



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

ILO

WEP 2-46 / W P 5

WORLD EMPLOYMENT PROGRAMME RESEARCH

Working Papers

GIANNINI FOUNDATION OF
AGRICULTURAL ECONOMICS
LIBRARY

MAR 20 1987



(International Labour Office) Geneva

db

WORLD EMPLOYMENT PROGRAMME RESEARCH

Working Paper

INTERNATIONAL EMPLOYMENT POLICIES

Working Paper No. 5

THE EXTERNAL ACCOUNT, GROWTH AND EMPLOYMENT IN EGYPT
AND TURKEY: HISTORICAL REVIEW AND PROSPECTS

by

Refik Erzan

Note: WEP Research Working Papers are preliminary documents circulated in a limited number of copies solely to stimulate discussion and critical comment. They are restricted and should not be cited without permission.

September 1986

Copyright © International Labour Organisation 1986

Publications of the International Labour Office enjoy copyright under Protocol 2 of the Universal Copyright Convention. Nevertheless, short excerpts from them may be reproduced without authorisation, on condition that the source is indicated. For rights of reproduction or translation, application should be made to the Publications Branch (Rights and Permissions), International Labour Office, CH-1211 Geneva 22, Switzerland. The International Labour Office welcomes such applications.

ISBN 92-2-105714-3

First published 1986

The designations employed in ILO publications, which are in conformity with United Nations practice, and the presentation of material therein do not imply the expression of any opinion whatsoever on the part of the International Labour Office concerning the legal status of any country, area or territory or of its authorities, or concerning the delimitation of its frontiers. The responsibility for opinions expressed in signed articles, studies and other contributions rests solely with their authors, and publication does not constitute an endorsement by the International Labour Office of the opinions expressed in them. Reference to names of firms and commercial products and processes does not imply their endorsement by the International Labour Office, and any failure to mention a particular firm, commercial product or process is not a sign of disapproval.

ILO publications can be obtained through major booksellers or ILO local offices in many countries, or direct from ILO Publications, International Labour Office, CH-1211 Geneva 22, Switzerland. A catalogue or list of new publications will be sent free of charge from the above address.

PREFACE

The International Policies Unit of the ILO has been undertaking a series of comparative studies in order to illuminate the interaction between external constraints and the achievement of employment and development objectives. By selecting pairs of countries with many structural similarities, which have faced similar external shocks, the aim is to explore the scope for government policies relative to the constraints and opportunities outside the national domain.

Egypt and Turkey provide an interesting comparison. They are of similar population size, and are middle income countries with substantial industrial sectors. Emigration and associated remittances have been very important to both. They have experimented with high degrees of protection and with relatively open policies. And they have a political and strategic importance which has allowed them somewhat more financial flexibility.

Yet there are significant differences - in the ratio of population to arable land, in the extent of un- and under-employment, in the nature of exportables and in sources of government revenue. Turkey, lacking petroleum, had adjustment forced upon her while Egypt obtained a multi-fold windfall (from oil exports, emigration to the Middle East, Suez Canal tolls, etc.). Both experienced domestically-generated recessions, with the external environment exerting a decisive influence on timing, intensity and duration of recession and boom. But the windfalls to Egypt encouraged elements of a (premature) welfare state through the "Dutch disease", undermining production of other tradables, while Turkey undertook an adjustment that is bearing

fruit. More recent strains on Egypt's external accounts with softer oil prices show that there may be some lessons in the Turkish case.

Given the importance of the world trading system and protectionism for employment in manufacturing the author estimates the effects of trade liberalisation on the two economies. Since Turkey's exports face more substantial restrictions than do Egypt's, she has far more to gain from OECD trade liberalisation; since her exportables are more labour-intensive, the employment gains could be very substantial from a reduction in tariff and non-tariff barriers to her exports. To benefit, Egypt would have to undertake a programme to increase efficiency and to promote non-oil exports. If a Generalised System of Trade Preferences among Developing Countries (GSTP) were to be established, however, the results for both countries might be negative in the short run, although for different reasons. Turkey, not being a member of the Group of 77, might not be able to participate, so would suffer the effects of trade diversion. Egypt's trade balance would worsen as liberalised imports from developing countries would expand far more than her exports to them. The secondary and longer run effects are not however subject to estimation.

This comparison thus provides some insights into the scope for national policy in countries which are highly integrated into the world economy through trade, financial and labour flows.

Martha F. Loutfi

Peter J. Richards

TABLE OF CONTENTS

	<u>Page</u>
PREFACE	i
I. INTRODUCTION	1
II. SOME THEORETICAL CONSIDERATIONS	5
Defining the Balance-of-Payments Constraint	5
The Impact of an Exogenous Sectoral Boom: "The Dutch Disease"	7
Other Central Issues	9
III. EGYPT	16
Background and Major Economic Developments	16
Population, Structural Change and Employment	22
- Services sector	24
- Public enterprises	24
Wage Developments	25
Savings and Investment	26
Public Finances	28
Emigrant Workers	29
Composition of Imports	30
Developments in Foreign Exchange Earnings	32
- Exports: structure and destination	32
- Workers' remittances	34
- Tourism and Suez Canal	34
- Foreign direct investment	36
IV. TURKEY	37
Background and Major Economic Developments	37
Population, Structural Change and Employment	45
Causes of the Decreasing Rate of Job Creation	47
Real Wages, Savings and Investment	49
Public Finances and State Economic Enterprises	51
Emigrant Workers	52
Composition of Imports	54
Developments in Foreign Exchange Earnings	56
- Exports: structure and destination	56
- Workers' remittances	58
- Tourism	59
- Turkish contractors abroad	61
- Foreign direct investment	62
V. CONCLUSIONS AND POLICY IMPLICATIONS	65
- Two similar cases	65
- Carrot to one, whip to the other	66
- Any lessons to take?	69
- The way to success: persistence in prudence	73

.../...

ANNEX I INFLUENCE OF PROTECTIONISM IN MAJOR DEVELOPED MARKET ECONOMIES: POSSIBLE EFFECTS OF TRADE LIBERALISATION	79
--	----

The Manufacturing Sector	83
--------------------------	----

ANNEX II TRADE POTENTIAL WITH DEVELOPING COUNTRIES: POSSIBLE EFFECTS OF A GLOBAL SYSTEM OF TRADE PREFERENCES (GSTP)	87
---	----

LIST OF TABLES

Table 1. Egypt's Balance of Trade 1953 - 1974	18
Table 2. Egypt's Balance of Payments, 1975-1984/85	19
Table 3. Source of GDP and Sectoral Distribution on Employment in Egypt, 1974-1983/84	23
Table 4. Consumption, Savings and Investment in Egypt	27
Table 5. Public Finances of Egypt as Percentage of GDP	28
Table 6. Egypt's Import Structure by Main Product Groups	31
Table 7. Egypt's Export Structure by Main Product Groups	32
Table 8. Egypt's Exports by Destination	33
Table 9. Turkey's Balance of Payments 1950-1970	40
Table 10. Turkey's Balance of Payments 1970-1984	41
Table 11. Sources of GDP and Sectoral Distribution of the Economically Active Population in Turkey	46
Table 12. Public, Private and Total Fixed Investment: Shares in GNP and Annual Volume Change	48
Table 13. Percentage Volume Change of Consumption and Change in Real Wages (over previous years) in Turkey, 1970-1984	50
Table 14. Savings in Turkey as a Percentage of GNP	51
Table 15. Public Finances in Turkey as a Percentage of GNP	52
Table 16. Emigration of Turkish Workers, 1962-1984	53
Table 17. Turkey's Import Structure by Main Product Groups	55
Table 18. Turkey's Export Structure by Main Product Groups	56
Table 19. Turkey's Exports of Processed and Manufactured Products, 1980 and 1984	57
Table 20. Turkey's Exports by Destination	58
Table 21. Turkish Contractors Abroad	61
Table 22. Foreign Direct Investment Approvals in Turkey	63
Table 23. Possible Effects of a Liberalisation in the EEC, Japan and the USA on Imports from Egypt and Turkey	82
Table 24. EEC's Imports of Manufactures from Turkey and Projected Increases Resulting from a Full Liberalisation of Tariffs and NTMs in the EEC on an MFN Basis	86
Table 25. Average Trade-Weighted Tariffs Rates of Egypt in Major Product Groups	89
Table 26. Egypt's Trade with Developing Countries and Projected Changes in Egypt's Exports, Imports and Trade Balances in Major Product Groups, due to the Adoption of a GSTP	91

BIBLIOGRAPHY	92
--------------	----

I. INTRODUCTION

Egypt and Turkey have similar characteristics which allow a comparative review of the interaction between the external sector and their domestic economies. The two countries have roughly the same population (nearly 50 million) and population growth rate (around 2.5 per cent). Both are lower-middle income countries, with GNP per capita of 700 dollars for Egypt and 1,240 dollars for Turkey (in 1983). In their modern history Egypt and Turkey have had relatively democratic or populist governments concerned with the support and hence the welfare of a majority of the population, and the State has, with varying degrees over periods, taken an active role in development efforts, in particular in industrialisation. For both countries, this implied a substantive or predominant share for public enterprises in industrial sectors which historically was a major stimulus for economic growth and employment generation but at present is a burden to the economy in many respects.

Industrialisation in Egypt and Turkey took place behind protective walls and policies in general discouraged export activities. The cyclical pattern of expansionary policies with a significant public consumption and investment component followed by a balance-of-payments crisis, calling forth a slowdown, were common to both countries. Yet in Turkey, unlike in Egypt where international conflicts and wars caused major disruptions, this pattern was more stylistic and regular.

The phenomenon of emigrant workers and the substantial foreign official capital inflows have been extremely important and similar features in the two countries. Unlike most developing countries, for political and strategic reasons Egypt and Turkey were financially rescued from acute crises.

On the other hand, the workings of the State machinery, its finances and the perception of the State in the two countries, which were very similar, have diverged considerably in the last decade. The concept of the State as the "Devlet Baba" (father State) is much less prominent in today's Turkey. Unlike Egypt, the Government makes most of its revenues from taxes. In Egypt, where taxes, especially income taxes, play a negligible role and Government incomes originate mostly from other sources, the State is held responsible to a much greater extent for welfare and equity.

Concerning employment, there are two basic differences between Egypt and Turkey. One is the fact that Egypt's arable land resources are limited whereas Turkey has a huge potential in agriculture and this sector enjoyed relatively favourable terms due to political considerations. As a result, while agriculture continued to be a reservoir of labour in Turkey, this role was to a greater extent shifted on to the services sector in Egypt. The other major difference concerning employment is that while the emigration of workers had an impact on employment in Turkey only in the early 1970s, for Egypt this phenomenon - together with public employment - is the main factor accounting for a low level of open unemployment. Consequently, the possibility of a major shift in this flow due to depressed financial conditions in neighbouring oil-producing countries poses an immediate threat to the Egyptian economy.

In addition to these differences, the oil price increases of the 1970s were major events which affected the two countries in the opposite direction. While these were among the most significant contributing factors in bringing the Turkish economy to a halt in the late 1970s, they gave a breathing space to the Egyptian economy. Consequently, Turkey could not resist undertaking a major and painful structural adjustment effort while Egypt could survive without such a major undertaking.

As the "windfall" foreign exchange earnings, i.e. workers' remittances, oil revenues, the Suez Canal dues and tourism revenue which have emerged virtually from nil since the mid-1970s, have stabilised, the relative ease in the balance-of-payments situation of Egypt seems to be over. From this point of view, Turkey's recent experience with a major structural adjustment programme is of great relevance to Egypt.

Against this background, the purpose of the study is to demonstrate the interaction between, on the one hand, foreign trade regimes, trade performance and the balance-of-payments constraint, and on the other, economic growth, with particular emphasis regarding employment.

The study is organised in the following manner: Section II takes up some theoretical considerations. First, the concept of the balance-of-payments constraint on growth is elaborated. Second, the impact of an exogenous sectoral boom on the rest of the economy, a phenomenon which has been of crucial importance in Egypt's experience, known as the "Dutch Disease", is discussed. Finally, a number of issues which have been central in development economics and practice and which have direct bearing on Egypt and Turkey are briefly reviewed.

Sections III and IV are devoted to the review of the economic record of the two countries. The balance-of-payments situation, growth, structural change and employment, including emigrant workers, are surveyed. Developments in wages, private and public savings and investment behaviour are studied. The role played by the public sector, its contribution to the economy, and its finances are discussed. Developments in the components of the balance of payments and the responsiveness of exports and other foreign exchange earnings such as workers' remittances are documented. Particular issues are given different emphasis depending on their relative urgency in the two countries.

In the concluding section, Section V, developments in the two countries are reviewed together to draw generalisations and lessons. In this perspective, the medium-run (i.e., 1985-1990) economic outlook for the two countries is discussed. The conclusions incorporate also the implications of protectionism and possible liberalisations in the international trading environment for Egypt and Turkey, analysed in detail in the Annexes.

In Annex I the possible effects of a liberalisation in the major Western markets on Egypt's and Turkey's trade are evaluated with the help of a simulation exercise. Interpreted from a different angle, it gives an insight into the dimensions of the negative effect of the protectionism in these markets. Using a similar methodology, in Annex II the possible effects of a scheme reducing barriers to trade among developing countries, i.e., a Global System of Trade Preferences (GSTP) among developing countries are discussed.

II. SOME THEORETICAL CONSIDERATIONS

Defining the Balance-of-Payments Constraint

The interaction between the external account and economic growth differs somewhat in developed and developing countries. If external funds are secured, so that a country can import more goods and services than it exports, investment can be increased without reducing consumption. This is obviously true for all countries, developed and developing alike. However, for the latter, the availability of foreign funds has an additional dimension concerning economic growth. A developing country may achieve a reduction in consumption to spare additional funds for investments, yet in the absence of sufficient foreign exchange to import necessary capital goods, it may not be possible to implement fully the investment plans. Or alternatively, if investments are undertaken, there would be less foreign exchange left to import intermediate goods to run the existing industry. In such a situation availability of foreign funds would release trapped domestic resources and hence have a contribution greater than their face value.

This analysis, which became known as the "two-gap" approach, emphasised the existence of a disequilibrium in developing countries arising from structural rigidities and an inflexible mechanism of adjustment. ^{1/} Among the rigidities were the inflexibility of the import content of domestic production and investment and the difficulty in transforming production into exportables. Accordingly, at the initial stages of development the inability of a low-income country to reduce consumption - or the savings constraint - is

^{1/} See Chenery and Strout (1968).

the binding limit on investment and hence on growth. External funds are needed to alleviate this constraint. At a later stage with higher income levels, the countries can potentially increase savings, yet inability to expand exports - or the foreign exchange constraint - becomes binding. For the transformation of domestic savings into investment, foreign exchange is needed.

While this description was representative for the initial stages of development in most cases and could be taken as given, the fact that foreign exchange availability continued to be a constraint on growth in many countries was the result of policies which perpetuated and even aggravated structural rigidities. Countries which adopted import substitution as a development strategy subsidised imports of capital goods and intermediate inputs while on the whole export activities were discouraged. This has resulted in a stop-and-go pattern of growth where slowdown in economic activity reduced the demand for the stagnant foreign exchange revenues, paving the way for a new upswing.

The fact that the balance-of-payments constraint in a number of countries which did not give emphasis to promoting exports was effectively a foreign exchange constraint needs to be qualified. ^{1/} When expansionary economic policies are pursued and final demand, i.e., current consumption and investment, exceeds domestic resources, the country runs a foreign account deficit. This is a resource gap. The concept of foreign exchange constraint is relevant only for the portion of the deterioration in the current account

^{1/} For an econometric test to determine the binding constraint, see Weisskopf (1972a). However, the methodology was subject to criticism. See Agarwala (1973).

that is above and beyond the real resource gap. Similarly, the question of foreign exchange availability is relevant in coping with the slowness of the improvement in the current account following a reversal of the expansionary policies to eliminate the resource gap. As long as the resource gap is there, however, what is needed are external resources; it is not only a question of foreign exchange shortage as such.

Finally, a related issue worth noting in the context of balance-of-payments financing is the impact of foreign funds on domestic savings. Whether or not done primarily to relax the foreign exchange constraint, when external funds are injected, they add to the supply of available resources. These resources are distributed between consumption and investment. To the extent that these resources - foreign savings - substitute for domestic savings, the urge to increase the latter would be lessened. ^{1/}

The Impact of an Exogenous Sectoral Boom: "The Dutch Disease"

The impact of the boom in the external sector of Egypt, i.e., in the petroleum industry and the Suez Canal, has been the major factor in shaping the Egyptian economy in the last decade. The phenomenon known as "the Dutch Disease" referred specifically to the rapid development in the Netherlands of the sector producing natural gas and the resulting squeeze put on other export

^{1/} For a discussion of the effects of foreign capital inflow on domestic savings, see Griffin and Enos (1970); for empirical estimations of the effect, see Weisskopf (1972b).

sectors of the Dutch economy. ^{1/} The same was observed in Norway and the United Kingdom where rapid exploration of North Sea oil created severe hardships for other tradable sectors, in particular the manufacturing industry, which compete in world markets. On the other hand, the sectors servicing purely local markets, i.e., the non-traded sector, were much less affected. What lies behind the phenomenon is the fact that the particular tradable sector which experiences a boom due to exogenous factors pays greater returns to the factors of production. In return, the other tradable sectors which did not enjoy such a benefit lose resources to the booming sector and could shrink in both relative and absolute terms. ^{2/} As well, with real incomes improved, increased domestic demand would cut into supplies available for export from other tradable sectors. This would result in an accelerated decline of the share of these sectors both in production and exports.

In a developing country the effects of the Dutch Disease may be more dramatic due to the relative weakness of its export industry. Furthermore, given the initial low level of income, a major increase in this leads to the domestic absorption of a sizeable portion of the country's traditional exports. Finally, the ease in earning foreign exchange and raising government revenues may remove the urge to increase the over-all efficiency of the economy. In a way, the revenues from the exogenous sectoral boom have effects similar to those of foreign grants.

