Introduction

Egypt’s economic reform and structural adjustment programme (known as ERSAP) has been under way since 1991. Coming after stabilization episodes in the 1970s and 1980s, it has already generated a great deal of interest on the part of the government, business, international organizations and the academic community. Naturally, different views of the programme have been expressed. Some are totally backing it, on the grounds that it represents a success story. In fact, the World Bank and the IMF consider ERSAP, in many ways, an example for other countries to follow. On the other hand, some are fiercely opposed to the programme. They resent its tendency to downsize the government, and fear that it may eventually have negative effects on growth and development. In addition, the negative social effects of ERSAP have also been a cause for concern. Occasionally, they may go even further to suggest alternative measures.

As the title indicates, the focus of the present study is on the impact of ERSAP on the industrialization of Egypt. The analysis of the effects of ERSAP is conducted at two distinct levels; the macro and the micro. At the macro level, we investigate the actual and/or likely effects of ERSAP on such variables as interest rate, exchange rate, domestic public debt, trade balance, budget deficit, inflation, saving, investment, growth and structure of GDP. At the micro level, two industry case studies are conducted in detail, since the focus of the study is on industrialization. The first case study is the aluminium industry and the second is the iron and steel industry. The reasons for the choice of these two industries should be explicitly declared from the beginning. Both are energy-intensive industries which are affected specifically and directly by one of ERSAP’s main components: raising energy prices towards eventual parity with world prices. They are also usually considered essential to any serious industrialization effort. The two case studies are based partly on guided interviews with the help of a questionnaire and field visits to the Aluminium Company of Egypt (EGYPTALUM) and the Egyptian Iron and Steel Company (HADISOLB). EGYPTALUM is the only aluminium smelter and HADISOLB is the oldest integrated steel mill in Egypt. Both are among the largest industrial enterprises in the country. Although the two firms are in the public sector, they appear to have been affected differently by ERSAP. This indicates that the effects of ERSAP may
depend more on the nature of the activity or industry than on the type of enterprise (public or private sector). It seems that the major difference here is that HADISOLB is an import-substituting firm, while EGYPTALUM has been conceived from the outset as an export project.

The study consists of seven chapters. Chapter 1 deals with the stabilization experiences in the 1970s and 1980s as precursors to ERSAP. Chapter 2 is concerned with the main components/measures of ERSAP. The focus here is on the essentials without getting bogged down in tiny details. Specifically, we deal with the following elements: macroeconomic reform, public enterprise reform, domestic price liberalization, foreign trade liberalization, private sector reform, and the Social Fund for Development.

The assessment of the effects of ERSAP is undertaken in Chapters 3, 5 and 6.

In Chapter 3, we deal with some of the macroeconomic effects. The analysis is conducted taking into account the external shocks to which the Egyptian economy was exposed, particularly in the late 1980s. Such external shocks manifest themselves in the gyrations of the main foreign-exchange sources: oil revenues, workers’ remittances, Suez canal dues and tourism revenue. The assessment of ERSAP is also based on certain guiding principles, which serve as criteria for judging success. Such principles include growth, equity and employment generation – these being the most pressing tasks for Egypt in our view. Also as a basis for the assessment, the performance of the Egyptian economy since 1987/88 (the period immediately preceding ERSAP) is examined.

The assessment focusses on the two elements most closely related to industrialization: foreign-exchange reform and trade liberalization. Attention is given to the sequencing of these macroeconomic measures and its implications for the sustainability of reform. Foreign-exchange reform occupies a central place as a component of ERSAP. The changes in the foreign-exchange regime are thoroughly documented and the real exchange rate under ERSAP is estimated. Despite the devaluation of the Egyptian pound as part of the ERSAP package, there has been significant real appreciation. The implications of this development for the competitiveness of Egyptian industry and the prospects of industrialization are self-evident.

Several measures of trade liberalization have been implemented during the various phases of ERSAP. They involved both bringing down the average tariff height (through a series of tariff cuts), tariffication of non-tariff barriers, and reduction of tariff dispersion. The Harmonized Tariff System was also adopted. Chapter 3 contains a comparative analysis of Egypt’s trade liberalization effort under ERSAP in terms of design, speed and sequencing. Clear distinction between trade liberalization and import liberalization is maintained throughout. The chapter also discusses the liberalization of capital.
transactions in the balance of payments. Issues of sequencing and sustainability are considered in detail here as well. The analysis demonstrates quite clearly that the so-called reform has actually generated clear Dutch disease symptoms.

