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Abstract

Since its establishment, the IMF has been subject to constant interest from both academic circles and the media. Of the three types of the IMF's functions (regulatory, consultative, and financial), the latter – particularly the provision of temporary balance of payments support in the upper tranches with high conditionality – appear to have gained most of this interest. The fundamental and controversial feature of the IMF's financial assistance is found in the concept of conditionality, which is the subject matter of this study. Critics often point out that IMF conditionality is imposed upon borrowing countries against their will. However, the IMF and its supporters have responded with the notion of ownership of IMF conditionality. This study focuses upon this controversy.

The research investigates the controversial nature of IMF conditionality with a case study of Egypt. In particular, it deals with the issue of imposition-ownership. Unlike the two opposing schools which see the nature of IMF conditionality as a matter of either imposition or ownership, the study argues that IMF conditionality can involve both elements. In capturing such a perspective regarding the nature of IMF conditionality, the study utilises the notion of the linear spectrum, at the opposing ends of which the elements of imposition and ownership are located. Their relative degrees can be assessed through the negotiation process rather than focusing on either the initial position of the parties or the final outcome. The nature of IMF conditionality can be examined with the aid of the concept of power, which distinguishes between resources and application. The relative power of the party can, in turn, help determine the degree of imposition and ownership on the imposition-ownership spectrum. The study further suggests that relative degrees of power, and the consequent location on the imposition-ownership spectrum, are not static but may vary during the course of negotiations, or indeed between negotiations.

IMF CONDITIONALITY: IMPOSITION OR OWNERSHIP? THE CASE OF EGYPT

NONTAPORN LAOBOONCHAROEN

A Thesis Submitted for the Degree of Doctor of Philosophy

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University of Durham

Institute for Middle Eastern and Islamic Studies

2004



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List of Abbreviations and Acronyms

ACC	Arab Cooperation Council
AMU	Arab Maghreb Union
ARE	Arab Republic of Egypt
ASU	Arab Socialist Union
BSFF	Buffer Stock Financing Facility
CBE	Central Bank of Egypt
CCFF	Compensatory and Contingency Financing Facility
CCL	Contingent Credit Lines
CFF	Compensatory Financing Facility
CIA	Central Intelligence Agency
CICT	Commission on International Commodity Trade
CSF	Central Security Force
EC	European Community
ECLA	Economic Commission for Latin America
ECOSOC	Economic and Social Council (of the UN)
EEC	European Economic Community
EFF	Extended Fund Facility
ERP	European Recovery Programme
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
FP	Financial programming
GAB	General Arrangements to Borrow
GCC	Gulf Co-operation Council
GDP	Gross Domestic Product
GNP	Gross National Product
GODE	Gulf Organisation for Development in Egypt
HIPC	Heavily indebted poor country
IBRD	International Bank for Reconstruction and Development
ICSID	International Centre for Settlement of Investment Disputes
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution

IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
ISI	Import Substitution Industrialisation
LE	Egyptian pound
MIGA	Multilateral Investment Guarantee Agency
NAB	New Arrangements to Borrow
NDP	National Democratic Party
NGO	Non-governmental organisation
NPT	Non-Proliferation Treaty
OAS	Organisation of American States
OECD	Organisation for Economic Cooperation and Development
OF	Oil Facility
OIC	Organisation of the Islamic Conference
OPEC	Organisation for Petroleum Exporting Countries
PFP	Policy framework paper
PL	Public Law
PLO	Palestine Liberation Organisation
SA	Subsidy Account
SAF	Structural Adjustment Facility
SAL	Structural Adjustment Loan
SAMP	Structural Adjustment Monitoring Programme
SBA	Stand-By Arrangement
SDR	Special Drawing Right
SECAL	Sectoral Adjustment Loan
SFF	Supplement Financing Facility
SRF	Supplemental Reserve Facility
STF	Systemic Transformation Facility
TF	Trust Fund
UAR	United Arab Republic
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States
USAID	US Agency for International Development
VAT	Value-added tax

Declaration

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Introduction

On 15 January 1998, a picture of President Suharto of Indonesia and Michel Camdessus, Managing Director of the International Monetary Fund (IMF), was taken at the conclusion of Indonesia's financial arrangement with the IMF. In the picture, President Suharto was, with a humiliated and hopeless look, seated and signing a Letter of Intent in the presence of Camdessus, who was standing with crossed arms and a stern face. For the IMF, this depicted a disaster in terms of both public relations and in its attempt to defend the long-guarded notion of "ownership" of IMF conditionality – which implicitly claimed that the borrowing country was willing to embrace terms included in IMF conditionality. However, to observers, the picture depicted the notion of imposition of IMF conditionality; President Suharto was being forced to hand over his country's economic sovereignty to the IMF.¹

Since its establishment, the IMF has been subject to constant interest from both academic circles and the media. J. M. Fleming identified three types of the IMF's functions: regulatory; consultative; and financial.² Of the three, the financial functions, particularly the provision of temporary balance of payments support in the upper tranches with high conditionality, appear to have gained most of this interest. The fundamental and controversial feature of the IMF's financial assistance is found in the concept of conditionality, which is the subject matter of this study. Critics often point out that IMF conditionality is imposed upon borrowing countries against their will. However, the IMF and its supporters have responded with the notion of ownership of IMF conditionality. I will be focusing upon this controversy in my thesis.

The issue of imposition versus ownership matters for the crucial reason that it has been recognised that the successful implementation of IMF conditionality partly depends on the willingness of the borrowing country to carry it out. The notion of imposition implies that there is a lack of will on the part of the borrowing countries to accept IMF conditionality, whereas that of ownership suggests that there exists willingness on the part of borrowing countries and an agreement with the IMF regarding IMF

¹ See, for example, Stiglitz, J. E., *Globalization and Its Discontents* (London: Penguin, 2002), pp. 40-41.

² Fleming, J. M., *The International Monetary Fund: Its Form and Functions* (Washington, D. C.: International Monetary Fund, 1964).



conditionality. Given the poor record of the implementation of IMF conditionality, the role of imposition or ownership becomes significant. However, despite its importance, the issue has been long neglected and it is only in recent years that the IMF, under the current Managing Director (Horst Köhler), has publicly turned its attention to the issue of ownership of IMF conditionality in the broader initiative of 'streamlining and focusing IMF conditionality.'

Much of the literature concerning IMF conditionality focuses on the *effects* of IMF conditionality, in particular macroeconomic adjustment policies, upon borrowing countries.³ The imposition critique of IMF conditionality and the ownership argument with which the IMF has responded have existed for a long time and the debate between them has been intense since the second half of the 1970s. Nevertheless, there is a dearth of literature concerning the *nature* of IMF conditionality in relation to the controversial question of imposition versus ownership. Few authors have attempted to systematically address the issue. Those that have attempted to really unravel the debate have tended to limit the scope of their studies. For instance, Kendall Stiles, in his article 'IMF Conditionality: Coercion or Compromise?', concludes that IMF conditionality is based on compromise rather than being imposed upon the borrowing countries.⁴ However, there are at least two weaknesses in his study. Firstly, his methodology is based on interviews with IMF officials which are used to construct his model. This would mean

³ See, for instance, Agarwal, M. and D. Sengupta, 'Structural Adjustment in Latin America: Politics and Performance,' *Economic and Political Weekly*, vol. 34, no. 44, 30 Oct. 1999, pp. 3129-3136; Auvinen, J. Y., 'IMF Intervention and Political Protest in the Third World: A Conventional Wisdom Refined,' *Third World Quarterly*, vol. 17, no. 3, 1996, pp. 377-400; Biersteker, T. J., 'Reducing the Role of the State in the Economy: A Conceptual Exploration of IMF and World Bank Prescriptions,' *International Studies Quarterly*, vol. 34, no. 4, Dec. 1990, pp. 477-492; Conway, P., 'IMF Lending Programs: Participation and Impact,' *Journal of Development Economics*, vol. 45, no. 2, Dec. 1994, pp. 365-391; Crisp, B. F. and M. J. Kelly, 'The Socioeconomic Impacts of Structural Adjustment,' *International Studies Quarterly*, vol. 43, no. 3, Sept. 1999, pp. 533-552; Donovan, D. J., 'Macroeconomic Performance and Adjustment under Fund-Supported Programs: The Experience of the Seventies,' *IMF Staff Papers*, June 1982, vol. 29, no. 2, pp. 171-203; Doroodian, K., 'Macroeconomic Performance and Adjustment under Policies Commonly Supported by the International Monetary Fund,' *Economic Development and Cultural Change*, vol. 41, no. 4, 1993, pp. 849-864; Foxley, A., 'Stabilization Policies and their Effects on Employment and Income Distribution: A Latin American Perspective,' in W. R. Cline and S. Weintraub (eds.), *Economic Stabilization in Developing Countries* (Washington, D. C.: Brookings Institution, 1981), pp. 191-233; Khan, M. S., 'The Macroeconomic Effects of the Fund-Supported Adjustment Programs,' *IMF Staff Paper*, vol. 37, no. 2, June 1990, pp. 195-231; Killick, T. (et al.), *The Quest for Economic Stabilisation: The IMF and the Third World* (London: Heinemann Educational, 1984b); Killick, T. and M. Malik, 'Country Experiences with the IMF Programmes in the 1980s,' *World Economy*, vol. 15, no. 5, Sept. 1992, pp. 599-632; Killick, T., M. Malik, and M. Manuel, 'What Can We Know About the Effects of IMF Programmes?,' *World Economy*, vol. 15, no. 5, Sept. 1992, pp. 575-597; and Schadler, S. (et al.), 'IMF Conditionality: Experience under Stand-By and Extended Arrangements,' part I: Key Issues and Findings, *IMF Occasional Paper*, no. 128 (Washington, D. C.: International Monetary Fund, Sept. 1995).

⁴ Stiles, K. W., 'IMF Conditionality: Coercion or Compromise?,' *World Development*, vol. 18, no. 7, 1990, pp. 959-974.

that part of the investigation focuses merely on one party, i.e. the IMF. Secondly, the issue of imposition-ownership is only tangentially addressed. The model is originally constructed with the aim of understanding the decision-making of the IMF and not the issue of imposition-ownership, even though the model has its own usefulness in explaining the decision-making of the IMF. It is argued in my study that it is necessary to deal with the issue of imposition-ownership directly and to pay attention to not only the IMF but also the borrowing countries.

Therefore, the purpose of this study is to fill the gap in the literature. The study will attempt to provide a better understanding of IMF conditionality by examining the role and the nature of that conditionality, particularly in relation to the imposition versus ownership controversy. The examination will be placed in the context of the relationship between the two parties regarding the upper-credit tranche lending. The study will use Egypt as a case study and will cover the period between the 1960s, when the first upper-credit tranche agreement between Egypt and the IMF was concluded, and 1998, when the last agreement expired.

The Argument of the Study

The study will argue that it is unnecessary and inappropriate to view the issue of imposition-ownership as a 'black-and-white' issue. The study will suggest an alternative perspective of looking at this particular controversy over the nature of IMF conditionality by locating the two opposing elements on a linear spectrum, instead of viewing them as entirely separate entities. By holding such a perspective, the study will move on to create a framework which will be utilised in analysing the imposition-ownership nature of IMF conditionality. An appropriate way of addressing the imposition-ownership nature of IMF conditionality is, as the study will suggest, to examine how IMF conditionality is derived in practice, i.e. the negotiations concerning IMF conditionality. In this study, the concept of power will be employed in the context of the negotiations between the IMF and a borrowing country. The use of the negotiation process in the analytical framework would allow one to consider the relationship between the IMF and a borrowing country in a dynamic rather than a static sense. Both parties will be considered as active. This means that they will not be assumed to be passive to the other's action nor to changes in the environment. In contrast with a widespread assumption that economic difficulties make the IMF

condition coercive/imposed in nature, this study will argue that in fact there are a number of variables which can shape the nature of IMF conditionality through the bargaining power of the negotiating parties.

Among these variables is the role of third parties. A predominant assumption about the role of third parties is that the external actors, like creditors and donors, side only with the IMF and always leave the borrowing developing countries' relationships with the IMF unbalanced, in favour of the IMF. This study will show that some developing countries, such as those with geopolitical importance, could also gain support from those external actors. That is, these external actors could play a double-edged role in dealing with the relationship between the developing countries and the IMF, as both supporters and pressurisers on the two parties. Besides the third parties, other factors include, for example, the international environment, domestic economic circumstances, internal pressures, technocratic alliances, and negotiating skills of individual negotiators.

Methodology and Outline of the Study

This study will analyse the nature of IMF conditionality through a case study of Egypt. One of the major disadvantages of employing a country case study approach is that it does not automatically facilitate generalisation across countries. Although this problem could partially be solved by undertaking a number of country case studies, such an approach requires a vast amount of resources which proved beyond the scope and limit of the study. Despite such weaknesses, the case study approach has its own advantages. As some scholars have noted: 'In practice, the case study approach can . . . go much further in explaining the reasons behind the results obtained.'⁵ Furthermore, using a single country case study allows one to cover a long period and to see whether any trend can be established in relation to a particular case.

So why is Egypt chosen as a case study? The author has chosen Egypt as a case study since there are several factors which make it a particularly interesting case. First of all, Egypt has had a long relationship with the IMF since the inception of the latter (see Introduction of Part II for more details). Secondly, the case of Egypt is rich in analytical factors which many other countries may lack, although it cannot be claimed

⁵ Killick, Malik, and Manuel, *op. cit.*, p. 579.

that Egypt is representative of every case. With its geopolitical significance, Egypt represents an important case and thus deserved to be studied. Thirdly, although the case of Egypt is often quoted in the literature, the official documentation regarding the relationship between the IMF and Egypt concerning IMF conditionality has rarely been consulted. This is largely due to the limited availability of such documentation in the past. The negotiations were conducted behind closed doors and the official documents regarding IMF conditionality and its negotiations in the case of Egypt were not made available to the public, except in the rare event of document leakage. As part of its policy to be open and transparent regarding its operations and activities, the IMF has made many borrowing countries' Letters of Intent and Memoranda for Understanding available on the IMF's website upon their consent. Nonetheless, this is still not the case for Egypt. Therefore, the above reasons make it worth studying the case of Egypt.

The study is organised into two major parts and six chapters. Part One (Chapters One and Two) deals with the historical development of the IMF and of IMF conditionality. Chapter One will begin by examining the evolution of the IMF since its inception, its shifting focus towards developing countries, and its increasing influence over the latter's economic policies. In Chapter Two, I will examine the historical development of IMF conditionality and its critiques. An analytical framework will be developed here to assist the analysis of the nature of IMF conditionality in the case of Egypt.

Part Two of the study, which contains Chapters Three to Six, will apply the analytical framework constructed in Chapter Two to the case study of Egypt from the 1960s to 1998. A focus will be placed upon the 1970s onwards since it was in the 1970s that the increasing involvement of the IMF had brought with it the growing controversy over several aspects of the IMF and its lending policies. Chapter Three will cover the period of the 1960s under Nasser's socialist regime. Chapter Four will examine IMF conditionality during the period 1974-1979 under a new political leader, President Sadat, and his Open Door policy. Chapters Five and Six will consider the period under Mubarak's leadership in 1985-1988 and 1989-1998 respectively. In the concluding chapter, the study will remark on three important issues. The first issue will deal with the Egypt-IMF relationship and the nature of their negotiating power. The second issue will touch upon the imposition-ownership nature of IMF conditionality in the case of

Egypt and other borrowing developing countries. The final issue will reflect upon a number of lessons drawn from this study.

Sources of Information

There are various sources which have been utilised in the study. They include both primary and secondary sources. For the primary sources, the study has made intensive use of official documents held at the IMF archives supplemented by qualitative evidence gained through detailed interviews in Cairo and Washington, D. C. The secondary sources include books, journals, and newspapers.

The interviews and document searches were carried out in two stages: the first in Cairo during the period January-March 2001; and the second in Washington, D. C. in October 2001. However, during the Cairo field trip, the hope to gain access to official documents in Cairo was virtually diminished since all the interviewees either denied that they had the documents or refused to grant the author access, even if they admitted having them. However, some interviewees made the helpful suggestion that the author should obtain documentation from the IMF itself. To order to emphasise the degree of confidentiality of the Egyptian official documents (such as the Letters of Intent signed with the IMF) and how difficult it is to obtain them in Cairo, the author would like to quote the remarks made by a journalist of *Al-Ahram Weekly* (a semi-official English newspaper): 'We do not know much else for the simple reason that nobody, not the press, not the public at large, were told. Parts of the World Bank 'Aide-Memoire' were leaked . . . , but the IMF's Letter of Intent is secret.'⁶ It should be noted that these remarks were made nearly ten years prior to the author's Cairo field trip and prior to the IMF's openness policy (see the following discussion). However, the observation that the author would like to make here is that up till the point of conducting the research, the situation has not changed in gaining access to official documents in Cairo. Furthermore, despite the liberalised policy of the IMF, Egypt's Letters of Intent and other documents have remained unavailable on the IMF's website, unlike those of many other borrowing countries. This, therefore, made it necessary for the author to visit the IMF archives.

⁶ *Al-Ahram Weekly*, 23 May 1991.

As a result of their unavailability in Cairo, virtually all of the official documents used in this study were obtained from the IMF archives in Washington, D. C. As part of its policy to promote greater openness in relation to its operations and activities, access to documentary materials more than thirty years old held at the IMF archives became available to those outside the IMF upon request in January 1996. Again, in March 1999, the IMF decided to further expand public access to documentary materials held at the IMF archives, which took effect on 8 September 1999. As a result, more official documents have been made available to the public. Less restricted access to official documents allowed the author to obtain valuable information about Egypt's financial agreements with the IMF and, for certain periods, correspondence between the two sides, and to gain better understanding regarding IMF conditionality. The author has tried her best to obtain relevant confidential documents concerning the relationship between Egypt and the IMF in the context of the upper-credit tranche lending, i.e. the Stand-by Arrangements (SBAs) and Extended Fund Facilities (EFFs). However, the reader may find that during certain periods, i.e. in the 1980s and 1990s, the reliance of the study on the confidential documents is less than in the earlier periods. This is due to the fact that at the time of conducting the research, most of the documents in these periods remained classified due to the 20-year rule and thus were not made available to the author (nor, either, to other members of the public). Nevertheless, the author tried to compensate for this weakness by relying on other sources such as personal interviews, journals, and newspapers.

With regard to the interviews, the author conducted 33 interviews in total. The 'snowball effect' strategy was used as a way to gain more interviewees. The interviewees were drawn from various careers and positions. They included former and existing Egyptian and IMF officials, academics, think-tank analysts, critics, and journalists. The author was reliant upon semi-structured interviews, each of which lasted between 30 minutes and 2 hours. Some interviews were completed by repeated visits. The interviews took place in several different locations in Cairo and Washington, D. C., in both formal and informal settings.

In addition to the two field trips during 2001, the author also made efforts to trace the whereabouts and correspond with former IMF officials and negotiators throughout the

process of research. Although her efforts were not fully achieved, they were worthwhile.

It remains to be pointed out that the study does not claim to represent the whole picture of the relationship between the IMF and Egypt. Instead, it seeks to demonstrate the major argument of the study which has been mentioned earlier through the available evidence that could be gathered by the author.

PART I

Chapter One

The IMF: Its Changing Role and Unbalanced Influence

This chapter serves two major purposes. First of all, it aims to provide an introduction to the origins, role, structure, and functions of the International Monetary Fund (IMF). Although the focus of the study is the IMF, the discussion on the IMF could not leave out the World Bank and the IMF-World Bank relationship due to their historical background and increasing collaboration. The second main purpose of this chapter is to determine the part the IMF has played in international economic relations between the developed and the developing countries.¹ In particular, it provides a discussion on the development of the relationships between the IMF and the developing countries. Using a chronological analysis, the chapter primarily aims at illustrating how the IMF has slowly shifted its focus towards the developing countries and has, since then, played an increasingly significant role in the latter. It also seeks to show:

- 1) how the role and policies of the two International Financial Institutions (IFIs), the IMF and the World Bank, have altered since their inception;
- 2) how the policy instruments of the IMF have developed;
- 3) how the relationships between the IFIs have evolved; and
- 4) the principal critiques of the IFIs, particularly of the IMF and the IMF's responses.

The chapter is divided into four major sections: first, the origins of the IFIs; second, the gradual shift of the IMF's focus towards the developing countries; third, the critiques of the relationship between the IFIs and the developing countries, and, last but not least, a discussion on technical issues in relation to the IMF such as the quota system and the sources of its finance, its structure, and voting power.

¹ It is not considered useful for the author of this thesis to provide a definition of "developed" and "developing" at this point. The definitions that matter are those that evolved within the thinking of the IMF during the period covered. This will be clarified during the course of this chapter.

1.1 The Origins of the International Financial Institutions

1.1.1 The Reason for Their Creation

The International Financial Institutions (IFIs) – the International Monetary Fund (IMF) and the World Bank² – have emerged as an outcome of the International Monetary and Financial Conference at Bretton Woods, New Hampshire on 1st-22nd July 1944. The establishment of the IFIs reflected the desire of the founders to avoid a recurrence of a similar international economic crisis to the ‘Great Depression’ of the 1930s which was characterised by the breakdown of international trade and investment, and high unemployment. A series of competitive currency devaluations and protectionist measures (including the use of import quotas and an increase in import tariffs) were widely practised during the interwar period following the breakdown of the gold standard (a fixed exchange rate regime prevailed during the late nineteenth and early twentieth centuries, coming to an end at the outset of the First World War) in 1931. Although such beggar-thy-neighbour policies could, on a temporary basis, improve a country’s balance of payments and domestic employment, they were pursued only at the expense of the exports and employment of other countries and, thus, provoked others’ retaliations. The culmination in the 1930s’ Great Depression of such self-defeating policies led to efforts, mainly dominated by the United Kingdom (UK) and the United States (US) during the early Second World War, to seek a solution to the international monetary and trade problems. The desire to avoid another Great Depression is manifest in the purposes contained in Article 1 of the IMF’s Articles of Agreement which read as follows:

- 1) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- 2) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

² Its original institution was the International Bank for Reconstruction and Development (IBRD). Now the institution, technically called the ‘World Bank Group,’ consists of five components: the IBRD; the International Development Association (IDA, created in 1960); the International Finance Corporation (IFC, established in 1956); the Multilateral Investment Guarantee Agency (MIGA, founded in 1988); and the International Centre for Settlement of Investment Disputes (ICSID, established in 1966). Gilbert, C. L. and D. Vines, ‘The World Bank: An Overview of Some Major Issues,’ in C. L. Gilbert and D. Vines (eds.), *The World Bank: Structure and Policies* (Cambridge: Cambridge U. P., 2000), ch. 1, pp. 12, 13 and 34; and World Bank, *World Bank Annual Report*, various issues since 1995.