^{1/} See Caves and Jones (1981), Chapter 6.

^{2/} Another mechanism through which traditional tradables can be squeezed is the exchange rate. For instance, the British exporters of manufacturers were hit at the end of the 1970s by the appreciation of the pound, caused in part by anticipation of future North Sea oil revenues (see Ibid.).

Other Central Issues

To put Egypt and Turkey's experience in perspective, it is useful to briefly review some issues which have been central in development theory and practice during the past three decades.

To induce rapid economic growth, how the State should exercise its power has been the fundamental controversy in development economics and practice. Among the many issues involved, three areas were probably the most pertinent ones. The first one was whether the State should take part directly in economic activities or, by reforms and infrastuctural investments, create an environment where the private initiatives have the lead and markets are the main instruments in resource allocation. The second was whether industry, in particular manufacturing, was the locomotive of development, which implied low priority on agricultural development and considered the expansion in the services sector to be an unwarranted outcome. The third issue was centered on foreign trade regimes in the context of industrialisation. Whether countries should start their industrialisation by import substituting production behind protective walls or have a liberal trade regime and promote the production of exportables.

To initiate an economic take-off, it was tempting to be for direct State participation in the economy, with high priority for industry and industrialisation through import substitution, since these approaches seemed more certain and definitely more concrete and active. With few exceptions, most developing countries which had a capacity to launch a concerted development effort did at some stage adopt this strategy. Industrial employment and output could be expanded rapidly from an insignificant base and most of the consumption items could be produced domestically. A major component of the "infant industry" justification - temporariness of protectionism - was ignored and became permanent, in some cases increasing.

To sustain rapid growth on these premises proved not to be possible. While exports stagnated or declined, imports soared due to capital goods necessary for investments and intermediate inputs to run industry. With shortage of foreign exchange, industry operated significantly below capacity. As industrialisation moved into intermediate goods, the incremental capital-output ratio increased, and output and employment generation demanded greater investment.

Three major arguments, namely, the lack of entrepreneurs capable of undertaking large-scale projects, inadequacy of capital markets to raise investment capital and positive externalities such as on-the-job training were probably justifiable reasons to promote public enterprise in developing countries. However, in many cases it was observed that, as the country developed, public enterprise became more prominent and assumed the role of a general policy tool with respect to investment, employment and income. These macro-economic considerations are obviously not compatible with efficient management of the enterprises. And, as a policy tool, public enterprise can be the most costly way to attain general objectives.

Negligence of the agricultural sector transformed many developing countries from exporters of foodstuffs into major importers of these items, draining a significant portion of their foreign exchange earnings. For countries with very limited land resources, this may have been an inevitable and, in certain cases, desirable outcome. However, for others, agricultural development could have been a much greater source of growth in income and employment.

In an historical perspective, with few exceptions, there was a strong correlation between growth of agricultural production and general economic growth and development. This goes for the past record of the developed

countries of today as well as the performance of the developing countries over the past three decades. ^{1/}

In those developing countries where agricultural production stagnated or declined, three factors seem to have played a major role: insufficient investment, scarcity of farm inputs and unfavourable or distorted farm prices.

Foreign exchange shortage was mainly responsible for inadequate imports of fertilisers. There now seems to be consensus that for many countries import substitution in this area is feasible.

Insufficient investment resulted from low priority given to agricultural infrastructural investment as well as to farm credits. Probably the most important underlying reason why agricultural policies went wrong in many countries, however, was the underestimation of the agricultural sector's sensitivity to incentives. ^{2/} Supply response was not, after all, as low as it was believed to be. Farmers planted crops which paid most even if that was not the most productive one. Where they were paid well, and when incentives were right, they did make investments to improve soil fertility.

Concerning the role of the services sector in development, the conventional view is being seriously challenged. ^{3/} It was widely accepted that in the process of industrialisation, countries moved from agriculture to manufacturing and gradually the services sector would become prominent at high levels of per capita income. Hence a large services sector in a developing country was categorically considered to be an anomaly. Recently the

^{1/} See World Bank (1982).

^{2/} Ibid.

^{3/} See UNCTAD (1985d).

"classical" distinction between "productive" and "non-productive" services or producers' versus consumer services is being revived. It is observed that some service activities are important inputs in the production of goods and other services. Their scarcity or low quality can constitute an economy-wide bottleneck in the efficient use of resources. It is also understood that revolutionary changes in transportation and communications technology increased the tradeability of services which were traditionally non-tradeable. Finally, it seems that technological advancement does not necessarily make services more capital intensive. On the contrary, in some services new technologies give a comparative advantage to the labour-abundant countries. 1/

Concerning the import substitution strategy, in addition to public sector investments, the instruments used to induce private sector investments were high tariff and non-tariff protection, and cheap credits, low duty or duty-free treatment of investment goods and other fiscal incentives to subsidise the cost of capital. Given no import competition, since the producers could reflect their increased costs on the consumers, they were not sensitive to wage developments. With relatively low capital costs, capital-intensive industries, and within these industries capital-intensive techniques became more attractive for investment. 2/ This implied less production (value-added) and less employment for the same amount of investment.

1/ Currently a number of sectoral and national studies are being undertaken. For a review, see UNCTAD (1985 d).

2/ For substitutability between capital and labour, see Krueger ed. (1982).

Calculations for Turkey, for instance, show that had the same amount of investment been made with more emphasis on industries with below average capital intensity during the 1963-67 period, manufacturing value-added could have increased up to 56 per cent above the actual level and up to 70 per cent more new jobs could have been created. ^{1/} For the 1967-72 period, these margins would have been 47 and 50 per cent, respectively. Furthermore, since the import component of capital and intermediate goods in import-substituting industries was significantly higher than in the alternative investment scenario, investments could have theoretically increased by 30 to 50 per cent without affecting the import bill.

While increasing exports is a necessity to relax the foreign exchange constraint for maintaining a high growth rate, export orientation is not identical with export expansion. Exporting non-competitive goods with the help of export incentives can be a justifiable practice during an adjustment period. However, full benefits of international trade can only be exploited by exporting what it is efficient to export rather than exporting what is feasible or possible.

Export orientation need not and should not imply a bias for exports. An import substitution strategy implied a greater effective exchange rate for imports and import-substituting activities compared to those for exports or exportables. ^{2/} In other words, this policy had a bias against exports or production of exportables. If the foreign trade and exchange regime does not distort the penetration of relative international prices into the domestic economy, efficient import-substitution industries would survive.

^{1/} See Krueger (1974), Chapter 9.

^{2/} See Bhagwati (1978).

On the compatibility of employment objectives and an export-oriented strategy in developing countries, two observations could be made. One is that exportable production is more labour intensive than import-substituting industries. ^{1/} Hence for the same amount of investment more value-added and employment are generated. On the other hand, it has to be true that industries which compete internationally are more sensitive to the level of wages as they are to other costs. This, however, goes hand in hand with the fact that the profit margins in such industries can be significantly lower than in those which face little or no competition thanks to protectionism.

Although a Lewis-type dual economy with unlimited labour supply is no more an accurate representation of the relatively industrialised developing countries, it remains true that wage formation in the modern sector often does not reflect the relative abundance of unskilled and semi-skilled labour. In addition to allocative efficiency considerations (i.e., making relatively labour-intensive industries and labour-intensive techniques more or less attractive), high wages would lead to a lower domestic savings rate if the propensity to save among the wage earners is below the average rate. Also, high wages, by reducing profits, may discourage investment, including foreign direct investment. However, the significance of wages in macro relations in developing countries is in general less than in developed countries since they often constitute a relatively small share of national income and of private disposable income. Concerning the sensitivity of investment, again, the wage bill in the often protected modern sector of the developing countries typically accounts for a smaller share of total costs compared to developed countries. In competitive and especially labour-intensive industries, however, investment could be highly sensitive to wage rates. With regard to

^{1/} See Krueger et. al., eds. (1981).

attracting direct foreign investment, it appears that the level of wages is one of the many determinants and not a predominant one. ^{1/}

Finally, in the context of wage formation in developing countries, an issue which is as detrimental as the possibility that wage rates may not reflect the relative abundance of unskilled labour is the case when the remuneration of skills does not reflect their scarcity.

^{1/} See, for example, Schneider and Frey (1985).

III. EGYPT

Background and Major Economic Developments

Free trade was basically the rule in Egypt until 1930 when tariff autonomy was gained. From that date on, the trade regime of Egypt evolved in the protectionist direction until the Korean war boom in 1951. Behind the tariff wall and encouraged by the relative fall in agricultural prices, the manufacturing industries expanded. Yet until World War II cotton constituted up to 90 per cent of Egypt's exports. The cut-off from foreign supplies during World War II, combined with allied military demand, gave an impetus to the emergence of some new industries.

The Korean war boom years 1951-52 mark the liberalisation of foreign trade which was reversed as the post-Korean war recession hit the country, reducing its major export revenue from cotton to a fraction of the average level of previous years. ^{1/} This was not only a cyclical phenomenon but also the beginning of a downward trend in cotton revenue due to external factors such as the decline of the British textile industry and the substitution of synthetic fibres for cotton.

Egypt came out of World War II with a very large foreign exchange reserve. Yet the machinery in most of industry was worn out, agriculture suffered from soil exhaustion due to lack of fertilisers and stocks of domestically-produced and imported commodities (except large stocks of cotton) were depleted. As the war ended, foreign exchange reserves were used to

^{1/} For a detailed analysis of the period 1950 to 1970, see Hansen and Nashashibi (1975).

replenish exhausted commodity stocks, to modernise industry and communications and to recover soil fertility. This led to large trade deficits yet, due to continued British military spending and the Suez Canal toll, the balance-of-payments situation was manageable. However, as cotton prices fell and foreign exchange reserves were depleted, imports had to be curtailed. Import licensing was extended to all trading partners, customs duties were raised and a surcharge was imposed on all remittances abroad. With the shortage of hard currency, bilateral agreements became attractive and by the end of 1953 more than half of Egypt's foreign trade was governed by such deals. Following a large balance-of-payments deficit in 1955, import controls were further tightened (see Tables 1 and 2 for Egypt's balance of trade to 1975 and balance of payments to 1985).

The Suez war in 1956 was a milestone in the Egyptian economic system. It marked the beginning of the move away from market orientation and relations with the West towards an administered economy with close ties with the Eastern Bloc. These tendencies culminated in 1961 when foreign trade was nationalised together with all large-scale industry and finance, and finally, when a national charter was adopted declaring "Arab Socialism" to be the basis of the economic system and the economic policy of the country.

Already in 1957 a foreign exchange budget was set up further restricting the imports of "non-essentials" and allocating strict quotas for the "essentials". Although Egypt's trade was shifting towards the Eastern Bloc, imports continued to reflect heavy reliance on Western sources, and the deficit in the current account was mainly with the latter. Export premiums were introduced to expand exports to the West.

Following a crop failure in cotton, major imports to meet the food shortage and extraordinary capital expenditure, such as compensations for the Suez Canal, the Aswan Dam and other nationalised property, an acute foreign

Table 1. Egypt's Balance of Trade 1953 - 1974
(million US \$)

	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>
Trade balance	-36	10	-121	-159	-92	-95	-151	-111	-176	-389	-323
Exports f.o.b.	395	414	399	380	480	468	480	585	474	417	526
Imports f.o.b.	431	404	520	539	572	563	631	696	650	806	849
<hr/>											
Memo items											
US dollars per pound <u>a/</u>	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.3	2.3	2.3
Annual per cent charge in GDP <u>b/</u>	----- 2.0 -----				----- 5.9 -----						
<hr/>											
	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
Trade balance	-320	-306	-270	-274	-109	-140	-267	-280	-357	-429	-1242
Exports f.o.b.	523	567	597	595	664	735	817	851	813	1000	1672
Imports f.o.b.	843	873	867	869	773	875	1084	1131	1170	1429	2914
<hr/>											
Memo items											
US dollars per pound <u>a/</u>	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.6	2.6
Annual per cent charge in GDP <u>b/</u>	..	..	5.0	-0.3	-0.9	5.5	1.8	4.9	3.9	-0.8	5.1

Source: International Monetary Fund (IMF), International Financial Statistics (IFS).

a/ End of period, official exchange rate (disregarding multiple rates)

b/ 1953 - 1963 compounded annual rate for GDP growth in 1959-60 prices, Hansen and Nashashibi (1975), p. 12; 1966 - 1973 increase over previous year in GDP in 1975 prices, IMF, IFS.

Table 2. Egypt's Balance of Payments, 1975-1984/85

	1975	1976	1977	1978	1979	1980/81	1981/82	1982/83	1983/84	1984/85
Trade balance	-2,832	-2,760	-2,673	-3,129	-4,036	-5,078	-5,095	-5,626	-6,634	-6,074
Exports, f.o.b.	1,566	1,610	2,042	2,170	2,951	3,985	4,144	3,555	4,033	4,059
Imports, c.i.f.	4,398	4,370	4,715	5,300	6,987	9,063	9,239	9,181	10,667	10,133
Services, net	357	1,160	1,460	2,032	2,558	3,473	2,801	3,842	4,519	3,318
of which:										
Suez Canal dues	85	311	428	515	589	780	909	957	974	927
Workers' remittances	366	755	897	1,767	2,214	2,855	2,082	3,166	3,930	2,800
Tourism	332	464	728	704	601	512	393	304	288	375
Trade and services balance	-2,475	-1,600	-1,213	-1,097	-1,478	-1,605	-2,294	-1,784	-2,115	-2,756
Unrequited transfers, net	..	..	445	346	89	..	130	500	700	900
Current balance	..	..	-768	-751	-1,389	-1,605	-2,164	-1,284	-1,415	-1,856
Long-term loans, net	1,278	369	568	707	690	1,062	897	946	925	550
Direct investment	6	61	103	316	350	230	250	247	146	150
Memo item										
Annual per cent										
change in GDP ^{a/}	9.3	8.3	11.1	8.0	9.7	9.2	7.6	9.0	7.6	8.1

^{a/} GDP at factor cost in 1975 prices.

Source: Central Bank of Egypt, Ministry of Planning and other national sources cited in various economic reports.

exchange crisis developed, leading to the 1962 devaluation. The premiums on exports and imports were unified, the multiple-exchange rate system was simplified, and pledges were made to cut down domestic demand. However, the devaluation did not improve the balance-of-payments situation due to the fact that public consumption and gross investment dominated by government investment projects continued to expand until 1964-65 when shortages, especially in consumer goods, became acute. This was the end of a period of rapid economic growth which had started in the late 1950s - a period during which the GDP increased at an annual (compound) rate of around six per cent. 1966 to 1974 was a period of stagnation or slow growth with an annual GDP increase of about three per cent. It was an era marked by price controls, foreign exchange shortages, heavy defence spending and two wars (1967 and 1973).

A turning point in the Egyptian economy came with the enunciation of the "open door" policy in 1974. Besides moving away from the Eastern bloc towards the West, the new policy implied a shift to a more liberal exchange and trade system, and encouragement of the private sector and direct foreign investment. The economy expanded at an average annual rate of 8.5 per cent during 1975-1983. This was an impressive achievement against the fact that Egypt had to employ massive resources to mend the damage inflicted upon its infrastructure by the war. On the other hand, the effects of favourable external conditions concealed the shortcomings of the economy. These were the oil revenue and the high oil prices of the 1970s, the Suez Canal receipts, workers' remittances when the region was in a boom and ample foreign aid. Agricultural and industrial production has lagged significantly behind the over-all growth figures, increasing only two to three per cent annually, and below six per cent, respectively, during the last decade.

Egypt had made major efforts since 1974 to reorient its economy. The Egyptian pound was devalued with the objective of maintaining a realistic exchange rate. State monopoly was removed from foreign trade and barter-based bilateralism as a policy was terminated. Market forces and the private sector, including direct foreign investment, were encouraged. The share of the public enterprises in industrial output was reduced from 75 per cent in 1974 to 66 per cent in 1984. Attempts were made to increase the independence of public economic enterprises.

However, these reforms fell short of achieving a dynamic and efficient economic environment. Public economic enterprises continue to be inefficient and to make losses. Price controls prevail. Subsidies for staple goods constitute a major burden on the budget. Egypt's foreign trade and, especially, foreign exchange regime remain highly regulated and extremely complex. ^{1/} A recent reform attempt to unify the fragmented foreign exchange system was not successful and had to be drawn back.

Currently Egypt is trying to maintain its high growth momentum but faces increasing pressure from its external account. The current account deficit is growing despite tighter import restrictions, because of falling oil prices, increased debt servicing and stagnation in workers' remittances. After a period of decline, non-oil exports, particularly industrial exports, picked up, but there are indications of a new decline. As a consequence of foreign

^{1/} There are three "pools" for foreign exchange transactions: the Central Bank pool which is mainly for central Government transactions and the commercial bank pool for mainly public sector companies, both being subject to the foreign exchange budget. The third, free market pool or "own exchange market" established in 1976 permits all transactions. The main source of this pool is workers' remittances. There exist three exchange rates which apply to the respective pools, i.e., the Central Bank rate, commercial bank pool rate and the free market rate. In addition, there is a "black market" rate at which many commercial transactions in fact take place.

exchange shortage, imports of the public sector had to be cut back and public investment was curtailed. Industrial output is increasing at a greater rate (seven to eight per cent) than in the previous decade but lags behind the targets and the agricultural sector is still stagnant.

Population, Structural Change and Employment

Egypt had a population of 45.2 million in 1984, including Egyptians living abroad. The population growth rate over the past decade has been around 2.8 per cent per annum. As a consequence of extremely low measured female participation in the labour force (9 per cent) and a large share of the population being below working age - 14 (around 40 per cent), the growth rate of the labour force has been 2.2 per cent. Rapid economic expansion since 1974, especially in the services sector, and mass emigration of workers to neighbouring oil-producing countries, has transformed Egypt into a labour-shortage country by developing country standards, to the extent that real agricultural wages have been rising substantially.

