show an upward turn. Despite a continued increase in military expenditures, investments were increased and some additional measures were taken to reactivate the economy. Although national accounts estimates are not yet available, the picture one can derive from partial indicators shows that GDP in constant terms has increased somewhat more than the increase in population.

13. After the June 1967 war there was an improvement in the balance of payments. This has been the result of a number of interrelated developments including a reduction of imports (basically investment goods and to some extent intermediary goods), improvements in the allocation of available foreign exchange, an increase in exports (especially non-traditional items) and a more responsible attitude towards payments on external credits.

The balance of current accounts and transfers had a surplus of LE 22.8 million in 1968/69. This compares with deficits of LE 49.2 and LE 71.3 million in the previous two years. The remarkable increase in petroleum production is only taking place in the current fiscal year and did not play a significant role in this improvement. Increases in export revenues other than oil and a partial recovery of tourist trade (together about LE 60 million higher than the previous year) were important factors in the recovery which was also helped by a larger transfer of Arab assistance (about LE 40 million higher than the previous year, mainly because payments covered a full fiscal year for the first time).

14. In 1970, the high debt service payments and rising import requirements resulting from increased investments may cause an overall balance of payments deficit despite rapidly increasing oil revenues and a larger cotton crop this year. This may explain why the U.A.R. Government has approached the Fund for a stand-by agreement. (At the beginning of December 1969 the Fund's holdings of Egyptian Pounds excluding the compensatory financing were within the first credit tranche). During the previous Fund operation in early 1968 there was an agreement in principle between the Fund and the U.A.R. Government that any subsequent Fund operation would be preceded by an exchange rate adjustment.

15. In the light of the existing uncertainties no reliable projections of medium-term prospects can be made. The purpose of projections in this paper is therefore merely to point to the weaknesses in the economy and to illustrate the prospects under some simple assumptions. Attachment 2 has been updated regarding the past figures but the projections are reproduced unchanged from the Country Program Paper of April 1969.

16. Egyptian newspapers recently reported an investment program between LE 2.2 and LE 2.7 billion for the five-year plan period. These magnitudes are in line with the amount of investments (LE 2.35 billion for the same period) considered feasible in the last Economic Report which projected a GDP growth rate of 6.5 percent. However, the ability to increase investment and other expenditure necessary for a better utilization of productive capacity will be greatly affected by the level of defense expenditures. Tax revenues and other government revenues are already relatively high. There are no large untapped sources of taxable income or wealth. In addition to their natural increase, tax revenues may be increased somewhat by adjustments in agricultural taxation and improved tax collection from public enterprises. As a consequence, an increase in public savings will depend primarily on the share of funds allocated to military expenditures and on the creation of larger surpluses by public enterprises.

Macro Economic Prospects (Bank Projections)

	<u>Unit</u>	<u>1967/68</u>	<u>1974/75</u>	
			<u>Absolute</u>	<u>Annual Growth Rate</u> 1970/71-1974/75
GNP at factor cost (1964/65 prices)	US\$ m.	4,850	7,080	6.5
Population	Million	32.1	37.8	2.5
GNP per capita (1964/65 prices)	US\$ m.	151	187	4.0
Gross Investment	US\$ m.	678	1,254	8.0
Total Foreign Exchange receipts (including Arab Assistance)	US\$ m.	901	1,463	5.3
Net capital inflow	US\$ m.	164	205.0	
Debt service ratio	%	19.5	23.0	

17. In our projections, defense expenditures were assumed to increase at the same rate as current expenditures of the Central Government, i.e. 6.5 percent. In 1969/70 the budget increase in current expenditure was about 6 percent, while the portion of the defense expenditures shown in the budget increased by about 7% (LE 12.6 million) in 1969/70. It is to be noted, however, that there is another substantial portion of defense expenditures which is supported by an Emergency Fund financed by Arab assistance and some extraordinary revenues such as the defense tax. The increase in this Fund in 1969/70 was LE 42.5 million, bringing it to a total of LE 170 million. If one assumes that this increase was wholly for defense, which is by no means certain, then the rise in total defense expenditures would have been about 20 percent, bringing the total to about LE 335 million which is equivalent to about 12 percent of GDP. It is clear that this rate of increase cannot continue very long, and that the present rate of spending could not continue without major readjustments if the Arab assistance declined.

18. Regarding the balance of payments, the conservative assumptions used in the last economic report indicated that foreign exchange receipts could increase about 5.5 percent per annum with an increase in imports slightly less than 6 percent giving a resource gap of about LE 180 million over the period 1969/70-1974/75. Gross requirements could be much higher depending on the terms of borrowing.