- 3) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid comparative exchange depreciation.
- 4) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
- 5) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
- 6) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.³

Although the IMF and the World Bank are seen as ‘twin’ Bretton Woods institutions, the coming into being of the World Bank was, in fact, overshadowed by that of the IMF. During the planning period, the World Bank’s establishment was uncertain until the last moment. In his invitation letter to 44 governments to a conference at Bretton Woods, the US Secretary of State described the conference as being ‘for the purpose of formulating *definite* proposals for an International Monetary Fund, and *possibly* [sic] a Bank for Reconstruction and Development (emphasis added).’⁴ Even at the Bretton Woods Conference, the first week’s attention and discussion were devoted to the IMF to the extent that fears began to be expressed that the Conference would never cover the World Bank.⁵ One commentator describes the World Bank as ‘something of a neglected sibling of the IMF.’⁶ The reason behind their creation and the marginalised idea of creating the World Bank, one of whose purposes was development, seem to indicate that there was hardly any special attention devoted to the developing countries and their problems in the initial thinking for the formation of both IFIs.

³ International Monetary Fund, *Articles of Agreement of the International Monetary Fund* [online], Article 1: Purposes, 2003. Available from: <http://www.imf.org/external/pubs/ft/aa/aa01.htm> [accessed 6th Oct. 2003]

⁴ Mason, E. S. and R. E. Asher, *The World Bank Since Bretton Woods* (Washington, D. C.: Brookings Institution, 1973), p. 12.

⁵ *Ibid.*, p. 21; and Keynes, J. K., *The Collected Writings of John Maynard Keynes*, vol. 26: *Activities 1941-1946*, Shaping the Post-War World Bretton Woods and Reparations, ed. by Moggridge, D. (London: MacMillan, 1980), p. 83.

⁶ Payer, C., *The World Bank: A Critical Analysis* (New York: Monthly Review P., 1982), p. 22.

1.1.2 The Traditional Role of the IFIs

Although the IMF was created in 1944, it did not begin its operations until 1st March 1947.⁷ In order to fulfil its purposes outlined above, the IMF carried out its functions of providing consultation, regulation and credit.⁸ The IMF had its major role in assisting the member countries which faced severe balance of payments problems with its short-term loans through the traditional Stand-By Arrangements (SBAs).

As for the World Bank, when its operations began on 25th June 1946, the World Bank⁹ was to serve two major purposes which were reflected in the original name of the institution, the International Bank for Reconstruction and Development (IBRD). First, it was set up to assist the reconstruction of the European and Japanese economies which were devastated by the Second World War. Second, it had another purpose in assisting the development of the developing countries.¹⁰ According to the founders, the major role of the World Bank would be to 'guarantee loans in order that investors may have a reasonable assurance of safety in placing their funds abroad. In this way it is expected that the international flow of capital in adequate volumes will be encouraged.'¹¹ The World Bank could provide direct lending only in exceptional circumstances. Thus, originally the guaranteeing of private investments was the primary role of the World Bank while lending was intended to be a less important one. However, the original role of the World Bank was not adhered to when later the World Bank became heavily involved in lending to the developing countries.

The World Bank also provided technical assistance to help the developing countries implement development projects. In its early years, the World Bank-supported project lending concentrated on such fields as infrastructure and energy. Since the 1960s, the Bank has moved away from the traditional fields of its project lending towards ones

⁷ International Monetary Fund, 'IMF Chronology,' *IMF Survey Supplement*, vol. 27, Sept. 1998.

⁸ Machetta, M., 'The International Monetary Fund Today: Problems and Prospects,' *Journal of Regional Policy*, vol. 12, Jan.-Mar. 1992, p. 150.

⁹ The World Bank and the IMF are linked through the former's Articles of Agreement, saying that to be a member of the World Bank, a country has to be a member of the IMF.

¹⁰ Ayres, R. L., *Banking on the Poor: The World Bank and World Poverty* (Cambridge, M. A.: MIT P., 1983), p. 1; and Keynes, *op. cit.*, Opening Remarks of Lord Keynes at the First Meeting of the Second Commission on the Bank for Reconstruction and Development, p. 72.

¹¹ U. S. Treasury Department, *Questions and Answers*, 10 June 1944. This was a set of questions and answers concerning the World Bank provided by the US treasury to the allied and associated countries. Cited in Mason and Asher, *op. cit.*, p. 18.

which 'can directly affect the well-being of the masses of poor people of developing countries' such as agriculture, rural development, education, family planning, water and nutrition.¹²

1.1.3 The Dominance of a Few Industrial Countries during the Formation Years

At the Bretton Woods Conference and other previous meetings, the discussions and negotiations concerning the two institutions were dominated by only a handful of Western industrial countries, particularly the US and the UK. The creation of the IFIs was largely the result of the Anglo-American initiatives. For two years prior to the Bretton Woods Conference, the UK and the US had exchanged drafts concerning the two IFIs, which were initially proposed by Lord Keynes and Harry Dexter White, respectively. On the whole, the two institutions were 'the product of English and American brains, with valuable assistance from the Canadians.'¹³ This left other countries, including the developing countries, to play a minimum role in the early stage of the formation of the two IFIs. As Lord Keynes commented prior to the commencement of the Bretton Woods Conference:

They [42 countries which had been invited for the Bretton Woods Conference] are to have no power of commitment or final decision and everything is to be *ad referendum*. Nevertheless it now appears that they are not even to have the semblance of doing any work, since that is to be done before they meet.¹⁴

He further added by pointing out a long list of specific countries, almost all of which were the developing countries, which, according to him, would have no role at all at the Conference:

Twenty-one countries have been invited which clearly have nothing to contribute and will merely encumber the ground, namely, Columbia, Costa Rica, Dominica, Ecuador, Salvador, Guatemala, Haiti, Honduras, Liberia, Nicaragua, Panama, Paraguay, Philippines, Venezuela, Peru, Uruguay, Ethiopia, Iceland, Iran, Iraq, Luxemburg. The most monstrous monkey-house assembled for years. To these might perhaps be added: Egypt, Chile and (in present circumstances) Yugo-Slavia.¹⁵

Nevertheless, among the two countries, it was the US which had avoided the devastating effects of the Second World War. It had, thereafter, emerged as the creditor country and

¹² World Bank, *World Bank Annual Report*, Introduction, various issues.

¹³ Harrod, R. F., *The Life of John Maynard Keynes* (London: MacMillan, 1952), p. 579.

¹⁴ Keynes, *op. cit.*, Note for Sir David Waley, 30 May 1944, p. 41.

¹⁵ *Ibid.*, p. 42.

dominant player in the international economy, and thus gained its ability to shape the outcome of the discussions concerning the two institutions according to its own interests and economic foreign policy. In particular, this is obvious when one considers the coming-into-being of the World Bank. The World Bank was largely the initiative of the US, although there was a contribution from the British and other countries' representatives. As Mason and Asher point out:

Almost all the preliminary work on the proposed Bank had been done within the U.S. government, and until the meeting in Atlantic City of the committee that was to shape the agenda for Bretton Woods, the participation of other countries had been perfunctory.¹⁶

In addition, the dominance of the US over the other participating countries during this period was manifest in several issues, some of which were controversial, regarding the IMF and the World Bank. They included the site of their headquarters, the questions of the decision-making body and the management of the two institutions, and the formula for the quota calculation. With regard to the site for the headquarters of the two new institutions, it was the American view that the location should be in Washington, D. C., the US political centre, which prevailed. Lord Keynes and a majority of the delegations at the Savannah Conference¹⁷ of March 1946 assumed that the location would be in New York, which was a centre of international finance and 'sufficiently removed from the politics of Congress and the nationalist whispering gallery of the embassies and legations of Washington.'¹⁸ However, the US was not prepared to discuss the matter and took its decision as the final say.¹⁹

The US dominance was also evident in the questions of the decision-making body and the management of the two institutions. The Executive Directors and Alternates of the two institutions were to work on a full-time basis as suggested by the US, despite Lord Keynes's argument for their part-time role.²⁰ Furthermore, the US influence was

¹⁶ Mason and Asher, *op. cit.*, p. 12.

¹⁷ This was a conference in which the first meeting of the Board of Governors was held and in which several controversial issues were discussed, including the location of the headquarters of the IMF and the World Bank, the duties of their Executive Directors and Alternates, and the question of salaries.

¹⁸ Harrod, *op. cit.*, pp. 629-630; and Keynes, *op. cit.*, pp. 211 and 221.

¹⁹ Harrod, *op. cit.*, p. 630; and Keynes, *op. cit.*, pp. 221-222.

²⁰ Harrod, *op. cit.*, pp. 632-633; Horsefield, J. K., *The International Monetary Fund, 1945-65: Twenty Years of International Monetary Cooperation*, vol. 1: *Chronicle* (Washington, D. C.: International Monetary Fund, 1969), p. 123; and Mason and Asher, *op. cit.*, p. 38.

manifest in the initial appointments made by the new Boards of the first Managing Director of the IMF and the first President of the World Bank. The obvious candidate for the first appointed Managing Director of the IMF was an American founder, Harry Dexter White. However, because of rumour about his political contacts, he was not selected²¹ and instead Camille Gutt (Belgium) became the first Managing Director of the IMF. As a result, the President of the World Bank could only be an American (Euhene Meyer). Since then, it has become a tradition to have a European as the IMF's Managing Director and an American as the World Bank's President.²²

Another crucial area over which the US had gained large control was the determination of each member's quota which had a great impact on the IMF's (and also the World Bank's) policy direction. At Bretton Woods, an ad hoc Committee on Quotas chaired by Fred M. Vinson, Vice-Chairman of the US delegation, was set up to decide the quotas for the member countries. The formula for the calculation of members' quotas, which was mainly based on a member country's exchange reserves, international trade figures such as average annual exports and imports, and national income, was initially worked out by the US. However, the quotas seemed not to have been purely determined according to the formula due partly to the difficulty in accommodating all of the considerations and unavailability or inaccuracy of the data. Identifying precisely what other factors entered into the quota decisions would not be easy due to the insufficient records of the basis of the Committee's work. At least, it was suggested by some that it was the US which took the final decision. As Professor Mossé, a member of the French delegation to Bretton Woods, remarked, quotas were created 'more or less arbitrarily by the United States in a series of deals.'²³ For each member, their quotas determine their subscription to the IMF and the credit they could draw as well as their voting power within the institution (see later discussions for more details). When the quotas were first established at the Bretton

²¹ However, it should be pointed out that a different account was put forward by the IMF's historian. According to J. K. Horsefield, the reason White was not proposed as Managing Director of the IMF was that 'the Bank would have to be headed by a U. S. citizen in order to win the confidence of the banking community, and that it would be impracticable to appoint U. S. citizens to head both the Bank and the Fund.' Horsefield, *op. cit.*, vol. 1, p. 135.

²² James, H., *International Monetary Cooperation since Bretton Woods* (Washington, D. C.: International Monetary Fund; New York: Oxford U. P., 1996), p. 72.

²³ Horsefield, *op. cit.*, vol. 1, pp. 94-98.

Woods Conference, the US was allocated the largest quota, approximately 36.2 per cent of the total,²⁴ and thereby the largest vote in the IMF, with an effective power of veto.

Last, but not least, at Bretton Woods the US dollar became the dominant currency in the international economic system, in place of the British Pound Sterling. The latter had, prior to the Second World War, enjoyed its powerful role in the international payments of foreign countries due largely to the pre-war position of the UK as the largest international trader.²⁵ However, under the Bretton Woods system the US dollar was pegged to gold and all other currencies were set relative to the dollar; thus the dollar effectively became the base currency. It was used as one of the two units in expressing the par values of the member states' currencies. As Article IV, Section ii (a) of the IMF's original Articles of Agreement stipulates: 'The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944.'²⁶

As for the developing countries, despite their participation drawn from Latin America, Asia and Africa at the Bretton Woods Conference, their power was trivial in affecting the course and outcome of the discussions. Out of the 45 countries, 26 (including Egypt) were designated as the developing countries.²⁷ Attempts had been made by some developing countries to play an active role in drafting the Articles of Agreement²⁸ of the IMF. For instance, at Bretton Woods India proposed the inclusion of the clause which would refer to the developing countries, calling on the IMF 'to assist in the fuller utilisation of the resources of the economically underdeveloped countries.' Following objections from the UK and South Africa, both of which believed that development fell under the remit of the World Bank, India opted to revise its proposal, calling for 'the development of the resources and productive power of all member countries, with due regard to the needs of economically backward countries.' However, the proposal still

²⁴ Horsefield, J. K. (ed.), *The International Monetary Fund, 1945-65: Twenty Years of International Monetary Cooperation*, vol. 2: *Analysis* (Washington, D. C.: International Monetary Fund, 1969), Table 14, p. 380.

²⁵ Ashworth, W., *A Short History of the International Economy since 1850*, 4th ed. (London: Longman, 1987), p. 265.

²⁶ International Monetary Fund, 'Agreement of Agreement of the International Monetary Fund,' 22 July 1944, in J. K. Horsefield (ed.), *The International Monetary Fund, 1945-65: Twenty Years of International Monetary Cooperation*, vol. 3: *Documents* (Washington, D. C.: International Monetary Fund, 1969), p. 189.

²⁷ Bernstein, E. M., 'The International Monetary Fund,' *International Organization*, vol. 22, 1968, p. 133.

²⁸ The Articles of Agreement is a constitutional document of the IMF.

faced opposition from some powerful developed countries, notably the UK and the US, both of which disliked an inclusion of the developing countries in the Articles of Agreement. As a consequence, in the final version of the Articles of Agreement there was no distinction made between the developed and the developing countries. Only a reference to development was included in the Articles. It referred to 'the development of the productive resources of *all members* as primary objectives of economic policy [emphasis added].'²⁹ Another example occurred when India and Egypt expressed their demand for the reference to the settlement of indebtedness as a result of war to be included in the Articles of Agreement. As with the first two proposals, their call was ignored.³⁰ Therefore, it was not because of the lack of their participation that the developing countries' influence in the discussions was insignificant. Due to the opposition from powerful developed countries, no distinction was drawn between the developed and the developing countries, in spite of the latter's demands. Consequently, the developing countries found themselves with little special consideration paid to them and their problems during the founding period of the IMF.

1.2 A Gradual Shift in the Focus of the IMF towards Developing Countries

1.2.1 The Years of US Dominance and of Little Attention to Developing Countries' Problems: Late 1940s-Late 1950s

From the late 1940s to the late 1950s, the dominance of the US in the IMF continued its strength. In February 1949, the US influence in the IMF was enhanced through the establishment of the position of Deputy Managing Director. The appointment of the first Deputy Managing Director was given to the US Treasury official, Andrew Overby.³¹ This period also saw US dominance in the IMF to such a degree that until 1956 there was a tendency for the Executive Director of the IMF representing the member country in question to approach the US Executive Director for the latter's approval before the country submitted a formal proposal or request to the IMF.³² By US law, the US

²⁹ Horsefield, *op. cit.*, vol. 1, pp. 93-94.

³⁰ *Ibid.*, p. 94.

³¹ James, *op. cit.*, 1996, p. 72.

³² Horsefield, *op. cit.*, vol. 2, p. 11.

Executive Director is bound to be under the instructions of the Secretary of Treasury.³³ It was in this sense that some observers commented that the IMF's policies, at least during the first twelve years of its existence, reflected the US economic foreign policy.³⁴ Some went further to suggest that until 1956 the US had absolute domination over the IMF since 'decisions were made effectively by the US Secretary of the Treasury, to the point that the IMF's staff had no authority to negotiate conditions for drawings.'³⁵

During its early years, it remained the case that the problems of the developing economies gained no particular attention from the IMF. Neither did the IMF make a differentiation between their problems and those of the developed countries. Instead, the IMF was preoccupied with its primary purpose of promoting trade liberalisation and monetary stability in the international economy with an assumption that this would be beneficial to all member countries. As Graham Bird has noted:

Annual Reports of the IMF during the early and middle 1950s . . . confirm that the Fund had little specific interest in the particular problems of LDCs [less developed countries] as such. LDCs were treated as if their problems were no different from those of developed countries. Fund policy continued to rest on the notion that the encouragement of monetary stabilisation and free trade was the main purpose of the IMF and that such policies were in the interests of *all* members.³⁶

Moreover, in its early years the IMF's view regarding its lending role was rather conservative. The IMF saw its lending as being for dealing with temporary balance of payments deficits only, and not for reconstruction. Its Annual Report for 1947 stated:

The Fund is intended as part of the permanent machinery of international monetary relations rather than as an emergency device to meet the special needs of the post-war years Now more than a year after the establishment of the Fund, the World is confronted with seriously unbalanced trade, with an urgent problem of financing international payments, and with severe shortages of goods

³³ Stange, S., 'IMF: Monetary Managers,' in R. W. Cox and H. K. Jacobson (eds.), *The Anatomy of Influence: Decision Making in International Organization* (New Haven: Yale U. P., 1974), p. 284.

³⁴ Bird, G., *The International Monetary System and the Less Developed Countries* (London: MacMillan, 1978), p. 17.

³⁵ Tew, B., 'The International Monetary Fund,' mimeographed, 1969, p. 86. Cited in Payer, C., *The Debt Trap: The IMF and the Third World* (New York: Monthly Review P., 1974), p. 217.

³⁶ Bird, *op. cit.*, 1978, pp. 16-17.

for reconstruction and even for maintaining minimal consumption standards in many countries. The Fund cannot solve these problems....³⁷

Such a narrow view also had an impact upon the developing countries whose problems of economic development required long-term financial assistance. Thus, the IMF during the early years after it came into being played only a restricted role in providing its lending to the developing countries. Although the problems of post war reconstruction in Europe were met by Marshall Aid and the conditions of the IMF precluded the use of the IMF's resources in anything other than 'exceptional and unforeseen circumstances,' the majority of total drawings from the IMF were carried out by Western European countries. During 1947-1957, out of the total drawings of SDR 2,886.1 million from the IMF, nearly two-thirds of drawings (SDR 1,838.4 million) were made by Western European countries whereas only one-third (SDR 994.2 million) by the developing countries.³⁸

Despite its limited role in the developing countries, during this period there emerged a number of IMF's policy changes and developments, which provided and facilitated its assistance to the developing countries among other member countries, even though they were not created especially for the developing countries. Missions were sent to the member countries at their request to provide technical assistance and advice concerning such issues as banking, monetary, exchange rate and balance of payments problems. Since its first mission in 1946 to Ecuador, there had been an expansion of the IMF's technical assistance throughout the period as its membership increased, including that from the developing countries.³⁹ Also in 1950 a formal Training Programme was introduced by the IMF following the proposals by the Managing Director, Camille Gutt, largely to enable member countries to become acquainted with its work while criticism on the US's involvement in the IMF's activities (mainly in Latin American countries) existed. A limited range of training courses was given to member countries' officials, primarily in balance of payments techniques.⁴⁰ Moreover, in the first half of the 1950s, decisions were, as part of the IMF's efforts to revive its lending operations, adopted to

³⁷ International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1947* (Washington, D. C.: International Monetary Fund), p. 2. Cited in Krasner, S. D., 'International Monetary Fund and the Third World,' *International Organization*, vol. 2, 1968, p. 672.

³⁸ International Monetary Fund, *International Financial Statistics Yearbook* (Washington, D. C.: International Monetary Fund, 1984), p. 14.

³⁹ Horsefield, *op. cit.*, vol. 1, pp. 185-187, 391-394, 428 and 444.

⁴⁰ *Ibid.*, p. 264.

make drawings in the gold tranche virtually automatic (as part of the 1952 'Rooth Plan' – see below) and drawings in the first credit tranche more easily accessible (see Chapter Two).

Some of the policies developed during the IMF's earlier years deserve more consideration since they would have considerable implications on the relationships between the IMF and the developing countries in the later years. Among them was the adoption of conditionality into the IMF's lending policy which was due largely to the US's pressing for the adoption of restrictions on IMF lending. After a long debate over the issue of conditionality, the Executive Board adopted the 'Rooth Plan' in 1952. The Rooth Plan granted the IMF the authority to supervise the members' economic and financial policies. Before a decision over granting financial assistance to a member could be made, the IMF would consider 'whether the problem to be met is of a temporary nature and whether the policies the members will pursue will be adequate to overcome the problem within such a period . . . [whether] use of the Fund's resources [was] in accordance with the purposes of the Fund.'⁴¹ The Rooth Plan was never intended specifically to help the developing countries but instead to solve the standstill in the IMF's operation largely instigated by the US's challenges over requests for IMF lending by some member countries such as the Netherlands, Nicaragua and South Africa (for further discussions on IMF conditionality, see Chapter Two).

In association with the developments of conditionality, the SBA was introduced in 1952, allowing the IMF's members to draw from its resources in higher tranches. Under this type of facility, performance criteria (which are quantitative targets written in the Letter of Intent – a letter appending to the SBA and containing a description of the member's proposal for measures aiming at correcting the balance of payments problem) were required and had to be met by the borrowing country in question. Drawings under the SBA were disbursed on a quarterly basis, provided that borrowing countries satisfied the agreed conditions.⁴² The conditions generally included limitations on public sector borrowing, bank credit, foreign borrowing and international reserve levels. In effect,

⁴¹ IMF Executive Board Decision no. 102-(52/11), 13 Feb. 1952, in Horsefield, *op. cit.*, vol. 3, p. 228.

⁴² The ideas of phasing, performance criteria, and Letter of Intent were not introduced until the second half of the 1950s. See Chapter Two.

these developments mean that access to the IMF's credit was subject to the performance of the borrowing country in trying to meet the set targets.

In sum, the period from the late 1940s to the late 1950s witnessed several developments of IMF policies which directed the IMF's assistance and benefits to its member countries. Yet, they did not arise with an aim to assist the developing countries in particular due partly to the IMF's perception of its primary domain of responsibility being monetary and trade issues, rather than development. Often these developments were, to a great extent, designed to overcome its own institutional problems and/or facilitate its own operations. Some of these devices, such as conditionality and SBAs, generated the means by which the IMF's influence in borrowing countries' economic policies could subsequently be enhanced. However, this limited view of the IMF's function did not carry on in the following period to which we now turn.