Despite the absence of a significant aggregate excess supply of labour, and while there is a shortage of skilled labour in industry and agriculture, there is an excess supply of university graduates and general industrial workers. However, open unemployment in these categories is kept low by the Government's guaranteed graduate employment policy and the lack of autonomy for public sector companies to lay off excess workers. There is further significant disguised unemployment in the urban sector due to the fact that part of the increase in employment in services was an increase in low productivity employment.

A rapid expansion in the services sector and the emergence of the petroleum industry were the major elements in the transformation of the

Egyptian economic structure since 1974. The share of agriculture in GDP decreased from 30 per cent to below 20 per cent in the 1980s and the employment in this sector fell from 47 per cent of total employment by more than ten percentage points. Industry's share of GDP increased from 26 per cent to 35 per cent. However, this was mainly due to the petroleum industry which accounted for 16 per cent of GDP in 1983/84 ^{1/} and only 2 per cent in 1974, such that other industry actually declined as a percentage of GDP. The employment share of industry increased from 17 to 20 per cent. The dramatic change was in the services sector where its employment share increased from 36 to over 43 per cent, although its share in GDP only moved by 4 percentage points from 44 per cent in 1974 to 48 percentage points in 1981/82.

Table 3. Source of GDP ^{a/} and Sectoral Distribution of Employment
in Egypt, 1974 - 1983/84
(per cent)

	<u>1974</u>		<u>1981/82</u>		<u>1983/84</u>	
	<u>GDP</u>	<u>Employment</u>	<u>GDP</u>	<u>Employment</u>	<u>GDP</u>	<u>Employment</u>
Agriculture	30	47	19	37	17	..
Industry ^{b/} (Petroleum)	26 (2)	17	33 (14)	20	35 (16)	..
Services (Production services) ^{c/}	44 (..)	36	48 (30)	43	48 (30)	..

Source: Ministry of Planning.

^{a/} GDP at factor cost, for 1974 in 1975 prices and for 1981/82 and 1983/84 in 1981/82 prices.

^{b/} industry including manufacturing, mining, petroleum, construction, electricity and public utilities.

^{c/} transportation and communications, Suez Canal, trade, finance and insurance, hotels and restaurants.

^{1/} Since 1980/81 national account figures are available on a fiscal year basis.

Services sector

Over the period 1974-1980/81, while employment in agriculture showed a slight decline and employment in all commodity-producing sectors taken together increased by 12 per cent, employment in the service sectors increased by 44 per cent, from 3.3 to 4.7 million. The major part of this increase was public sector employment. In 1980/81 central Government, local governments and public service authorities had 2.1 million employees. This figure increased to 2.8 million in 1984/85 where local governments accounted for most of the expansion.

Recent data on employment in the private services sector are not available. However, the absolute size of public employment in services is indicative of the importance of the "non-productive" component of employment in services.

In 1983/84 "social service sectors" accounted for 18 per cent of GDP, of which 12 per cent was Government services, 4 per cent social and personal services and 2 per cent housing. The share of "production services sectors" in the GDP was 30 per cent. This was made up of trade, 12 per cent; finance and insurance, 7 per cent; transportation and communications, 7 per cent; Suez Canal, 3 per cent; and hotels and restaurants, 1 per cent.

Public enterprises

The non-financial public enterprise sector in Egypt consists of the public economic authorities, i.e., agencies providing public services (such as public utilities and transportation, including the Suez Canal) and the public sector companies. The latter are engaged in a wide range of commercial, industrial

and agriculture related activities. In 1974 the share of public enterprises in total industrial output was 75 per cent. In 1984 this share fell to 66 per cent. However, in certain industries public enterprises maintained their predominant role. For instance, 74 per cent of output in spinning and weaving and 84 per cent of engineering and metallurgical products originated from these enterprises.

Assessment of the operations of public enterprises is extremely difficult due to the lack of data on revenue and expenditure. However, aggregate data on expenditure, direct subsidies and profit transfers that appear in the Government budget strongly suggest that few of the public enterprises are commercially viable. The profit transfers from non-financial public enterprises to the budget appear to be smaller than the funds they receive in the form of subsidies and capital investment.

Recently there has been an increase in the autonomy of the public enterprises to improve their profitability. They enjoy less compulsory hiring of workers and somewhat greater flexibility in pricing. However, they still cannot offer competitive wages and salaries and have to find artificial means to circumvent price controls.

Wage Developments

During the stagnant period from the mid-1960s to 1972, both agricultural and Government wages were almost constant or slightly falling. ^{1/} Since 1973, due to high growth, expansionary fiscal policies, internal migration and emigration, wage rates have been rapidly increasing. The highest increases

^{1/} See Hansen and Radwan (1982), Chapter 4.

were in agriculture where the money wages increased around 20 to 30 per cent annually. Wage developments in the public sector were much more modest at 6 to 12 per cent per year, recently below the urban inflation rate. Wages in public enterprises increased at a somewhat greater rate than Government wages, yet they lag significantly below private sector wages. Although there are no accurate data, supporting evidence to this is the fact that public enterprises have difficulty in retaining their skilled labour force.

Besides its major impact on the general level of wages, emigration to neighbouring oil-producing countries has caused shortages in skilled labour, especially in certain services and construction sectors. As economic activity in these countries has slowed down, it can be expected that construction workers would be among the first to return to Egypt. Yet these will most likely be the less skilled ones.

Another development which can affect the labour market is the slowing down of rural-urban migration, partially due to the increasing gap in the cost of living between rural and urban areas. This should moderate wage increases in the agricultural sector.

Savings and Investment

From 1974 until the early 1980s total real consumption in Egypt increased at an average annual rate of 8 per cent. The average annual rate of increase in the public component of consumption was 9 per cent. During the same period, total real investment expanded at an average annual rate of 13 per cent. This rate was 17 per cent for the private sector, significantly higher than the 11 per cent for the public sector.

Despite this substantial development in real consumption, its share in GDP declined from 94 per cent in 1974 to 77 per cent in 1982/83. The share of gross investment in GDP increased from 23 to 31 per cent during the same period. The change was more pronounced for the private sector investment as its GDP share nearly doubled from 6 per cent in 1974.

Table 4. Consumption, Savings and Investment in Egypt
as Percentage of GDP a/

	<u>1974</u>	<u>1980/81</u>	<u>1982/83</u>
Consumption	94	80	77
Private	(73)	(64)	(60)
Public	(21)	(16)	(17)
Gross investment	23	32	31
Private	(6)	(10)	(11)
Public	(17)	(22)	(20)
Gross domestic savings <u>b/</u>	6	20	23
Resource gap <u>c/</u>	17	12	8

Source: Ministry of Planning and Central Bank of Egypt.

a/ GDP at market prices.

b/ GDP less consumption.

c/ Imports of goods and non-factor services less exports of goods and non-factor services.

Also, the resource gap, i.e., the foreign net savings, narrowed down from 17 per cent of the GDP in 1974 to 8 per cent in 1982/83. However, this did not necessarily imply less dependence on external factors. The displacement was with the emerging "exogenous resources" such as oil and the Suez Canal revenue which expanded at a dramatic rate.

The current rate of consumption, the share of public investment in comparison to private investment, and the resource gap are still too high and cannot be maintained in the medium and longer run. Recently public sector expenditure, notably investment, had to be curtailed.

Public Finances

The share of the public sector in the economy of Egypt has increased significantly during the last decade, contrary to the policy of creating a more liberal economic environment. In 1974 public sector revenues and expenditures constituted, respectively, 27 and 48 per cent of the GDP. In 1980/81 these shares were 43 and 61 per cent of the GDP, respectively. As the revenue from the oil sector is shrinking, there is a downward trend in these shares. However, the public sector deficit remained around 20 per cent of the GDP in 1983/84.

Table 5. Public Finances of Egypt as Percentage of GDP

	<u>1974</u>	<u>1980/81</u>	<u>1983/84</u>
Public sector revenues	27.3	42.6	38.5
of which: Oil & Suez Canal	(11.9)	(13.8)	(6.6)
Public sector expenditure	47.8	60.9	58.0
of which: Current expenses	(24.6)	(26.7)	(28.2)
Subsidies	(9.4)	(12.5)	(10.2)
Investment	(13.8)	(21.7)	(19.7)
Public sector deficit	20.5	18.4	19.5
financed by:			
External sources	(4.7)	(6.4)	(3.8)
Non-Bank domestic sources	(8.6)	(7.0)	(5.9)
Bank financing	(7.2)	(5.0)	(9.9)

Source: Ministry of Finance.

In 1983/84 public expenditure was 58 per cent of the GDP, of which 28 per cent in current expenditure, 20 per cent in investment and 10 per cent in subsidies. Compared to 1980/81 there was a reduction in the share of investment and subsidies, but an increase in current expenses, mainly due to greater interest payments and a higher wage bill arising from expansion in public sector employment.

In 1974 when the per capita income level was significantly lower in Egypt, subsidies amounted to 9 per cent of the GDP. In 1983/84 this share was 10 per cent and more than half of it was spent to subsidise basic commodities.

On the revenue side, taxes on personal income are negligible in Egypt. Taxes on business profits amounted to 16 per cent of total Government revenue in 1983/84. Excise and consumption duties, customs duties, stamp taxes and other miscellaneous taxes collected by the Central Government, added up to 46 per cent of total public revenue. Central Government non-tax revenue, mainly transferred profits from public financial and non-financial enterprises, constituted 30 per cent of total Government receipts.

Taxes on profits of the petroleum sector and the Suez Canal accounted for 34 per cent of all business taxes. Taxes and profit transfers from these two sectors amounted to 17 per cent of total public revenue.

Emigrant Workers

Permanent emigration from Egypt, mainly to the USA, Australia and Canada, was in the range of a few thousand persons a year, and has declined sharply since 1973. On the other hand, the number of Egyptians seeking work abroad jumped from an average of 50 to 80 thousand in 1968-1972 to 157 thousand in

1973. The improvement of relations between Egypt and the other Arab States, the oil boom in the region and the Egyptian Government's encouragement of emigration as a source of foreign exchange accounted for this development. From 1973 to 1980, annual temporary emigration, which was confined to Arab countries of the region, amounted to between 200 thousand and 600 thousand according to alternative estimations. ^{1/} The stock of workers abroad was estimated to be around 360 thousand in 1975. This yields an estimated average duration of stay of about 1.5 years. Hence in 1980 the number of temporary Egyptian workers abroad would have been in the range of 400 to 800 thousand. In the 1976 census the number of Egyptians living abroad was estimated to be 1.4 million. Currently this figure could easily be above 2.5 million.

Statistics on the profile of emigrants which are available up to 1973 show that professionals constituted nearly 40 per cent of the total, whereas, for instance, construction workers made up for only 16 per cent. ^{2/} In the later years, however, unskilled workers, farmers and construction workers were predominant among Egyptian emigrants. Despite this change in profile, it is evident that emigration was not only an important phenomenon for Egypt in sheer numbers, but very much so in accumulated skills varying from scientists and teachers to skilled and semi-skilled workers.

Composition of Imports

The most significant change in the composition of Egypt's import bill since 1970 was the increase in the share of food items, from 23 per cent to 36 per cent in 1975, and maintaining a share above 30 per cent in the early 1980s.

^{1/} See Hansen and Radwan (1982), Chapter 5.

^{2/} Ibid.

In dollar terms, food imports were less than 200 million in 1970, 1.4 billion in 1975 and 2.8 billion in 1982. ^{1/} Imports of cereals alone increased from 70 million dollars in 1970 to 1.3 billion dollars in 1982.

Imports of machinery and equipment were the largest item, accounting for 27 per cent of imports in 1970. There was some reduction in this in the mid 1970s, but as investment accelerated, imports of machinery and equipment rose to 34 per cent of all imports in the late 1970s, stabilising at around 30 per cent in the early 1980s. Again in dollar terms, the increase was huge: from 200 million in 1970 to nearly 3 billion dollars in 1982.

During the same period the share of fuels and industrial inputs such as agricultural raw materials, ores and metals and chemical products declined in total imports while the share of other manufactured products increased.

Table 6. Egypt's Import Structure by Main Product Groups a/

	<u>Foodstuffs</u>	<u>Agricultural Raw Materials</u>	<u>Fuels</u>	<u>Ores and Metals</u>	<u>Chemical Products</u>	<u>Machinery & Equipment</u>	<u>Other Manufactures</u>
1970	23.2	8.3	9.4	9.1	13.0	26.6	10.4
1975	35.9	5.5	6.9	8.5	13.2	20.5	9.5
1980	32.4	6.2	1.1	9.1	9.4	27.3	14.3
1982	30.8	4.6	4.1	6.9	7.8	29.4	16.4

Source: UNSO Series D Trade Tapes.

a/ Foodstuffs SITC 0 + 1 + 22 + 4, Agricultural Raw Materials SITC 2 less (22 + 27 + 28), Fuels SITC 3, Ores and Metals SITC 27 + 28 + 67 + 68, Chemical Products SITC 5, Machinery and Equipment SITC 7, Other Manufactures SITC 6 + 8 less (67 + 68).

^{1/} These are actual import values, not calculated at international prices. Hence, due to domestic subsidies, e.g., in the EEC, the volumes and changes in them can be understated.

Developments in Foreign Exchange Earnings

Exports: structure and destination

As late as 1970, foodstuffs and agricultural raw materials, notably cotton, accounted for about 70 per cent of Egypt's total exports. Since the mid-1970s, exports of crude oil, gas and petroleum products surged drastically to make up nearly 70 per cent of total exports of around 4.4 billion dollars in 1983/84. Until 1981/82 the increase in oil revenue was a result of the combined effect of volume and price increases. For instance, between 1979 and 1981/82, the volume of crude oil exports rose at an annual rate of 14 per cent and the price of oil was up nearly 30 per cent in the latter period. Since then there were major drops in oil prices, and no major gains in export volumes, partially due to the production-sharing agreements with foreign oil companies which make Egypt's share of production sensitive to international prices. Another reason for the recent slow growth in oil exports was increased domestic consumption. Exports of petroleum products declined from about 400 million dollars in 1981/82 to 250 million dollars in 1983/84.

Table 7. Egypt's Export Structure by Main Product Groups a/
(per cent)

	<u>Foodstuffs</u>	<u>Agricultural Raw Materials</u>	<u>Fuels</u>	<u>Ores and Metals</u>	<u>Manufactured Goods</u>
1970	21.3	46.3	4.8	1.6	26.1
1975	17.4	38.5	9.5	2.4	32.2
1980	6.8	15.6	64.3	3.0	10.4
1982	7.4	14.2	66.3	4.1	7.9
1983/84 ^{b/}	..	..	67.9	..	8.2

Source: UN Statistical Office, Series D Trade Tapes

a/ Foodstuffs SITC 0 + 1 + 22 + 4, Agricultural Raw Materials SITC 2 less (22 + 27 + 28), Fuels SITC 3, Ores and Metals SITC 27 + 28 + 67 + 68, Manufactured Goods SITC 5 to 8 less (67 + 68).

b/ Provisional figures from national sources.

Exports of non-oil products were on the whole stagnant due to slow growth in production, rising domestic consumption and depressed profitability of exports as a consequence of foreign exchange, trade and pricing policies. Up to 1983, for example, exporters had to surrender 75-90 per cent of their export receipts to the commercial bank pool, implying payments according to the official exchange rates which were significantly lower than the premium rates. As this condition was dropped, non-oil exports increased by 28 per cent to 1.4 billion dollars in 1983/84. In 1984/85 there was a surge in the exports of textiles and textile products, inspite of the fact that textile exports are constrained by quantitative restrictions in developed market economies and clothing exports face harsh competition from more efficient producers. Exports of engineering products are predominantly "local exports", i.e., sales to Egyptians who have been working abroad.

The destination of Egypt's exports has shifted radically as a result of the termination of most bilateral trade arrangements, closer ties with the West and the surge of petroleum exports. In the early 1970s, 60 to 70 per cent of Egypt's exports were received by socialist countries. In 1983, while

Table 8. Egypt's Exports by Destination
(per cent)

	<u>Developed market</u>	<u>(of which</u>	<u>Socialist</u>	<u>Developing</u>	<u>(of which</u>
	<u>economy countries</u>	<u>EEC)</u>	<u>countries</u>	<u>countries</u>	<u>OPEC)</u>
1970	22.4	(12.6)	58.9	18.5	(3.8
1975	16.5	(12.3)	72.2	11.2	(6.7)
1982	71.1	(43.6)	14.2	9.9	(3.5)
1983 <u>a/</u>	73.3	(...)	5.1	18.0	(2.0)

Source: UN Statistical Office, Series D trade Tapes.

a/ Provisional figures derived from partner country statistics.

this went down to 5 per cent, the developed market economies' share was over 70 per cent, the EEC alone accounting for nearly 50 per cent (preliminary estimate). Developing countries received 18 per cent of Egyptian exports, of which 2 per cent was to oil exporters.

Workers' remittances

Since 1973 workers' remittances grew rapidly, to about 2.4 billion dollars in 1979 and 3.9 billion in 1983/84. However, this level has fluctuated substantially, reaching a low of 2.1 billion dollars in 1981/82. A major reason for the volatility is the fact that officially-recorded remittances consist of "own exchange imports", i.e., private sector imports financed through the free foreign exchange market, and cash remittances through the banks. However, a significant amount of remittances go into foreign currency accounts of residents which are permitted since 1976 and are not subject to exchange controls or statistical monitoring. If it is assumed that net changes in foreign currency accounts of residents are due to workers' remittances, it would appear that the total inflow was relatively stable, around 4 billion dollars annually in the 1980/81 to 1983/84 period.

In 1984/85 there has been a significant reduction in cash remittances and signs of a decline in the total amount, partially due to the reduced level of economic activity and employment in the neighbouring oil-exporting countries.