B. Economic Sectors

a) Agriculture

19. Agriculture provides work for over half of those employed, more than a quarter of GNP and about four-fifths of exports. Farming methods are labor-intensive and the average unit of land is cropped about 1.6 times a year. Modern practices and inputs are in general use. Land reform has been virtually completed, significantly changing the ownership distribution without disrupting production. Although agricultural land is predominantly privately owned, the Government has as a result of the pattern of agriculture and tradition an effective control on the acreages allocated for major crops, the supply of inputs to farmers and the prices of major crops.

20. The most important factor determining agricultural employment and output capacity will continue to be the supply of water available for irrigation. Studies of the alternatives of using the water available to the U.A.R. from the Nile and from other sources most economically need to be intensified. The principal effort in agriculture is now going into land reclamation and drainage. These measures are necessary to realize fully the potential benefits from the heavy investment already made in the Aswan Dam. But there are technical and economic limitations regarding the possibilities of expanding the cropped area and the need for careful programming and concerted action in several directions to improve the agricultural development prospects is evident. In addition to the availability of the Nile waters, two factors should be taken into account. First, underground water has proved costly to find and to tap. Large fresh water reserves found recently in Libya have created some hopes which, however, require careful investigation. Second, some of the desert soils proved to be more difficult and costly to manage than expected.

21. Taking into account the additional reclamation possible through the full utilization of the new Aswan waters, conversion from basin to perennial irrigation and the increase in the cropping factor that will be realized as a result of the intensified program of drainage, one reaches a figure of

potential increase of 1.2 million feddans^{/1} (expressed in terms of cropped area equivalent) as of the beginning of 1976 in comparison with the end of 1967. This represents an annual compound growth rate for the period 1968-75 of about 1.4 percent which is significantly less than the population increase. The likelihood of developing land faster than is now contemplated without producing forbiddingly high unit costs is not very great. This places much emphasis on finding better cropping patterns and increasing resources going into promoting improved technology to the full extent that soil and ground water conditions permit.

22. The importance of improved drainage is recognized by the Government. The availability of technically trained personnel and the existence of sophisticated agricultural research provide a favorable basis for efforts to improve yields, but the appropriate strategy to employ existing personnel in the most efficient manner has still to be found. Certain recent experiences with intensified extension have given very promising results.

23. The methods of supplying inputs such as fertilizers, machinery and the availability of agricultural credits are in need of improvement. The Government realizes that the large organization which so far has been in charge of these matters has to be made more effective by applying better management techniques. A law was passed recently to improve its very unsatisfactory accounting and bookkeeping procedures.

24. Better use of water and intensified and better use of modern inputs would make it easier to grow crops worth more per unit. The Government controls the cropping patterns by various institutional and economic means. It has long been the policy to shift more agricultural resources into the production of higher value crops, but the cropping pattern still contains a significant acreage of low-value crops. The Government believes that the present allocation pattern is needed for balance of payments reasons. Cotton acreage is controlled so as to maximize export earnings.^{/2} The policy in recent years of supporting a rapid expansion of rice cultivation was also related to obtaining maximum benefit from world market conditions. Changes in technical and economic circumstances make a continuous study of alternative cropping patterns necessary. Specific recommendations on the cropping pattern are not possible without detailed study but two observations can be made. First, movement to higher-value crops such as fruits and vegetables requires organized effort to discover and exploit

^{/1} feddan = 1.038 acres

^{/2} cotton exports constitute between 45 to 50 percent of total commodity exports

market openings and to follow closely the development in other countries which are seeking similar markets. Secondly, it is necessary to establish a system which permits farm product prices in the domestic market to reflect real costs and international market conditions. In the U.A.R. today price controls are used as one of the main instruments of economic policy. This practice has created a complex system of producer and consumer subsidies which makes it difficult for the Government to reach decisions providing for a better allocation of resources.

b) Transportation

25. The U.A.R. has a good network of railways, roads and waterways which connect most of the country's important economic areas which are concentrated in the Nile Delta and along the Nile Valley. There is no immediate need for major extensions to the transport network with the exception of a new rail line connecting Baharia Oasis iron ore mines with the Helwan Steel Mill and improvements to the Nubaria Canal. The present problem is one of catching up with deferred maintenance and improving the utilization of the existing transport modes. In the past, maintenance has been neglected due to lack of funds. For instance, the railways which carry more than half of the freight traffic in ton-kilometers and about one third of the passenger-kilometers, and which have traditionally been efficiently run, suffer from lack of track renewal and rolling stock, as well as other equipment. Similarly a shortage of spare parts makes it difficult and costly to maintain the road network which is now mainly done by hand labor. Inland water transport suffers from operational inefficiencies and inadequate navigation facilities and plays therefore a smaller role in the transport sector than would be economically desirable.