1.2.2 The Years of the Decline in US Dominance and Greater Attention to Developing Countries' Problems

1.2.2.1 The Turning-Point Period: Late 1950s and 1960s

During the 1960s, the issue of development gained more of the IMF's attention and consequently its role in the developing countries was substantially enlarged. Several factors which contributed to such changes can be identified. After the success of the reconstruction of the European and Japanese economies, it would be expected that the IFIs were able to direct more of their interests towards the developing countries. In addition, on the side of member countries, the emergence of the newly independent countries in Africa and Asia following the end of the colonial regimes resulted in the growing representation of the developing countries in international organisations, including the IFIs. From 1960 to 1963, the membership of the IMF increased by approximately 49 per cent from 68 to 101.⁴³ With anti-colonialist sentiment, it was not surprising that these countries initially found multilateral institutions, including the IMF and the World Bank, very appealing in providing both financial and technical assistance for their development programmes. In their eyes, joining these institutions would, in effect, help to get rid off their dependence on ex-colonial powers.

⁴³ James, *op. cit.*, 1996, p. 120.

Also this period was marked by increasing concern over the deterioration in the terms of trade of the developing countries’ primary products and the fluctuation of their export earnings. Following the report provided in 1953 to the Economic and Social Council (ECOSOC) of the United Nations (UN) on ‘The Adequacy of Monetary Reserves’ and a subsequent study by the IMF staff of international liquidity, the IMF in 1957 began to recognise that quotas were too small in relation to the financial need of its member countries and therefore should be increased. In particular, the IMF considered that at the time of the US recession and the decline in primary product prices, it might possibly face the difficulty arising from the greater use of its resources by the primary product exporting countries.⁴⁴

This period also saw a shift of US policy in its overseas economic aid. With the emergence of the European countries and Japan as powerful economies, the US began to experience a decline in its relative economic strength and hence its domination in international monetary and financial affairs, as reflected in the size of its quota at the IMF. Since the Bretton Woods Conference, the relative size of the US quota had been on a decline. As shown in Table 1.1, by the end of 1965, the US quota stood at approximately 26 per cent of the total, compared with about 36 per cent decided at Bretton Woods.

Table 1.1 The Quotas of the US at Selected Dates, 1944-1965

	July 1944	End of 1950	End of 1955	End of 1960	End of 1965
Quotas in Total	7,600	8,036.5	8,750.5	14,740.7	15,976.6
US quota	2,750	2,750	2,750	4,125	4,125
Percentage of the total	36.18	34.22	31.43	27.98	25.82

Source: Horsefield, J. K. (ed.), *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Cooperation*, vol. 2: *Analysis* (Washington, D. C.: International Monetary Fund, 1969), Table 14, p. 380.

The US, in the late 1950s, pursued several strategies which marked a major change in US aid policy.⁴⁵ This was due to the desire to correct its own balance of payments deficits while at the same time facing the criticism that much of its spending on foreign aid to Latin American countries was being wasted.⁴⁶ Among these strategies was a growing use

⁴⁴ Horsefield, *op. cit.*, vol. 1, pp. 446-448, and vol. 2, pp. 357-358.

⁴⁵ Payer, *op. cit.*, 1974, pp. 27-28.

⁴⁶ James, *op. cit.*, 1996, pp. 134-135.

of 'tied aid,' whereby the aid recipient was required to purchase the donor country's products. In addition, the US was keen to enhance the role of the IFIs, including the IMF, by increasing the latter's lending. It recognised that more credit would enable the developing countries which experienced a decline in their export earnings to purchase its own exports of consumer and capital goods.⁴⁷ Also the IMF was, according to C. Douglas Dillion, Deputy Secretary of State for Economic Affairs during the Eisenhower administration, 'better able to advise sovereign governments on sensitive matters of financial policy, or to insist on appropriate corrective measures in return for credits, than are sovereign governments.'⁴⁸ As a result, in 1958-1959 the US successfully pressed for a general increase in IMF quotas by 50 per cent,⁴⁹ which substantially enlarged IMF lending capacity. Other important elements marking the change in the US aid policy included the development of the 'consortium' technique, the shift in emphasis from 'project' to 'programme' aid and the reliance on the SBA of the IMF in determining the granting of its aid programme; all of these enhanced the role and power of the IMF. Nevertheless, this does not necessarily imply that the US gave up its power and stayed aloof from the institution. In fact, the US was still able to influence all important decisions of the IMF via its dominant, though declining, quota and voting power in the institution and through informal influence.⁵⁰

In addition, the developing countries, as well as other international organisations, also played a part in directing the IMF's attention towards the developing countries' problems. Due partly to the instability of their export receipts, several developing countries, such as Egypt, Syria, and El Salvador, in the early 1960s pushed their case in the IMF for an increase in their quotas.⁵¹ At the same time, the UN Commission on International Commodity Trade (CICT) asked the IMF to consider a greater role in providing compensatory financing for export fluctuations.⁵² In response to these demands and partly to solve the problems of international liquidity, the IMF adopted a second general

⁴⁷ Payer, *op. cit.*, 1974, p. 30.

⁴⁸ A statement by C. Douglas Dillion before the House Banking and Currency Committee on 4 March 1959. Cited in *ibid.*, p. 31.

⁴⁹ Horsefield, *op. cit.*, vol. 1, p. 448, and vol. 2, pp. 358-359.

⁵⁰ Payer, *op. cit.*, 1974, p. 31.

⁵¹ Horsefield, *op. cit.*, vol. 2, p. 359.

⁵² Horsefield, *op. cit.*, vol. 1, p. 532, and vol. 2, pp. 360 and 418.

increase in quotas in 1965,⁵³ which further raised the entitled amount of drawings and enhanced the IMF's lending role in the developing countries.

With the changes that had occurred in the international economy and the increasing demands placed upon it by various parties, the IMF began to change its perspective towards the problems of the developing countries. However, such a shift in the IMF's attitude was at the same time subject to restrictions imposed upon it by its own limited domain of responsibilities. In 1960, Per Jacobsson, Managing Director of the IMF, publicly recognised the positive role of the IMF in promoting development, not by providing development finance, but rather by protecting development plans via the provision of short-term lending to countries facing temporary balance of payments deficits. Monetary stability remained the IMF's prime objective, but the change that this perspective brought in was that it then became specifically linked to development.⁵⁴

Besides the two general increases in quotas mentioned previously, the shift in the IMF's attitude and focus was highlighted by the introduction of several other devices designed to help the developing countries lessen their balance of payments problems. These included the creation of the IMF's new special facilities. Among them was the Compensatory Financing Facility (CFF), which was established in February 1963 for financing short-term shortfalls in export earnings arising from adverse circumstances beyond the members' control. To start with, the CFF was unattractive to the developing countries owing to its relatively restrictive terms of borrowing. First of all, there was a lack of sufficient automaticity, despite the call for automatic access by both Organisation of American States (OAS) and UN proposals.⁵⁵ In resisting to such a demand, the Executive Directors asserted that an overall assessment of a country's payments situation was necessary to avoid generating an excessive short-term debt burden on the borrower; that automatic drawing rights might be harmful to the borrower if they forestalled needed reforms; and that differences between present and past prices might indicate a long-term trend rather than a short-term cyclical movement in which case the IMF's assistance would not be appropriate.⁵⁶ Secondly, drawings made under the CFF were included in

⁵³ Horsefield, *op. cit.*, vol. 2, pp. 361-363.

⁵⁴ Bird, *op. cit.*, 1978, p. 18.

⁵⁵ Horsefield, *op. cit.*, vol. 2, pp. 419-420.

⁵⁶ Krasner, *op. cit.*, p. 677.

assessing further requests for drawings. A current borrowing member under the CFF might, in effect, find it difficult to gain access to subsequent regular drawings from the IMF. As a result, during the period between 1963 and 1966, only three countries (Brazil, Egypt and the Sudan) requested financing under the CFF for a total of US\$ 87.25 million, although the small number of requests was in part reflected by the general rises in world prices of primary commodities.⁵⁷ However, following lobbying by the developing countries via the OAS and the United Nations Conference on Trade and Development (UNCTAD) and in the IMF at the 1965 Annual Meeting in 1965, and subsequent amendments to the borrowing terms, the CFF was, in September 1966, made more attractive to the developing countries, but still not automatically available. The amount allocated to the CFF was enlarged from a maximum of 25 per cent to a maximum of 50 per cent of quota by allowing the holdings of a member's currency to reach 250 per cent of the quota in place of 225 per cent under the previous term. Drawings made under the CFF were excluded from the consideration of future drawings. Also greater weight was given to qualitative estimation of export shortfalls in determining the amount that a member could draw.⁵⁸ Since the CFF was amended in 1966, 31 member countries had, by April 1975, purchased a total of SDR 913 million under the facility, bringing total use of the facility to more than SDR 1 billion since its creation.⁵⁹

In June 1969, the Buffer Stock Financing Facility (BSFF),⁶⁰ which would be of benefit to the developing countries, was created as a consequence of the developing countries' efforts during 1967-68 in pressing their concerns over the problem of stabilisation of fluctuating primary product prices in the IMF via their Governors of the IMF at the Annual Meetings as well as in other forums such as the UNCTAD.⁶¹ The BSFF was intended to help the member countries which had balance of payments difficulties due to

⁵⁷ Horsefield, *op. cit.*, vol. 2, pp. 422-423; and de Vries, M. G., *The International Monetary Fund, 1966-1971: The System Under Stress*, vol. 1: *Narrative* (Washington, D. C.: International Monetary Fund, 1976), p. 263.

⁵⁸ Krasner, *op. cit.*, pp. 676-678; Horsefield, *op. cit.*, vol. 2, pp. 423-427; and de Vries, *op. cit.*, vol. 1, 1976, pp. 261-262.

⁵⁹ International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1975* (Washington, D. C.: International Monetary Fund), p. 52, and Table I.9, p. 80.

⁶⁰ It should be noted that under the BSFF, no drawings have been made since January 1984. International Monetary Fund, 'Financial Organization and Operations of the IMF,' *IMF Pamphlet Series*, no. 45, 5th ed. (Washington, D. C.: Treasurer's Department, International Monetary Fund, 1998), p. 72. In February 2000, as part of streamlining and simplifying IMF facilities, the BSFF was eliminated.

⁶¹ de Vries, *op. cit.*, vol. 1, 1976, pp. 270-272, and 278.

their participation in international buffer-stock schemes.⁶² Under the BSFF, a member country was allowed to raise the IMF's holdings of its currency to reach a maximum of 250 per cent and thereby to draw up to 50 per cent of its quota being used to finance an international buffer stock. However, drawings under the CFF and the BSFF taken together could not exceed 75 per cent of quota. Similar to the CFF, the amount drawn under the BSFF was separated from the amount that the member was normally able to draw under the IMF's usual tranche policies. Therefore, the developing countries would benefit from the enlarged access to the IMF's financial resources through both the establishment of the CFF and the BSFF.

In addition to the creation of the two special facilities, this period saw the expansion of the range of the IMF's advisory and training activities. Following several years of debates within the IMF concerning its authority in the field of restrictions, in 1960 the IMF enlarged its jurisdiction of consultations, which was previously limited to only exchange restrictions, to cover trade policies, with a view that various forms of restrictions were interrelated and thereby could not be considered separately.⁶³ By the mid-1960s, the scope of consultations was broadened further to include a wide range of financial and economic matters. In the case of the developed countries, consultations were, after 1967, extended to cover issues such as the causes of recurrent exchange crises and inflation.⁶⁴ On the other hand, the extended scope of consultations with the developing countries was far greater, partly reflecting the larger scale of economic problems that these countries had to encounter. As Margaret de Vries writes:

Consultations with developing members . . . began to cover more fully the consequences of economic development efforts, both in the short run and in the somewhat longer run, for prices, production, monetary and fiscal policies, and the balance of payments problems of joblessness and the measures to increase employment opportunities; the size and servicing of external indebtedness; and members' relationships with regional organizations . . .⁶⁵

⁶² It was a mechanism to avoid erratic short-term fluctuations in price. Generally, this involved the creation of a stock of commodity (such as copper, wheat, and sugar) with funds held by an international trade body to regulate the price of that commodity through the management of the stock. If the market price decreased below the range of established prices, the trade body would buy the surplus generated by the decline in price and add it to the buffer stock in an attempt to bring the price back up. By contrast, if the market price rose above the range of established prices, then the trade body would sell part of their buffer stock in order to bring the price down.

⁶³ de Vries, M. G., 'The Consultations Process,' in Horsefield, *op. cit.*, vol. 2, ch. 11, pp. 237-238.

⁶⁴ de Vries, *op. cit.*, vol. 1, 1976, pp. 575-576.

⁶⁵ *Ibid.*, p. 576.

The larger the scope of consultations, the more information the IMF obtained from member countries. The increased information in turn provided the essential basis for deriving the conditions for its loans to member countries.

The issue of indebtedness provides a good example. As de Vries points out, during this period the IMF's consultations with its member countries were extended to deal with the issue of indebtedness. For the first time, the issue of external indebtedness was included in the Annual Report for 1964 (and also for 1965).⁶⁶ With great concern having been raised by several debtor and creditor countries at the IMF over the problem of servicing of external debt by the developing countries, by the mid-1960s the IMF's activities in dealing with the issue of external indebtedness had gone beyond consultations. The IMF's staff began to participate as observers and advisors in multilateral debt negotiation meetings between creditor and debtor countries; for example, by analysing debtor countries' economic situations and prospects, assessing the economic impacts of various renegotiation proposals, and preparing reports on the progress of the debtors' debt position to the creditors. More importantly, the IMF's action concerning external indebtedness also included the working out of conditions in the developing countries' stabilisation programmes in regard to the issue. As a result, limitations on external indebtedness were often incorporated in many financial stabilisation programmes.⁶⁷

The increase in the IMF's membership also led to a rapid growth in requests, particularly from the developing countries, for its technical assistance. The IMF, in the second half of the 1960s, began to provide technical assistance to the developing countries in the fields of central bank matters, fiscal affairs and statistics.⁶⁸ It established the IMF Institute in 1964 in Washington, D.C. for training finance and central bank officials of member countries.⁶⁹ Also, the IMF expanded its publications in the forms of periodicals, monograph series, and pamphlet series, and began to make available some of its publications in other languages than English (such as French, Spanish and German).⁷⁰ To some extent, the IMF's publications (as well as its training and technical assistance) were helpful to the developing countries, such as in the provision of essential statistics for

⁶⁶ Horsefield, *op. cit.*, vol. 1, p. 553; and de Vries, *op. cit.*, vol. 1, 1976, p. 593.

⁶⁷ de Vries, *op. cit.*, vol. 1, 1976, pp. 593-596.

⁶⁸ Horsefield, *op. cit.*, vol. 1, pp. 552-553; and *ibid.*, pp. 579-586.

⁶⁹ Horsefield, *op. cit.*, vol. 1, p. 554.

⁷⁰ *Ibid.*, pp. 555-557.

members' use. Yet, the dramatic growth of these areas of the IMF's activities, particularly publications, was, to a larger extent, motivated by the growing realisations on the part of the IMF that there was a need to technically justify its role and policies at the time when the IMF encountered persistent criticism that the US was closely involved in many IMF (and World Bank) programmes,⁷¹ and that it was crucial to make as many people as possible familiar with its work, so increasing their confidence in, and the credibility of, the institution.

It can be summarised that as a result of changes that occurred in the international economic and political system as well as pressure from various parties, between the late 1950s and 1960s the IMF began to turn its attention toward the developing countries and their problems; namely, the fluctuation of their primary commodity prices and the adverse impact upon their balance of payments. During this period, the IMF augmented its lending resources through general increases in quota and the establishment of special lending facilities, which enlarged the developing countries' access to its financial resources. It also sharply expanded other areas of its activities. However, such expansions produced an increasing scope of its authority in several monetary and economic fields, on which IMF conditionality could soon be based, and thereby added to its leverage over the developing countries' economies.

1.2.2.2 The Proliferation of IMF Facilities: 1970s-Early 1980s

The 1970s were marked by two important events in the international economy. First was the collapse of the so-called 'Bretton Woods system',⁷² and the second was the rapid increases in oil prices. Both developments had a profound impact upon the role and lending activities of the IMF with regard to the developing countries.

The period of the early 1970s witnessed a substantial imbalance in international payments (on the one side, a large US balance of payments deficit, and, on the other side, sizable surpluses built up by many Western European countries and Japan), and the massive capital movements. The increasing deterioration of the US balance of payments deficit in

⁷¹ Horsefield, *op. cit.*, vol. 1, pp. 199-200 and 555; and James, *op. cit.*, 1996, p. 134.

⁷² The Bretton Woods system was a par-value (fixed but could vary) international monetary system where the US dollar was pegged to gold and used as a base currency for all other currencies, i.e. the latter were set in rates relative to the dollar.

1971 and subsequent speculation against the dollar led to the devaluation of the dollar (both in December 1971 and February 1973). When the US, in August 1971, declared the suspension of official convertibility of dollars into gold, the system of agreed par values and convertibility into gold (the two important pillars of the Bretton Woods system) virtually no longer functioned as it had done in the past. Although substantial efforts were made during late 1971 and 1972 to retain the par value system, culminating in the currency realignment of the so-called Smithsonian agreement in December 1971, the agreement was short-lived. By the early months of the 1973, the Bretton Woods system had collapsed entirely following the adoption of a regime of widespread floating exchange rates, instigated by persistent speculative capital movements.

The effective breakdown of the Bretton Woods system paved the way to the creation of the Committee on Reform of the International Monetary System and Related Issues (the so-called 'Committee of Twenty').⁷³ Although the idea of setting up a committee of the Board of Governors of the IMF had been around since 1966,⁷⁴ it was in the course of the discussions concerning a reform of the international monetary system during the crisis of the Bretton Woods system that such a committee was successfully set up. Following the US's and, to a lesser extent, the developing countries' demands, the Committee of Twenty was created in July 1972. In the light of the growing influence of the Group of Ten,⁷⁵ which worked exclusively in the interest of the large industrial countries, by the early 1970s there were persistent demands from the developing countries calling for their participation in the negotiations on any reform of the international monetary system, and for the creation of a forum by which they could express their views on the issue.⁷⁶ More importantly, at the same time the US felt that the Group of Ten had become excessively

⁷³ This was a committee of the IMF's Board of Governors which was established in July 1972 and ceased to exist in October 1974. It was then succeeded by two new Committees: the Interim Committee of the Board of Governors on the International Monetary Systems (known as the Interim Committee); and the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (known as the Development Committee). International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1975* (Washington, D. C.: International Monetary Fund), p. 41.

⁷⁴ For more details on earlier attempts prior to the creation of the Committee of Twenty during 1966-1970, see de Vries, M. G., *The International Monetary Fund, 1972-1978: Cooperation on Trial*, vol. 1: *Narrative and Analysis* (Washington, D. C.: International Monetary Fund, 1985), pp. 145-148.

⁷⁵ The Group of Ten consisted of financial ministers and central banks ministers from ten industrial countries: Belgium, Canada, France, the Federal Republic of Germany, Italy, Japan, the Netherlands, Sweden, the UK and the US. It was created in 1961 during the course of discussions on the establishment of the General Arrangements to Borrow. However, it was not a body of the IMF.

⁷⁶ de Vries, *op. cit.*, vol. 1, 1976, pp. 552-553; and de Vries, *op. cit.*, vol. 1, 1985, p. 144.

weighted in favour of the five EC countries (Belgium, France, the Federal Republic of Germany, Italy, and the Netherlands) which often took a common line opposed to the US's views. The US thus pressed for the creation of a new body to include more countries largely in a hope that those outside the Group of Ten might lend support to strengthen US positions vis-à-vis those of the five EC countries.⁷⁷ The Committee of Twenty had an advisory role and made reports on international monetary reform. In June 1974, its final Report, together with an 'Outline of Reform,' was published. In its recommendations on the management of future international monetary arrangements, the 'Outline' explicitly referred to economic development in the developing countries. The introduction of the 'Outline' stated that future international monetary arrangements would be carried out in a manner that would 'encourage the growth of world trade and employment, promote economic development, and help to avoid inflation and deflation.' One of the features of the reformed international monetary system listed in the 'Outline' was the promotion of the net flow of real resources to the developing countries, which had never previously been regarded as one of the IMF's primary responsibilities. In order to attain the purposes of the reform, the 'Outline' emphasised the importance of satisfactory and consistent arrangements for international trade, capital, investment, and development assistance, including the access for the developing countries to both financial and goods markets in the developed countries.⁷⁸ Therefore, the Committee of Twenty, its Report, and the 'Outline of Reform' marked another significant development in the relationship between the IMF and the developing countries at least in the sense that they recognised the idea that the development problems of the developing countries should be incorporated into proposed actions on the international monetary reform.

Following a recommendation of the Committee of Twenty, a joint Ministerial Committee of the Boards of Governors of the Bank and the IMF on the Transfer of Real Resources to Developing Countries (commonly known as the 'Development Committee')⁷⁹ was established in October 1974. The Development Committee dealt with the issue of real resource transfer to the developing countries, in particular to those developing countries facing severe balance of payments problems. In effect, with the coming-into-being of the Development Committee, the issues of international monetary reform and of the

⁷⁷ de Vries, *op. cit.*, vol. 1, 1985, pp. 148-149, and 152.

⁷⁸ *Ibid.*, pp. 256-259.

⁷⁹ For more detail on the Development Committee, see the following section on the structure of the IMF.

development problems of the developing countries became linked at an institutional level within the IMF.

In addition to the breakdown of the Bretton Woods system, the oil price rises of the 1970s further enhanced international concerns, including the IMF's, over the problems of oil importing countries, including oil importing developing countries. The 1970s' oil price crisis had important implications for the latter: external inflationary pressures resulted from the dramatic rise in the cost of imports; and low demand for their exports developed due largely to the recession in the developed industrialised countries. Therefore, the oil price increases were expected to aggravate the balance of payments situation in many developing countries.