Tourism and the Suez Canal

In 1975 nearly 800 thousand tourists visited Egypt. 55 per cent of the arrivals were from Arab countries and 35 per cent from the OECD countries. In 1983/84 this number was over 1.5 million and, while the share of Arabs has gone down to 39 per cent, tourists from OECD countries, who accounted for the

increase, constituted 52 per cent of the total. Official receipts of foreign exchange from tourism, which was around 300 million dollars in 1975, increased parallel with the number of arrivals until 1980/81, reaching half a billion dollars, but since then has declined to 300-400 million dollars per year.

One apparent reason for the declining official foreign exchange revenue from tourism was the reduction in the average number of nights spent by tourists, from 7 at the beginning of the 1980s to 5.6 in 1983/84.

The introduction of compulsory purchase of a fixed amount of Egyptian pounds in 1982 and the requirement that currency for the hotel bills had to be exchanged at the commercial bank rate - which was significantly below the free market rate - were factors which adversely affected tourism income. A premium rate for tourists was introduced in 1984 but did not cover the compulsory purchase and hotel bills. Currently, in 1985, the premium rate also applies to hotel bills.

The steady increase in the number of tourist arrivals indicates the potential of this sector for Egypt. Relaxations in the currency exchange regulations and investment to diversify tourism activities - such as in seaside resorts - are expected to induce tourists to extend their stay and expenditures in Egypt.

From 1975, when the Suez Canal reopened, until 1978 the number of transit passages increased significantly. Since then, although this number remained constant, the average net tonnage of the vessels increased by over 50 per cent. The widening and deepening of the channel in 1980, the structure of the toll system and the increasing share of oil tankers in the transit traffic - partially due to the new Saudi Arabian pipeline to Yanbu - accounted for this development.

Suez Canal dues increased rapidly to reach 780 million dollars in 1980/81. Toll fees which were kept unchanged until 1981 have been revised upwards annually since then. By 1983/84 the receipts increased to nearly one billion dollars, despite the appreciation of the dollar against SDRs in which the toll fees are denominated. In 1984/85 there was a decline in the traffic due to concerns about the security of the Canal. Provisional figures also indicate a decline in the receipts by around 4 per cent.

Foreign direct investment

In 1974 a new foreign investment law was enacted giving incentives and guarantees to investors against non-commercial risks, most importantly against nationalisation. An amendment in 1977 clarified certain issues, including the exchange rate provision securing the highest rate prevailing to be used in repatriation of profits and capital.

Direct investment increased rapidly from around 60 million dollars in 1976 to over 300 million in 1978. 1979 was an unusual year when the actual flow reached a peak due to deferred imports of investment goods for projects approved in previous years.

In 1980 total foreign investment, including projects in the implementation stage, was 1.6 billion dollars. Nearly 80 per cent of this was in inland projects and the remainder was in free zones. About a quarter of foreign capital was to set up financial institutions, over 15 per cent in tourism projects, only about 5 per cent in agriculture, and the remainder was in industry.

Since 1980 foreign direct investment has amounted to about 200 million dollars annually.

IV. TURKEY

Background and Major Economic Developments

The Turkish Republic, at its birth in 1923, inherited the huge debts of the Ottoman Empire. Turkey was also obliged to permit the "capitulations" - allowing some foreign countries the right to impose taxes and tariffs - to continue until 1929 to help repay part of the Ottoman debt. There was no conscious economic policy other than relying on private enterprise. Due to the capitulations, neither was there much room for trade policy. The decade of the 1920s was a period of consolidation of the new Republic with numerous political and social reforms. The economy was stagnant partially due to massive population movements associated with the ending of the war and heavy debt-servicing obligations.

With the impact of the great Depression, both psychological and economic (which was felt in export earnings), the free enterprise orientation of the Government ended. The new economic philosophy was that State Economic Enterprises (SEEs) would be the major stimuli to economic growth. Development plans focusing on industrialisation were formulated. Infant industry protection was endorsed and the production of basic industrial goods by the SEEs was implemented. Initially, the economy picked up, with a relatively high growth rate of three to four per cent per annum during 1933-38, but this slowed down to approximately two per cent per annum from 1938 to 1948.

During World War II (Turkey was neutral), some industries' output increased significantly; however, supply bottlenecks hindered rapid expansion in most of them. Despite substantial tax increases, increases in Government expenditures and the disappearance of foreign sources of supply led to inflation. In 1946 the Turkish lira had to be devalued.

A major political change occurred in 1950 when the elections were won by the party which campaigned on a platform of economic liberalisation, i.e., removal of stiff economic controls, encouragement of the private sector and agriculture, reduction of the role of SEEs and a liberal foreign trade and investment regime. ^{1/}

In the years 1951-53, the economy expanded at an impressive rate, 15, 9 and 11 per cent, respectively. The boom originated from agriculture and massive governmental infrastructure investments. But in 1954, as a result of a crop failure, agricultural production dropped by 20 per cent leading to a nine per cent decline in national income. Government expenditure on agricultural price support operations and infrastructure investments became extremely inflationary. The economic policy became increasingly interventionist, emphasis upon agricultural development was reduced and the SEEs once again became a major policy instrument. From 1950 to 1960, under the rule of the Government which came into power on a liberal market platform, the share of the SEEs in industrial value-added increased from 37 to 48 per cent.

Imports doubled between 1950 and 1952. To a large extent this was due to the Korean war boom implying very favourable conditions for the agricultural exports of Turkey and foreign aid. However, already by the end of 1952 the shortage of foreign exchange was acute. Imports were being financed by short-term suppliers' credits and a large volume of overdue debt had accumulated. Until 1958 importers were often not able to get foreign exchange

^{1/} For a detailed analysis of the period 1950 to 1970, see Krueger (1974).

to pay their commercial debts abroad. Starting in 1954, Turkey concluded a number of bilateral agreements with Western European countries for exporting and debt repayment (see Tables 9 and 10 for Turkey's balance of payments).

With high inflation and an over-valued currency, imports were restricted by a maze of quotas, licences and taxes yielding a system of multiple exchange rates. Black markets, especially for imported goods, were flourishing and the economy was progressively slowing down. In 1958 the Turkish lira was (de facto) devalued (maintaining the official rate in which transactions were registered) by 80 per cent in real terms, and a stabilisation programme was adopted. Turkey's foreign debt was consolidated and re-scheduled and sizeable foreign credits were secured. The conditions attached to the debt re-scheduling and credit package, in addition to the devaluation, were the unification of exchange rates, a halt to suppliers' credit financing, limits on domestic credits and the budget, liberalisation of the foreign trade regime, adjustment of the SEEs' prices and removal of price controls. The stabilisation programme led to a recession in its first year, and as the Government was relaxing its policy it was overthrown in 1960. The recession intensified and continued until the end of 1961.

Partly as a reaction to a complete lack of policy co-ordination and the erratic day-to-day management of the economy during the 1950s, in the early 1960s the State Planning Organisation was formed and began implementing the first five-year plan (1963-1967) which was followed by consecutive five-year plans. The major target of the plan was to maintain an annual growth rate of seven per cent by increasing the saving ratio and investment, and to eliminate the need for external finance in 10 to 15 years. New industries were to be

Table 9. Turkey's Balance of Payments 1950 - 1970

(million US \$)

	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Trade balance	11	-40	-126	-72	-86	-125	-53	-15	-37	-70	-86	-83	-168	-193	-42	-26	-145	-78	-190	-189	-262
Exports, f.o.b.	262	314	363	396	335	313	305	331	247	363	336	365	399	395	433	479	494	530	498	537	588
Imports, f.o.b.	252	354	489	468	421	438	358	346	284	433	422	448	567	588	475	505	639	608	688	726	850
Workers' remittances ^{a/}														1	9	70	115	93	..	141	273
Net goods and services	-42	-84	-182	-141	-159	-130	-25	-34	-84	-127	-117	-123	-235	-256	-89	-30	-109	-87	-228	-179	-132
Donations	56	40	52	49	45	51	89	67	91	91	91	99	105	78	23	21	27	29	70	46	62
Private capital	9	-30	43	141	76	12	-29	-61	73	14	25	-34	50	-7	58	-1	-8	-2	11	-10	78
Official capital	8	28	90	-49	28	113	7	126	-47	86	-30	25	111	187	20	39	109	127	193	192	129
Memo items																					
Liras per US \$ ^{b/}	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	14.9
Per cent change in GNP from previous year ^{c/}	..	15.1	8.5	11.2	-8.8	7.2	7.0	6.3	5.2	3.9	3.7	-1.6	6.1	7.7	5.0	4.6	10.2	6.2	6.7	6.2	5.8

a) State Planning Organization (SPO)

b) End of period, official exchange rate (disregarding multiple rates)

c) GNP in 1961 prices, SPO

Source: International Monetary Fund, Balance of Payments Yearbook, various issues.

Table 10. Turkey's Balance of Payments 1970 - 1984
(million US \$)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984 ^{a/}
Trade balance	-360	-494	-678	-769	-2245	-3337	-3169	-4044	-2311	-2808	-4999	-4230	-3097	-3507	-2942
Exports, f.o.b.	588	677	885	1317	1532	1401	1960	1753	2288	2261	2910	4703	5746	5727	7389
Imports, c.i.f.	948	1171	1563	2086	3777	4738	5129	5797	4599	5069	7909	8933	8843	9235	10331
Services, net	188	372	670	1253	1526	1458	867	657	792	1105	1319	1888	1830	1314	..
of which:															
Workers' remittances	273	471	740	1183	1426	1312	982	982	983	1694	2071	2490	2187	1554	1807
Interest payments ^{b/}	-48	-60	-62	-59	-103	-124	-217	-320	-489	-1010	-1138	-1443	-1566	-1512	-1586
Tourism, net	4	21	44	78	42	46	-27	-65	145	179	212	277	262	284	271
Current balance	-172	-122	-8	484	-719	-1879	-2302	-3387	-1519	-1703	-3680	-2342	-1267	-2193	-1407
Repayment of principal on external debt ^{b/}	-146	-125	-130	-77	-156	-147	-119	-214	-451	-945	-1556	-1185	-1502	-2023	..
Private capital	92	72	82	129	146	251	360	1243	728	-160	313	-18	119	493	..
of which:															
Commercial credits	..	..	..	..	55	97	197	1074	561	-370	165	-147	15	365	..
Official capital ^{c/}	420	400	368	381	300	417	576	503	855	1845	3585	2332	2590	2117	..
of which:															
Debt relief ^{d/}	..	..	..	..	30	29	-	-	295	924	1450	850	750	1000	..
IMF, net	66	-1	-116	-	-	216	130	-	170	8	461	335	205	193	..
Memo items															
Liras per US \$ ^{e/}	14.9	14.0	14.0	14.0	13.9	15.0	16.5	19.3	25.0	47.1	89.3	110.2	160.8	223.8	364.9
Per cent change in GNP from previous year ^{f/}	5.9	5.7	10.2	7.4	5.4	7.3	7.9	7.7	3.9	2.9	-0.4	-1.1	4.1	4.6	3.3

^{a/} Provisional

^{b/} Before debt relief

^{c/} Project credits, programme, credits and debt relief

^{d/} Debt relief

^{e/} End of period, official exchange rate (disregarding multiple rates), 1981-1984 annual average

^{f/} GNP in 1968 prices

Source: Office of the Under Secretary for the Treasury and Foreign trade.

established to substitute for imports and exports would be diversified. The role of the public sector through SEEs was emphasised in both the first and second five-year plans, though less so in the latter which was drawn up in a different political environment. The growth objective of the first two plans was by and large fulfilled. During the first plan period (1963-67) GDP increased at an average annual rate of 6.4 per cent and that of the second plan (1968-72) by 6.7 per cent. However, the need for external finance did not fall but increased. As a result of the 1958 devaluation, exports did pick up and until 1968 their growth was higher than projected. Starting from 1966, an export rebate scheme was in effect. Workers' remittances also encouraged by special premia have become a major source of foreign exchange. On the other hand, the need to increase imports was significantly greater than expected. Thus, beginning from 1964 there was a strain on the balance of payments and the import regime was progressively tightened. However, unlike the 1950s, the pressure on the balance of payments was not stemming from excess aggregate demand, but was originating from emphasis on manufacturing and an increased rate of investment.

In 1969, anticipating elections, the Government introduced an inflationary budget putting great pressure on the Turkish lira. Exports stagnated and imports had to be cut back. In 1970 the lira was devalued and special rates were eliminated. Yet export rebates on manufactured exports were retained. There was a rapid increase in foreign exchange earnings immediately after the devaluation and the import regime was liberalised again.

In the third plan period (1973-77), to achieve high growth the rate of investment was accelerated. The share of public sector fixed investment in the manufacturing industries reached 50 per cent. An average annual GDP growth of 7.2 per cent was achieved.

From 1974 on, however, this expansion relied heavily on external financing, mostly on a short-term basis. Firstly, the domestic savings rate, partially due to explosive increases in public investment and consumption, was far below the investment rate. Secondly, the capital-output ratio increased considerably as import substitution moved into intermediate goods. Thirdly, the import bill was inflated by the new oil prices and higher prices for all items, mostly capital goods and industrial inputs. Finally, with stagflation and high unemployment in the West, foreign exchange earnings, both from exports and workers' remittances, were stagnating.

By the end of 1977, as the short-term external debt peaked, the inflow of external capital dried up. Inflation and shortages started to soar. To avoid a complete collapse, short-term debt had to be consolidated and rescheduled and long- and medium-term credits had to be secured. Stabilisation programmes were announced in 1978 and 1979 yet public spending continued to increase. Inflation rose to over 50 per cent in 1978 and over 80 per cent in 1979. Growth fell to approximately four per cent in 1978 and in 1979 the GDP decreased by 0.6 per cent. In 1978 and 1979 the current account deficit was brought down to less than half of the 1977 record of 3.4 billion dollars. However, this was achieved mainly by severe import restrictions.

In 1980, an economic stabilisation programme was launched which radically changed the whole orientation in economic policy. Known as the 24 January programme, ^{1/} its elements in extended form constitute today's rules of the game in Turkey. Including modifications in later years, ^{2/} these were:

^{1/} See OECD (1980), Annex I.

^{2/} See OECD (1980)-(1985) Calendar of Main Economic Events.

- a) (following a major devaluation) liberalisation of the foreign exchange system, including daily adjustments of the exchange rate (since May 1981);
- b) a liberal import regime implying a move from restrictive licensing and quotas;
- c) export orientation;
- d) liberal application of the foreign investment code;
- e) (following a significant upward adjustment) revision of the SEEs' prices and the abolition of price controls;
- f) maintaining positive real interest rates; and
- g) co-ordination and centralisation of money, credit, investment and foreign trade policies at the top level of the Government.

Lowering tax rates on income, a tax reform introducing a value-added tax and abolishing SEEs' tax privileges were among the other major moves in the later years. Since 1980 labour activities and wages are regulated by guidelines set by the State. Also, lay-offs are virtually forbidden.

In 1980, the initial response of the economy was a one per cent decline in GDP and an inflation of 100 to 120 per cent. However, this was brought down to around 35 per cent in 1981 and 30 per cent in 1982 and 1983, until it started rising again to the 40 to 50 per cent range in 1984 and 1985. Economic growth resumed in 1981 and the GDP growth rate was above four per cent per annum during 1981-83, reaching nearly six per cent in 1984. Exports increased from 2.3 billion dollars in 1979 to 7.4 in 1984. Workers' remittances went up to a record level of over two billion dollars per year. With the help of fresh credits, imports could be increased from five billion dollars in 1979 to eight to nine billion dollars annually during 1980-83 and to over ten billion in 1984.

Population, Structural Change and Employment

Turkey's population growth over the past 20 years has been, on average, 2.5 per cent annually. This has recently gone down to 2.1 per cent, yet due to previous high birth rates, the working age population (aged 15 to 64) is increasing at a rate of 2.8 per cent. A major slowdown in this latter rate is not expected before the late 1990s.

In 1984 Turkey's population was 48.8 million, and the working age population 28.6 million. With a labour force participation rate of 63 per cent, the total civilian labour force was 18 million. The participation rate has shown a drastic decline since the 1950s but particularly during the last decade. This rate was 84 per cent in 1950 and 72 per cent in 1970. A decline related to structural change is characteristic in developing countries. However, behind this extraordinary magnitude lies the phenomenon of "discouraged workers", i.e., individuals who have removed themselves from the labour market because of perceived inability to obtain jobs.

Including disguised unemployment in agriculture, out of a labour force of 18 million, 3 million, or 16.5 per cent, were unemployed in 1984. Disguised unemployment in agriculture was estimated to be 665 thousand persons. In the early 1960s 77 per cent of the economically active population was in agriculture. As agriculture's share in GDP declined from 34 to 22 per cent, its employment share went down to 60 per cent in 1984. Industry (manufacturing, mining, energy, gas and water and construction) contributed 25 per cent of GDP in the early 1960s, which has increased to 30 per cent in 1984. During the same period industrial employment has gone up from 10 to 16 per cent of total employment. The contribution of services to GDP increased from 41 to 48 per cent while the employment share of this sector doubled from 12 to 24 per cent.

Table 11. Sources of GDP ^{a/} and Sectoral Distribution of the Economically Active Population in Turkey
(per cent)

<u>Sectors</u>	<u>1962</u>		<u>1984</u>	
	<u>GDP</u> <u>b/</u>	<u>Employment</u>	<u>GDP</u>	<u>Employment</u>
Agriculture <u>c/</u>	34.0	77.2	22.1	60.0
Industry <u>d/</u>	25.0	10.4	29.9	16.2
(Manufacturing)	(16.0)	(7.5)	(..)	(11.1)
(Construction)	(..)	(2.1)	(..)	(3.7)
Services	41.0	12.4	48.0	23.8
 TOTAL	 100.0	 100.0	 100.0	 100.0

Source: State Institute of Statistics and State Planning Organisation

a/ GDP at factor cost

b/ GDP pertains to 1965

c/ Agriculture includes livestock, forestry and fishing

d/ Industry includes mining, quarrying, manufactures, electricity, gas, water and construction

Employment in the non-agricultural sectors of the economy increased by an average of 5 per cent per annum from the early 1960s to 1975, by 4 per cent per annum during 1975-1980 and by 2.5 per cent per annum during 1980-1984.