26. Little attention has so far been given to transportation policy and investment planning; long-term studies of transport strategy and investment priorities in this sector are required. Transport coordination is particularly essential, since the major economic and population centers are served by all major modes of transport. However, new rolling stock and track renewal on the railways as well as improvements to the Nubaria Canal and the capacity of the Port of Alexandria are needed straight away.

27. Although important to the country's economy and to international transport, the Suez Canal played only a minor role in inland transport. When the political situation permits, its reopening will require expenditures for clearing which have been estimated in press reports at around \$25 million. Earlier plans for its improvement and deepening, which require very large investments will have to be reconsidered in the light of the situation at the time. Since 1967, the construction of supertankers and of new pipelines linking the Red Sea with the Mediterranean and the rapid development of Libyan oil production have already affected the potential use of the Canal by oil traffic.

c) Industry and Oil

28. In the ten years from 1957 when the first industrialization plan was launched, the share of industry in GDP has increased from 16 percent to 22 percent. The U.A.R. now has a diversified industrial structure including industries relying on domestic raw materials, such as textiles and food processing, as well as branches dependent on imported raw materials and intermediate goods, such as engineering industries, chemicals, and electrical appliances. Following widespread nationalization in 1961 most industrial enterprises are now in the public sector. They suffer in general from a lack of power to take decisions, a highly regulated pricing structure and employment legislation which makes it very difficult to dismiss unproductive or redundant labor. Although the U.A.R. exports include substantial amounts of manufactured goods, their destination usually is bilateral agreement countries. Therefore, it is not easy to have a judgement over the market orientation of industry. Starting in 1966 several branches of industry suffered increasingly from unused capacity resulting from a shortage of raw materials, operational inefficiency and also slack internal demand. Government efforts to improve the allocation system of foreign exchange for imports, a strong export drive, and increasing internal demand have partially remedied the situation, but most of the basic problems still exist. During the last two years the Government has become increasingly aware of the deficiencies in industrial organization and has said so publicly, but so far no concrete decisions seem to have been taken.

29. There is no clear definition of the areas where private initiative could play a role. The Government has recently announced several times its willingness to support an increase in private investment activity, but this has not yet been translated into actual policies. Press reports about the development plan under preparation included news that the plan foresees an investment of between LE 20-50 million for the private industrial sector during the next five years. If realized, this would mean an increase over recent years.

30. The U.A.R.'s largest project in the next phase of development of industry is the expansion of the Helwan Steel Works for which the final decision to go ahead was taken during 1969. We do not have enough information on this project to judge its merits. It is scheduled to expand from a present capacity of some 300,000 ingot tons a year to 1.5 million tons by 1974. The expansion is being carried out mainly with the help of the U.S.S.R., both in equipment and technical assistance, and a substantial part of the production is intended to be exported to Russia in lieu of payments due on the credit provided for the financing of the project. The project includes the exploitation of the Bahariya Oasis iron deposits and the construction of a railway from there to Helwan. The other projects for which the U.S.S.R. provides credits are construction of the first stage of a phosphate plant near Aswan and a 40,000 ton aluminum plant which should also be completed by 1974.

31. There are promising prospects for natural resource industries. The most important are the latest finds of new oil sources which may increase oil production to 25 million tons in 1969/70 and 50 million tons in 1974/75. These would not only offset the loss of the Sinai oilfields (4.4 million tons in 1966/67^{/1}) but also provide a basis for further development of already existing chemical, pharmaceutical and other industries and eliminate the import of crude oil which amounted to about ~~IE~~ 20 million annually on an average for the years 1964/65-1967/68. Since the nationalization of Shell at the beginning of this decade the U.A.R. has developed satisfactory relations with international oil companies based on a pragmatic attitude on the part of the Government. The only problem may be in the marketing of the increasing oil production. In the latest Pan American contract, the partners (i.e. Pan American and the U.A.R. Government) will be independently responsible for the marketing of their own shares. Encouraging developments in the natural resources sector are not limited to crude oil production. Many signs of commercially attractive natural gas reserves exist. Recently Phillips made a new gas discovery of industrial value located some 20 km from Alexandria and a project is now under preparation for production by the joint operating company owned 50 percent by the U.A.R. government and 50 percent by Phillips.

d) Tourism

32. Tourism is very sensitive to political and other events and after record activity in 1965/66, declined from a level of 10.4 million of tourist nights in 1965 and 9.8 million in 1966 respectively, to only 6.4 million in 1967 and 4.4 million in 1968. It is estimated that tourist receipts declined in the first year after the June war 1967 by some U.S. \$30 million. The situation has not improved markedly since, though the number of tourist nights in the first nine months of 1969 were 7 percent higher than the same period in 1968.