In these circumstances, IMF lending and resources were expanded, in particular through the establishment of a number of new credit facilities. Among the numerous facilities created by the IMF during this period included the Oil Facility (OF). The OF, which was an ad hoc financing facility available until March 1976, was set up in June 1974, as the IMF's response to the oil price crisis under the personal initiative of Managing Director Johannes Witteveen and having been endorsed by the Committee of Twenty.⁸⁰ It was designed to provide financial assistance to the IMF's member countries which faced balance of payments problems caused by increases in the costs of imports of petroleum and petroleum products. Drawings under the OF were supplementary to IMF resources under other policies, but were subject to a limit of 75 per cent of quota (under the OF for 1974) and of 125 per cent (under the OF for 1975) with a maximum repayment period of 7 years.⁸¹ The financing of drawings under the OF through borrowings from 17 countries mainly came from 7 oil-exporting countries (Saudi Arabia, Iran, Kuwait, Venezuela, Nigeria, Abu Dhabi, and Oman), representing 72 per cent of the total fund.⁸² Out of the total drawing under the OF of SDR 6,902.4 million made by 55 member between 1974 and 1976, ten industrial developed countries drew 63 per cent. Only 37 per cent went to 45 developing countries, six of which (Chile, India, Israel, Korea, Pakistan, and

⁸⁰ de Vries, *op. cit.*, vol. 1, 1985, pp. 305-306.

⁸¹ Gold, J., *Financial Assistance by the International Monetary Fund: Law and Practice*, 2nd ed. (Washington, D. C.: International Monetary Fund, 1980), pp. 31-32; and International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1975* (Washington, D. C.: International Monetary Fund), pp. 53-54.

⁸² International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1976* (Washington, D. C.: International Monetary Fund), p. 54, and Table I.16, p. 91.

Philippines) took 56 per cent.⁸³ This suggests that the OF benefited the developed rather than the developing countries, and that the majority of the developing countries gained relatively little from the OF, despite the majority of the financing having come from the oil-producing developing countries. Effectively, the IMF through the OF helped to transfer a vast amount of financial resources from the developing to the developed countries. This is in contrast to what had been recommended by the Committee of Twenty.

In connection with the OF, a Subsidy Account (SA) was created in August 1975 to reduce the interest burden arising from drawings under the OF for the most seriously affected members. In other words, the SA was to help subsidise the interest payments incurred since the interest rates charged under the OF (7.7 per cent) were higher than the IMF's traditional charges, reflecting the cost of borrowing. The SA was funded by contributions from 24 members (including oil-exporting and industrial countries) and Switzerland. The cumulative amount of payments under the SA in April 1980 totalled SDR 113.15 million, 54 per cent of which went to the three largest beneficiaries, India, Pakistan, and the Philippines. The remainder of the payments was allocated among 21 developing countries with differing amounts between SDR 0.03 million and less than SDR 9 million.⁸⁴

In September 1974, members' access to IMF resources was further enlarged through the establishment of the Extended Fund Facility (EFF), as a response by the IMF to the lack of agreement and the failure of negotiations on a reformed international monetary system. In particular, the establishment of a connection between allocations of SDRs and the provision of development finance, which had strongly been pressed for by the developing countries, had not materialised due to the lack of support from many developed countries.⁸⁵ The EFF was designed to help a member which was described as either 'suffering serious payments imbalance relating to structural maladjustments in production and trade and where prices and cost distortions have been widespread,' or as 'characterized by slow growth and an inherently weak balance of payments position

⁸³ International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1976* (Washington, D. C.: International Monetary Fund), p. 54, and Table I.12, p. 87.

⁸⁴ International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1980* (Washington, D. C.: International Monetary Fund), Table 26, p. 89.

⁸⁵ de Vries, *op. cit.*, vol. 1, 1985, pp. 203-209, and 361.

which prevents pursuit of an active development policy.’⁸⁶ Therefore, it was largely intended to benefit the developing countries which were typically characterised by such a situation, particularly those that depended on one or two export commodities, or lacked the financial and monetary instruments for mobilising and allocating domestic savings. The EFF was normally limited to a period of three years with a maximum of drawings of 140 per cent of quota and a repayment period within four to eight years after drawings.⁸⁷ Thus, under the EFF, the IMF provided financial assistance to its members for longer periods and in larger amounts available than those available under the SBA.

However, the large amount and longer period features of the EFF come with a high price. The EFF is, similar to the SBA, attached to a number of conditions under the IMF’s supervision. A member applying for financial assistance under the EFF is required to present a programme setting forth the objectives and policies for the whole period of the EFF, as well as a detailed statement of policies and measures for the first year, plus the understanding that for each subsequent years, the member would submit a detailed statement of the programme progress and of the policies and measures which would be followed.⁸⁸

Not surprisingly, very little use was made of IMF resources under the EFF in its earlier years. Within three years and eight months of its operation, only three countries (Kenya, the Philippines, and Mexico) had entered into the EFF with the IMF.⁸⁹ The small number of the EFFs requested and concluded largely reflected the fact that members were able to avoid such a high-conditionality facility by preferably opting to meet their needs for balance of payments financing from the IMF’s other facilities, particularly the low-conditionality facilities such as the OF and the CFF, or from other sources whose financing carrying very limited or no conditionality, such as the Organisation for Petroleum Exporting Countries (OPEC) and private commercial banks.

⁸⁶ Executive Board Decision no. 4377-(74/114), 13 Sept. 1974, in International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1975* (Washington, D. C.: International Monetary Fund), app. II, p. 88.

⁸⁷ In December 1979, the maximum repayment period under the EFF was extended from eight to ten years from the date of drawing.

⁸⁸ International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1975* (Washington, D. C.: International Monetary Fund), p. 54.

⁸⁹ International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1977* (Washington, D. C.: International Monetary Fund), p. 53, 1978, p. 66.

In May 1976, the Trust Fund (TF) was created to provide highly concessional finance with 0.5 per cent interest, available in two periods until the end of 1980, on a medium-term basis to help the lower-income developing countries (those with a per capita gross national product (GNP) in 1973 of less than US\$ 300) to meet their balance of payments requirement. It was financed with a portion of the profits from the sale of the IMF's gold and resources lent or contributed by members. The credits were to be repaid in equal instalments between five and a half and ten years after disbursement. Conditionality for drawings under the TF was similar to that for drawings in the first credit tranche, i.e. a member must have a need for balance of payments assistance and also must be making a reasonable effort to correct its balance of payments position. However, if the member had, within a relevant period, adopted a programme in connection with the upper credit tranches such as a SBA or an EFF, conditionality became stricter, i.e. the member was deemed to satisfy the second requirement.⁹⁰

In August 1977, the Executive Board of the IMF set up another facility, the Supplement Financing Facility (SFF, also known as the 'Wittveen facility'). It was designed to supplement credits drawn under the SBA or the EFF reaching into the upper credit tranches and thus being subject to similar conditions. Drawings under the SFF were normally limited to a maximum of 140 per cent of quota with a repayment period of between three and a half and seven years after the purchase.⁹¹

Moreover, in December 1975, the IMF expanded its lending role by further liberalising its existing facility, the CFF, to help primary producing countries meet the intensified payments problems, especially when there was weakness in international demand and prices for their primary products arising from the widespread recession, particularly in the industrial countries. The principal changes made to this facility covered both the maximum entitled amount under the CFF in terms of quota and the formula for calculating export shortfalls: a) the limit on drawings was raised from 50 to 75 per cent of quota, and the joint limit of 75 per cent of quota, which previously applied to drawings under both the CFF and the BSFF, was abolished; and b) the method of calculating the

⁹⁰ Gold, *op. cit.*, 1980, p. 36; and International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1976* (Washington, D. C.: International Monetary Fund), p. 60.

⁹¹ Gold, *op. cit.*, 1980, pp. 34-35; and International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1978* (Washington, D. C.: International Monetary Fund), p. 67.

export shortfalls under the CFF was improved by giving greater weight to the trend of past growth rates of export earnings.⁹² As a consequence, the use of the CFF substantially expanded following the 1975 amendment to the CFF. In 1975/76, drawings under the CFF amounted to a record SDR 828 million, bringing the amount outstanding under the CFF in April 1976 to SDR 1,208 million. Most of the drawings were made after its 1975 liberalisation, with 25 members drew a total of SDR 956 million under the CFF in the first six months of 1976.⁹³

Nevertheless, as G. C. Abbott points out, there were a number of shortcomings of the CFF which indicated why the developing countries were unable to benefit fully from the facility and also why the amount provided was insufficient to meet their deficit needs. First of all, calculations of shortfalls were based entirely on the behaviour of exports in nominal terms, and did not take into account changes in import prices, nor earnings from services. Secondly, CFF drawings were limited by quota, and not linked to the needs of individual deficit countries. The developing countries with small quotas might have greater shortfalls, and thus greater needs, than those with relatively larger quotas. Thirdly, the repayment schedule was fixed at three to five years, and not related to the recovery of export earnings. Fourthly, no allowance was made for increases in the volume of imports arising out of factors beyond the control of the deficit country. Finally, drawings under the CFF must be made within six months of the occurrence of the shortfalls, while for many countries statistics were available after a considerably longer time-lag.⁹⁴ More importantly, there was conditionality attached to the CFF, although it was less severe than that of the EFF or the SBA. The conditionality consisted of a requirement that the member would 'cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.'⁹⁵ If drawings under the CFF exceeded 50 per cent, the IMF must be satisfied that the member had been cooperating in this way.⁹⁶ Thus, although the CFF contributed to the alleviation of the developing countries' payments problems caused by fluctuating export earnings, it simultaneously strengthened

⁹² Abbott, G. C., *International Indebtedness and the Developing Countries* (London: Croom Helm, 1979), p. 171; and International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1976* (Washington, D. C.: International Monetary Fund), p. 52.

⁹³ International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1976* (Washington, D. C.: International Monetary Fund), p. 52.

⁹⁴ Abbott, *op. cit.*, p. 172.

⁹⁵ Executive Board Decision, no. 1477-(63/8), 'Compensatory Financing of Export Fluctuations,' 27 Feb. 1963, in Horsefield, *op. cit.*, vol. 3, p. 239.

⁹⁶ Gold, *op. cit.*, 1980, p. 30.

the IMF influence in the developing economies. In particular, this occurred after changes in borrowing terms in 1982 which turned it to become a high-conditionality facility, and in general there appeared to be an imbalance of power between the IMF as a lender and the developing countries as borrowers.

During this period, the relationships between the IMF and the developing countries were seen as paradoxical. Even though the IMF had expanded its lending resources so as to help meet the payments needs of the developing countries, the use of IMF lending by the developing countries was not as high as it might have been. This was largely due to two factors. First, the developing countries found IMF lending less attractive than that of private commercial banks. Lending provided by the IMF was often attached to conditionality which would take time to work out and, more significantly, could have adverse implications for the developing countries, particularly political ones. Second, the IMF also faced competition from other sources, particularly from private commercial banks, in providing lending to the developing countries. One of the major consequences of the oil price crisis was the accumulation of liquidity in several private commercial banks, mostly Western commercial banks, following the steadily rising deposits from oil-producing countries. This in turn increased the willingness of the banks to lend to the developing countries as a way to recycle their excessive 'petrodollars' (which were dollar revenues of the oil-exporting countries earned from exporting their oil),⁹⁷ especially at the time when the 1974-1975 recession reduced credit demand in the developed industrial countries. Underlying the increased willingness of the banks to lend was a popular belief that 'countries do not go bankrupt.'⁹⁸ Furthermore, the real cost of borrowing in the commercial markets was remarkably low since real interest rates were zero or negative as a result of high inflation. Thus, to finance their balance of payments deficits or development projects, the oil-importing developing countries often opted for private commercial banks' lending as an alternative and/or a supplement to IMF lending. As a consequence, during 1977-82, short-term lending of private commercial banks to the

⁹⁷ It should be noted that in contrast to a conventional belief, the role of the Euromarkets in recycling petrodollars was modest. See for example, Spiro, D. E., *The Hidden Hand of America Hegemony* (Ithaca, N. Y.: Cornell U. P., 1999).

⁹⁸ This belief was expounded by Walter Wriston, Citicorp Chairman, who usually said, 'countries don't go out of business.' James, *op. cit.*, 1996, p. 352.

developing countries was at an average of US\$ 19.5 billion annually while net purchases from the IMF were merely US\$ 2.5 billion.⁹⁹

In sum, the international developments as well as the discord between the US and other industrial countries which occurred during the 1970s helped provide the developing countries with forums within the IMF and also with limited opportunities to press the case for the IMF's dealing with their economic problems. Although the consequent enlargement of access to IMF resources through both the proliferation of IMF facilities and the liberalisation of the CFF would, to some extent, be of benefit to the developing countries, at the same time it provided additional instruments through which the IMF's influence in their economic policies could be reinforced, especially through the new facilities with high conditionality like the EFF. Nonetheless, in practice such an influence in the developing countries as a whole was, during this period, not substantial due to less reliance of the developing countries on the IMF's financial assistance than other alternative financial sources, namely private commercial lenders. Yet, the legacy of this period was to change the course of the relationship between the IMF and the developing countries in the following periods, to which we now turn.

1.2.2.3 The IMF-World Bank Convergence: 1980s Onwards

The period of the 1980s onward saw the emergence of several crises. Among them was the debt crisis which was characterised by the inability of a number of the developing countries, which had borrowed heavily from Western private commercial banks, to meet their debt repayments. This had a significant impact upon the IMF's influence, especially in the field of debt renegotiations between the creditors (both official and private) and the debtor countries.

To understand the changes that occurred during this period, it would be helpful to look briefly at the origins of the debt crisis. During the 1970s and the early 1980s, the industrial countries faced stagflation, a low level of output combined with inflation, which had followed the oil price rises of 1973 and 1979. Controlling inflation became the priority of virtually all industrial countries, especially the US, in a belief that it would stimulate growth and employment. Anti-inflationary measures principally based on

⁹⁹ Bird, G., *IMF Lending to Developing Countries: Issues and Evidence* (London: Routledge, 1995), p. 4.

restrictive monetary policies were pursued after late 1979, even though this would exacerbate the already-high level of unemployment. This included the sharp increase in interest rates. The inflation rate did eventually fall but this brought about a substantial rise in real interest rates since nominal interest rates now exceeded the reduced inflation rate.

Due to the rise in real interest rates, the prevailing situation of inflation eroding debt prior to 1979 was no longer the case. Higher interest rates obviously had an immediate impact in raising the interest payments since most of loans were contracted at floating interest rates, and reflected US rates.¹⁰⁰ Interest payments incurred by the developing countries more than tripled during 1978-1982 from US\$ 21 billion to US\$ 72 billion.¹⁰¹ Also the majority of loans from private commercial banks to the developing countries' governments had been made on a short-term basis and, as time went on, the maturity of the loans fell. While in 1974, two thirds of the loans in the Euromarkets still had a maturity of between seven and ten years and one tenth had a maturity of more than ten years, in the following years two thirds were dated between one and six years, and only 1 per cent had a maturity of more than ten years.¹⁰² Moreover, the weak demand arising from the recession and an intensification of protectionist measures in the industrial economies made it difficult for the non-oil developing countries to export and thus further worsened their export performance which had also been weakened by the fall in primary commodities prices and their declining terms of trade.¹⁰³ As the economic prospects of the world and particularly of many developing countries grew bleaker, in 1978 private commercial banks sought to minimise risk by increasing short-term lending and by reducing loans with longer maturities. Simultaneously, the level of capital outflows from some developing countries, particularly, Argentina, Mexico, and Venezuela, began to increase on a large scale, which was often compensated through increased short-term borrowings.¹⁰⁴ Therefore, many developing countries, which had borrowed heavily, especially from private commercial banks, after 1973, found themselves caught in massive and increasing debt burdens. By mid-1982, the aggregate external debt of many

¹⁰⁰ James, *op. cit.*, 1996, p. 355.

¹⁰¹ Loxley, J., *Debt and Disorder: External Financing for Development* (Boulder: Westview, 1986), Table 3.3, p. 60.

¹⁰² James, *op. cit.*, 1996, pp. 319-320.

¹⁰³ de Vries, M. G., *The IMF in a Changing World, 1945-85* (Washington, D. C.: International Monetary Fund, 1986), pp. 183-184.

¹⁰⁴ Loxley, *op. cit.*, p. 64; and James, *op. cit.*, 1996, p. 358.

oil-importing developing countries was over US\$ 600 billion, over half of which was on a commercial terms.¹⁰⁵

Yet, the important issue in relation to the debt crisis is not the total amount of debt but rather the ability of a borrowing country to service its debt which can be measured by a debt-service ratio (debt-service payments (principal plus interest payments) as a percentage of export earnings). With the persistent weakness in the export markets of many developing countries combined with the considerable rise in the interest payments and an increase in maturing loans, the combined debt-service ratios for the developing countries rose sharply from 15.1 per cent in 1977, to 19 per cent in 1979, and to 24.4 per cent in 1982. For non-oil developing countries it rose from 16.1 per cent, to 19.7 per cent and to 25 per cent in the same years.¹⁰⁶ As noted in the earlier section, the problems of debt servicing were not new to the developing countries. However, the fear of default on debts was triggered, especially when the major debtor country of Mexico, which was itself an oil exporting country and regarded by officials and bankers as the least likely to default on its loans, announced in August 1982 that it could no longer meet its debt-servicing payments. The Mexican crisis was shortly followed by the outbreak of similar crises in major debtor countries such as Argentina and Brazil.

However, the debt crisis was not confined to only large debtor countries in Latin America; a large number of middle-income and minor debtor countries in other regions were also affected. This was due largely to a sharp cut back in bank lending to non-oil developing countries after the Mexican crisis, and also to oil-exporting countries by 1983 as oil prices fell dramatically. As a consequence, net flows of finance to the developing countries in 1983 and 1984 were negative to the estimates of US\$ 24 billion and US\$ 31 billion, respectively.¹⁰⁷ The negative net financing flows meant that net lending (new lending minus principal payments of old loans) to the developing countries was insufficient even to cover their interest payments on past debt.

With the onset of the debt crisis in late 1982, there had been a greater degree of cooperation between creditor countries (developed industrial countries), private

¹⁰⁵ de Vries, *op. cit.*, 1986, p. 183.

¹⁰⁶ *Ibid.*, Table 1, p. 185.

¹⁰⁷ Loxley, *op. cit.*, p. 62.

commercial banks, international organisations (namely the IMF and the World Bank), and debtor countries. Their attention turned to the IMF as 'the lender of the last resort,' in the search for a solution to the developing countries' debt problems which were also the creditors' problems. Since the IMF recognised that its financial assistance was insufficient to cover the debtors' financial requirements, it then had to bring in additional financing from the private commercial banks and also the creditor countries in managing the debt problems. On the other hand, the creditor countries, especially the US, had adopted a new strategy towards their foreign aid policy as previously pointed out, in particular the increasing reliance on the IMF as 'a seal of approval.' Also the private commercial banks, having tried unsuccessfully in the past to bring about changes in economic policies in debtor countries, as in the case of Peru in 1976, had become aware that they lacked the technical expertise, data, and monitoring capabilities to do so.¹⁰⁸ As a result, after August 1982 a new relationship between private commercial banks and the IMF emerged. The IMF, which had previously in the 1970s been in competition with the private commercial banks as institutional channels for petrodollar recycling, now closely coordinated with them. In particular, debtor countries' negotiations with the private commercial banks and creditor countries, both for additional net lending and for debt restructuring, became linked with the elaboration of IMF programmes.

As previously noted, the re-negotiation of debts was not a new field to the IMF. It had occurred between 1959 and 1971 in eight countries: Argentina, Brazil, Chile, Turkey, Ghana, Indonesia, India, and Peru.¹⁰⁹ Since the second half of the 1970s, the IMF has increasingly been involved in debt negotiations through the provision of new resources or rescheduling in cases such as Zaire, Peru, Turkey, Jamaica and Sudan during 1976-78.¹¹⁰ However, the significance of the debt crisis is that it led to an emergence of more debtor countries and to the IMF's involvement in a larger number of the developing countries. Between 1979 and 1983, no fewer than 68 developing countries and 12 of the 20 major developing country debtors turned to the IMF for financial assistance.¹¹¹ Thus, through the process of managing the debt crisis, the IMF was able to expand its lending activities in the developing countries and thereby to enhance its opportunity in influencing

¹⁰⁸ Loxley, *op. cit.*, p. 74.

¹⁰⁹ de Vries, *op. cit.*, vol. 1, 1976, p. 595.

¹¹⁰ James, *op. cit.*, 1996, pp. 330-331 and 359-360.

¹¹¹ Loxley, *op. cit.*, p. 88.

economic policies of a large number of the developing countries through the application of its conditionality.

Not only had the debt crisis activated the relationship between the IMF and the developing countries but it also had an impact on the IMF-World Bank relationship. In fact the division of labour between the IMF and the World Bank had already begun to change in the 1970s but it was in the 1980s that major changes took place. The division of labour between the World Bank and the IMF was clear prior to the collapse of the Bretton Woods system. The IMF was designated to deal with short-term balance of payments problems, the demand side, and the monetary sector of the economy, through its supported programme lending. The World Bank, on the other hand, was oriented towards long-term economic development, the supply side and the real sector of the economy through its supported project lending. The 1966 memoranda assigned each institution 'primary responsibilities,' following the increasing overlap between activities of the two institutions during the first half of the 1960s. This was notably in the case of India in 1965-1966, which the World Bank's large-scale project lending in practice amounted to a balance of payment programme.¹¹² The memoranda stipulated that the World Bank was mainly responsible 'for the composition and appropriateness of development programmes and project evaluation, including development priorities.' The IMF's primary responsibility was 'for exchange and restrictive systems, for adjustment of temporary balance of payments disequilibrium and for evaluating and assisting members to work out stabilisation programmes as a sound basis for economic advance.'¹¹³

Yet, the introduction of the EFF by the IMF in 1974 can be seen as a first step towards intruding into the World Bank's field. The IMF under the EFF recognised that the balance of payments difficulties in the developing countries could be structural. The EFF was, thus, largely aimed at structural adjustment in the developing countries with longer-term finance. In addition, after the approval of the UK's and Italy's SBAs in 1977, no major industrial countries concluded a policy programme with the IMF. As previously discussed, the IMF had gradually shifted its focus towards the developing

¹¹² James, *op. cit.*, 1996, p. 143.

¹¹³ Mason and Asher, *op. cit.*, p. 551.

countries. This shift had become manifest since the mid-1970s with the growing range of its facilities.

However, Table 1.2 shows that during the 1970s, the industrial countries continued to draw a substantial amount from the IMF.¹¹⁴ It was not until the late 1970s that most of drawings from the IMF were made by the developing countries. Since the mid-1980s, the overall picture has changed; the industrial countries have ceased to draw from the IMF whereas all drawings have been made by the developing countries. Consequently, the IMF has become involved in mainly the developing countries, and has, in effective, moved closer to the World Bank's domain of responsibilities.