During the 1979-1984 period there were approximately 650 thousand job applications per year to the Employment and Labour Placement Office. Applicants who found employment through this channel decreased from 212 thousand in 1979 to 151 thousand in 1982. This number increased to 158 thousand in 1983 and to 178 thousand in 1984. However, according to the Labour Placement Office, the number of registered unemployed increased by over 30 per cent in the 12-month period in March 1985, reaching 922 thousand.

Causes of the Decreasing Rate of Job Creation

The most important and apparent reason for declining rates of employment creation since the mid-1970s was slower economic growth related to the balance-of-payments situation. Foreign savings, which climbed from 2 per cent of the GNP in 1973 and 1974 to 5, 6 and 7 per cent in 1975 to 1977, respectively, fell to 3 per cent of the GNP in 1978 and to 2 per cent in 1979. As the inflow of foreign funds could not be maintained, investment had to be curtailed. In 1978 the volume of fixed capital investment declined by 10 per cent, followed by 4 and again 10 per cent reductions in 1979 and 1980, respectively. At the same time, mainly due to shortage of foreign exchange, capacity utilisation in industry had fallen below 40-50 per cent.

The fundamental causes of slower growth in output and employment, however, lie in the investment strategy consciously pursued since the early 1960s, and carried out to its extreme in the early 1970s. Significant increases in incremental capital-output and output-employment ratios were unavoidable outcomes of heavy reliance on import substitution for industrialisation. Fixed investment in Turkey increased by 9.4 per cent annually in real terms during the 1963-1967 period and 8.1 per cent during 1968-1972, generating growth rates of around 6.5 per cent annually. In the 1973-1977 period the annual rate of fixed investment nearly doubled, its share in the GNP increasing from 18 to 20 per cent, yet the rate of economic growth accelerated marginally, less than one percentage point. Parallel to this development, the average incremental capital-labour ratio increased by 40 per cent between the first two periods and by 38 per cent between the second and the third.

Table 12. Public, Private and Total Fixed Investment: Shares
in GNP and Annual Volume Change
(per cent)

	1963/1968/		1973/								
	1967	1972	1977	1978	1979	1980	1981	1982	1983	1984	
Share in GNP:											
Total fixed investment	..	17.8	19.8	21.7	20.4	19.5	18.9	18.9	19.0	18.3	
(Private/total)	..	..	(49.9)	(51.8)	(50.3)	(44.2)	(37.3)	(38.9)	(39.7)	(41.1)	
<hr/>											
Annual volume change:											
Total fixed investment	9.4	8.1	14.8	-10.0	-3.6	-10.0	1.7	3.4	3.0	2.0	
Public	8.5	6.5	16.7	-13.7	4.6	-3.7	9.4	2.2	1.8	-0.3	
Private	10.5	9.8	12.8	-6.0	-11.6	-17.3	-8.8	5.4	4.8	5.6	

Source: State Institute of Statistics and State Planning Organisation

The existence of substantial unutilised capacity in industry during the late 1970s and the early 1980s also retarded the creation of new jobs. Low capacity utilisation, particularly in manufacturing, has been a chronic problem in Turkey. In the 1960s and 1970s foreign exchange shortage was the main reason, while shortfall of demand persisted only briefly following stabilisation measures. In the late 1970s, combined energy and foreign exchange shortage and labour market conflicts brought down capacity utilisation in manufacturing below 40 - 50 per cent. By 1980-81, foreign exchange was no more a binding constraint on capacity utilisation yet this rate only gradually increased to 60 per cent in 1981 due to weak domestic demand. Although capacity utilisation increased significantly in the following years, to 70 per cent in 1983 and to 80 per cent in 1984, demand shortage remained the prime problem for industry. As part of the Government's labour policy, firms have not been allowed to lay off redundant workers since 1980. Hence the labour "pool" within the firms partially explains the weakness of demand for labour despite economic recovery.

Starting in 1981, fixed capital investment has been increasing, yet only marginally. Since 1982 the main source of this modest increase has been the private sector. Hence the share of the private sector in fixed investment,

which fell from 50 per cent in the 1970s to 37 per cent in 1981, gradually increased to 41 per cent in 1984.

Real Wages, Savings and Investment

Developments in real wages, savings and investment in Turkey witness the weakness of the link between the former and the two latter macro variables. Namely, the level of real wages did not significantly affect either the savings ratio or the rate of investment.

Real wages in Turkey showed an almost steady increase during the 1960s. In 1971-72 there was a fall but consumption continued to increase. In the 1973-1977 period, one could talk of a "wage explosion". However, this did not affect the domestic savings rate. Furthermore, it was a peak period of investment for both the public and private sectors. For the private sector this was the reflection of lack of competition and excess profits granted by investment subsidies and high protectionism.

Since 1978 real wages have been declining steadily at an annual rate of 5 to 10 per cent. Private consumption fell by an average annual rate of approximately 4 per cent during 1978 to 1980, and since then has been climbing up gradually. During the period 1978 to 1981 the share of private savings in the GNP increased up to 17 per cent, i.e., 7 percentage points (in 1979) above its trend value of 10 per cent, to drop back in 1982. In the meantime, the fall in public savings, especially in 1979, almost compensated for the austerity in the private sector, except in 1980 and 1981 (see table 13).

In 1983 and 1984, although real wages continued to decline 5 to 10 per cent, the volume of private consumption increased by 5 per cent both years.

**Table 13. Percentage Volume Change of Consumption and Change in Real Wages
(over previous year) in Turkey, 1970-1984**

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Consumption	2.4	12.5	6.6	1.2	9.1	8.3	10.2	5.0	-2.4	-2.5	-3.4	0.6	3.4	4.6	5.1
Public	3.3	6.5	7.3	10.3	9.9	13.5	10.8	3.2	9.9	1.7	8.8	0.8	3.5	1.8	3.9
Private	2.3	13.6	6.4	0.2	9.0	7.7	10.1	5.2	-3.9	-3.1	-5.2	0.6	1.5	4.9	5.3
Real wages <u>a/</u>															
MI survey <u>b/</u>	..	..	..	8.5	4.2	10.3	3.4	2.1	-5.2	-3.5	-7.2	6.1	-4.5	-5.2	-9.8
SII data <u>c/</u>	..	-5.4	-1.4	8.4	1.4	3.7	14.5	0.7	-12.3	-13.6	-25.1	-8.0	-4.0	3.9	-5.4

a/ 1970-1980 nominal wages deflated by Istanbul cost of living index, 1981-1984 deflated by the State Institute of Statistics' consumer price index.

b/ MI survey (Annual Survey of the Manufacturing Industry) wage is calculated by dividing total payments by the number of persons engaged.

c/ Average daily wage reported by Social Insurance Institute

Source: State Institute of Statistics and State Planning Organization

A recent positive development which could be related to lower wages was the increase in private fixed investment since 1982. However, this was in the range of 5 to 6 per cent per annum and increases in domestic and export demand seemed to be the main factor behind this development.

Table 14. Savings in Turkey as a Percentage of GNP

<u>Years</u>	<u>Private Savings</u>	<u>Public Savings</u>	<u>Total Domestic Savings</u>	<u>Foreign Savings</u>
1963-1967	8.5	7.1	15.6	1.8
1968-1972	9.8	8.6	18.3	1.3
1973-1977	10.1	7.9	18.0	3.6
1978	13.0	6.7	19.8	2.7
1979	17.2	2.6	19.7	2.0
1980	15.7	5.3	21.0	5.2
1981	11.9	8.6	20.5	3.5
1982	9.2	8.9	18.2	2.1
1983	9.2	7.3	16.5	4.1
1984	11.3	5.3	16.6	3.5

Source: State Planning Organisation.

Public Finances and State Economic Enterprises

The consolidated budget deficit, which was 2 to 3 per cent of the GNP in the early 1970s, jumped to 6 per cent in 1977 as public consumption and investment increased from 23 to 28 per cent of the GNP. During the crisis years of 1978 and 1979 expenditure remained at this high level. Starting in 1980, as a result of austerity measures, public expenditure gradually declined to 20 per cent of the GNP in 1984. Initially, this reduced the budget deficit to 2 to 3 per cent of the GNP. However, in 1984 the deficit went up again to 5 per cent of the GNP due to a major shortfall in tax revenues. This was the result of lowering income tax rates and some other taxes and charges, and the inability of many enterprises to pay taxes due to insolvency.

Table 15. Public Finances in Turkey as a Percentage of GNP

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Revenues	21.6	24.0	23.5	18.9	20.3	19.6	18.7	15.3
(Tax revenues)	(19.2)	(18.9)	(19.8)	(16.0)	(18.2)	(14.9)	(16.7)	(12.9)
Expenditures	27.6	26.9	27.5	24.2	22.9	21.6	21.9	20.3
(Transfers to SEEs)	(3.6)	(3.1)	(3.8)	(3.7)	(4.1)	(3.2)	(2.5)	(1.5)
Balance	-6.0	-2.9	-4.0	-5.3	-2.7	-2.1	-3.3	-5.0

Source: Ministry of Finance, Under-Secretariat of Treasury and Foreign Trade.

Tax revenue constitutes 85-90 per cent of total public revenue in Turkey. Over 60 per cent of this is taxes on income, predominantly personal income. The recent introduction of the value-added tax (VAT) aims at shifting this burden from fixed incomes. To promote the VAT the Government has introduced a tax return scheme which will delay the benefits of the reform.

In 1983 and 1984 the prices of the State Economic Enterprises' (SEEs) output were raised substantially to reflect costs. Consequently, taken together, SEEs' operating losses turned to sizeable gross profits. To meet the investment requirements of the SEEs, budgetary resource transfers are still needed. However, these transfers, which were on the order of 3 to 4 per cent of the GNP, amounted to 1.5 per cent of the GNP in 1984.

Currently the share of the SEEs in the GDP is 8.6 per cent and they account for 22 per cent of total industrial value-added.

Emigrant Workers

The massive emigration of Turkish workers started in the early 1960s. Their destination was predominantly Western Europe, in particular West

Germany. The migration culminated in 1973 when a yearly record of almost 136 thousand was set. Together with the oil shock and the following recession in the West, the number went down to 20 thousand in 1974 and to a bare four thousand in 1975. Since 1975 Northern African and Middle Eastern oil producers, particularly Libya and subsequently Saudi Arabia, became the major destinations of Turkish workers and emigration to the West became negligible. The peak in emigration to Iraq, Libya and Saudi Arabia was reached in 1981, putting the total at 59 thousand. This later wave of workers' emigration was related to the Turkish contractors' construction activities in the region. As the falling oil prices put financial pressure on these countries, the construction activities are on a downward trend. In 1984 the number of Turkish workers emigrating was down to 42 thousand.

Table 16. Emigration of Turkish Workers, 1962 - 1984
(in thousands)

Year	Number of Workers	Year	Number of Workers	(of which to Western countries (%))
1962	11	1973	136	(98)
1963	30	1974	20	(90)
1964	66	1975	4	(36)
1965	52	1976	11	(34)
1966	34	1977	12	(21)
1967	9	1978	19	(13)
1968	43	1979	24	(8)
1969	104	1980	29	(10)
1970	130	1981	59	(2)
1971	88	1982	49	(1)
1972	85	1983	52	(1)
		1984	42	(1)

Source: Labour Placement Office.

The "guest workers" of the 1960s and early 1970s to Western Europe had an average stay of four to five years in the host countries. ^{1/} By gaining

^{1/} See Aker (1972).

social and economic rights in the host countries and as a result of integration with the host countries' societies to some extent, some have become quasi permanent. Currently there is a net return of Turkish workers from the West. Yet despite incentive schemes for their return, given their low chances of finding employment and the relative level of wages in Turkey, a voluntary mass return of workers cannot be expected.

Emigrant Turkish workers going to North Africa and the Middle East resemble the "guest workers" of the 1960s to Western Europe, with one difference. The qualifications of the workers who went to the West were significantly higher than those of the average Turkish labour force. ^{1/} This had at times led to shortages in skilled labour in some Turkish industries.

The flow and stay of Turkish workers in the North African and Middle Eastern region are mainly determined by economic factors. Hence the current decline in this region's economies can be expected to have serious repercussions.

To conclude, however, today's level of emigration and return of Turkish workers in relation to the labour resources of the country is minor. Neither a drastic change in this, nor any major impact on the domestic labour market is expected in the near future.

Composition of Imports

Prior to the oil price increase of 1973, investment goods and industrial inputs predominated in Turkey's import bill. In 1970, imports of machinery and

^{1/} Aker (1972).

equipment accounted for 41 per cent of total imports. Another 17 per cent was chemical products, mainly inputs.

As a result of the oil price increases, the share of fuels in the import bill jumped from 8 per cent in 1970 to 18 per cent in 1975, and further to nearly 50 per cent in 1980. Currently this share is around 35 per cent of total imports.

During the recession in the late 1970s which was related to the balance-of-payments crisis, imports of machinery and equipment fell sharply both in absolute terms and as a share of total imports. In 1975 when it was still possible to pursue an expansionary investment policy by the help of external borrowing, imports of machinery and equipment amounted to 1.6 billion dollars, or 35 per cent of total imports. These figures in 1980 were 1.3 billion dollars and 18 per cent, respectively.

Table 17. Turkey's Import Structure by Main Product Groups ^{a/}

	<u>Food-</u> <u>stuffs</u>	<u>Agr. Raw</u> <u>Materials</u>	<u>Fuels</u>	<u>Ores and</u> <u>Metals</u>	<u>Chemical</u> <u>Products</u>	<u>Machinery</u> <u>and Equipment</u>	<u>Other</u> <u>Mfrs.</u>
1970	7.6	4.7	7.5	11.5	17.4	41.2	10.2
1975	7.4	2.3	17.5	17.3	14.1	34.8	6.6
1980	3.5	1.6	48.5	7.8	16.1	18.1	4.4
1983	1.8	2.9	43.8	10.9	15.0	20.5	5.0

Source: UNSO Series D Trade Tapes.

^{a/} Foodstuffs SITC 0 + 1 + 22 + 4, Agricultural Raw Materials SITC 2 less (22 + 27 + 28), Fuels SITC 3, Ores and Metals SITC 27 + 28 + 67 + 68, Chemical Products SITC 5, Machinery and Equipment SITC 7, Other Manufactures SITC 6 + 8 less (67 + 68).

Currently, as investment is gradually picking up and as foreign exchange availability has improved considerably, imports of capital goods are increasing both in absolute and relative terms. Imports of intermediate goods

have reached record levels allowing a high capacity utilisation in the industry.

A novel development in Turkey's foreign trade is the emergence of consumer goods imports which were negligible during the last three decades. Although they constitute less than five per cent of total imports, it is a major break with the philosophy of the past import regimes.

Developments in Foreign Exchange Earnings

Exports: structure and destination

In 1970 nearly half of Turkish exports were foodstuffs and another 40 per cent was agricultural raw materials and ores and metals. Manufactured goods (narrowly defined as SITC 5 to 8 less 67 + 68) had a share of only eight per cent. By 1983 this share had increased to 40 per cent. If broadly defined including processed agricultural products, etc., 64 per cent of Turkish exports were manufactures in 1983. Preliminary figures for 1984 put this share at 72 per cent.

Table 18. Turkey's Export Structure by Main Product Groups ^{a/}

	<u>Foodstuffs</u>	<u>Agricultural Raw Materials</u>	<u>Fuels</u>	<u>Ores and Metals</u>	<u>Manufactured goods</u>
1970	49.3	33.6	0.6	8.1	8.4
1975	45.5	20.3	2.6	9.3	22.4
1980	51.1	13.6	1.4	8.0	25.9
1983	38.3	6.6	4.1	10.8	40.3

Source: UNSO Series D Trade Tapes.

^{a/} Foodstuffs SITC 0 + 1 + 22 + 4, Agricultural Raw Materials SITC 2 less (22 + 27 + 28), Fuels SITC 3, Ores and Metals SITC 27 + 28 + 67 + 68, Manufactured Goods SITC 5 to 8 less (67 + 68).

Textiles and clothing were the leading manufactured exports, accounting for 26 per cent of total exports of goods in 1984. They showed an increase of 89 per cent in 1981 and 32, 23 and 44 per cent, respectively, in the following years. During the same period, exports of a number of manufactured products expanded rapidly from an insignificant base.

Table 19. Turkey's Exports of Processed and Manufactured Products,
1980 and 1984

(million US dollars)

	1980	(as percentage of total exports)	1984	(as percentage of total exports)
Processed agricultural products	190	(6.5)	808	(11.3)
Textiles and clothing	440	(15.1)	1875	(26.3)
Hides and leather	50	(1.7)	401	(5.6)
Forestry	8	(0.3)	24	(0.3)
Chemicals and industry	76	(2.6)	173	(2.4)
Rubber and plastics	16	(0.6)	97	(1.4)
Petroleum products	39	(1.3)	409	(5.7)
Glass and ceramics	36	(1.2)	146	(2.0)
Cement	40	(1.4)	56	(0.8)
Iron and steel	34	(1.2)	576	(8.1)
Non-ferrous metals	18	(0.6)	86	(1.2)
Metal products and machinery	30	(1.0)	134	(1.9)
Electrical equip. & products	12	(0.4)	100	(1.4)
Motor vehicles	50	(1.7)	134	(1.9)
Others	8	(0.3)	126	(1.8)
All items above	1047	(36.0)	5145	(72.1)

Source: State Planning Organisation

While in 1970 developed market economy countries received 75 per cent of Turkish exports, this figure went down to less than 50 per cent by 1983. Also, the share of socialist countries in total exports declined from 14 to 4 per cent during the same period. The big gain was in exports to developing countries, which absorbed 46 per cent of Turkish exports in 1983. The major markets for Turkish products were the Middle Eastern and North African countries. Iran, which became Turkey's largest market in 1983 had a share of 19 per cent, followed by Iraq and Saudi Arabia (each approximately 6 percent),

Libya (3 per cent) and Algeria, Jordan, Lebanon and Kuwait (around 2 per cent each). In 1984, however, exports to developed market economies expanded at a faster rate while exports to oil producers of the North African and Middle Eastern region either stagnated or declined. Exports to developed market economy countries constituted over 52 per cent of the total, of which the EEC accounted for 38 per cent. West Germany once again became Turkey's major export market with a share of 18 per cent.