33. The government is making efforts to improve tourist facilities by erecting new hotels, taking steps to maintain their high standards, encouraging private investments both domestic and foreign. More emphasis is being laid on the construction of less luxurious hotels, which may attract the mass tourist market over time. The full utilization of existing hotel capacity would, however, depend on increased promotion efforts in addition to an improvement in the general political situation in the Middle East.

^{/1} Total crude oil production in 1966/67 amounted to 6.3 million tons

C. External Aid

34. The U.A.R. received substantial amounts of external assistance on favorable terms both from the West and the East until the mid 1960's. Net loans received by the Central Government during the period 1961-65 amounted to U.S.\$826 million. Thereafter, Western assistance practically ceased because of debt arrears and for political reasons. Apart from Arab assistance, recent capital inflows to the U.A.R., including assistance from Eastern Europe, have been limited. The capital account in the balance of payments changed from a net capital inflow of U.S.\$158 million in 1966/67 to a net capital outflow of US\$33 million in 1968/69. There have been reports about large amounts of military assistance in the last three years but they are not reflected in the balance of payments. By December 1, 1969, the U.A.R. had completed rescheduling operations with all but one of her Western creditors, the United States, and discussions were underway with the U.S. These rescheduling arrangements have again made possible limited medium-term borrowing from the West but with three disadvantages. First, all new credit facilities are on suppliers' credit terms which will result in a quick accumulation of medium-term debt. Secondly, in almost all cases new credit facilities are to be extended only as payments are made on rescheduled debt. Since the individual repayment installments are relatively small, only a small amount of new credit becomes available each time and this generally limits its use to replacement of small items of equipment, instead of being channelled to significant investment projects. Thirdly, the new credit facilities to be extended in connection with the rescheduling are, with the exception of the U.K. and Italian agreement, in all cases less than the total debt service which the U.A.R. has to pay to each country. This results in a net outflow of capital. Consequently, the U.A.R. has recently had to increase its reliance on short-term banking credits.

Creditworthiness

35. The future debt service burden of the U.A.R. will very much depend on the terms of external assistance. Global figures prepared by the U.A.R. on the outstanding debt as of December 31, 1969 show the unfavorable structure of present debt. Total service payments decline from LE 146 million in 1969/70 to LE 59 million in 1974/75. By that time 74 percent of the existing debt will have been paid (83 percent of debts to western countries). The U.A.R. cannot at present be considered creditworthy for Bank lending because of a high debt service ratio (more than 25 percent in 1969/70 and about 23 percent in 1974/75, assuming that new debt will be roughly on the same average terms as present debt) and serious uncertainties about factors that will determine the level of future foreign exchange earnings. Another factor in this connection is the U.A.R.'s attitude towards meeting its external debt obligations. In 1966/67 the U.A.R. defaulted generally on debts to Western countries and the IMF, but maintained its payments to the Bank. The U.A.R. has now reached agreement for settlement of arrears and resumption of normal payments with all creditors except the U.S. Negotiations with the U.S. have been protracted and many proposals have been exchanged. The latest U.A.R. proposal seems to be one which the U.A.R. could afford within its balance of payments constraints. At the same time it would give the U.S. a relatively larger net repayment of debt than any of the other creditors whose debts have been rescheduled.

36. A change in a set of interrelated factors, which may or may not occur quickly, could alter the picture. If the U.A.R. can (a) conclude a successful arrangement with the Fund, (b) reschedule its debt to the U.S., (c) continue to pay its external obligations without creating too heavy service payments in the near future either by negotiating new credits on softer terms or a substantial rescheduling of her external debt which would improve the profile of the future payments and if (d) oil income continues to increase and tourism revival speeds up, her creditworthiness may improve enough to warrant a small amount of Bank lending. Also, when the Five-Year Development Plan becomes available, we shall be in a better position to evaluate performance and the soundness of economic policies.

37. As far as IDA-worthiness is concerned, in view of the level of per capital income, marginal improvement in performance and the balance of payments situation, the U.A.R. qualifies for the program described below. An element of strength is the availability of good projects and the ability to implement them.