Following the emergence of the 1970s balance of payments crisis in many developing countries, the World Bank had meanwhile diversified its own activities to provide programme lending. This was not specific project lending, but rather lending to support the balance of payments of recipient countries through structural adjustment programmes. The move of the bank was based on the belief that in addition to the implementation of development projects, changes in domestic policy were crucial in avoiding the future balance of payments crises which could in turn seriously jeopardise the World Bank's development projects and impede economic development in the developing countries.

¹¹⁴ All member countries of the IMF have the right to seek the IMF's financial assistance. Unlike the IMF, the World Bank lends only to creditworthy governments of developing countries. The IBRD lends to developing countries whose per capita gross national product (GNP) in 1997 exceeded US\$ 925. On the other hand, only the poor developing countries whose per capita GNP in 1997 was US\$ 925 or less are entitled to borrow from the IDA. World Bank, *World Bank Annual Report*, 1998.

Table 1.2 All Purchases from 1961-2000, excluding reserve tranche purchases (in millions of SDRs, otherwise stated)

Years	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
ICs	1,080	138	0	516	1,431	142	156	1,404	1,355	635	0	0	0	1,513	1,974	2,628	2,416	99	23.8	0
DCs	646	257	324	139	509	603	405	528	367	314	380	650	342	1,575	1,962	3,391	929	1,110	1,672	3,394
World	1,726	395	324	655	1,939	745	560	1,932	1,721	949	380	650	342	3,088	3,936	6,019	3,345	1,209	1,696	3,394
ICs/World (%)	63	35	0	79	74	19	28	73	79	67	0	0	0	49	50	44	72	8	1	0
DCs/World (%)	37	65	100	21	26	81	72	27	21	33	100	100	100	51	50	56	28	92	99	100
Years	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
ICs	0	54	355	217	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
DCs	6,771	7,394	12,264	7,074	4,014	3,820	3,299	2,669	3,478	4,270	7,387	4,791	5,042	4,980	16,968	5,271	16,113	20,586	10,010	7,178
World	6,771	7,448	12,619	7,291	4,014	3,820	3,299	2,669	3,478	4,270	7,387	4,791	5,042	4,980	16,968	5,271	16,113	20,586	10,010	7,178
ICs/World (%)	0	1	3	3	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
DCs/World (%)	100	99	97	97	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Sources: International Monetary Fund, *International Financial Statistics Yearbook* (Washington, D. C.: International Monetary Fund, 1991), pp. 24-25, 1988, pp. 26-27, and 2001, p. 29.

Note: ICs and DCs denote industrial countries and developing countries.

As a result, the idea of the Structural Adjustment Loans (SALs) was initiated during the September-1979 Annual Meeting of the IMF's and the World Bank's Boards of Governors and was approved in 1980 by the Executive Directors of the World Bank. The World Bank recognised that 'the recent changes in the international economy, including the increase in the price of petroleum, continued high levels of inflation, and a prolonged period of slow growth in the industrialized countries, were posing acute problems for many of the developing countries.'¹¹⁵ The SAL was intended to provide long-term finance to supplement the short-term finance from private commercial banks and the IMF.¹¹⁶ As a type of programme loan, the SAL was conditional. Ernest Stern identified four areas of conditions attached to the SAL: 1) the restructuring of incentives, including pricing policies, tariff reforms, taxation, subsidies, and interest rates; 2) the revision of public investment priorities; 3) reform on budget and debt management; and 4) institutional reform, particularly strengthening public enterprises.¹¹⁷ With the introduction of the World Bank's programme loans (including both the SALs to support programmes relating to the economy in general and the Sectoral Adjustment Loans (SECALs) which provided loans supporting programmes linked to particular sectors), the World Bank had in effect entered into the areas originally designated for the IMF.

On the other hand, the IMF had made further moves and became closer to the fields of the World Bank. This move was manifest in the establishment of the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF). The SAF was set up in 1986 to provide loans at a highly concessional interest rate to low-income countries which faced protracted balance of payment difficulties. It supported medium-term adjustment programmes of three years with a repayment period of five and a half to ten years. Its establishment was followed by that of the ESAF in 1987. Similar to the SAF, the ESAF was to provide highly concessional loans to low-income developing countries with the stronger conditionality attached than that under the SAF.

¹¹⁵ World Bank, *World Bank Annual Report*, 1980, p. 67

¹¹⁶ *Ibid.*

¹¹⁷ Stern, E., 'World Bank Financing of Structural Adjustment,' in J. Williamson (ed.), *IMF Conditionality* (Washington, D. C.: Institute for International Economics, 1983), pp. 93-98.

Therefore, since the mid-1970s, the difference between the World Bank as an international institution providing long-term project lending to promote development and the IMF as one which provides short-term balance of payments lending to alleviate temporary payment problems has become blurred. The increasingly overlapping nature of their activities and responsibilities brought about greater cooperation and collaboration between the two institutions as a way to deal with the overlap itself. Their collaboration was both formal, through a policy framework paper (PFP),¹¹⁸ and informal, through personal contact of their staff members.¹¹⁹ Nonetheless, the IMF-World Bank collaboration did not always go smoothly. They might agree on broad issues like the need for policy adjustment and conditionality. However, at times, they failed to agree on detailed policies which borrowing countries were required to pursue. Thus, a difference in their approaches to the same problem could arise. The classical example was that of Kenya in the late 1970s and the early 1980s, in which the World Bank's conditions 'differed from those of the IMF both in taking the form of agreed policy actions (rather than numerical outcomes) and in relating to longer-term variables.'¹²⁰ A worse case happened in Argentina. Tensions between the two institutions arose following the announcement of the World Bank in 1988 that it was to grant a US\$ 1.25 billion loan to Argentina who had failed to meet the performance criteria of its latest SBA with the IMF. In the case of Argentina, the World Bank took the view that the IMF approach concentrated unduly on aggregate macroeconomic targets to be achieved in a short time and questioned whether these targets were attainable without radical structural changes. It was also concerned about 'the realism of the fiscal targets' and the lack of adequate regard for their effect on the efficiency of the economy. A similar scenario took place in Turkey in the same year when the World Bank agreed to release the second tranche under a SECAL to Turkey, despite the dissatisfaction of the IMF over its macroeconomic

¹¹⁸ A policy framework paper is the joint-prepared document between the borrowing country, the World Bank, and the IMF in connection with the SAF and ESAF arrangements. It was introduced in 1986, the same year when the SAF was created. It contains a medium-term policy framework, including information on economic policies and economic estimates for the borrowing countries. It has more importance to the IMF's operations than to the World Bank's because its approval by the IMF's Executive Board is required for an SAF or an ESAF arrangement. Goreux, L. M., 'The Fund and the Low-Income Countries,' in C. Gwin and R. E. Feinberg (eds.), *The International Monetary Fund in a Multipolar World: Pulling Together* (New Brunswick: Transaction, 1989), p. 157.

¹¹⁹ Bird, *op. cit.*, 1995, pp. 49-50.

¹²⁰ Killick, T., 'Kenya, the IMF, and the Unsuccessful Quest for Stabilisation,' in Williamson, *op. cit.*, 1983, p. 409.

performance. However, in early 1989, the release was delayed until October 1990 in the context of the Gulf War.¹²¹

The early 1990s saw the emergence of a new group of borrowing countries, the Central and Eastern European economies, following the collapse of the former Soviet Union and the Eastern Bloc. This presented a new challenge to the IMF, which responded by introducing a new temporary facility to help the 'countries in transition.' The creation of the Systemic Transformation Facility (STF) was approved by the Executive Board in April 1993. It was designed to assist member countries which experienced balance of payments problems arising from transformation from a planned to a market economy. Repayments under the STF are made over four and a half to ten years. The Kyrgyz Republic was the first member to use the STF.¹²² However, during this period loans to the developing countries continued to dominate the lending pattern of the IMF.¹²³

In the 1990s, the IFIs' focus towards the developing countries was further been enhanced by several developments in international politics and economy, principally the second Gulf War of 1990-91 and the East Asian financial crisis of 1997. With regard to the 1990-91 Gulf War, the IMF-World Bank joint support was provided to the Gulf Crisis Financial Coordination Group.¹²⁴ In mid-April 1991, the Group had agreed to grant about US\$ 15.7 billion to mainly Egypt, Jordan and Turkey, and about US\$ 8.3 billion was disbursed. In addition, the IMF responded to the crisis by adapting the existing credit instruments rather than introducing new ones with more flexibility, quick access and disbursement of financing. This reflected the belief of the IMF that the impact of the crisis was 'relatively limited and manageable.'¹²⁵

During the East Asian financial crisis, the IMF set up the Supplemental Reserve Facility (SRF) in December 1997. It was designed to assist member countries which faced

¹²¹ Polak, J. J., *The World Bank and the International Monetary Fund: A Changing Relationship* (Washington, D. C.: Brookings Institution, 1994), pp. 30-37.

¹²² International Monetary Fund, *IMF Survey Supplement*, Sept. 1998.

¹²³ Bird, G., 'The International Monetary Fund and Developing Countries: A Review of the Evidence and Policy Options,' *International Organization*, vol. 50, no. 3, summer 1996, p. 477; and Killick, T., *IMF Programmes in Developing Countries: Design and Impact* (London: Routledge, 1995), p. 6.

¹²⁴ This was a group of 12 major donors and creditors and chaired by the United States. It was set up to mobilise and coordinate assistance to countries seriously suffered from the Middle East crisis.

¹²⁵ Cheney, D. M., *Dealing With the Unexpected: The IMF's Response to the Middle East Crisis* (Washington, D. C.: External Relations Department, International Monetary Fund, 1991).

balance of payments problems arising from 'a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves.'¹²⁶ Drawings under the SRF run up to one year with a repayment period of one to one and a half years from each purchasing date (an extension up to one year of repayment may be granted). The SRF also carried conditions: its availability was subject to the implementation of adjustment policies.

The persistent debt problem of many developing countries had provided another opportunity for the IMF (and the World Bank) to direct more attention towards the developing countries. In September 1996, the Interim and Development Committees of the IMF and the Bank adopted a joint initiative for heavily indebted poor countries (HIPC). The so-called HIPC Initiative provided 'exceptional assistance' to countries to reduce the burden of their external debt 'to levels that they can service through export earnings, aid, and capital inflows.' Both the World Bank and the IMF recognised that the external debt had become a heavy burden in some HIPCs to the degree that it jeopardises their adjustment and growth. The Initiative is available to all HIPCs who are entitled to finance under the IMF's ESAF and the IDA-supported programmes.¹²⁷

In sum, this period witnessed major changes in both relationships between the IMF and the developing countries, on the one hand, and between the IMF and other parties, namely creditor countries, private commercial banks and the World Bank, on the other. In the course of the debt crisis, there had been a rise in the number of indebted developing countries with debt-servicing difficulties and the increasing IMF-World Bank collaboration. This, together with a shift in the creditor countries' and the banks' approach towards reliance upon the IMF's approval, has highlighted the lending role and enriched potential sources of leverage of the IMF in relation to the developing countries, as its borrowing countries.

¹²⁶ International Monetary Fund, *IMF Survey Supplement*, Sept. 1998, p. 17.

¹²⁷ International Monetary Fund, *IMF Survey Supplement*, Sept. 1998.

1.3 Critiques of the Relationships between the IMF and Developing Countries

As the IMF has become increasingly involved in the developing countries and their economies, it has also become the focus of controversy, especially since the 1970s. A number of criticisms of the IMF have been raised over time and the institution has been called upon to defend its role and policies. This section looks at both the issues frequently raised by critics of the IMF, some of which may also apply to the World Bank, and the arguments in defending the IMF. The criticisms of the IMF can be classified into three major lines: first, the power of the IMF over the question of the international payments adjustment; second, the issue of IMF conditionality; and, third, the issue of the organisation and structure.

1.3.1 The Power of the IMF in International Payments Adjustment

Critics rightly argue that there exists asymmetry in the IMF's power in dealing with the question of who should take responsibility in adjusting to international payments imbalances between countries in balance of payments deficit and those in surplus.¹²⁸ The IMF has been criticised for having little influence in making the countries in surplus bear their share of adjustment, while being able to exert such an influence through IMF conditionality on the countries in deficit. It is the countries in deficit (with very few exceptions of those with alternative sources of financial support or in a privileged position whose currency acts as an international reserve currency, namely the US), which are in need of IMF financial assistance, and which are, thus, subject to the policy changes required by the IMF. On the other hand, the countries in surplus, which have no need to resort to IMF financial assistance, are able to treat such policy changes as optional or even to avoid them altogether. Thus, it has always been the deficit countries (mainly the low-income developing countries) which have to adjust to imbalances in international payments and to bear the burden of the adjustment. The defenders admit that due to its limited power, there is little that the IMF can do regarding the issue, apart from exercising 'firm surveillance' over the exchange rate policies of surplus countries and that the effectiveness of such an exercise depends upon their cooperation.¹²⁹

¹²⁸ Dell, S., 'Stabilization: The Political Economy of Overkill,' *World Economy*, vol. 10, no. 8, 1982, p. 600.

¹²⁹ Nowzad, B., 'The IMF and its Critics,' *Essays in International Finance*, no. 146 (Princeton, N. J.: International Finance Sec., Dept. of Economics, Princeton U., Dec. 1981), pp. 6-7.

1.3.2 The Issue of IMF Conditionality

The second line of criticisms of the IMF is concerned with the nature and appropriateness (both theoretical and political) of IMF conditionality. There are a number of criticisms in relation to this issue, which will be discussed in the following section.

First of all, it is argued that the IMF has failed to distinguish between exogenous and endogenous factors contributing to the balance of payments deficits.¹³⁰ Critics point out that many developing countries, particularly the poorest ones, are often faced with balance of payments deficits caused by external factors outside their governments' control (such as natural disasters like floods and droughts, and low international prices of primary products) rather than by internal factors (such as economic mismanagement). They thus suggest that IMF conditionality should be less severe where the causes of balance of payments problems are beyond the government's control. In response to this critique, both the IMF and its defenders take the view that what is important in determining the need for adjustment policies is not the issue of their causes, but whether the balance of payments problem is transitory and self-reversing. If it is transitory, then adjustment is not necessary. However, if not, adjustment policies are required, regardless of the causes of the payments deficit; otherwise the problem will re-emerge.¹³¹ Furthermore, they argue that exogenous factors are not totally absent from the IMF's consideration. They refer to the special facilities made available by the IMF such as the CFF¹³² and the OF, which take into account exogenous causes of balance of payments problems.

Secondly, IMF conditionality is claimed to be inflexible. The monetarist framework adopted by the IMF in its policy analysis is, according to the critics, rigid: one simplistic solution applies to all countries, regardless of different circumstances they have encountered. Thus, the IMF's policy programmes are often seen by the critics as a 'standard package' for all countries in all circumstances. The assertion is rebutted by the defenders who claim that it is incorrect to say that IMF policy programmes are rigid. They point out that in practice the similarity of IMF programmes arises partly because the

¹³⁰ Dell, *op. cit.*, 1982, pp. 599-600.

¹³¹ Nowzad, *op. cit.*, p. 16.

¹³² In 1988, the Compensatory and Contingency Financing Facility (CCFF) was established, superseding the CFF. However, in February 2000, the contingency element of the CCFF was eliminated in order to streamline and simplify IMF facilities.

balance of payments problems in the developing countries share common elements, such as large budget deficits, monetary expansion and the lack of exchange and price adjustment, and partly because the IMF tends to focus on a limited number of broad macroeconomic variables.¹³³

Thirdly, relating to the above argument, a question has persistently been raised over the appropriateness of the IMF's approach to the problems being faced by the developing countries. The critics assert that the IMF focuses on short-term balance of payments problems, and ignores long-term economic development. Its programmes have an adverse impact on development of the developing countries, and thus, the IMF has been labelled as an anti-developmental institution. According to the critics, IMF conditionality is said to be 'harsh' and the IMF has little interest in the negative socio-economic costs of its adjustment programmes, in particular on the poor and on income inequalities, and in their political consequences. This argument is often used to explain why countries have tried to avoid seeking financial assistance from the IMF.

However, the defenders of the IMF argue that the ability and policies of the IMF are constrained by such factors as available limited resources and the role laid down in its Articles of Agreement of providing short-term financing. Moreover, it is not the role of the IMF to act like a development agency. In fact, the issue of development problems in the developing countries is the responsibility of the World Bank, its twin Bretton Woods sister. The defenders point out that the IMF does not, nevertheless, completely ignore such an issue. Its special facilities, operations and promotion of international trade growth are said to have benefits to the developing countries. Such facilities as the EFF, the SAF and the ESAF are often quoted as beneficial to the developing countries due to the longer time over which resources are provided, and the longer repayment period than under the traditional SBA. In response to the criticism of harshness of IMF measures, the defenders argue that often countries approach the IMF at the very late stage of its economic difficulties. In such situations, tough measures are then necessary in dealing with the severe problems.¹³⁴ Along the same line, Managing Director Michel Camdessus states that:

¹³³ Nowzad, *op. cit.*, p. 12.

¹³⁴ *Ibid.*, p. 21.

It is not Fund conditionality that is unduly harsh. It is the difficult underlying economic problems that demand rigorous economic discipline in the countries seeking Fund help. Quite simply, countries cannot live beyond their means. With or without the Fund, they have to adjust sooner or later. And delay does not help . . . most members requesting an arrangement have not only needed resources urgently, they have also approached the Fund only after some delay, when their difficulties have become such that they could be solved only by a more rigorous adjustment program than would have been necessary at an earlier date.¹³⁵

With regard to the issue of social predicaments, the IMF's view is that it is not the responsibility of the IMF, but rather the domestic government to introduce measures to relieve the adverse social effects arising from the implementation of the IFIs' adjustment programmes. However, recently there has been a joint IMF-World Bank effort to alleviate such adverse effects in countries which adopt their programmes.

Furthermore, in linking their criticism of IMF conditionality to its lending, critics add that the amount of IMF financial assistance is small and even insufficient for the balance of payments needs of borrowing countries, in comparison to harsh conditions that they have to endure. Also the critics argue that the proportion of low and high conditionality lending provided by the IMF is inappropriate. By placing an increasing emphasis on high conditionality lending since the early 1980s, the IMF in effect pushes the borrowing countries into high-conditionality drawings.¹³⁶

More importantly, the critics further argue that IMF conditionality is ineffective in helping indebted poor countries to reduce their debts, but rather increases them. Poor developing countries end up repaying more than the amount they have received from the IMF. Thus, the critics claim that IMF facilities cause the perverse transfer of resources from the poor developing countries to the IMF and thus contribute to the drain on the developing countries' scarce financial resources.¹³⁷

¹³⁵ Camdessus, M., 'The IMF: Facing New Challenges: An Interview with Michel Camdessus, Managing Director of the International Monetary Fund,' *Finance and Development*, June 1988, pp. 3-4.

¹³⁶ Dell, S., 'On Being Grandmotherly: The Evolution of IMF Conditionality,' *Essays in International Finance*, no. 144 (Princeton, N. J.: International Finance Sec., Dept. of Economics, Princeton U., Oct. 1981), pp. 29-30.

¹³⁷ Oxfam Policy Department, *A Case for Reform: Fifty Years of the IMF and World Bank* (Oxford: Oxfam, 1995), pp. 38-40.

Table 1.3 shows the net credit and loans from the IMF to the developing countries from 1984 to 2001. Since 1986, IMF net credit and loans to all developing countries has tended to be negative with some exceptions such as in 1991, 1995 and 1997-1999. As critics point out, this suggests that the amount which the developing countries paid back to the IMF was in fact more than the amount of which they had received from the IMF in terms of credit and loans. The positive net credit and loans from the IMF in 1991, 1995 and 1997-1999 can be explained by particular major crises to which the IMF had responded: the Gulf crisis in the early 1990s; the Mexican economic crisis in 1995; and the Asian economic crisis commencing in 1997. For instance, in 1995 a vast amount of the IMF's credit and loans went to the Western hemisphere as illustrated by a net credit of US\$ 12.9 billion. In 1997, Asia received a positive net credit of US\$ 5 billion which was the highest amount compared with other regions in the same year and also the highest amount compared with the amount received in previous years since 1984. Particularly, newly industrialised Asian economies in the same year received net credit of US\$ 11.3 billion from the IMF.¹³⁸ In these periods, negative net credit and loans incurred by other economies elsewhere are offset by such large positive net credits, and, thus, the positive net credit to the developing countries as a whole, particularly since the late 1990s does not show the negative trend of net credit to Africa and sub-Saharan Africa, in which the majority of low-income developing countries are.

Furthermore, as a commentator has pointed out, the trend of negative net credit and loans from the IMF has raised the question of the consistence between its lending performance and its role which is stated in its Articles of Agreement.¹³⁹ Article 1 describes the IMF's role as 'to give confidence to members by making the general resources of the IMF temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to

¹³⁸ The term 'newly industrialised Asian economies' includes Hong Kong, Korea, Singapore, and Taiwan Province of China. The figure is quoted from International Monetary Fund, *World Economic Outlook* (Washington, D. C.: International Monetary Fund, Oct. 1998), Table 37, p. 229.

¹³⁹ Bird, *op. cit.*, 1996, pp. 502-503.

Table 1.3 Net Credit and Loans from IMF of the Developing Countries^a (in billions of US dollars)

YEARS	1984	1885	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Developing Countries	4.2	0.3	-2.2	-4.7	-4.1	-1.5	-1.9	1.1	-0.4	-0.1	-0.8	12.6	-2.9	0.8	8.5	1.3	-6.7	23.3
Africa	0.6	0.1	-1	-1.1	-0.3	0.1	-0.6	0.2	-0.2	0.2	0.9	0.8	0.6	-0.5	-0.4	-0.2	-0.1	-0.4
Sub-Sahara Africa	0.5	0	-0.4	-0.5	-0.2	-0.4	-0.3	0	0	0.7	0.5	0.6	0.1	-0.5	-0.3	-0.1	0	-0.2
Asia	0.3	-1	-0.9	-2.4	-2.4	-1.1	-2.4	1.9	1.3	0.6	-0.8	-1.5	-1.7	5	6.6	1.7	0.9	-2.2
Middle East & Europe	-0.1	-0.2	-0.5	-0.4	-0.5	-0.2	-0.1	0	0.1	0	0.4	0.4	0.1	0.2	-0.1	0.6	3.3	10.3
West Hemisphere	3.4	1.5	0.1	-0.8	-0.9	-0.2	1.2	-1	-1.6	-0.9	-1.3	12.9	-2	-4	2.5	-0.9	-10.7	15.6

Sources: International Monetary Fund, *World Economic Outlook* (Washington, D. C.: International Monetary Fund, Oct. 1992), Table A44, p. 153, Oct. 1998, Table 37, p. 229, and Apr. 2002, Table 37, p. 210.