Table 20. Turkey's Exports by Destination
(per cent)

	Developed Market Economy Countries	(of which EEC)	Socialist Countries	Developing Countries
1970	75.4	(48.8)	14.4	10.2
1975	71.2	(43.9)	8.8	19.9
1983	49.2	(35.3)	4.4	46.4
1984	52.4 ^{a/}	(38.3) ^{a/}	4.0 ^{a/}	43.6 ^{a/}

^{a/} Provisional figures from national sources.

Source: UNSO, Series D Trade Tapes.

Workers' remittances

By the mid-1960s workers' remittances were around 100 million dollars a year. In the late 1960s and early 1970s, as annual emigration of workers reached about 100 thousand, their remittances climbed rapidly. The peak was 1.4 billion dollars in 1974. In 1975 this flow decreased by 100 million dollars and, with a further major drop in 1976, stabilised at one billion dollars until 1979.

Since 1974 as emigration to Western Europe was sharply curtailed - never to pick up again - a stagnation in workers' remittances was inevitable. However, the fall of 30 per cent over the 1974 level was the result of the Turkish lira's overvaluation. During the foreign exchange crisis of the late

1970s, the black market rate was substantially higher than the official exchange rate. The fact that in 1979, when a premium rate was applied to workers' remittances, they increased by 70 per cent to 1.7 billion dollars, can be taken as proof that their actual level never declined, but they were flowing in from unofficial channels. In 1980 and 1981 there was a further increase in workers' remittances, reaching 2.5 billion dollars. The exchange rate policy, which by and large eliminated black markets, and confidence in political and economic stability, would account for this development.

In 1982 and 1983 there was a fall in the level of workers' remittances which picked up somewhat to 1.8 billion dollars in 1984. The peak in the early 1980s was a once and for all phenomenon. The recent fall can be considered to be a signal of stagnation in the source of foreign exchange since the returning workers from Western Europe outnumber new emigrants and emigration to the oil-producing countries of the region is stagnating, if not declining. *

The fifth five-year plan counts on a gradual increase in the workers' remittances, reaching nearly two billion dollars in 1989. This has presumably two sources: one is a gradual shift of the accumulated savings of Turkish workers in Western Europe and the other is remittances from the countries of the region, mostly associated with Turkish contractors' construction activities. The latter is regulated by agreements such that part of the wage bill is directly transferred through official channels by the contracting firms.

Tourism

An extremely underexploited source of foreign exchange in Turkey is tourism. Turkey's revenues from tourism constitute a small fraction of the

foreign exchange earned by comparable countries in the Mediterranean area. Part of this probably may be explained by the insufficiency of facilities and the restrictiveness of (previous) foreign currency regulations. Also, the political turmoil, especially in the late 1970s, definitely had a retarding effect on tourism. However, probably the most important cause of the slow growth in this industry, in addition to lack of major investments, was competition from countries like Spain and Greece. Currently there seems to be a change in the trend as the former tourist paradises are to some extent losing their attraction due to over-familiarity, congestion and increased price levels (in major currencies). Also, for tourists from Moslem countries, religious and cultural factors give Turkey a comparative advantage. With the exchange rate policy since 1980, Turkish prices are extremely attractive and there are no exchange restrictions for foreigners. Domestic and foreign investments in the tourism sector are eligible for most favourable investment incentives. It can be expected that there will be a rapid expansion in tourism revenue in the medium and longer term. However, since restrictions on foreign travel of Turks are also by and large eliminated, it may take some time for tourism expenditure to level off to yield a significant increase in net tourism revenue.

From 1970 to 1975 annual net tourism revenue was around 50 million dollars. In 1976 and 1977 it was negative and from 1978 to 1980, although the number of incoming tourists stagnated, net revenue increased to around 200 million dollars due to strict restrictions on Turks travelling abroad and the devaluation which shifted a greater portion of foreign exchange to official channels. In 1981, gross tourism revenue was 350 million dollars. In the following years it increased 5 to 10 per cent annually and in 1984 by 33 per cent to reach 548 million. Tourism expenditure by Turks abroad was around 110 million dollars in 1981 and 1982, which increased by 17 per cent in 1983 and

118 per cent in 1984 to 277 million dollars; thereby net tourism revenue was down to 271 million dollars in 1984 from 284 million in 1983.

Turkish contractors abroad

Starting from the late 1970s, Turkish contractors were taking part in the huge construction activity in the North African and Middle Eastern oil-producing countries. From 1978 to 1984 the number of Turkish companies operating abroad increased from 22 to 296, ^{1/} and their total outstanding contracts from 1.7 to 15 billion dollars. The initial concentration of Turkish firms in Libya decreased as Libya started facing a financial squeeze and as Turkish firms moved into new markets. In 1984 there were 120 Turkish contracting firms operating in Saudi Arabia, 105 in Libya, 35 in Iraq, 11 in Jordan, six in Kuwait and 19 in other countries. The remittances of these companies (including affiliated Turkish workers' remittances) totalled 233 million dollars in 1983.

Table 21. Turkish Contractors Abroad

	1978	1979	1980	1981	1982	1983	1984
Number of companies ^{a/}	22	30	62	113	242	283	296
Remittances ^{b/} (million US\$)	56	80	91	161	209	233	..
Outstanding contracts (million US\$)	1,675	2,099	3,517	9,052	12,576	14,028	14,975

^{a/} Firms which operate in more than one foreign country are double counted. In 1984, for instance, there were 66 such firms. Hence the number of individual firms was 230.

^{b/} Remittances include affiliated Turkish workers' remittances

Source: Turkish Contractors' Association.

^{1/} 66 firms had operations in more than one foreign country. Hence the net number of firms operating abroad in 1984 was 230.

The importance of Turkish contractors abroad is far beyond the operating profits which are transferred to Turkey. Firstly, they create employment for Turkish labour, especially for the semi-skilled workers. Secondly, they open markets for Turkish exports. On both accounts the expansion during recent years is closely related to the construction activities of the Turkish contractors. Finally, the international financial and trade operations of the contractors have significantly contributed to the new outward-looking orientation of the Turkish economy.

As the oil boom in the Middle East and North Africa has ended, the expansion of the operations of the Turkish contractors cannot be expected to keep up with the previous rate. During the last two years the increase in the total outstanding contracts of Turkish firms has slowed down and it appears that they are paying greater attention to possibilities of diversifying their markets, notably trying to move in the Far East. Their future success in expansion will be to a greater degree a function of their competitiveness and upgrading their know-how to get a larger share in a shrinking market. Some Turkish contractors are already well established in relatively sophisticated projects. Yet it should be noted that during the 1973-1984 period 98 per cent of total overseas contracts of the Turkish firms was in construction activities, only two per cent in design, engineering services, maintenance, etc.. This is a low start in an area where competition from developed countries and some relatively industrialised developing countries is fierce.

Foreign direct investment

Although since 1954 Turkey had a liberal "Law for the Encouragement of Foreign Capital", the amount of foreign direct investment in Turkey has been relatively low. In 1979 there were 91 firms with a total foreign capital of 228 million dollars.

Table 22. Foreign Direct Investment Approvals in Turkey

Period	Number of Firms	Amount (million US\$)	Cumulative (million US\$)
Up to 1979	91	228.1	228.1
1980	100	97.0	325.1
1981	127	337.5	662.6
1982	170	167.0	829.6
1983	185	102.7	932.3
1984	215	271.0	1,204.3

Source: State Planning Organisation.

The unattractiveness of Turkey for foreign investments can partially be explained by the considerable red tape prior to 1980. In 1980 there was a shift in the level of foreign investment. However, for 1980, 1981 and to some extent 1982, this was mostly due to the possibility of converting non-guaranteed Turkish trade debts into equity participation and physical investments. ^{1/} On the other hand, the high level of 1983-84 foreign investment approvals totalling 374 million dollars reflects the increased attractiveness of Turkey for foreign investors, including the liberal application of the investment code.

Of the 215 firms in 1984, 166 were operating in the manufacturing sector and 43 in services. Lately, as the banking sector was opened to foreign competition, it has been attracting a considerable amount of foreign investment.

Despite the recent dynamism in foreign direct investment in Turkey, and its importance in certain sectors such as chemicals, etc., at a macro level it is far from being a major source of investible funds. Since the red tape in

^{1/} See OECD (1983), Annex I.

granting permissions is significantly reduced, and the incentives are already generous, there is not much that the Government can do on this front. Nevertheless, passing the pending new legislation which would further simplify the procedures and the opening of duty-free zones, which are in the implementation stage, are moves which can have a positive impact in attracting foreign investment. What counts most, however, is to convince potential investors of the stability of the economy and the rules of the game.

V. CONCLUSIONS AND POLICY IMPLICATIONS

Two similar cases

Both Egypt and Turkey have shown that, through expansionary policies with a major public consumption and investment component, high rates of growth and job creation could be achieved. However, it was also observed that this was not sustainable if savings did not accelerate. Another bitter experience was that when their foreign trade regimes discriminated against export activities and economic expansion absorbed a greater portion of the exportables, the economy would first hit the foreign exchange ceiling.

During brief periods, following devaluations and/or the introduction of premium rates for exports, workers' remittances and tourism, both countries registered dramatic increases in exports and other foreign exchange inflows. However, these accomplishments were short lived, as new waves of expansionary policies increased domestic absorption and soon the currencies became overvalued.

As a consequence of the foreign trade regime, the domestically-generated recessions tended to be more severe and to last longer when investment became less efficient, i.e., less value-added and less employment was generated with the same amount of investment, and as the import content of production and investment proved to be inflexible. The external economic and political environment and particular events exerted a decisive influence on the timing, intensity and duration of the recession and boom periods, inter alia, by affecting export and other foreign exchange revenues and availability of external resources, and by determining import prices. In the case of Turkey, unlike Egypt where international conflicts and wars caused major disruptions, the cyclical pattern was more stylistic and regular. With ten-year intervals starting with the early 1950s, expansionary periods were followed by severe balance-of-payments crises and recessions.

The availability of foreign resources which made recessions more tolerable and contributed to recovery at the same time lessened the pressure for reorientation of the basic policies. In the case of both Egypt and Turkey, their political and strategic importance has given them some leverage in securing official capital inflows, including military-related aid which had a significant spillover to other sectors. For instance, the knowledge that they would be somewhat rescheduled seems to have contributed to the huge build-up in short-term and suppliers' credits during the mid-1970s in both Egypt and Turkey.

For a brief period, in 1977, Egypt and Turkey were in a similar situation. They were unable to finance the current account deficit and creditors were demanding austerity measures. Although foreign donors stepped in, cash did not come rapidly. Egypt went as far as introducing major increases in the prices of basic foodstuffs to reduce public expenditure, yet the measures had to be quickly rolled back due to popular unrest.

Carrot to one, whip to the other

Given this situation, the second major rise in oil prices dealt Turkey the final blow while helping Egypt's balance of payments. Also, the greater amounts of foreign aid Egypt has received, especially from other Arab countries, made a big difference to the outcome in the two countries.

For the first time in the last three decades, Turkey was faced with the absolute necessity of fundamental changes in its policy orientation. In the late 1970s, compared to similar situations in the 1950s and the 1960s, with a much bigger economy and industry, import requirements and the resource gap were many fold greater in both absolute and relative terms. Short-lived austerity measures, a temporary slowdown in economic activity and some export

Incentives could no more suffice for recovery. The external funds needed for servicing debt and bolstering the economy were huge, Turkey's creditworthiness was extremely low and foreign donors had become weary. Hence, in adopting and adhering to the "January 24 Economic Programme" in 1980, Turkey had no other realistic alternatives.

Rapid economic growth during the last decade in Egypt from the very beginning depended on substantial inflows of foreign funds. It may be fair to assess the major motive of Egypt in declaring the "open door" policy in 1974 as to tap resources from the West and Western-oriented Arab countries. Already in 1975 Egypt could finance a deficit of 2.5 billion dollars in its current account, or nearly 60 per cent of its imports. As the oil exports, the Suez Canal and tourism revenues picked up, there was less need for foreign funds. Also, the rapid increase in workers' remittances significantly contributed to Egypt's capacity to import. However, the partial replacement of foreign funds by other exogenous sources of income and foreign exchange was not a major change with respect to achieving a balanced economy necessary for sustainable economic development. Exogenous resources - defined in this case as the petroleum and natural gas sector, workers' remittances and net foreign capital inflows - which constituted 6 per cent of total available resources in 1974, went up to over 40 per cent in the early 1980s. This dependence also applied to Government revenue. In the early 1980s the petroleum sector and the Suez Canal alone provided nearly 20 per cent of total Government revenue.

The spectacular expansion of the external sector in Egypt while allowing for an unprecedented growth in the service sectors, suppressed or hindered development in other productive, particularly commodity-producing, sectors. This phenomenon could probably be considered the developing country variety of "the Dutch Disease" which inflicted countries like the Netherlands, Norway and the United Kingdom. While the booming sector put a resource squeeze on other

tradeable sectors, rising income levels absorbed a greater proportion of exportables. With a predominant public sector, increased revenues from the booming sector paved the way for the creation of a premature "welfare state".

- Public sector revenues constituted up to 40 per cent of the GDP, expenditures reached 60 per cent (of the GDP) yielding a public sector deficit of about 20 per cent of the GDP. The public sector accounted for one-fourth of total consumption and two-thirds of gross investment.
- Direct subsidies paid by the Central Government accounted for nearly 20 per cent of total Government revenue. Basic commodity subsidies alone used 10 per cent of the total revenue.
- During the period 1980/81 - 1984/85, public sector employment increased by an annual compound rate of 6.5 per cent. In 1984/85 the public sector had 3.2 million employees. Central and local Government accounted for 77 per cent of this while public service and public economic authorities had the remaining 23 per cent.
- University graduates were guaranteed employment in the public sector.
- Lay-offs in the public companies are not permitted.

In a populous country with a rapidly expanding economy, the share of external resources in foreign exchange, savings and Government revenue are bound to decline. Stagnation in export earnings and in workers' remittances are already leading to a curtailment of both the public sector and free market imports. Public sector investment declined, so did the growth rate, from 9 per cent in 1982/83 to 7.6 per cent in 1983/84. If the current trend in the

external sector continues, it is questionable that the 8.1 per cent target annual growth rate of the plan covering the period 1982/83 - 1986/87 will be reached. Yet this is not the main issue. For the coming years, in principle, Egyptian funds invested abroad would alone be sufficient to fulfil plan targets.

Any lessons to take?

Egypt is in a way at the beginning of an episode where to maintain high growth and employment it will have to expand and improve the efficiency of its tradeable sectors and start an export drive in non-oil products. Developments in oil prices and over-all economic activity in the region - which are both falling - and the treatment of Egyptian workers abroad will be decisive factors in determining the urgency of a major adjustment. The major challenge Egypt will have to face at some point will be of a political rather than economic nature. Egypt may no longer be able to guarantee employment or a certain living standard for low-income groups. Expectations built on rapidly increasing consumption levels during the past decade might also have to be frustrated.

The experience Turkey had to go through recently, its achievements, failures, and the prospects in the near future are of considerable relevance to Egypt.

The substantive reorientation of economic policies in Turkey in January 1980 was preceded by a 3 to 4-year period of economic paralysis and intensified political violence. Not long after the economic measures were announced, the armed forces took charge of the country. Hence the political viability of the economic measures was not tested for a couple of years. The subsequent endorsement of the policies by a large majority was to a great

extent the consequence of relief after the chaotic political and economic situation of the late 1970s.

The impressive accomplishment Turkey achieved through the reorientation of its foreign trade and exchange regime was the persistent expansion in exports and other foreign exchange receipts since 1980. However, economic recovery was slow, investment was low and job creation was negligible. These were the consequences of the grave initial conditions when the new policies were launched. Foreign donors and creditors were not willing to continue financing the huge resource gap. Over half of the industrial capacity was idle. Hence the adjustment Turkey has been going through has not only been painful in terms of reduced consumption, but in the absence of new investment, has not significantly altered the production structure. As domestic demand was suppressed, and export activities became profitable, whatever was feasible to sell abroad was exported. Also, the special circumstances due to the Iran-Iraq conflict and the construction activities of Turkish contractors in the Middle East and North Africa, have played important roles in this export drive. Without new investment and an efficient production structure geared to international competition, maintaining the export boom will be difficult for Turkey. The fact that export subsidies have to be lowered will not make things easier. ^{1/}

The most important lesson for Egypt is that postponing adjustment can bear significant costs. In a "last hour" rescue operation with strict austerity measures which halt growth, and with limited external resources, adjustment is extremely difficult and a longer time is needed for changing the production

^{1/} By signing the GATT Subsidy Code, Turkey pledged to phase out export subsidies by 1989. It is believed that this will increase Turkey's market access.

structure. While there is no substantial open unemployment and resources are still available to maintain a high level of investment, Egypt should deal with the problems in its public sector and induce a major shift of resources to productive sectors. Expansion in public employment has to be contained and public expenditure, especially subsidies, has to be tackled. To initiate such changes without having to go through a major crisis and with maintaining public support is the challenge for the Egyptian leadership.