D. Bank/IDA Plan

a) Aim and Character of the Program

38. At the present time the amounts available from IDA are not large enough to make a decisive contribution to the investment requirements in the U.A.R. The lending program is limited by our available resources and not by lack of projects worthy of assistance. However, the program could accomplish two important objectives: first, it could bring about a useful dialogue between the Bank Group and the U.A.R. about sectoral and general economic policies and second, its satisfactory execution might improve the U.A.R.'s standing among Western creditors and investors and thereby help to provide a basis for eventual Bank lending. It is too early to define general policy conditions which might be attached to Bank/IDA activity in the medium-term. If the Nile Delta Drainage Project and the Railways Project move ahead and when the U.A.R.'s Development Plan for 1970/75 is reviewed by the 1970 Economic Mission, we may be in a position to be more specific about policy recommendations and the U.A.R. may be receptive. An early recommendation would be that a study of the utilization of the water resources available to the U.A.R. be undertaken with Bank advice and assistance as a basis for increased agricultural lending.

39. Bank Group operations are regarded by the U.A.R. as fitting in the context of their overall relations with creditors in western countries and with the IMF, and they expect satisfactory relationships with these creditors to go hand in hand with an active Bank Group program.

b) Amounts and Terms of Financing

40. Since the U.A.R. may not become creditworthy in the near future for Bank lending, the principal constraint on lending is the availability of IDA funds. Local currency financing need not be considered, except possibly for population projects, at the level of lending presently contemplated, although it would be justified on both country and project grounds if more funds were available and an adequate development program prepared. The terms of past lending to the U.A.R. from Western sources have progressively hardened. An easing of these terms, accompanied by other improvements in the balance of payments position, might open the way for some Bank lending.

c) Sectors

41. Agriculture: A dialogue has already been established to some degree between the Bank and the U.A.R. for the development of this sector. The Nile Delta Drainage Project and the program of which it is a part have been fully reviewed by the Bank. It is expected that two projects in addition to the one which has been appraised and negotiated will be ready for implementation within the next five years. On the Bank's advice, an authority to carry out this program has been established and contacts with consultants to assist in its management and execution have been made. A proposed outline for a study of the optimum utilization of water resources was sent to the Government in February 1969 with an offer of Bank assistance. Although no formal response to this offer has been made, it is reasonable to expect that this subject could be reopened for discussion soon after a credit is made for the Nile Delta Drainage Project. The initiation of such a study should probably precede or accompany lending for land reclamation projects because the choice of lands for development could depend in some areas upon the outcome of the study. Agricultural credit is a very important factor in the long-term improvement of agricultural practices in the U.A.R. and should complement the large investments required for drainage and land reclamation. Since it may take a series of policy discussions and organizational reforms to lay the basis for an agricultural credit project, it has been included in the program for 1975.

42. Transportation: The problems of the existing domestic transportation system are characterized more by bottlenecks that have developed than by a lack of basic facilities. The projects that are included in the lending program are designed to overcome particular problems of this nature, with the possible exception of the urban transport project scheduled for 1975, by which time a major investment in a new rapid transit system for the Cairo area might be required. The Egyptian Railways are efficiently managed, and a project for the import of replacement rails and signalling equipment has already been fully appraised and would be ready for negotiations in February/March. Project preparation missions for the Inland Waterways and Port of Alexandria projects have reported that some further steps need to be taken before these projects would be ready for appraisal. These two projects are closely interrelated, inasmuch as they would together greatly increase the capacity for the transport and handling of dry bulk cargo between Cairo and Alexandria. The Inland Waterways project would be related to organizational and operational improvements in this sector.

43. Industry: The industrial sector is increasingly gaining importance in the economy and the U.A.R. has shown some interest in Bank involvement in this field. As indicated earlier, major steps toward reorganization of industrial policies and enterprises would be necessary to improve the performance of this sector and should at least be initiated if lending is to be undertaken. The advice offered by an IFC mission in November 1968 on the preparation of an elemental phosphorus project was received without response. It appears from news reports that this project will now be undertaken with assistance from the USSR. The Government has expressed interest in Bank advice and assistance to the Industrial Development Bank, particularly with respect to its activities in the private sector. However, the role of this institution is at present so insignificant and the private sector is so limited that this does not appear to be a suitable object of the Bank's

attention at least for the time being. An unidentified industrial project has been tentatively included in the program for 1974 with the hope that improvements in this sector will permit lending by that time either for the Industrial Development Bank or for specific projects.