Note: ^a includes net disbursements from programmes under the General Resources Account, Trust Fund, Structural Adjustment Facility (SAF), and Poverty Reduction and Growth Facility (formerly ESAF).

measures destructive of national or international prosperity.’¹⁴⁰ In 1994 (the year of the fiftieth anniversaries of the IMF and the World Bank), the so-called ‘Fifty Years is Enough’ organisation was created by a group of non-governmental organisations (NGOs) which were sceptical about the neo-liberal trend of the IMF and the World Bank and were, thus, identified with the Left of the political spectrum. The group asserted that the IMF’s role as a development agency was inadequate. Structural adjustment programmes of the IMF and the World Bank brought more disadvantages than advantages to the developing countries, in particular the poorest ones. They caused deflationary pressure, high unemployment, the worsening of the social welfare for the poor, and an increase in poverty in borrowing countries. Therefore, according to the NGOs, if the IMF ceased its policy programmes, these countries would be better off.¹⁴¹

At the other end of the political spectrum, rightwing critics asserted that the IMF had lost its monetary functions since the breakdown of the Bretton Woods in the early 1970s and has changed its role to become a development institution. They saw such a change as inappropriate. For them, the solution for the IMF is either to abolish the institution¹⁴² or to return to its traditional monetary role and programmes.¹⁴³

In addition to the above criticisms concerning IMF conditionality, the IMF has often been accused of imposing such harsh policy conditions upon borrowing countries. Since the question of imposition is the core of the study, it deserves to be examined extensively (see Chapter Two).

1.3.3 The Issue of the Organisation and Structure

The third line of criticisms deals with the issue of the IFIs’ organisation and structure. It is argued that both the IMF and the World Bank (specifically, the IBRD) are dominated by the industrial countries and their interests through their voting power.¹⁴⁴ Their dominant position in the two financial institutions provides them an opportunity to exploit the

¹⁴⁰ International Monetary Fund, *Articles of Agreement of the International Monetary Fund* [online], Article 1: Purposes, 2003. Available from: <http://www.imf.org/external/pubs/ft/aa/aa01.htm> [accessed 6th Oct. 2003]

¹⁴¹ See, for example, Oxfam Policy Department, *op. cit.*, 1995.

¹⁴² See, for example, Walters, A., ‘Do We Need the IMF and the World Bank?’, *Current Controversies*, no. 10 (London: Institute of Economic Affairs, Sept. 1994).

¹⁴³ Killick, *op. cit.*, 1995, p. 157; and Bird, *op. cit.*, 1996, pp. 477-478.

¹⁴⁴ See Payer, *op. cit.*, 1974, app. II, pp. 217-219.

developing countries. The issue of industrial country domination in the IMF is defended on the grounds that it reflects the economic and financial significance of countries, and that reducing the industrial countries' influence in the IMF would bring more disadvantages to the developing countries due to the possible risk of the industrial countries bypassing the IMF. The defenders also assert that the developing countries have gained a certain degree of influence in the IMF, pointing to the CFF and the EFF established as a result of the pressure of the developing countries.¹⁴⁵ However, as previously noted, the EFF, which is attached with high conditionality, was in fact not the preferred choice called for by the developing countries, but rather the SDR-aid link. In order to gain a better understanding on the debate on the issue, it is necessary to describe how the IMF is now structured and organised, to which we turn.

1.4 The Structure and Organisation of the IMF Today

1.4.1 The Quota System of the IMF

Before one can understand the IMF's structure and voting power, the issue of quotas should be discussed since it plays a crucial role in defining a member's financial and organisational relationships with the IMF. Each member country, when joining the IMF, is assigned a quota, which is expressed in Special Drawing Rights (SDRs). A member's quota is equal to the maximum amount of its obligatory financial resources made to the IMF, or its capital subscription.¹⁴⁶ At present, each member of the IMF pays 25 per cent of its own subscription in SDRs or in other member countries' currencies indicated by the IMF, and the remaining 75 per cent in its domestic currency.¹⁴⁷ The subscription itself constitutes a primary source of IMF financial resources from which IMF lending to its members is drawn. Another source of IMF financing is borrowing from official and private sources with the purpose to balance the demand for and the supply of IMF resources when the IMF faces the inadequacy of its own resources. Although the IMF can borrow from both official and private sources, it has so far borrowed only from the official sources. At present, there are two arrangements in which borrowing can be undertaken:

¹⁴⁵ Nowzad, *op. cit.*, pp. 2-3.

¹⁴⁶ The total amount of quotas, as of the end of August 2003, paid by the 184 members of the IMF stood at SDR 213 billion (approximately US\$ 296 billion). International Monetary Fund, *IMF Quotas: A Factsheet* [online], Sept. 2003. Available from: <http://www.imf.org/external/np/exr/facts/quotas.htm> [accessed 6th Oct. 2003]

¹⁴⁷ Until the second amendment of the IMF's Articles of Agreement came into force in 1978, 25 per cent of a member's subscription was payable in gold and the remaining 75 per cent in its domestic currency.

the General Arrangements to Borrow (GAB); and the New Arrangements to Borrow (NAB). Under the GAB, which was set up in 1962, 11 industrial countries or their central banks¹⁴⁸ have agreed to lend SDR 17 billion (plus SDR 1.5 billion through an associated agreement with Saudi Arabia) to the IMF at market interest rates under special circumstances such as when the international monetary system or its stability are under threats. With the growing concern over the adequacy of IMF resources,¹⁴⁹ the NAB were established in 1998. Under the NAB, the IMF can, under similar circumstances to those under the GAB, borrow from 25 member countries and institutions as a supplement to its quota resources. However, borrowing under the GAB and the NAB together cannot exceed SDR 34 billion. In addition to the subscription payments and borrowing, IMF resources can be raised in several other ways. These include the sale of gold, bilateral contributions, interest repayments from its borrowing countries, and the use of SDRs.

Besides determining the subscription payment to the IMF, a member's quota serves several other functions. It is used as the basis for determining the amount to which the member is entitled to borrow from the IMF.¹⁵⁰ Also it defines the member's voting power in the IMF (see later discussions). In addition, a member's quota determines the allocations of SDRs to the member. The share of the member's SDRs is allocated in proportion to its quota; the greater the quota, the larger the SDR allocations to which the member is entitled.

As required by the IMF's Articles of Agreement, at intervals of not more than five years, quotas paid by the member countries are reviewed by the Board of Governors.¹⁵¹ The modification of members' quotas could be made either to all member countries or to selective member countries whose economic importance in the international economy has increased. The size of the quotas depends on partly the economic factors such as the size of the economies and on how important the economies are in the international trade. It also partly reflects political considerations. As was discussed earlier, the initial process of

¹⁴⁸ The GAB participants are Belgium, Canada, the Deutsche Bundesbank, France, Italy, Japan, the Netherlands, the Seriges Riksbank, the Swiss National Bank, the UK, and the US.

¹⁴⁹ Following Mexico's economic crisis in the early 1995, in June of the same year, the Group of Seven industrial countries proposed a plan to deal with financial emergencies by doubling the credit amount available under the GAB.

¹⁵⁰ This rule does not apply to the IMF's finance under the Supplemental Reserve Facility (SRF). All member countries are in general entitled to borrow with limits determined by their quotas. However, the SRF is an exception, not subject to limits relating to quotas.

¹⁵¹ Since the first review in 1950, 4 out of 12 general reviews of quotas resulted in no increase in quotas.

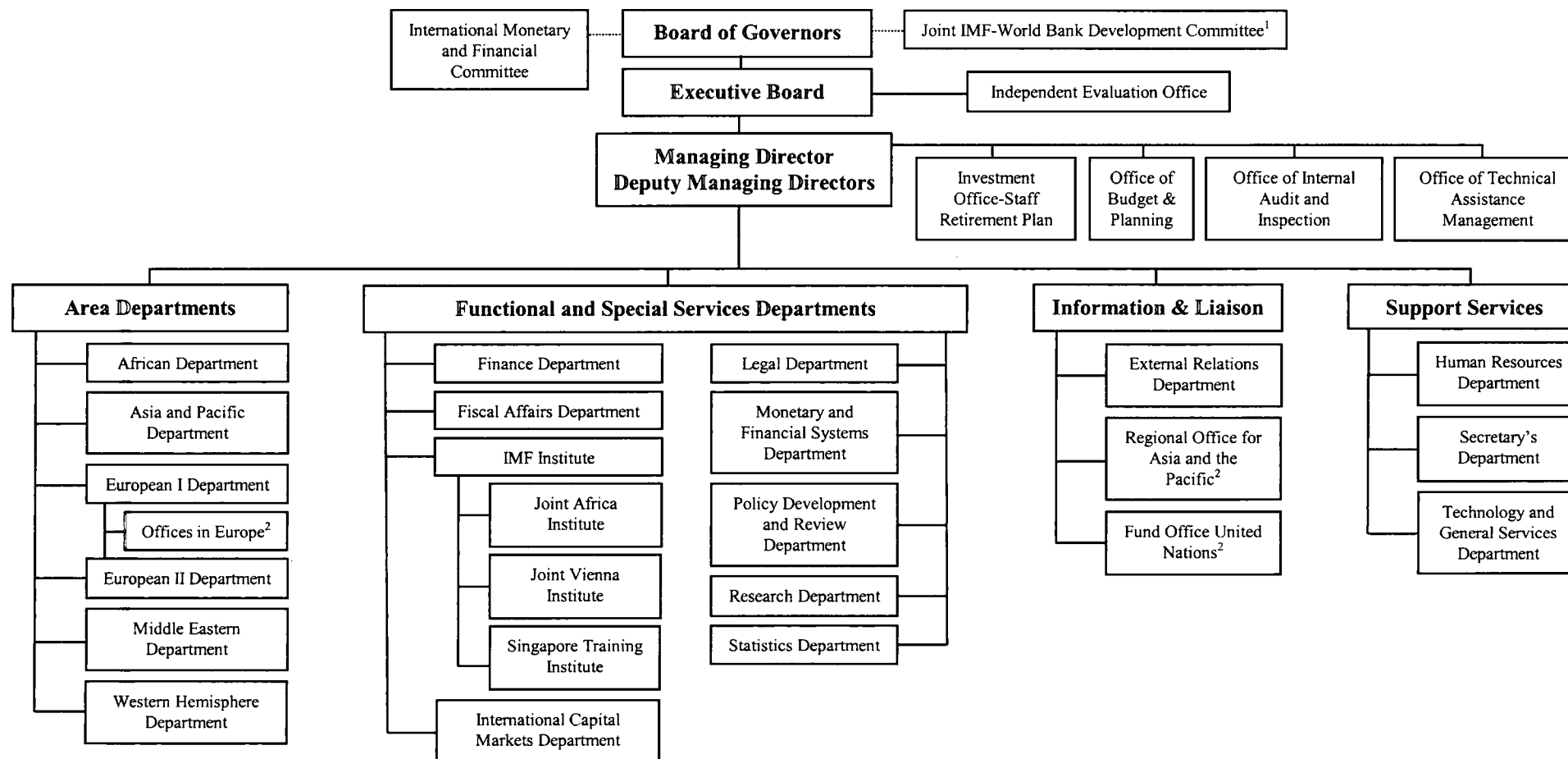
determining quotas was seen as dubious and unsatisfactory due to the political involvement. It seems that since then, this trend has continued in the process of reviewing and increasing quotas. As one scholar has concluded, the outcome of quota reviews is heavily influenced by political factors and depends on bargaining power within the IMF's Executive Board since the empirical evidence suggests that 'variations in the size of the quota increases cannot be explained simply in terms of key international economic variables.'¹⁵²

1.4.2 The Structure of the IMF

At the top of the hierarchy, the Board of Governors resides as the highest authority of the IMF (see Figure 1.1). It is the decision-making body of the IMF. Nevertheless, it only decides on major policy issues such as the admission of new member countries and any change in quotas, and delegates most of its powers to the Executive Board. Its members are a Governor and an Alternate Governor appointed by each member country (normally, ministers of finance and central bank governors), therefore speaking on the behalf of their countries. The Board of Governors usually meets once a year at the Annual Meetings of the IMF and the World Bank, which are normally held at the end of September or the beginning of October. However, between annual meetings, Governors may take votes by mail or other means. As previously noted, there are also two advisory bodies within the Board of Governors: the International Monetary and Financial Committee, or IMFC (until September 1999 known as the Interim Committee); and the joint IMF-World Bank Development Committee. The IMFC currently consists of twenty-four Governors of the IMF (usually ministers of finance and central banks governors). Each member country that appoints, and each group of member countries that elects, an Executive Director appoints a member of the IMFC. It has an advisory role, making reports to the Board of Governors involving such broad issues as changes in the international monetary and financial system including disturbances that might threaten the system, and the amendment of the Articles of Agreement. The Development Committee at present comprises twenty-five members (usually ministers of finance or development), each of whom is appointed for a two-year term by one of the member countries or a group of

¹⁵² Bird, *op. cit.*, 1995, p. 86.

Figure 1.1 The Structure of the IMF (as of May 2003)



Source: International Monetary Fund, *IMF Organization Chart* [online], May 2003. Available from: <http://www.imf.org/external/np/obp/orgcht.htm> [accessed 6th Oct. 2003]

Note: ¹ Known formally as the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries

² Attached to the Office of Managing Director

member countries that appoints an Executive Director of the IMF or of the World Bank. Its role is to advise and report to the Boards of Governors of the IMF and the World Bank on development issues (which have, over the years, been extended to include trade and global environmental issues) and on financial resources required to promote economic development in the developing countries, and to make recommendations on their implementation.

Beneath the Board of Governors is the Executive Board,¹⁵³ responsible for day-to-day decision-making of the IMF. Unlike the Board of Governors which meets annually, the Executive Board holds meetings regularly (normally three times a week) at the IMF's headquarters in Washington, D.C. It is the Executive Board which has the power to take decisions on the request for credits and loans from members. Members of the Executive Board are made up of twenty-four Executive Directors chaired by an appointed Managing Director who serves for a five-year term. The five large industrial countries with the largest IMF quotas (at present, the US, Japan, Germany, France, and the UK), along with Saudi Arabia, China and Russia, directly appoint their own Executive Directors. The other sixteen Executive Directors are elected every two years by groups of member countries (or known as constituencies) with smaller quotas.

Since the inception of the IMF, the Managing Directors of the IMF have always been Europeans. This gives no opportunity for the developing countries' representatives to take the post, despite the IMF's substantial involvement in the developing countries and its trivial role in the developed countries. As J. E. Stiglitz comments:

While almost all of the activities of the IMF . . . today are in the developing world (certainly, all of their lending), [it is] led by representatives from the industrialized nations [The head of the IMF is] chosen behind closed doors, and it has never even been viewed as a prerequisite that the head should have any experience in the developing world. The institution [is] not representative of the nations [it] serve[s].¹⁵⁴

The Managing Director is also the head of IMF staff members, most of whom are located in a number of departments and offices based in the Washington headquarters. Apart

¹⁵³ Since the mid-1970s, ministerial guidance has been provided to the Executive Board from the two groups of committee: the Interim Committee and the Development Committee.

¹⁵⁴ Stiglitz, J. E., *Globalization and Its Discontents* (London: Penguin, 2002), p. 19.

from the headquarters, there are small offices situated elsewhere such as in Paris, Tokyo, Geneva, at the UN in New York, plus the resident representatives in some of the larger borrowing countries.

It should be noted that there also exist a number of interest groups,¹⁵⁵ which have some say in the decision-making process in the IMF. Among them are the Group of 10 and the Group of 24. The Group of 10 was created in 1962 in association with the GAB. It consists of representatives of the major industrial countries. On the other hand, the Group of 24¹⁵⁶ was set up in 1972 at the Lima meeting of the Group of 77. It is aimed to represent the interests of developing countries in negotiating on international monetary issues. Although the Group of 24 is not part of the IMF's structure, its meetings are normally held in association with those of the Interim or Development Committees.

1.4.3 Voting Power

Concerning the voting system of the IMF, it is not based on the principle of one-country-one vote as operating in the UN organisations. Rather, it is based on weighted votes due to the quota system used by the IMF. Each member country has 250 basic votes plus one additional vote for each SDR 100,000 of its quota.¹⁵⁷ In both Boards of Governors and of Executive Directors, relatively unimportant decisions require a simple majority, more important ones require a 70 per cent majority, while an 85 per cent majority is required on such crucial matters as the structure of the IMF, allocations of SDRs, and quota changes. Nevertheless, the Executive Board rarely conducts formal voting in making decisions, although each Executive Director has a certain number of votes in proportion to the quota(s) of a member country/countries being represented. In practice, the Executive Board relies on the 'sense of the meeting' or consensus among its members.

¹⁵⁵ For information on the other groups, see International Monetary Fund, *A Guide to Committees, Groups, and Clubs: A Factsheet* [online], Apr. 2003. Available from: <http://www.imf.org/external/np/exr/facts/groups.htm> [accessed 6th Oct. 2003]

¹⁵⁶ Group of 24 is officially known as the Intergovernmental Group of 24 on International Monetary Affairs. Its 24 members are drawn from 8 African, 8 Asian, and 8 Latin American countries: Algeria, Argentina, Brazil, Colombia, Congo, Côte d'Ivoire, Egypt, Ethiopia, Gabon, Ghana, Guatemala, India, Iran, Lebanon, Mexico, Nigeria, Pakistan, Peru, Philippines, South Africa, Sri Lanka, Syria, Trinidad and Tobago, and Venezuela.

¹⁵⁷ Prior to the second amendment of the IMF's Articles of Agreement, each additional vote was given to a member for each US\$ 100,000 of fixed gold value held as its quota.

As a member’s quota determines its voting power; the larger the quota held by a member, the greater its voting power is. Table 1.4 shows quotas and votes of the five largest contributors of the IMF: the US, Japan, Germany, France, and the UK. Together their votes are under 40 per cent of the total votes. Out of the five member countries, it is the US which has, since the inception of the IMF, continued to hold the largest vote in the IMF’s decision-making. Despite the constant decline in its voting power to over 17 per cent of the total votes in 2003 from about 36 per cent since the IMF’s inception, the US has managed to retain its influence in the IMF’s decision making through the changes in the size of the majority required for certain decisions. As one scholar explains: ‘This is because the decrease in the US’s percentage holding of the total quotas has been matched by an increase in the percentage of total quotas needed for key decisions.’¹⁵⁸ Therefore, its voting power of over 17 per cent has continued to provide the US with the power to exercise vetoes unilaterally on the issues that require at least 85 per cent of the total votes.

Table 1.4 Quotas and Voting Rights of Five Largest Contributors of the IMF (in millions of SDRs), as of September 2003

Country	Quota	Quota (%)	Votes	Votes (%)
US	37,149.3	17.46	371,743	17.14
Japan	13,312.8	6.26	133,378	6.15
Germany	13,008.2	6.11	130,332	6.01
France	10,738.5	5.05	107,635	4.96
UK	10,738.5	5.05	107,635	4.96
Total	84,947.3	39.93	85,072.3	39.22

Source: International Monetary Fund, *IMF Members’ Quotas and Voting Power, and IMF Board of Governors* [online], 5th Sept. 2003. Available from: <http://www.imf.org/external/np/sec/memdir/members.htm> [accessed 6th Oct. 2003]

Summary

This chapter has highlighted the development of the IMF, and its gradual move towards the developing countries. The creation of the IMF at the end the Second World War is based on the recognition, mainly among the developed industrial countries, that as the

¹⁵⁸ Thomas, C., *In Search of Security: The Third World in International Relations* (Hemel Hempstead: Harvester Wheatsheaf, 1987), p. 48.

monetary and financial system has become increasingly internationalised, there is a need to prevent the pursuit of national interests by individual countries, which may not coincide, from impeding international trade, growth, and stability. Due largely to the dominance of a few industrial countries in discussions for its creation, the IMF was not specifically designed to deal with the problems of the developing countries. As a result, they received less attention during the earlier years of the IMF. Nonetheless, since the late 1950s, a number of changes have taken place in the international system. These changes have contributed to the shaping of the IMF's role and led to an orientation towards the developing countries and at the same time away from the industrial developed world. Various factors have led to such a shift in the IMF's focus. These include: the changes in international political and economic conditions; the changes in the foreign aid policy of the US, the largest contributor of the IMF; at-times tensions between the US and Western European countries; and, as well – although to a lesser extent – the developing countries' demands. The emergence of several major international crises and the shift in other creditors' (both private and official) strategy in dealing with debtor countries have further deepened the growing involvement of the IMF in the developing countries, which are more vulnerable to such crises than the industrial countries.

Despite the IMF's shift of focus and its increasing role in the developing countries, especially the fact that most of the IMF's lending goes to the developing countries, the developing countries still have less say in the institution itself due to the use of the quota system where the large industrial countries as major subscribers of the IMF hold a substantial part of voting power. As a result, there exists a disproportion in the influence exercised within the IMF by the industrial and the developing countries. Often the developing countries have been unable to push for their preferred options. This is manifest in the increasing reliance of the IMF on conditional lending, which might be seen as largely reflecting the interest of the industrial countries, as the large creditors of the IMF, rather than that of the developing countries, as the major borrowers of the IMF. Moreover, as the tacit custom practiced since its creation, the institution is still led by the representatives of the industrial developed countries.

In the course of the process, the ability of the IMF (and also the World Bank) to influence economic policies in the borrowing countries, mainly the developing countries, has increasingly expanded through its conditionality and recently through its shared

neo-liberal conditionality with the World Bank. Such an expansion has prompted several key critiques of the IMF while, at the same time, both the IMF and its defenders have offered counter-arguments to such critiques. From the above discussions, the issue of IMF conditionality has attracted numerous severe criticisms. Chapter Two of the study will look at the issue of IMF conditionality in more detail.