To increase efficiency in resource use, both in current production and in allocation of investible funds, Egypt has to give more room to private initiative and allow the supply and demand factors and international prices to penetrate the domestic price structure.

In 1984 the share of public enterprises in total industrial output was 66 per cent, and 74 per cent in spinning and weaving and 84 per cent in engineering and metallurgical products. Nearly 30 per cent of the value of industrial production (under the supervision of the Ministry of Industry) was subject to centralised price control. Given the price controls and the employment and wage policies imposed on the public companies, a fundamental change in their performance cannot be expected. The recent drive to improve the profitability of public companies is giving some positive results. However, to some extent this is achieved by distortive practices such as artificial product discrimination to evade price controls. Not allowed to pay competitive wages and salaries, the inability of public companies to attract skilled personnel is also a major hindrance in improving managerial efficiency and product quality.

In addition to industry, agriculture and productive service sectors deserve great attention for their role in employment and the balance of payments. The share of agriculture has fallen to less than 20 per cent of the

GDP and below 40 per cent of employment. Egypt has become a major importer of foodstuffs which constitute 30 per cent of its total imports. Agricultural raw materials add another 5 per cent to the import bill.

The squeeze put on by the booming oil sector and emigration to urban centres and to neighbouring countries had a major negative impact on agriculture. Also, it seems that large prestigious projects such as land reclamation schemes absorbed great resources with meagre returns. Furthermore, pricing policies which discriminated against crops with high yields played an important role in the decline of agriculture.

Attaining major increases in agricultural output and hence reducing net imports in this sector should be a high priority for Egypt. The fact that wages in agriculture have been increasing much more rapidly than in the other sectors of the economy points to the employment potential of agriculture.

The services sector in Egypt accounts for nearly half of the GDP and over 40 per cent of employment. Expansion of unproductive employment in services was related to the public sector and the boom in the external sector which created fringe or marginal jobs. Parallel to this, however, the share of production services in the GDP reached 30 per cent, being trade, 12 per cent; finance and insurance, and transport and communications, each 7 per cent; Suez Canal, 3 per cent; and hotels and restaurants, 1 per cent. Unfortunately, no data are available for employment and productivity in these sub-sectors.

There is no a priori reason to take for granted that production and employment are less productive and less desirable in competitive service industries compared with industries producing goods. On the contrary, there is evidence that the availability of some key service inputs plays a crucial role in the development of other sectors. Furthermore, the increasingly

tradeable nature of many services give them the potential of being major sources of foreign exchange. Tourism and construction are cases in point.

While unproductive employment in services is a major burden to Egypt and has to be cut down, particular service sub-sectors should be studied to evaluate their potential contribution to the economy in order to formulate relevant policies.

Finally, concerning Egypt's export potential, the main constraint is supply conditions, including high domestic absorption. Egypt's exports are predominantly petroleum and petroleum products and face only marginal protection abroad. Therefore Egypt's immediate gains from a liberalisation abroad would be limited. However, if production and domestic demand conditions allowed and Egypt launched an export drive, protectionism would severely limit the expansion of exports in a number of products, notably in processed food, textiles and clothing.

Egypt has shown interest in participating in the negotiations for a Global System of Trade Preferences (GSTP) among developing countries. Due to its current low level of trade with developing countries and its supply constraints, this may not bring about a significant increase in Egypt's exports, and furthermore its trade balance may be affected negatively in the short run. However, in reorienting the Egyptian economy towards export activities and in increasing its competitiveness, in particular in its manufacturing industry, the GSTP could provide some of the needed stimuli (see Annex II).

The way to success: persistence in prudence

For Turkey, which has undertaken a major structural adjustment effort, to receive the rewards there is no option but to persist with the export-oriented

strategy. The continuation of the current policy orientation is also necessary to maintain international creditworthiness to secure inflow of capital. In its efforts to further expand exports, market access will be extremely important for Turkey.

Despite economic recovery, major concerns are the absence of indications of a reduction in unemployment, high inflation, a low investment level and signs of an end to the rapid expansion of exports. The balance of payments does not pose an immediate threat; however, the possibility that exports may fail to expand at previous rates would change the situation. The budget deficit, which increased from 3.3 per cent of the GNP in 1983 to 5 per cent in 1984, is the major concern. Besides interest payments on debt, an important contributing factor to the deficit was the failure of tax revenues to rise with growing incomes and activity. Lowering of income tax rates and some other taxes and charges was one reason. The inability of many enterprises to pay taxes due to insolvency - which also had a negative effect on investment - was another. This was the outcome of raising interest rates and tightening credit to bring down inflation.

To serve as a basis for evaluating Turkey's problems and options in the medium term, reviewing the parameters and projections of the fifth five-year plan for the period 1985-1989 is useful. The plan projects an annual GNP growth rate of 6.3 per cent which would accelerate from 5.5 to 7 per cent by the end of this period.

Employment is expected to grow by nearly 2 per cent a year, bringing down unemployment from 16.5 per cent to below 14 per cent of the labour force. This would be achieved by an annual average export volume growth of 10 per cent and import growth of 8 per cent. Workers' remittances would reach 1.9 billion dollars and net tourism income around half a billion. Interest

payments on foreign debt would amount to 1.5 billion dollars per year. Given these, the prospective current account deficits would be around 1.5 billion dollars. Debt repayments (including IMF commitments) would be some 2.2 billion dollars per year. The flow of foreign direct investment is also counted on to reach an annual rate of 300 million dollars. The remaining deficit and debt repayments are expected to be financed by medium- and long-term credits, mainly from official sources. This would still necessitate increased short-term credits above one billion dollars a year.

These projections imply that the current account deficit will fall from about 3 per cent of GNP in 1984 to 1.5 per cent in 1989. The debt service ratio would fall from around 29 per cent of exports of goods and services to 18 per cent during the same period.

For the necessary investment of an annual average 21 per cent of the GNP, 6.2 per cent is expected to come from public savings and 12.9 per cent from private savings. On average, public sector net savings (after public investment is deducted) would be negative in the order to 5.3 per cent of the GNP. This would be financed by net private savings, 3.4 per cent, and the foreign deficit, 1.9 per cent of the GNP.

The projections demonstrate three crucial relations. The first is that annual growth rates of 6-7 per cent are necessary to bring down unemployment. Secondly, the calculations underline the fact that the balance of payments remains a binding constraint on the rate of growth. Even if the export expansion is sustained, substantive amounts of foreign capital will be needed. Thirdly, for the given growth rate, the exercise reveals that to meet the investment requirements, if public expenditure is not restrained, private incomes will have to bear the cost.

Given that the balance of payments sets the limit on growth, both as a resource and foreign exchange constraint, expanding exports of goods and services and cutting down resource waste are the primary concerns for the medium run. Further improvements in the competitiveness of industry and accelerating export-oriented investment are necessary to reach this goal.

Increasing protectionism in developed market economies is already a major hindrance in Turkey's export expansion. Turkey's manufactured exports to these countries are predominantly textiles and clothing. These and most other major export products - which are agriculture based and/or relatively labour intensive - are subject to very restrictive non-tariff measures. It is estimated that, for instance, a general liberalisation in the EEC could lead to the expansion of imports from Turkey by 32 per cent. Textiles and clothing would constitute over 80 per cent of this increase. A number of other industries would also enjoy high rates of expansion. These were foodstuffs and beverages, rubber products, plastic products, pottery and china, iron and steel and electrical machinery. These estimates understate potential gains in other products which have a low base to start with due to nearly prohibitive protection. Nevertheless, the conclusion is that a liberalisation in developed market economies would have significant production, export and employment effects for Turkey (see Annex I).

Recently, developing countries of the region have become Turkey's major trading partners. Turkey exports a great variety of products to these countries. In case Turkey, not being a member of the Group of 77, cannot participate in the GSTP, this trade would be affected negatively. However, since Turkey's trade with them to a large extent involves special circumstances, including trade associated with Turkish contractors' activities, the greater detrimental effect of not being in the GSTP would be on its trade potential with developing countries of other regions.

Probably the major challenge for Turkey in the medium run, besides export expansion, is managing the inflation/growth trade-off. High interest rates and tight credit policies to bring down inflation cause insolvency in the private sector and discourage investment, badly needed to diversify and expand efficient production of exportables. Hence well-managed public finances would significantly relax the inflation/growth trade-off. To avoid undesirable effects on the private sector and on lower incomes, the domestic savings rate should be augmented by increasing public savings. Public expenditure has to be cut down and revenues must be increased by reducing tax evasion and by broadening the tax base. The value-added tax reform is a positive and important step in this direction.

Major increases in the prices of the State economic enterprises' output have eliminated their operational losses. However, substantial public funds are still injected to meet their investment requirements. Efficiency of these enterprises has to be increased by further subjecting them to market forces. Reflecting their high costs to consumers is not a long-term solution.

Combatting structural elements behind inflation would also be a very productive effort in the context of the inflation/growth trade-off. Concerning imports, removing imperfections in the import regime, such as some of the privileges given to industrialists and exporters, would reduce speculative price increases. If the balance-of-payments situation is under control, allowing the imports of any product where a shortage appears - which is currently practised on a minor scale - could be adopted as a general measure. Improvements in the domestic distribution and marketing systems, especially in agricultural and food products, can increase the incomes of this sector while having a dampening impact on inflation.

Finally, the labour market conditions in Turkey must be reviewed. Currently wages are determined within guidelines set by the State and lay-offs are, in principle, forbidden. In Turkey, where basically market forces are entrusted with the allocation of resources, conditions in the labour market constitute a major exception. Moderation in wages rather than direct intervention, allowing the supply and demand factors to operate, could lead to significant productivity increases.

ANNEX I

INFLUENCE OF PROTECTIONISM IN MAJOR DEVELOPED MARKET ECONOMIES:

POSSIBLE EFFECTS OF TRADE LIBERALISATION

As a result of the Tokyo Round of trade negotiations, the average tariff level on manufactured goods in developed market economies has gone down to below four per cent. However, the use of various types of non-tariff measures (NTMs) has been increasing, especially on products in which developing countries have a comparative advantage. ^{1/} For instance, trade in textiles and clothing is strictly regulated by the Multi-Fibre Arrangement. Furthermore, trade in the agricultural sector is by and large governed by national domestic agricultural practices.

With the help of a trade simulation model, an effort has been made to quantify the likely magnitude of trade expansion resulting from a complete liberalisation of tariffs and non-tariff measures (NTMs) in the EEC, Japan and the USA facing imports from all countries which receive Most-Favoured Nation (MFN) treatment. The same exercise was repeated for a liberalisation covering only imports from countries which are beneficiaries of the Generalised System of Preferences (GSP) in each market. ^{2/} Interpreted from a different angle the exercises offer some quantification of the impact of protectionism in the West on Egypt's and Turkey's exports. However, since the calculations are based on actual exports, potential export gains are understated in sectors

^{1/} See UNCTAD (1985 b).

^{2/} Including least-developed country beneficiaries.

where protectionism is extremely high or prohibited. The simulation results concerning the EEC's, Japan's and the USA's imports from Egypt and Turkey are reported in this section. 1/ Since the exercise is based on imports, it should be noted that the import values differ from the exports of Egypt and Turkey to the markets concerned. 2/

The model used for the estimations makes the calculations at the tariff line level using actual applied tariff rates. The ad valorem equivalents of NTMs, on the other hand, are extremely crude approximations. The term "full liberalisation" is used to mean the removal of both tariffs and NTMs in the markets concerned. As a result of the liberalisation, imports from Egypt and Turkey increase together with all countries in the MFN scenario, and together with GSP countries in the next scenario. The increase is the sum of "new trade", i.e., trade creation and displacement of other suppliers, that is, trade diversion. 3/

1/ The UNCTAD Trade Policy Simulation Model was used for the exercise (see UNCTAD/TD/B/1039 (Part I), Annex II). The author is grateful to Samuel Laird for this particular application. The simulation model calculates only the primary or impact effect of the liberalisation. For price elasticities of import demand, the most detailed estimates available for the respective markets were used. The substitutability of goods originating from Egypt and Turkey, and other suppliers, i.e., the elasticity of substitution was assumed to be 1.5 (which is a conservative assumption compared to 2.5 normally used in similar simulations for trade among developed countries). Export supply was assumed to be perfectly elastic implying that increased exports do not lead to supply shortages and hence price increases. However, sensitivity analysis concerning this assumption showed that when supply is not perfectly elastic, within reasonable ranges, the price effect compensates for loss in volume leaving the revenue by and large unchanged.

2/ This is due to the timing differences in the registry of imports and exports, differences arising from CIF and FOB pricing and a number of other questions related to invoicing and customs clearance practices.

3/ In the scenario where liberalisation is on an MFN basis, there is both trade creation and trade diversion resulting from the removal of tariffs. However, since the discriminatory nature of the NTMs is not identified, their removal only results in trade creation. In the scenario where liberalisation is confined to imports from GSP countries, there is trade creation and trade diversion resulting from both the removal of tariffs and NTMs.

For both Egypt and Turkey, the EEC is the major market among developed market economies. In 1983, the imports of the EEC totalled 2.5 and 1.8 billion dollars, respectively, from the two countries. Imports of the USA from Egypt and Turkey were below 300 million dollars each and Japanese imports were 250 million dollars from Egypt and a mere 54 million from Turkey. Petroleum and petroleum products constituted more than 85 per cent of all the EEC's and USA's imports from Egypt and 70 per cent of Japan's imports from this country. Given that petroleum and petroleum products face only marginal trade hindrance in these markets, a liberalisation would significantly affect only a fraction of Egypt's exports.

In the case of Turkey, agricultural products and metals and ores predominated in Japan's and the USA's imports. Agricultural products constituted approximately 30 per cent of the EEC's imports from Turkey and textiles and wearing apparel had a share of over 40 per cent. Hence, for Turkish exports taken together, tariffs and NTMs in all three markets were significantly more restrictive than in the case of Egypt, implying substantially greater benefits from a liberalisation.

The simulation exercise shows that a full liberalisation on an MFN basis in the EEC, Japan and the USA would lead to an increase in imports from Egypt by 2.8, 2.3 and 3.9 per cent, respectively. In the event that the liberalisation was extended only to GSP beneficiaries [Egypt being one in all three markets] these figures would be 5.1, 3.3 and 4.2 per cent, respectively. It should, however, be noted that, since the substitution elasticity between Egyptian goods and goods from other sources was assumed to be 1.5, in particular the latter estimates are extremely conservative.

Table 23. Possible Effects of a Liberalisation in the EEC, Japan and the USA on Imports from Egypt and Turkey

	I	II	III	III/I	IV	IV/I
	1983 import value (million US\$)	Trade weighted average tariff rate facing the respective country in the respective market (per cent)	Increase in imports due to full liberalisation of tariffs and NTMs on an MFN basis (million US\$)	(Percentage increase in imports)	Increase in imports due to full liberalisation of tariffs and NTMs for GSP beneficiaries (million US\$)	(Percentage increase in imports)
Imports from Egypt by:						
EEC	2,532.0	0.9	72.8	(2.8)	129.9	(5.1)
Japan	250.1	1.0	5.8	(2.3)	8.2	(3.3)
USA	293.5	0.8	11.5	(3.9)	12.3	(4.2)
Imports from Turkey by:						
EEC	1,753.8	6.4	564.5	(32.2)	-	(-)
Japan	53.5	6.6	2.7	(5.0)	3.7	(6.9)
USA	293.8	5.2	19.7	(6.7)	23.3	(7.9)

Data source: Trade and tariff data GATT tapes.

Estimations: UNCTAD Trade Policy Simulation Model, see UNCTAD/TD/B/1039 (Part I) Annex II.

In the case of Turkey, a full liberalisation in Japan and the USA on an MFN basis was estimated to induce an increase of 5 and 6.7 per cent, respectively, in imports from Turkey. A liberalisation limited only to GSP beneficiaries - as Turkey is in both markets - would put these figures at 6.9 and 7.9 per cent, respectively. The magnitude of a possible increase in the EEC's imports from Turkey as a result of a full liberalisation on an MFN basis appears to be huge. ^{1/} The figure is over half a billion dollars and implies an increase of 32.2 per cent over the 1983 trade value.

The Manufacturing Sector

The EEC is by far the major market for both Egypt and Turkey in the West. A closer look into the composition of the EEC's imports from the two countries and the possible magnitude of trade gains for the manufacturing sector of Egypt and Turkey is worthwhile.

In 1983, the EEC's imports of manufactures - defined according to the industrial classification ISIC 3 ^{2/} - from Egypt constituted only 16.4 per cent of total imports from that country. On the other hand, 99 per cent of the projected increase in imports under the MFN liberalisation and 98 per cent of the increase in the GSP liberalisation scenario were expected to come from manufactures. Put differently, while the projected increases for imports from Egypt taken as a whole were 2.8 and 5.1 per cent, respectively, in the two scenarios, for manufactures alone these figures were 17.4 and 30.7 per cent,

^{1/} As an associate member of the EEC, Turkey receives special preferences and is not among the GSP beneficiaries. Therefore the second scenario is not relevant for Turkey.

^{2/} This is a broader definition of manufactures compared to the one defined on trade classification SITC 5 to 8.

respectively. The figures in manufacturing, reflecting Egypt's potential gains from more liberal markets, are still low due to the fact that petroleum products constitute nearly half of the manufactured imports from Egypt. Given relatively low trade barriers in these products, a liberalisation would only bring about 15 - 25 million dollars of trade gains over the 1983 figures. An increase in production of this order in this capital-intensive industry would have negligible employment effects. Excluding petroleum products, the projected increase in trade in the manufacturing sector is on the order of 55 to 105 million dollars over an actual trade volume of 220 million dollars, or 25 to 48 per cent. These potential trade gains pertain mainly to food products, textiles and clothing, which face extremely high levels of protection. Although these products are relatively labour-intensive, the trade volumes involved are too low to have any significant employment impact in Egypt.