44. Other Sectors: The justification of any tourism project would depend of course upon the revival of tourist traffic, but once this takes place the extraordinary combination of tourist attractions in the U.A.R., antiquities, favorable winter climate and good beaches, some of which are still undeveloped, should provide a good project basis.

d) Possible Changes in Program

45. The present lending program is virtually a token one in relation to the lending possibilities that could be developed in the U.A.R. For example, the foreign exchange investment requirements of the Egyptian Railways over the next five years for greatly needed replacements and improvements are estimated to exceed \$100 million. The low proportion of project costs covered by the proposed credit for the Nile Delta Drainage Project (18 percent, corresponding to the foreign exchange cost) provides less leverage over the execution of the project than would be attained if IDA funds were available for local currency financing. The same is true of the Inland Waterways Project. Other projects might be added or financed earlier, e.g. urban transport, agricultural credit, municipal water supply and sewerage.

46. The potentialities for increasing the program are far greater than the possibilities of reducing it. However, if cuts become necessary, the still unidentified tourism project and the Port of Alexandria Project, which might be politically sensitive, could be eliminated or deferred.

e) Possible Scheduling Problems

47. No delays in the 1970 program are expected for project reasons. Both projects in the program have been well prepared and fully appraised. A recent preparation mission for the Inland Waterways and Port of Alexandria projects has reported that additional engineering and economic studies, which may require the assistance of outside consultants, need to be completed before these projects can be appraised. Since these two projects comprise the entire lending program for 1971 and their timing is to some extent related to the completion of several non-Bank Group projects for which their facilities will be required, every effort will be made to advance their preparation, but there is a possibility of some slippage. In such a case a second railway project could be prepared relatively easily. Not enough is known as yet about the projects in later years to judge possible scheduling problems.

f) Sectoral Preinvestment Studies and Related Technical Assistance

48. (1) An outline for a Nile water resources study was sent to the Government early this year. If this were undertaken it would require considerable effort by Bank staff, particularly in the initial stages. The later stages might be carried out by the UNDP.

(2) A UN population control project identification mission visited the UAR in January 1969 and recommended that a resident mission be set up to help formulate projects in this field. Accordingly, a UN expert is

scheduled to arrive in Cairo in January 1970. This may provide the basis for a Bank project, and the results of the further UN activity will be watched closely.

(3) Important policy measures are required to improve the efficiency of the industrial sector. The Bank's advice in the review of policies and organization and the development of better financial institutions, as well as in the preparation of individual projects, may be appropriate, particularly if prospects of a lending program for this sector materialize through a more determined move of the Government in the direction of the necessary reforms.

(4) A study of transport planning and co-ordination may be warranted as the lending program in this sector progresses. The contemplated projects in Railways, Inland Water Transport and the Port of Alexandria would be justified without such a study but the execution of the study could be agreed upon at the occasion of one of these operations.

(g) Joint Financing Prospects

49. As operations get underway, joint operations with the Kuwait Fund and other potential lenders may be a way of increasing available funds. However, none of the projects presently under consideration envisages such arrangements.

Attachments: U.A.R. Past Lending Operations
5-Year Economic Development Program
U.A.R. 5-Year Lending Program (Proposed)

Europe, Middle East and North Africa Department

December 30, 1969

UNITED ARAB REPUBLIC - PAST LENDING OPERATIONS

		(\$ millions)						
		Through						
		1963	1964	1965	1966	1967	1968	1969
Transportation								
(Suez Canal Authority)	IBRD	56.5						
	No.	<u>1</u>						
IBRD Loans Outstanding		51.0	49.2	45.2	41.2	37.5	33.5	29.5
- including undisbursed		51.0	49.2	45.2	41.2	37.5	33.5	29.5
- excluding undisbursed								