In conclusion, there is an imbalance of power within the IMF between the major creditors of the IMF, mostly the industrial developed countries, and borrowing countries, mostly the developing countries. This largely mirrors the continuation of the dominant role of the industrial countries, particularly the US, since the founding years of the IMF. With the increasing use of conditional lending, there appears to be another type of imbalance: one between the IMF and the borrowing countries. However, as will be argued in Chapter Two, this may not always be the case.

Chapter Two

The Concept of IMF Conditionality and Its Development

Chapter Two is concerned with IMF conditionality. The purposes of Chapter Two are threefold. First of all, it aims to critically examine the concept of IMF conditionality as it has evolved in IMF lending policy. The second purpose is to determine critiques of IMF conditionality, to examine the two opposing views of imposition and “ownership,” and to establish the relationship between the two views. The third and final purpose is related to the question how the relationship between the IMF and borrowing countries can be examined and assessed in order to determine the role and character of IMF conditionality and to decide whether it is imposition or whether the borrower can “take ownership” or else.

In order to pursue the three main purposes, the term ‘IMF conditionality’ will be first defined. The chapter then moves on to look at its origins in a historical context to provide a better understanding of IMF conditionality. This will be followed by the second section of the chapter, focusing on the critiques of IMF conditionality, especially over the question of imposition and the IMF’s response. Last, but not least, an analytical framework will be developed which will be utilised as a guideline for the subsequent chapters in examining the case of Egypt.

Section I

2.1 The Definition and Its Origins

2.1.1 Definition

The term ‘conditionality’ refers to the conditions attached to loans extended. In the context of the IMF, it means a set of economic reform programmes applied by the IMF on its ‘upper-tranche’ (or ‘higher-tranche’) loans. It should be clarified that despite its loaded appearance, the term ‘IMF conditionality’ used in this study does not suggest the presumption that IMF conditionality is forced upon a borrowing country. It is simply taken to mean the conditions attached to IMF credit.

From a revolving pool of funds consisting of its member countries' subscriptions, the IMF makes available hard currency and Special Drawing Rights (SDRs; an 'international currency' administered by the IMF) to its member countries. The amount is subject to limits in relation to their quotas or subscriptions to the IMF, except that for the Supplemental Reserve Facility (SRF) and the Contingent Credit Lines (CCL) there are no limits specified. In an exchange for hard currency, a borrowing country provides the IMF with its own domestic currency. This is why such a transfer is officially called a 'purchase.' However, very often this transfer is, in the literature, termed as a 'loan' or 'lending.' At the end of the borrowing period, the borrowing country has to buy back the excessive amount of its own domestic currency held by the IMF and, thus, such an exchange is referred to as a 'repurchase.' The IMF's financial resources are made available to its member countries in tranches (segments). The first tranche (known as the 'reserve tranche') drawing is automatically made available by the IMF without any application of conditionality to the loan. Under this tranche loan, a member country can request up to the amount which would not make the IMF's holding of its currency to exceed 100 per cent of its quota. However, a reserve tranche purchase does not constitute a use of IMF credit since a member country's reserve tranche is part of its own reserves. It is the following tranches that are counted as IMF credit (made available in four tranches). Thus, the next tranche is called the 'first credit tranche' where the member country can borrow up to 25 per cent of its quota in addition to the reserve tranche loan. The loan under this tranche comes with small conditions that the money is used in a policy programme that deals with its balance of payments problem and it will undertake measures to correct such a problem. Once the borrowing country requests more than the amount available under the first two tranches (i.e. the reserve and the first credit tranches), it has to deal with an 'upper-credit tranche' loan with an application of conditionality. Normally, such drawings are associated with Stand-By Arrangements (SBAs) or Extended Fund Facilities (EFFs). Under the upper-credit tranche loans, the IMF will require more economic policy reforms such as a reduction of government budget deficits and trade liberalisation as conditions of providing its loans. Such economic reform conditions are collectively known as 'IMF conditionality.'

2.1.2 Origins

2.1.2.1 'Automaticity' versus 'Conditionality'

When one reads through the original Articles of Agreement, no reference is made to conditionality. However, this does not mean that the concept of conditionality was not raised prior to the original Articles of Agreement being drawn up at the Bretton Woods Conference in July 1944. In fact, the origins of IMF conditionality can be traced back to the controversial discussions before the Bretton Woods Conference. From the outset of the plans for the establishment of what later became the Bretton Woods institutions, there existed two different views over the issue of the use of the IMF's financial resources: the British and the American views.¹ On the one hand, the British were in favour of the right that could be enjoyed by every member country to draw financial resources from the IMF without being subject to any conditions, i.e. such resources would be automatically available when requested. This view initially found support among many representatives of other countries, which were in the position of being potential deficit countries. On the other hand, the US, which was in the position of being a potential net lender in the early post-Second World War period and thus feared an abused use of balance of payments support merely from its own resources, insisted that the resources should not be available freely. Instead they should be subject to the IMF's close scrutiny in order to ensure that there would be no misuse of the IMF's resources such as the use of drawings as a source of long-term capital.

It should be noticed that both sides agreed that there should be a quantitative limit on drawings as manifest in the plans for the Clearing Union (the so-called 'Keynes Plan') and for the Stabilisation Fund (the so-called 'White Plan'). The type of conditions both sides were in dispute was, thus, qualitative limits on the use of drawings rather than quantitative limits on the amount of drawings. More importantly, at the beginning the objective of the concept of conditionality pressed by the US was rather narrow. It largely aimed to avoid the abuse of the use of the IMF's resources. As reflected by White's suggestion in a meeting between the US and the UK in Washington in August 1943:

¹ This is reflected in the different opinions held by Keynes (on the British side) and White (on the US side) on the IMF's policies towards the use of its resources. For a detailed examination, see Horsefield, J. K., *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Cooperation*, vol. 1: *Chronicle* (Washington, D. C.: International Monetary Fund, 1969), pp. 67-77.

The Fund's facilities should not be used to finance either a flight of capital or the issue of foreign loans by a country which could not afford to undertake foreign lending. Again, the Fund would be justified in intervening where a country was using its quota for rearmament. On the other hand, it would not be justified in the case of an unbalanced budget. In general, the Fund would intervene only in extreme cases of violation of qualitative rules, and would bear the burden of proof.²

Thus, the concept of IMF conditionality at that time simply focused on the criteria which the IMF could apply in judging whether a member's request to draw should be accepted in order to ensure its 'appropriate' use.

Surprisingly, at the Bretton Woods Conference the issue of 'automaticity' versus 'conditionality' was not discussed. Without declassified documents to explain such an absence, the following is a conjectural reason put forward by Sidney Dell:

One possible version might run as follows. The U.S. delegation, having encountered strong opposition in Atlantic City, was anxious that the conflict on conditionality should not surface at Bretton Woods. The fact that other countries interpreted the draft Agreement as authorizing unconditional drawings within certain quantitative limits, would, it might well have been felt, be bound to endanger the prospects of ratification by Congress. Congress was well aware that the United States would, for some time to come, be the only possible source of substantial net credit to the system. Prospects for ratification were already uncertain because of strong opposition to the idea of a Fund by the American Bankers' Association.

On the other hand, the delegations opposed to Fund conditionality had every reason to believe, after Atlantic City, that they had won their point and that, as long as the key words of the Joint Statement [which later became Article V, Section 3 (a) of the original Articles of Agreement] were maintained, there was no need to engage in another confrontation with the Americans on the matter. Moreover, Keynes had decided that he would raise as few issues as possible that might be embarrassing to the United States, because he was aware of the Administration's difficulties with Congress and was unwilling to add to them.³

As a consequence, the issue remained unresolved; a fact reflected in the original Articles of Agreement, which contained a number of ambiguities and inconsistencies. Among them were two ambiguous words found in Article V, Section 3 of the original Article of Agreement for conditions governing use of the Fund's resources. Article V, Section 3 (a) stipulates:

² Horsefield, *op. cit.*, vol. 1, p. 69.

³ Dell, S., 'On Being Grandmotherly: The Evolution of IMF Conditionality,' *Essays in International Finance*, no. 144 (Princeton, N. J.: International Finance Sec., Dept. of Economics, Princeton U., Oct. 1981), p. 5.

A member shall be *entitled* [emphasis added] to buy the currency of another member from the Fund in exchange for its own currency subject to the following conditions:

- (i) The member desiring to purchase the currency *represents* [emphasis added] that it is presently needed for making in that currency payments which are consistent with the provisions of this Agreement.

The two words allowed two different interpretations of the access to the IMF's financial resources. The word 'entitled' seems to lend support to the concept of automaticity, i.e. a member country of the IMF possessed the automatic right to draw. On the other hand, the ambiguous word 'represents' was viewed by the US as that the IMF had the power to challenge the presentation, if it believed that the presentation was incorrect. However, the decisions, which were adopted by the Executive Directors in May 1947 and which were later reaffirmed by the decision of 10 March 1948, favoured the second view. In addition to the permission of the power to challenge, the decisions added that the IMF could also 'postpone or reject, or accept it subject to conditions,' if the IMF concluded that a representation was incorrect.⁴

2.1.2.2 Movements towards the Concept of Conditionality

When the IMF began its operations, the ambiguous and inconsistent terms in the original Articles of Agreement, including those concerning the use of the IMF's resources, had to be discussed and interpreted. It was during this process that a move away from the idea of automaticity and towards that of conditionality began.

For several years the dichotomy had repeatedly created a serious problem for the IMF. In implementing the IMF's policy on the use of its resources, the issue of 'automaticity' versus 'conditionality' had, over the years, caused an increasingly sharp division within the Executive Board between those who supported the concept of automaticity and the US who pressed for conditionality. The attempts of the latter were, for example, highlighted during several discussions at the Executive Board in which Andrew N. Overby, the US Executive Director, questioned the requests for drawings proposed by

⁴ Horsefield, J. K. (ed.), *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Cooperation*, vol. 2: *Analysis* (Washington, D. C.: International Monetary Fund, 1969), pp. 385-386; and IMF Executive Board Decision, no. 284-4, 10 Mar. 1948, in J. K. Horsefield (ed.), *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Cooperation*, vol. 3: *Documents* (Washington, D. C.: International Monetary Fund, 1969), p. 227.

countries such as the Netherlands and South Africa in October 1948, and Nicaragua in the same year with regard to their temporary character or the prospects for repurchase.⁵

The discussions within the Executive Board and subsequent decisions adopted until May 1949 resulted in further moves away from the concept of automaticity. Nevertheless, the development of the concept of conditionality remained restricted. The focal point was still on whether the IMF had power to do something in dealing with a member country's request for drawings in order to prevent their misuse. This can be illustrated by the decision adopted by the Executive Board on 15 March 1948,⁶ in addition to the decision of 10 March 1948 (as discussed above). The decision of 15 March 1948 stated that under Article V, Section 5 for ineligibility to use the Fund's resources, the IMF had power to delay a transaction if at the time when a request for a purchase was received the IMF was considering sending the member a report under that Section, or if it found when the request was before it that action under that Section should be considered.

In May 1949, Frank A. Southard Jr.'s (the US Executive Director) memorandum provided another major step of the development of the concept of conditionality. It was a report on an outcome of a review by the US government of the IMF's policy on the use of its resources which insisted on the temporary character of drawings and the IMF's power to challenge them. Thus, in his memorandum he proposed four criteria which would help the IMF judge whether a proposed drawing was temporary. They were: 1) that the member's par value was appropriate; 2) that its balance of payments disequilibrium was temporary; 3) that drawing was not used for rehabilitation or development; and 4) that the member was undertaking all steps essential to assume as soon as possible its full obligations under the Articles of Agreement of the IMF, particularly maintenance of convertibility, avoidance of restrictions on currency payments and of discriminatory current arrangements and multiple currency practices. These criteria were applied to Mexico's request a few days after. In this case, part of the Executive decision was that Mexico might draw the IMF's resources, on condition that Mexico put forward a proposal for a new exchange rate to which the IMF could agree, and followed appropriate fiscal,

⁵ Horsefield, *op. cit.*, vol. 2, pp. 398-399; and Horsefield, *op. cit.*, vol. 1, pp. 242-244.

⁶ Here the question under the discussions was whether the IMF could, when it received a request for a drawing, postpone transaction in order to prepare a report and then limit the use of its resources by the member under Article V, Section 5 which permitted the IMF to declare the member ineligible to use of its resources if the IMF believed that the resources were being misused.

credit, and trade policies.⁷ It was the decision by the Executive Board in this case which established a SBA in the following years (see the following section).

During 1948-49 the IMF experienced a decline in drawings made to its member countries which culminated in a complete standstill of the IMF in 1950, in which there were no drawings at all.⁸ This was partly due to the 'ERP Decision' (whereby European countries receiving assistance under the European Recovery Programme (ERP) were only to request the purchase of US dollars from the IMF in 'exceptional or unforeseen' circumstances), and due partly to the improvement of developing countries' balance of payments because of the demand for primary products caused by the Korean conflict. Another important factor was the discouragement created by the US's insistence on the IMF's power to challenge requests which led to an atmosphere of uncertainty about circumstances in which drawings would be made available.

Due to the IMF's attempts to search for a solution to the problem of repurchase raised by the US and also to revive the IMF's operations following the decline, the concept of conditionality was further developed through a series of proposals, discussions and decisions among IMF staff and the Executive Board during 1949-1951.⁹ These proposals and discussions culminated in an incorporation of the concept of conditionality in the IMF's lending policies when the Executive Board approved a decision to adopt the Rooth Plan on 13 February 1952. It should be clarified that in practice IMF conditionality was applied prior to the Rooth Plan as early as 1949 in the case of Mexico (as discussed above). However, it was the Rooth Plan which institutionalised the concept of conditionality. The plan which was proposed by Ivar Rooth, Managing Director of the IMF, was regarded as one of the most significant moves towards the idea of conditionality. In the words of Sir Joseph Gold, former General Counsel of the IMF, on comparing the decisions made on March 10, 1948 and on February 13, 1952: 'If the decision of March 10, 1948 on the power to challenge representations is a landmark, the decision of February 13, 1952 is the Mount Everest that towers over all other decisions on the use of the Fund's resources.'¹⁰

⁷ Horsefield, *op. cit.*, vol. 1, p. 245.

⁸ *Ibid.*, p. 276.

⁹ For detailed discussions, see Horsefield, *op. cit.*, vol. 1, pp. 278-282 and 321-324.

¹⁰ Gold, J., 'Use of the Fund's Resources,' in Horsefield, *op. cit.*, vol. 2, ch. 23, pp. 523-524.

The Rooth Plan¹¹ contained several major features. First, it stated that the IMF's attitude towards a member country's request for its financial resources would be guided primarily by its judgement on whether the member's policies would be adequate to overcome the balance of payments problem. Second, it referred to what subsequently became known as the SBAs. They were intended to ensure a member who had no immediate need for a drawing that a drawing would be available if, within a period of six to twelve months, the need presented itself. Third, it clarified the IMF's view on the temporary use of its resources. It stated that in order to ensure the revolving character of the IMF's resources, 'exchange purchased from the IMF should not remain outstanding beyond the period reasonably related to the payments problem for which it was purchased from the Fund. The period should fall within an outside range of three to five years.'¹² Last, but not least, it introduced the concept of the gold tranche (which is a drawing that increased the IMF's holdings of a member's currency to no more than 100 per cent of its quota)¹³ by declaring that each member could receive 'the overwhelming benefit of any doubt,' when they applied for a drawing within the gold tranche.

2.1.2.3 Further Developments: Instrument and Characters

Although the Rooth Plan distinguished only between drawings in the gold tranche and all other drawings, in the following years its creation gradually paved the way for the development of several tranche policies which were among crucial aspects of the concept of conditionality. In 1955, a drawing policy beyond the gold tranche was adopted, differentiating drawings in the gold tranche from those in the first credit tranche (which are drawings raising the IMF's holdings of a member's currency above 100 per cent but within 125 per cent of its quota). Requests for drawings in the first credit tranche would be considered by the IMF with a 'liberal' attitude.¹⁴ This was followed by the policy towards drawings beyond the first credit tranche which was established three years later. Requests for such drawings would require 'substantial justification' with 'a sound program aimed at establishing or maintaining the enduring stability of the member's

¹¹ IMF Executive Board Decision no. 102-(52/11), 13 Feb. 1952, in Horsefield, *op. cit.*, vol. 3, pp. 228-230.

¹² *Ibid.*, p. 229.

¹³ The second amendment of the Articles of the Agreement, which entered into force on 1 April 1978, replaced the term 'gold tranche' with 'reserve tranche.' This can be found in, for example, in Article V, Section 3 (c). Gold, J., 'Conditionality,' *IMF Pamphlet Series*, no. 31 (Washington, D. C.: International Monetary Fund, 1979), p. 12.

¹⁴ International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1955* (Washington, D. C.: International Monetary Fund), pp. 84-85, cited in Horsefield, *op. cit.*, vol. 2, p. 404.

currency at a realistic rate of exchange.’¹⁵ Therefore, the distinction between drawings in the successive tranches was primarily based on the progressiveness of the concept of conditionality: the higher the tranches and the larger the size of drawings reached, the stronger the conditionality would be.

Not long after the creation of the Rooth Plan, the SBA was established in October of the same year. Since then, this has become one of the key instruments in applying the concept of conditionality to drawings beyond the first credit tranche by linking IMF conditions to its financial resources provided to its member countries.

Besides the above tranche policies, other key elements of IMF conditionality were also developed in the second half of the 1950s. These included the introduction of phasing in March 1956 (in which drawings were disbursed in instalments over a period of time, each of which were approved if the performance by the drawing member was satisfactory), and that of the Letter of Intent in February 1958.¹⁶

2.2 The Expansion of IMF Conditionality

2.2.1 The Expansion in the Early Years

In addition to the above, another important development took place in July 1957 when performance criteria (which are quantitative targets written in the Letter of Intent) were first introduced in the Paraguay’s SBA in which a drawing was made dependent on Paraguay’s commitments to the credit ceiling and to the maximum levels for budget expenditures and for the public works programme.¹⁷ In 1958, a SBA with Haiti included a wider range of specific policy commitments, and since then performance criteria had gradually evolved and proliferated further. As Emil G. Spitzer puts it:

The specific policies referred to in stand-by arrangements have varied widely in numbers and range of coverage. In addition to a ceiling (or a number of ceilings) on the domestic assets of the central bank, they have frequently included fiscal, exchange rate, and balance of payments policies. There has been a tendency toward the proliferation of specific limitations and targets . . .¹⁸

¹⁵ International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1959* (Washington, D. C.: International Monetary Fund), p. 22, cited in Horsefield, *op. cit.*, vol. 2, p. 404.

¹⁶ Horsefield, *op. cit.*, vol. 1, pp. 430-433.

¹⁷ Spitzer, E. G., ‘Stand-By Arrangements: Purposes and Form,’ in Horsefield, *op. cit.*, vol. 2, p. 484.

¹⁸ *Ibid.*, p. 486.

In other words, the scope and extent of IMF conditionality has gradually expanded over the years since the 1950s. However, its evolution during the 1950s and 1960s focused primarily on macroeconomic policies and so programme monitoring was typically confined to key macroeconomic indicators. An analytical framework known as 'financial programming' (FP) was used by the IMF in the design of its economic adjustment programmes. FP was developed in the late 1950s and early 1960s by a group of economists in the Research Department of the IMF led by J. J. Polak, and has changed very little since it was created.¹⁹ The IMF's analytical framework was largely based on the Polak model published in the IMF Staff Papers in 1957. The Polak model was associated with a set of equations that link the behaviour of the financial and monetary sectors to the balance of payments. The model focused on controlling such variables as domestic credit and money supply as an attempt to arrive at balance of payments equilibrium.²⁰

According to FP, the major cause of balance of payments problems was the existence of excess demand pressures. As a result, FP usually consisted of policy measures aiming at controlling the level or the rate of growth of nominal aggregate demand. The IMF claimed that excessive levels of demands often resulted from undue expansion of domestic credit by the banking system. At times, this was accompanied by heavy reliance on foreign borrowing. The root of these disequilibriums was said to be fiscal and public sector imbalances. Therefore, FP involved policies in the fiscal, domestic credit, and foreign borrowing field. Furthermore, these imbalances were often worsened by distortions in cost-price relations which could have an adverse impact upon the international competitiveness of the economy. Supplementary policies were designed to improve resource allocation and reinforce the external sectors. The classical examples were policies in exchange rates, prices, wages, and interest rates.²¹

¹⁹ Edwards, S., *The International Monetary Fund and the Developing Countries: A Critical Evaluation* (Cambridge, M. A.: National Bureau of Economic Research, 1989), pp. 10-11; and Polak, J. J., 'The Changing Nature of IMF Conditionality,' *Essays in International Finance*, no. 184 (Princeton, N. J.: International Finance Sec., Dept. of Economics, Princeton U., Sept. 1991), p. 33.

²⁰ Polak, J. J., 'Monetary Analysis of Income Formulation and Payments Problems,' *IMF Staff Papers*, vol. 6, 1957-58, pp. 1-41.

²¹ Guitián, M., 'Fund Conditionality and the International Adjustment Process: The Early Period, 1950-70,' *Finance and Development*, vol. 17, no. 4, Dec. 1980, p. 26.

2.2.2 The Guidelines on IMF Conditionality

In the light of the proliferation of IMF conditionality and its practices developed since the 1950s, considerable concerns were raised by developing countries and, in the early years, also by some developed countries over the increasingly stringent IMF conditions.²² In particular, this became evident in the case of the SBA approved for the UK in November 1967 with a relatively large amount but minimum conditions.²³ Although the SBA was in the highest credit tranches and thus should have been attached to stringent performance criteria, there were no clauses for phasing (which meant the full amount of the drawing could be made in one transaction), no performance clauses, and relatively monetary or credit ceilings in the SBA. Instead, it contained unusual provisions for frequent consultations. The developing countries, during the discussion of the UK's SBA, had expressed their desire for the SBAs approved to them to be modelled on the same lines, and subsequently raised the question about the need for uniform treatment for all members.

These developments prompted the first review of the IMF's policies on conditionality. The review concluded with the Executive Board Decision of 20 September 1968 which provided certain guidelines for IMF policy on the use of its resources.²⁴ The preamble to the decision emphasised the significance of providing adequate safeguards to preserve the revolving character of the IMF's resources, and also the need for a flexible but uniform treatment of all members. The decision clarified the use of consultations, phasing and performance criteria. This was reflected in the following elements:

- 1) Clauses requiring the member to remain in consultation with the IMF were to be included in all SBAs. Periodic consultations were to be required in all drawings beyond the first credit tranche, whether or not under a SBA.
- 2) No provisions for phasing of the amount drawn and for the achievement of performance criteria would be required in SBAs which did not go beyond the first credit tranche. However, such provisions would normally be included in all other SBAs but applicable only to drawings beyond the first credit tranche.