The conclusion of the simulation for Egypt is that since its current exports are predominantly petroleum and petroleum products which face only marginal protection, Egypt's immediate trade gains from a liberalisation in the major markets would be very limited. However, it should be noted once again that the exercise is based on actual trade performance. If supply and domestic demand conditions allowed and Egypt launched an export drive, protectionism would severely limit the expansion of exports in a number of products, notably in processed food, textiles and clothing. In this event, the gains resulting from liberalisation abroad would be correspondingly great.

In the case of Turkey, 63 per cent of the EEC's imports, i.e., 1.1 billion dollars belonged to the manufacturing sector (broadly defined as ISIC 3) . Turkish textiles and clothing (wearing apparel) imported by the EEC amounted to nearly 750 million dollars. Ninety-eight per cent of the projected increase in imports from Turkey resulting from a full liberalisation in the

EEC (on an MFN basis) would be manufactures. ^{1/} Textiles and clothing would constitute 88 per cent of this. Also, a number of other industries which have a low export base would enjoy high rates of expansion. These were foodstuffs and beverages, rubber products, plastic products, pottery and china, iron and steel and electrical machinery.

The employment effects of export expansion due to increased market access would be very significant for Turkey since most goods involved are labour intensive. Take for instance the hypothetical increase in exports of textiles and clothing to the EEC. If there were no excess capacity in the industry, this would directly translate into increased output. A crude calculation shows that this gives an increase in output of roughly 10 per cent. Using the average output/employment ratio, ^{2/} it is found that this production increment implies nearly 20 thousand new jobs. ^{3/}

^{1/} This understates the potential gains in agricultural products due to the fact that the exercise is based on actual trade values; trade in items which face strict restrictions is negligible to start with.

^{2/} Using an incremental output/labour ratio would be more accurate. Yet it was observed that this ratio was very unstable.

^{3/} This is only the first impact effect; secondary effects through increased production in other sectors and effects due to increased import requirements, etc., are excluded. For a thorough analysis, see, e.g., Lydal (1975).

**Table 24. EEC's Imports of Manufactures from Turkey and Projected Increases
Resulting from a Full Liberalisation of Tariffs and NTMs in the EEC
on an MFN Basis**

ISIC	Industry	EEC's imports from Turkey 1983 (million US\$)	(Trade-weighted average tariff rate (%))	Increase in imports from Turkey due to liberalisation (million US\$)	(Percentage increase in imports)
311		63.5	(9.9)	24.3	(38.2)
312	Food products	2.3	(12.4)	0.9	(38.5)
313	Beverages	5.3	(19.5)	2.1	(38.4)
321	Textiles	519.3	(8.5)	292.4	(56.3)
322	Wearing apparel	228.8	(10.9)	194.7	(85.1)
323	Leather and products	1.5	(4.8)	0.3	(19.4)
331	Wood products	1.4	(5.5)	0.1	(7.4)
341	Paper and products	1.2	(6.4)	0.1	(8.2)
342	Printing, publishing	1.1	(1.1)	0.0	(1.5)
351	Industrial chemicals	23.8	(6.6)	5.2	(21.9)
352	Other chemical products	5.3	(2.5)	0.2	(4.3)
353	Petroleum refineries	179.4	(5.9)	17.6	(9.8)
354	Petroleum, coal products	0.9	(1.7)	0.1	(5.3)
355	Rubber products	4.4	(5.1)	1.3	(29.1)
356	Plastic products	0.8	(8.3)	0.3	(42.0)
361	Pottery, china, etc.	1.0	(11.8)	0.5	(49.1)
362	Glass and products	17.9	(10.1)	3.4	(19.0)
369	Non-metal products	2.7	(5.2)	0.2	(7.9)
371	Iron and steel	7.2	(7.7)	4.3	(59.1)
372	Non-ferrous metals	6.2	(1.0)	0.1	(1.0)
381	Metal products	8.1	(3.3)	0.6	(7.5)
382	Machinery	8.8	(3.5)	0.5	(5.4)
383	Electrical machinery	4.0	(7.3)	1.2	(29.8)
384	Transport equipment	9.3	(4.0)	0.7	(8.1)
390	Other industries	1.8	(4.2)	0.3	(16.1)
Other manufacturing (ISIC 314, 324, 332 and 385)		0.5	-	0.1	(14.0)
Total Manufacturing		1,106.5	-	551.3	(49.8)

Data source: Trade and tariff data GATT tapes.

Estimations: UNCTAD, Trade Policy Simulation Model, see UNCTAD/TD/B/1039 (Part I), Annex II.

ANNEX II

TRADE POTENTIAL WITH DEVELOPING COUNTRIES:

POSSIBLE EFFECTS OF A GLOBAL SYSTEM OF TRADE PREFERENCES (GSTP)

Egypt and Turkey have shown interest in participating in a Global System of Trade Preferences (GSTP) among developing countries which is at present in a preparatory phase. Also, previously, both countries were among the active participants in trade negotiations among developing countries under the GATT Protocol which was adopted in the early 1970s. The GATT Protocol, originally signed by 16 countries, did not lead to any major trade expansion. ^{1/} Besides its limited country and product coverage, the exclusion of non-tariff measures (NTMs) makes the Protocol ineffective. The GSTP, on the other hand, as suggested by the Group of 77, is meant to deal not only with tariffs, but also with para-tariffs (i.e., taxes and charges on imports other than customs duties) and NTMs among developing countries and cover other instruments for trade expansion such as "direct trade measures including long-term contracts and arrangements relating to trade in specific sectors".

It can be expected that the developing countries will, in the context of the GSTP, agree upon an across-the-board 10 to 20 per cent cut in the tariffs facing each other. This has to be accompanied by some preferential liberalisation of the NTMs for the tariff cuts to have any significant effect on trade expansion. Tentative estimates using a trade simulation model show that a 20 per cent linear across-the-board preferential tariff cut by

^{1/} See Hamza (1981) for a review of the GATT Protocol.

all developing countries would expand South-South exports by nearly 3.5 per cent assuming that NTMs will be relaxed to accommodate this increase. ^{1/} As the model is set up, trade expansion is proportional to the tariff cut, i.e., a 10 per cent across-the-board linear cut would yield a 1.7 per cent increase in South-South exports. An across-the-board preferential tariff cut accompanied by relaxations on NTMs would affect the trade balances of individual countries differently depending, inter alia, on the structure of their current exports and imports and the initial level of their tariffs.

Egypt's average level of tariffs weighted by its imports from all sources was 24 per cent in 1981. The product group which faced the highest tariffs was manufactures (SITC 5 to 8) with a weighted average of 36 per cent followed by agricultural raw materials, 24 per cent, chemicals and foodstuffs both around 16 per cent, ores and metals 13 per cent, and fuels 5 per cent.

Due to Egypt's structure of imports, there was a significant difference between the average tariff rates faced by imports from developing countries and those from developed countries. The trade-weighted tariff rates were 36 per cent for the developing countries and 23 per cent for the developed. In major product groups with significant imports (foodstuffs and manufactures) this difference was pronounced. It was calculated that a 20 per cent

^{1/} This is the primary or impact effect of the tariff cut, not taking into account secondary effects. The simulation model assumes that the import demand elasticity of developing countries resembles that of Japan - for which detailed data are available. Furthermore, the elasticity of substitution between developed and developing country goods is assumed to be 1.5. Finally, supply conditions are not taken into account by assuming infinite supply elasticity. Yet sensitivity analysis on this final assumption shows that less elastic supply conditions do not significantly affect the export revenues, due to the fact that price increases compensate for the reduction in volume. For the simulation model and the assumptions used, see UNCTAD/ECDC/179, in particular Annex III.

Table 25. Average Trade-Weighted Tariff Rates ^{1/} of Egypt
in Major Product Groups ^{2/} (per cent)

Product Groups	Tariff rates weighted by imports from developed countries	Tariff rates weighted by imports from developing countries	Tariff rates weighted by imports from all sources
Foodstuffs	13.9	29.2	15.8
Agricultural Raw Materials	24.4	22.2	24.0
Ores and Metals	13.2	10.6	13.1
Fuels	5.3	15.2	5.4
Chemicals	16.5	6.5	16.3
Other Manufactures	34.1	50.4	35.6
All Items	22.8	35.5	24.1

^{1/} Tariffs and trade weights used pertain to 1981. For the methodology used in taking trade-weighted averages, see UNCTAD/ECDC/179, Appendix I.

^{2/} In terms of the (Revision 1) Standard International Trade Classification (SITC), the product groups were defined as follows: Foodstuffs (SITC 0 + 1 + 22 + 4); Agricultural Raw Materials (SITC 2 less (22 + 27 + 28)); Ores and Metals (SITC 27 + 28 + 67 + 68); Fuels (SITC 3); Chemicals (SITC 5); Other Manufactured Goods (SITC 6 to 8 less (67 + 68)); All Items (including SITC 9).

Source: UNCTAD Trade Information System (TIS)

across-the-board preferential tariff cut for imports originating from developing countries would increase Egypt's total imports by 43 million dollars whereas Egypt's exports to developing countries would expand by 10 million dollars, which is an increase of 2.7 per cent. The greatest projected increases in both exports and imports were in miscellaneous manufactures.

This possibility, that Egypt's trade balance may be affected negatively as a result of a GSTP, has to be qualified: the exercise is based on actual trade flows, in this case 1981 figures due to data availability and does not take into account untapped export potential.

The decision of Egypt to participate in the GSTP negotiations can be considered a very positive move. In reorienting the Egyptian economy towards export activities and in increasing its competitiveness, in particular of its manufacturing industry, the GSTP would provide some of the needed stimuli.

Recently developing countries of the region have become Turkey's major trading partners. This trade could be affected negatively in case Turkey, not being a member of the Group of 77, cannot participate in the GSTP. However, since Turkey's trade with the region's developing countries to a large extent involves special circumstances including trade associated with Turkish contractors' activities, the greater detrimental effect of not being a part in the GSTP would be on its trade potential with developing countries of other regions.

**Table 26. Egypt's Trade with Developing Countries and Projected Changes
in Egypt's Exports, Imports and Trade Balances, in Major
Product Groups, due to the Adoption
of a GSTP, ^{1/} (million US\$)**

Product Group ^{2/}	Egypt's 1981 trade with developing countries ^{3/}		Projected trade change due to GSTP			
	Exports	Imports	Increase in Exports ^{4/}	(as % of exports to developing countries)	Net increase in imports from all sources ^{5/}	Net change in overall trade balance
Food	127.0	342.4	2.9	(2.3)	6.5	- 3.6
Agricultural Raw Materials	64.7	56.5	0.5	(0.7)	2.4	- 1.9
Ores and Metals	31.2	24.0	1.8	(5.9)	1.0	0.8
Fuels	81.8	0.2	1.2	(1.4)	0.0	1.2
Chemicals	14.7	17.0	0.3	(1.9)	0.2	0.1
Other Manufactures	49.4	271.4	3.3	(6.7)	32.9	- 29.6
All Items	369.7	721.8	10.1	(2.7)	43.2	- 33.1

^{1/} The projections are based on a 20 per cent linear tariff cut applied by all developing countries on all imports of goods originating only from developing countries. The projections do not take into account export supply constraints that may arise in some of the goods/countries. See UNCTAD/ECDC/179 for the description of the simulation model used in making the projections and the underlying assumptions.

^{2/} In terms of the (Revision 1) Standard International Trade Classification (SITC), the product groups were defined as follows: Foodstuffs (SITC 0 + 1 + 22 + 4); Agricultural Raw Materials (SITC 2 less (22 + 27 + 28)); Ores and Metals (SITC 27 + 28 + 67 + 68); Fuels (SITC 3); Chemicals (SITC 5); Other Manufactured Goods (SITC 6 to 8 less (67 + 68)); All Items (including SITC 9).

^{3/} Trade figures in the table are underrepresented due to the fact that the underlying detailed data do not have full coverage. (Residual items not classified by group are coded with UN special codes.) Also, for the consistency of the simulation analysis, imports originating from countries for which no data were available for 1981 were excluded. Finally, for consistency reasons, export figures are based on data on imports (c.i.f.) reported by trade partners.

^{4/} Exports to developed countries are not affected. The whole increase in exports comes from the increase in exports to developing countries.

^{5/} Due to the preferential treatment of developing countries, some imports from developed countries are displaced by imports from developing countries (trade diversion). This does not affect Egypt's import bill. However, on top of that, Egypt's imports from developing countries expand (trade expansion).

BIBLIOGRAPHY

Agarwala, R. (1973) "An Econometric Test of Alternative Constraints on the Growth of Underdeveloped Countries: Comment", Review of Economics and Statistics, Vol. 55, No. 1.

Aker, A. (1972) Isci Göcu (labour migration), Sander, Istanbul.

Balassa, B., et. al. (1983) Turkey: Industrialization and Trade, World Bank Country Studies.

Bhagwati, J.N. (1978) Foreign Trade Regimes and Economic Development: Anatomy and Consequences of Exchange Control Regimes, Ballinger Press for National Bureau of Economic Research, Cambridge.

Caves, R.E. and R.W. Jones (1981) World Trade and Payments (third ed.), Little, Brown & Co., Boston.

Chenery, H.B. and A.M. Strout (1966) "Foreign Assistance and Economic Development", American Economic Review, Vol. 56, No. 4.

Dubey, V., et al. (1980) Turkey: Policies and Prospects for Growth, World Bank Country Studies.

Griffin, K.B. and J.L. Enos (1970) "Foreign Assistance: Objectives and Consequences", Economic Development and Cultural Change, Vol. 18, No. 3.

Hamza, M. A.-B. (1981) "Review of Preferential Arrangements Established under the GATT Protocol Relating to Trade Negotiations among Developing Countries" (UNCTAD/TD/B/C.7/49).

Hansen, B. and K. Nashashibi (1975) Foreign Trade Regimes and Economic Development: Egypt, Columbia University Press for National Bureau of Economic Research, New York.

Hansen, B. and S. Radwan (1982) Employment Opportunities and Equity in Egypt, International Labour Office, Geneva.

Ikram, K., et. al. (1980) Egypt: Economic Management in a Period of Transition, World Bank Country Studies.

International Monetary Fund, Balance of Payments Yearbook, various issues.

International Monetary Fund, International Financial Statistics, various issues.

Krueger, A.O. (1974) Foreign Trade Regimes and Economic Development: Turkey, Columbia University Press for National Bureau of Economic Research, New York.

Krueger, A.O. (1978) Foreign Trade Regimes and Economic Development: Liberalization Attempts and Consequences, Ballinger Press for National Bureau of Economic Research, Cambridge.

Krueger, A.O. ed. (1982) Trade and Employment in Developing Countries, Vol. 2, Factor Supply and Substitution, The University of Chicago Press for National Bureau of Economic Research, Chicago.

Krueger, A.O., H.B. Lary, T. Monson and N. Akrasanee, eds. (1981) Trade and Employment in Developing Countries, Vol. 1, Individual Studies, The University of Chicago Press for National Bureau of Economic Research, Chicago.

Lydall, H.F. (1975) Trade and Employment, International Labour Office, Geneva.

OECD (1978) - (1985) Economic Surveys: Turkey, Paris.

Radke, D. and H.-H. Taake (1983) "Financial Crisis Management in Egypt and Turkey", Journal of World Trade Law, Vol. 17, No. 4.

Schneider, F. and B.S. Frey (1985) "Economic and Political Determinants of Foreign Direct Investment", World Development, Vol. 13, No. 2.

TUSIAD (1985) The Turkish Economy (Turkish Industrialists' and Businessmen's Association), Istanbul.

UNCTAD (1985a) Handbook of International Trade and Development Statistics, New York.

UNCTAD (1985b) "Problems of Protectionism and Structural Adjustment", report by the UNCTAD secretariat (TD/B/1039).

UNCTAD (1985c) "Considerations Relating to the Negotiating Elements and Likely Economic Effects of a Global System of Trade Preferences (GSTP) among Developing Countries", technical working note (UNCTAD/ECDC/179).

UNCTAD (1985d) Services and the Development Process, study by the UNCTAD secretariat (TD/B/1008/Rev. 1), New York.

UNIDO (1985) Handbook of Industrial Statistics: 1984, New York.

Weisskopf, T.E. (1972a) "An Econometric Test of Alternative Constraints on the Growth of Underdeveloped Countries", Review of Economics and Statistics, Vol. 54, No. 1.

Weisskopf, T.E. (1972b) "The Impact of Foreign Capital Inflow on Domestic Savings in Underdeveloped Countries", Journal of International Economics, Vol. 2, No. 1.

World Bank (1982) - (1985) World Development Report.

INTERNATIONAL EMPLOYMENT POLICIES

Working Papers

WEP Research Working Papers are preliminary documents circulated informally in a limited number of copies solely to stimulate discussion and critical comment. They are restricted and should not be cited without permission. A set of selected WEP Research Working Papers, completed by annual supplements, is available in microfiche form for sale to the public. Orders should be sent to ILO Publications, International Labour Office, CH-1211 Geneva 22, Switzerland. This list includes many, but not all, papers which exist or may be issued in microfiche form.

- | | |
|---------------|---|
| WEP 2-46/WP.1 | Stabilisation, adjustment and poverty: A collection of papers presented at an informal ILO expert group meeting (Geneva, 9-10 January 1986) (July 1986) |
| WEP 2-46/WP.2 | Efficiency pre-conditions for successful integration of developing countries into the world economy by U. Hiemenz and R.J. Langhammer (September 1986) |
| WEP 2-46/WP.3 | Interest rates, employment and income distribution: A review of issues by A. Roe. |
| WEP 2-46/WP.4 | The impact of liberalisation on growth and equity by T. Addison and L. Demery. |
| WEP 2-46/WP.5 | The external account, growth and employment in Egypt and Turkey: Historical review and prospects by R. Erzan. |