			Actual Data /a						Projected Data /a						Period Growth Rates	
			1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1964-68	1971-75
Population - growth rate	%	1	2.7	2.4	2.4	2.7	2.7								2.6	
birth rate	per 1000	2	42.0	41.4	41.0	39.2										
Price Change - c.o.l. index /b	%	3	4.0	14.4	9.2	0.8										
exchange rate (pound)	per US\$	4	0.43	0.43	0.43	0.43	0.43	0.43								
Means of Payment - change	%	5	15.5	6.9	1.6	4.8	3.0									
GNP at factor cost; 1964 prices - Total	\$ mil.	6	4161.0	4492.6	4711.8	4710.6	4600.2		5166.0	5502.0	5860.0	6241.0	6647.0	7079.0	1.1	
per capita	\$	7	145	153	157	152	145									
GNP at constant factor cost - real growth rate	%	8	8.9	8.0	4.9	0.0	-2.0			6.5	6.5	6.5	6.5	6.5	4.0	6.5
GDP at current market prices - Total	\$ mil.	9	4342.2	5091.1	5526.7	5705.6	5773.0									
Production Growth (real) - agriculture	%	10	7.4	21.6	7.8	5.3										
food per capita	%	11														
manufacturing/c	%	12	14.4	5.7	-4.0	-3.0	10.9									
GDP by Branch - agriculture	%	13	27.3	29.6	28.8	28.1	29.8									
mining	%	14														
manufacturing /e	%	15	22.6	21.6	21.8	21.9	22.6									
construction	%	16	5.5	4.7	4.5	4.3	3.7									
transport & communication	%	17	9.0	9.0	9.3	9.4	5.3									
public admin. & defense	%	18	20.8	21.5	22.1	22.5	24.1									
other branches	%	19	14.9	13.6	13.4	13.8	14.5									
Resource Gap	% of GDP	20	7.2	2.5	5.1	1.0	4.3									
Net Factor Payments	% of GDP	21	0.4	1.0	0.6	0.9	0.6									
National Saving - private	% of GDP	22	11.8	9.8	11.0	9.5	6.4		6.8	7.6	6.9	6.6	5.9	5.7		
public	% of GDP	23	1.6	3.9	1.9	4.2	2.4		3.6	4.1	4.6	5.1	5.6	6.2		
Total	% of GDP	24	13.4	13.7	12.9	13.7	8.8		10.4	11.7	11.5	11.7	11.5	11.9		
Marginal Saving Rate		25														
Consumption - private	% of GDP	26	66.2	65.5	66.4	65.7	68.0									
public	% of GDP	27	21.3	19.8	20.1	19.7	22.6									
Total	% of GDP	28	87.5	85.3	86.5	85.4	90.6									
Exports of Goods and Services /d	\$ mil.	29	843.0	903.0	967.0	1009.7	717.6	860.2	1131.0	1247.0	1283.0	1341.0	1378.0	1463.0	-2.7	5.3
Imports of Goods and Services	\$ mil.	30	1119.0	1148.0	1138.0	1191.4	1074.1	1097.1	1189.0	1292.0	1347.0	1421.0	1495.0	1573.0	-0.5	5.8
Net Goods and Services	\$ mil.	31	-276.0	-245.0	-171.0	-181.7	-356.5	-236.9	-58.0	-46.0	-65.0	-80.0	-117.0	-110.0		
Interest on Public Debt, Gross: Outflow (-)	\$ mil.	32	-18.0	-17.0	-11.0				-82.0	-76.0	-83.0	-87.0	-91.0	-95.0		
Other Investment Income, Net: Outflow (-)	\$ mil.	33							-82.0	-76.0	-83.0	-87.0	-91.0	-95.0		
Net Investment Income: Outflow (-)	\$ mil.	34	-18.0	-17.0	-11.0				-82.0	-76.0	-83.0	-87.0	-91.0	-95.0		
CURRENT SURPLUS(+) DEFICIT(-)	\$ mil.	35	-294.0	-262.0	-182.0	-181.7	-356.5	-236.9	-140.0	-122.0	-148.0	-167.0	-208.0	-205.0		
Long Term Private Capital, Net inflow	\$ mil.	36	-2.0	-6.0	-7.0											
Long Term Public Capital, Gross inflow	\$ mil.	37	105.0	250.0	206.0	319.9	320.4	464.3	385.0	339.0	389.0	409.0	456.0	451.0		
less: amortization	\$ mil.	38	152.0	95.0	109.0	126.3	125.8	222.2	245.0	217.0	241.0	242.0	248.0	246.0		
Net long term pub. cap. inflow	\$ mil.	39	253.0	155.0	97.0	193.6	194.6	242.1	140.0	122.0	148.0	167.0	208.0	205.0		
Short Term Capital, Net inflow	\$ mil.	40				33.8	46.0	12.4								
Other Capital, Net inflow (incl. errors & om.)	\$ mil.	41	52.0	20.0	95.0											
NET BALANCE	\$ mil.	42	9.0	-93.0	3.0	45.7	-115.9	17.6								
IMF Drawings(+) Repayments(-)	\$ mil.	43	13.0	-13.5	-20.0											
Foreign Exchange Reserves, Inc.(+) Dec.(-)	\$ mil.	44														
Foreign Exchange Reserves, Net - Total	\$ mil.	45	-101	-177	-235	-292	-305									
Foreign Exch. Reserves, Gross - govt. entities	\$ mil.	46	279	272	270	228	246									
comm. banks	\$ mil.	47	151	133	111	110	110									
Total	\$ mil.	48	430	405	381	338	356									
External Debt	\$ mil.	49		1386		1670	1851		28.3	23.5	25.4	24.5	24.6	23.0		
Debt Service Ratio/d	%	50					19.5									
Export Price Index	%	51														
Central Government - Current revenue	% of GDP	52	19.5	19.4	19.7	21.2	20.5		20.3	20.6	20.9	21.2	21.5	21.8		
Current expenditure	% of GDP	53	26.1	26.0	28.5	26.7	25.2		25.0	25.1	25.0	25.0	25.0	25.0		
Saving/e	% of GDP	54	1.6	3.9	1.9	4.2	2.4		3.6	4.1	4.6	5.1	5.6	6.2		
Capital revenue	% of GDP	55														
Capital expenditure	% of GDP	56	19.5	13.2	12.4	10.8	9.5									
Surplus(+) Deficit(-)	% of GDP	57	-17.9	-9.3	-10.5	-6.6	-7.1									
Military expenditure	% of GDP	58	9.4	9.6	9.8	7.4	10.3		4.8	4.9	4.9	5.0	5.1	5.2		
Education - expenditure (general government)	% of GDP	59	4.3	4.1	3.7	4.0	4.3		56.0	58.0	60.0	63.0	65.0	68.0		
school enroll., primary & second	%	60	47.0	49.0	50.0	52.0	54.0	54.0								
literacy rate, adult	%	61	20.0													
Tax Revenue (general government)	% of GDP	62	14.4	14.3	14.2	14.0	13.6		16.1	16.3	16.5	16.8	17.0	17.2		
Public Saving (% of public fixed investment)	%	63														
Gross Investment - private fixed	% of GDP	64														
public fixed	% of GDP	65														
increase in stocks	% of GDP	66		1.1	2.9	1.1	2.0									
Total	% of GDP	67	19.7	17.2	18.6	15.5	13.6		13.3	13.5	13.6	13.9	14.1	14.3		
Finance of Investment - National saving	%	68	61.7	79.6	69.3	94.8	64.4	84.5	78.4	86.7	84.9	84.2	82.0	83.5		
Foreign capital	%	69														
private	%	70														
public	%	71														
Total/f	%	72	38.3	20.4	30.7	5.2	35.6	15.7	21.6	13.2	15.1	15.7	18.0	16.5		
Change in reserves	%	73														
Public Investment by Sector - agriculture	%	74	27.1	24.8	21.8	22.9	21.4									
industry/g	%	75	28.0	27.9	26.6	27.4	29.3									
power	%	76	9.4	14.8	16.2	19.3	18.1									
housing	%	77	9.9	8.5	12.6	11.8	14.3									
transportation/h	%	78	12.9	13.7	14.1	12.8	13.1									
telecomm.	%	79														
education	%	80														
health	%	81														
other	%	82	12.6	10.2	8.7	5.7	3.8									