In Chapter 4 we deal with the main features of the manufacturing sector within the broader context of the Egyptian economy prior to ERSAP. This involves first examining some sector indicators of manufacturing: growth and structural change, contribution to total value added, and share in total investment and exports. The issue of factor proportions and the related question of comparative advantage are also examined in this chapter. Available evidence suggests that Egypt may have been witnessing a process of de-industrialization prior to ERSAP. A relevant question therefore is whether ERSAP will sustain this trend or will reverse it.

From the macroeconomic analysis of Chapter 3 we move to the microeconomic analysis in Chapters 5 and 6. The analysis is conducted against the background of the development of the main features of the manufacturing sector in Chapter 4. Thus, Chapters 5 and 6 include two case studies for assessing the effects of ERSAP at the micro level: one study on the aluminium industry and the other on the iron and steel industry. These two studies are based on field work, organized around a questionnaire and discussions with officials of the two companies.

The case of the aluminium industry, where only one firm is involved, is examined in Chapter 5. Aluminium smelting is by far the most energy-intensive industry in Egypt. Energy in the form of electricity represents some 35 per cent of unit cost, and the activity uses 6–7 per cent of total annual electricity sales. ERSAP is likely to impact on aluminium smelting in a number of different ways: some of which are positive, the others negative. For example, raising energy prices is decisively the most important factor on the negative side. Devaluation may be the most significant factor on the positive side. Liberalizing input and output prices, trade liberalization, liberalizing interest rates, and abolition of credit ceilings also push in various directions. But overall, one may say that ERSAP will have a benign effect on aluminium smelting.

The question of the shadow price of electricity and determination of the long-run marginal cost (LRMC) of electricity is discussed at length in this chapter. This issue is central to any serious discussion of the prospects of the aluminium industry in the context of ERSAP. The analysis shows that the future of aluminium smelting may not be bleak, provided EGYPTALUM takes the necessary measures. Such measures fall within two distinct categories: measures necessary to cut cost through raising X-efficiency, and measures necessary to increase value added. Foremost in the first category are measures to reduce the specific energy consumption. Among measures of the
second category, increasing the proportion of fabricated/semis to total production of aluminium and moving further downstream are the most important.

In Chapter 6 we take up the other case study in this volume: that of the iron and steel industry. To examine the likely effect of ERSAP on such basic industry, we have chosen to focus on the Egyptian Iron and Steel Company (HADISOLB). Established in the 1950s, this is the oldest integrated steel works in Egypt. As in the case of the aluminium industry, albeit to a lesser extent, steel production is an energy intensive activity. Coke is the most important input. The steel industry is also a highly capital intensive activity. HADISOLB is an ideal prototype of an import-substituting public sector enterprise which has been operating significantly below capacity in a non-competitive environment until recently. The company is also one of the largest in the industrial sector in Egypt in terms of employment; its work force is more than 20,000 strong. With regard to the likely effects of ERSAP on HADISOLB, the following measures are particularly relevant: raising energy prices, liberalizing interest rates, trade liberalization, aggregate demand deflation, and devaluation. These factors, as they impinge on HADISOLB, are discussed in detail in this chapter. The results of the questionnaire and field interviews regarding the views of HADISLOB’s management on ERSAP are also reported in this chapter.

Chapter 7 is the concluding chapter. This chapter puts in perspective the relation between economic reform and industrialization. What are the prospects of industrialization under ERSAP? Will ERSAP lead eventually to industrialization or de-industrialization? Such questions constitute the heart of this chapter. It draws on the main findings of all the previous chapters.

POSTSCRIPT

Since the manuscript of this book was sent to the publisher, most recent developments seem to provide support to its main conclusions. There is now growing evidence that ERSAP has resulted in the de-industrialization of Egypt, as private investment in manufacturing failed to fill the vacuum resulting from the downsizing of the public sector. Although external debt was maintained at about US$ 28 billion, domestic public debt continued to mount, approaching LE 250 billion by end of June 2000 (representing 87 per cent of GDP). Pressures in the foreign-exchange market are increasingly felt as the trade deficit has increased, and the pound was recently devalued by about 15 per cent. There are public suggestions of imposing some discipline on imports to avoid the continued drawing down of international reserves of the country.

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