/a Fiscal years ending June 30, unless otherwise indicated. /b Calendar years. /c Includes mining. /d In the projections exports include proceeds from Suez Canal operation or Arab assistance which compensate for foregone earnings. /e Public saving. /f Including change in reserves. /g Including private investment which in the years 1965-68 represented less than 10% of total investment. Excludes change in inventories. /h Including telecommunications.

Attachment 3

Population: 32.5 million
Per Cap. Inc.: \$160

UNITED ARAB REPUBLIC - 5 YEAR LENDING PROGRAM
(proposed)

		(\$ million)							
		Fiscal Years					Total	Total	
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Drainage I	IDA	26							
Drainage II	IDA				23				
Delta Reclamation I	IDA			15					
Drainage III	IDA						15		
Delta Reclamation II	IDA				15				
Agricultural Credit	IDA						10		
Industry Unidentified	IDA					20			
Inland Waterways	IDA		7						
Railways I	IDA	14							
Railways II	IDA					23			
Port of Alexandria	IDA		13						
Urban Transport	IDA						20		
Population Unidentified	IDA			3					
Tourism Unidentified	IDA			10					
Total	IDA	40	20	28	38	43	45	-	126
No.		2	2	3	2	2	3	-	9

IBRD Loans Outstanding
- including undisbursed
- excluding undisbursed

IDA Credits Outstanding
- including undisbursed
- excluding undisbursed