²² Horsefield, *op. cit.*, vol. 2, pp. 484-485.

²³ For a detailed discussion on the UK's case, see de Vries, M. G., *The International Monetary Fund, 1966-1971*, vol. 1: *Narrative* (Washington, D. C.: International Monetary Fund, 1976), pp. 338-346.

²⁴ IMF Executive Board Decision, no. 2603-(68/132), 20 Sept. 1968, in de Vries, M. G. (ed.), *The International Monetary Fund, 1966-1971: The System Under Stress*, vol. 2: *Documents* (Washington, D. C.: International Monetary Fund, 1976), p. 197.

In addition, the decision provided a limit on performance criteria to those considered necessary for evaluating the implementation of the member's financial stabilisation programme with a view to ensuring the achievement of its objectives. Also, language having a contractual connotation would be avoided in SBAs.²⁵ This decision was later revised by the decision of 2 March 1979.

Despite all this development and practices of IMF conditionality, the concept of IMF conditionality was not incorporated into the Articles of Agreement until the latter was amended in 1969. As made explicit in Article V, Section 3 (c) and (d):

(c) A member's use of the resources of the Fund shall be in accordance with the purposes of the Fund. The Fund shall adopt policies on the use of its resources that will assist members to solve their balance of payments problems in a manner consistent with the purposes of the Fund and that will establish adequate safeguards for the temporary use of its resources.

(d) A representation by a member under (a) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the provisions of this Agreement and with the policies under them, with the exception that proposed gold tranche purchases shall not be subject to challenge.²⁶

By 1978, there was a widespread concern among the developing countries over the severity of IMF conditionality and its negative impact on the level of drawings from the IMF.²⁷ The developing countries felt that the amount of IMF financial support available was too little to justify the considerable changes in economic policies which had to be made for the drawings to be allowed. This seems to account for the concentration of the use of the IMF's resources on the facilities with relatively low conditions during the mid- and late 1970s. There were only ten cases of drawings beyond the first credit tranche in 1974-76 among the entire IMF membership.²⁸

At a ministerial meeting held by the Group of 24 (which consists of the ministers of developing members of the IMF) in September 1978, the Group expressed its concern about the multiplicity of performance criteria and some other forms of conditionality that

²⁵ de Vries, *op. cit.*, vol. 1, 1976, p. 347.

²⁶ Articles of Agreement of the International Monetary Fund as amended entered into force on 28 July 1969, Article V for Transactions with the Fund, Section 3 (c) and (d), in de Vries, *op. cit.*, vol. 2, 1976, p. 102.

²⁷ For the statements made by several Governors for the developing countries during the IMF-World Bank Annual Meetings in September 1978, see International Monetary Fund, 'Discussions on the Fund . . . Future of New Surveillance Role Sparks Brisk Exchange of Views,' *IMF Survey*, 16 Oct. 1978, p. 329.

²⁸ Dell, *op. cit.*, 1981, p. 24.

were inhibiting access to the IMF's resources by member countries. The Group also urged the Executive Board of the IMF to set appropriate guidelines designed so as to restrict the performance criteria only to relevant macroeconomic variables, paying due regard to the growth considerations of member countries as well as their economic and social situations.²⁹

At its ministerial meeting in April 1978, Interim Committee members from the developing countries urged the Executive Board to review IMF conditionality on the use of the IMF's resources in the credit tranches.³⁰ In response to the concern made regarding IMF conditionality and the request of the Interim Committee, the Executive Board began in June 1978 to conduct its second review of conditionality.³¹ On 2 March 1979, the review concluded with the adoption of a decision containing a set of guidelines for 'Use of Fund's General Resources and Stand-By Arrangements.' The new set of guidelines was largely a revised and extended version of the decision reached in 1968. It included several conclusions which had been reached in 1968 while there were certain new or clarified elements added to it.³² The main elements of the March 1979 decision included:³³

- 1) It clarified that the IMF would 'pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems.'
- 2) Performance criteria would be limited to those that were necessary to evaluate implementation of the stabilisation programme, and would normally be confined to macroeconomic variables and those necessary to implement specific provisions of the Articles or policies adopted under them.

²⁹ Group of 24, 'Communiqué Urges Faster Growth in Industrial Nations,' issued on 22 Sept. 1978, *IMF Survey*, 2 Oct. 1978, p. 307, paragraph 12.

³⁰ 'Press Communiqué of the Interim Committee of the Board of Governors on the International Monetary System,' Tenth meeting, Mexico City, 30 Apr. 1978, in International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1978* (Washington, D. C.: International Monetary Fund), p. 140.

³¹ Mookerjee, S., 'New Guidelines for Use of Fund Resources Follow Review of Practice of Conditionality,' *IMF Survey*, 19 Mar. 1979, p. 82.

³² *Ibid.*, pp. 82-83; and Gold, *op. cit.*, 1979, p. 15.

³³ IMF Executive Board Decision no. 6056-(79/38), 2 Mar. 1979, in International Monetary Fund, *Conditionality in Fund-Supported Programs - Policy Issues* [online], prepared by the Policy Development and Review Department, in consultation with other departments, approved by Jack Boorman, 16 Feb. 2001, pp. 5-6. Available from: <http://www.imf.org/external/np/pdr/cond/2001/eng/policy/021601.pdf> [accessed 7th Oct. 2003]

Furthermore, the 1979 guidelines required IMF staff to prepare, for review by the Executive Board, periodic studies of programmes supported by SBAs. Such reviews of IMF conditionality would enable the Executive Board to determine when it may be appropriate to have the next comprehensive review. Since then several reviews had been carried out but there was no decision to adopt a new set of guidelines to replace the 1979 guidelines, even though consideration was given to a change to the 1979 guideline to provide for more routine inclusion in IMF arrangements of performance criteria on microeconomic policies.³⁴ The Executive Board repeatedly concluded that the 1979 guidelines remained satisfactory and sufficiently flexible for IMF policies on the use of its resources and were consistent with the increased emphasis the IMF had placed on structural adjustment, in particular since the mid-1980s (see a later discussion).³⁵ Nevertheless, some commentators pointed out shortcomings of the 1979 guidelines, in particular its failure to explicitly tackle the issue of conditionality in relation to structural problems. As Sidney Dell writes: 'the guideline did not deal with the question of the applicability of the Fund's standard performance criteria to the particular types of structural balance-of-payments problem experienced in recent years.'³⁶

2.2.3 The Substantial Expansion of Conditionality: Structural Adjustment

2.2.3.1 Expanding Scope

By the mid 1970s, the IMF had begun to recognise that in some cases, imbalances in the balance of payments with which the developing countries faced could be structural and not, therefore, be corrected over a short period of time. The IMF had initially attempted to address them through the introduction of medium-term loans such as the EFF in which financial support provided for a longer period and in a larger amount than in the SBAs.

Nonetheless, such recognition did not have a great impact on IMF conditionality until the early 1980s. The balance of payments experienced by several countries in the late 1970s and early 1980s led the Fund to conclude that the creation of special facilities to provide financial resources attached to low conditionality (such as the oil facility of 1974 and 1975) would not be appropriate, and that a more comprehensive approach was, thus,

³⁴ International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1986* (Washington, D. C.: International Monetary Fund), p. 45.

³⁵ See, for example, International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1986* (Washington, D. C.: International Monetary Fund), p. 45, 1988, p. 49, 1989, p. 31, and 1992, p. 50

³⁶ Dell, *op. cit.*, 1981, p. 26.

needed. As Managing Director J. de Larosière remarks in his speech in Bonn on 29 October 1980 before the Annual Assembly of the Federal Association of German Banks:

... our response to the new rise in oil prices has not been to establish a facility, like the oil facility, offering assistance with a low degree of conditionality. Our new borrowings next year are intended for relending on what we call upper credit tranche conditionality. This reflects our belief that members must respond with appropriate policies to the present situation; financing and adjustment must go hand-in-hand.³⁷

In a subsequent interview, he elaborates further:

In the wake of the first oil shock ... [u]nconditional facilities, or facilities with light conditionality, were resorted to or designed in the expectation that the balance of payments problems might be reversible. It became very clear by 1978 that such an unconditional or "recycling-oriented" approach was not warranted by the realities of the situation as we saw it evolve at that time. Balance of payments must be adjusted and the Fund must link its high credit tranche resources to the adoption of meaningful adjustment policies by member countries.³⁸

While the IMF increasingly relied on the upper credit tranche lending which was attached to high conditionality, at the same time it sought to renew emphasis on structural adjustment policies to increase productivity and to improve resource allocation. J. de Larosière states in his address before the Economic and Social Council of the United Nations in Geneva on 13 July 1982:

... we have sought to broaden the base of our programs so as to help member countries handle the more deep-rooted structural problems that have been characteristic of the payments difficulties for many of them in recent years. The Fund has been placing emphasis, therefore, not only on demand management but also on measures to strengthen the economy. In doing this, the Fund has not moved into the field of development policies itself but has been taking the steps needed to ensure that its programs are in consonance with sound investment and production strategies and, hence, with the longer-term structural adjustment To this end, close collaboration with the World Bank has been an important aspect of our work ³⁹

³⁷ de Larosière, J., 'Recycling Needs and the Capital Markets,' excerpts of a speech delivered in Bonn on 29 October 1980 before the Annual Assembly of the Federal Association of German Banks, in *Finance and Development*, vol. 18, no. 1, Mar. 1981, p. 12.

³⁸ 'A Conversation with Mr. de Larosière,' *Finance and Development*, vol. 19, no. 2, June 1982, p. 5.

³⁹ de Larosière, J., An address delivered on 13 July 1982 before the Economic and Social Council of the United Nations in Geneva, in International Monetary Fund, *IMF Survey*, 19 July 1982, p. 213.

In the light of these developments, since the early 1980s IMF conditionality has substantially evolved and extended to cover structural adjustment (or 'supply-oriented') policies, which were the original domain of the World Bank (see Section 2.2.4 Conditionality Convergence).

When the Executive Board discussed the potential role of structural adjustment policies in IMF-supported programmes in 1981, most Executive Directors from the developing countries expressed strong disagreement with IMF staff's analysis and were against greater IMF involvement. Until the mid-1980s IMF conditionality in relation to structural measures, thus, remained relatively limited, although the staff encouraged structural reforms in its discussions with member countries.⁴⁰ By the mid-1980s, according to the 1986 Annual Report of the IMF which discussed the Executive Board's review of the IMF's policy on conditionality, there was a consensus within the Executive Board that a higher priority should be given to the supply side, or structural aspects of IMF-supported programmes, including pricing policy, tax reform, financial sector reform, and trade liberalisation.⁴¹

2.2.3.2 Enlarging Objectives

While the scope of IMF conditionality has expanded to include structural adjustment policies, the number of its objectives has at the same time seemingly enlarged. By the mid-1980s, economic growth had gained importance in IMF conditionality along with the balance of payments correction. According to the 1986 Annual Report of the IMF, in a review of IMF conditionality, the Executive Directors emphasised the need for a growth-oriented approach aimed at enhancing economic efficiency and competitiveness and increasing supply responses.⁴² The enlargement to include economic growth as one of the main objectives of IMF conditionality was evident in Michel Camdessus's (Managing Director) speech:

Our prime objective is growth. In my view, there is no longer any ambiguity about this. It is toward growth that our programs and their conditionality are aimed. It is with a view toward growth that we carry out our special

⁴⁰ Boughton, J. M., *Silent Revolution: The International Monetary Fund, 1979-1989* (Washington, D. C.: International Monetary Fund, 2001), ch. 13, pp. 32-33.

⁴¹ International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1986* (Washington, D. C.: International Monetary Fund), p. 45.

⁴² *Ibid.*, pp. 44-45.

responsibility of helping to correct balance of payments disequilibria and, more generally, to eliminate obstructive macroeconomic imbalances.⁴³

The establishment of the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF) in March 1986 and in December 1987 respectively provided additional means for the IMF to expand the scope and the objectives of IMF conditionality.

Besides economic growth, since the late 1980s, there has been a wide range of other issues related to IMF conditionality what Jacques Polak called 'secondary objectives of IMF conditionality.'⁴⁴ Such issues have emerged partly as responses to public concern on the adverse impact of IMF conditionality on issues such as those of poverty and the environment, or the effect of the latter on IMF conditionality such as the issue of 'good governance.' More importantly, the rise of these issues is due largely to the influence of developed countries' neo-liberal perception within the IMF (see Section 2.2.4 Conditionality Convergence).

The IMF's stance towards the issues of income distribution and the environment was that they are merely areas of concern. Thus, it denied the adoption of environmental and income-distribution conditionality. Concerning the issue of poverty-reduction, the Executive Board reiterated that 'the questions of income distribution should not form part of IMF conditionality.'⁴⁵ As for the environmental issue, the same line was stressed: 'there would be no environmental conditionality.'⁴⁶ Therefore, according to the IMF, they are the issues that the IMF would like to promote and take into account when dealing with its policy analysis and programme design to achieve its primary objectives of correcting the balance of payments and encouraging economic growth.

Changes in the political environment, in particular the collapse of the centrally planned economies and the outbreak of the Asian financial crisis in 1997, gave rise to the new concern over issues of governance. The IMF (and also the World Bank) have, since the

⁴³ Camdessus, M., Excerpts of Remarks before the United Nations Economic and Social Council in Geneva on 11 July 1990, *IMF Survey*, 30 July 1990, pp. 235.

⁴⁴ Polak, *op. cit.*, 1991, p. 24.

⁴⁵ International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1989* (Washington, D. C.: International Monetary Fund), p. 31, and 1990, p. 41.

⁴⁶ International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1991* (Washington, D. C.: International Monetary Fund), p. 54.

early 1990s, placed increasing emphasis on issues of good governance in areas such as military expenditures, eradication of corruption and transparency of government operations. The declaration 'Partnership for Sustainable Growth' adopted by the IMF's Interim Committee⁴⁷ at its meeting in September 1996 identified 'promoting good governance in all its aspects, including ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption' as an essential element of a framework within which economies could prosper. The subsequent discussions at the Executive Board led to the adoption of guidelines regarding the issues of governance promulgated in August 1997.⁴⁸ Under the section 'Use of IMF Resource' of the governance Guidance Note, paragraph 15, it states:

Conditionality, in the form of prior actions, performance criteria, benchmarks, and conditions for completion of a review, should be attached to policy measures, including those relating to economic aspects of governance that are required to meet the objectives of the program.

Such policy measures would include ones that 'may have important implications for improving governance but are covered by IMF conditionality primarily because of their direct macroeconomic impact' such as the elimination of tax exemptions and recovery of non-performing loans.

2.2.4 Conditionality Convergence

As has been pointed out earlier, the expansion of the scope and objectives of IMF conditionality since the 1980s has led to increasing convergence of its conditionality with those of programme lending provided by the World Bank. Commentators of the Bank and the IMF have often described the ideology underpinning conditionality convergence as being neo-liberal-driven. The prime objective of the neo-liberal school (or a 'market-friendly' school) of economic policy analysis is economic growth which could efficiently be achieved through free markets with the elimination of government intervention in the economy. The way to achieve this objective is internally, through capital accumulation in terms of savings and investment, and externally, through an increase in exports.

⁴⁷ The Interim Committee is official known as the Interim Committee of the Boards of Governors on the International Monetary System. It was established in October 1974 as an advisory body to the Board of Governors of the IMF on issues such as the supervision of the management and adaptation of the international monetary system.

⁴⁸ For the full text of the governance Guidance Note, see *IMF Survey*, 5 Aug. 1997, pp. 234-238.

Concerning the World Bank, the Bank has, since its inception, undergone two main alterations in its approach. In its early years prior to 1973, the Bank's primary objective was to promote economic growth. However, since 1973, the Bank underwent two major changes while under the presidency of Robert M. McNamara (1968-81). First, a vast increase in the Bank's financial resources flowed towards developing countries. Second, the types of project lending were reoriented. Following the 1973 Nairobi speech by McNamara, the Bank had diversified its project lending toward those projects concerned with the alleviation of poverty in the developing countries.⁴⁹ Although McNamara's speech marked a major change in the World Bank's approach towards development, the idea of poverty alleviation was not initiated with this speech. Concern that economic growth in many developing countries failed to produce a trickle-down effect on living conditions of the poor had also been raised among academics, international forums and organisations, and developing countries. However, it was the Bank which had the resources to put this new developmental approach into practice.⁵⁰

In effect, the Bank's approach became a combination of both growth-driven and poverty-oriented schools. Growth was the important goal of such a strategy as a way to reduce poverty in developing countries. This would mean that although the Bank had re-oriented its emphasis towards poverty alleviation since 1973, its concern over growth remained. As R. L. Ayres puts it:

While there was a heightened concern for the social aspects of rural development, this did not mean any less attention to the requirements for increasing agricultural production. While there was a heightened concern for the consumption needs of the poorest, this did not mean that national savings and investment rates should fall. While a heightened concern for poverty and income distribution presumably entailed more concern for the political and social aspects of economic development, Bank loan decisions were still held to be governed by purely economic considerations. While poverty-oriented development projects were by their very nature riskier and more innovative than traditional projects, they still had to meet traditional canons of economic and financial analysis.⁵¹

In the early 1980s, the Bank underwent another shift in its approach. A new strategy was adopted by the Bank in striving against poverty problems in many developing countries

⁴⁹ Ayres, R. L., *Banking on the Poor: The World Bank and World Poverty* (Cambridge, M. A.: MIT P., 1984), p. 1.

⁵⁰ *Ibid.*, pp. 7-10.

⁵¹ *Ibid.*, p. 75.

through the free-market ideology. This is reflected in the policy measures of the Bank-supported programmes including the elimination of state intervention in determining domestic prices (such as agricultural and urban food subsidies, and minimum wages), the liberalisation of financial markets and foreign trade, and the unification of exchange rates.⁵² In effect, its main objective has again moved to improve the efficiency of the price system and of resources allocation.⁵³

During the 1950s, there had been an increasing number of developing countries pursuing the Import Substitution Industrialisation (ISI) strategy. This trend was influenced by the recommendation of the UN Economic Commission for Latin America (ECLA) under Raul Prebisch.⁵⁴ By following ISI, these developing countries tried to industrialise their economy but only aimed for domestic consumption. To achieve this goal, several protectionist measures were carried out (such as the imposition of quotas and tariffs on imports, and exchange rate manipulation) as a way to create barriers to entry for imports and to protect domestic industry. In fact, the ISI strategy recommended by the ECLA was not in line with the thinking of the IFIs. The pursuit of the ISI strategy in developing countries received negative responses from the IFIs. The classical example was India during the 1950s. Following the 1952 visit of the Bank's President in India, the President first responded to India's pursue of the ISI strategy by writing a letter to the Indian Minister of Finance, stating:

Once again, I wish to emphasise my conviction that India's interest lies in giving private enterprise, both Indian and foreign, every encouragement to make its maximum contribution to the development of the economy...I have the distinct impression that the potentialities of private enterprise are commonly underestimated in India and that its operations are subjected to unnecessary restrictions. Above all, in a country which is short of capital, and with limited resources of managerial talent, it is important that the respective roles of public and private enterprise should be fixed entirely . . .⁵⁵

⁵² Hunt, D., 'Development Economics, the Washington Consensus and the Euro-Mediterranean Partnership Initiative,' *Journal of North African Studies*, vol. 3, no. 2, summer 1998, p. 20.

⁵³ *Ibid.*, p. 22; and Taylor, L., 'Editorial: The Revival of the Liberal Creed-The IMF and the World Bank in a Globalised Economy,' *World Development*, vol. 25, no. 2, 1997, pp. 148-149.

⁵⁴ For a detailed explanation on the logic behind the favoured-ISI-strategy recommendation of the ECLA, see Roxborough, I., *Theories of Underdevelopment* (Basingstoke: MacMillan P., 1986), ch. 3, pp. 27-41.

⁵⁵ IBRD, 'Some Observations of the IBRD Mission on Economic Programmes and Policies in India,' June 30, 1956, processed. Cited in Mason, E. S. and R. E. Asher, *The World Bank Since Bretton Woods* (Washington, D. C.: Brookings Institution, 1973), p. 372.

Nevertheless, the ISI strategy pursued from the 1950s to the 1970s in many developing countries failed to achieve economic development targets and the growing indebtedness of many developing countries became serious issues in the 1980s. It was not until then that the IFIs' stance against the ISI countries became manifest.

In addition to the failure of ISI, Diana Hunt pointed out that, the liberal ideology of the IFIs was linked to the 1980s policy formation dominated in the US and the UK under the Reagan and Thatcher administrations. The writings of Friedrich Hayek, which emphasise two principles of free market liberalism in the economic domain and 'true individualism' in the social domain,⁵⁶ became influential in the Thatcher and Reagan governments in the US and the UK from the late 1970s. With the US in a position to influence the IFIs via its voting power, a similar shift in economic view was found among the Bank's senior economists.⁵⁷ In the case of the IMF, Kendall Stiles also confirmed this point by pointing out that in the context of Executive Directors' conflicts, 'during the 1980s, the United States Executive Director was generally loyal to the Reagan administration's ideology and pressed for greater liberalization measures in IMF conditionality.'⁵⁸

John Williamson used the term 'Washington consensus' to represent the notion of conditionality convergence between not only the IFIs but between them and the US.⁵⁹ In mid-1989, he provided a list of 'the conventional wisdom of the day among economically influential bits of Washington, meaning the US government and the international financial institutions' as follows:

- 1) fiscal discipline: budget deficits should be kept small and able to be financed;
- 2) public expenditure priorities: the redirection of spending from the areas with low economic returns (such as defence, administration and subsidies) toward ones with higher economic returns (such as health care, education and infrastructure);

⁵⁶ As, for instance, reflected in Hayek, F., *The Road to Serfdom* (London: Routledge, 1943); and *Individualism and Economic Order* (London: Routledge, 1949). For a brief discussion on his philosophy, see Hunt, *op. cit.*, pp. 22-25.

⁵⁷ Hunt, *op. cit.*, pp. 21-22.

⁵⁸ Stiles, K. W., *Negotiating Debt: The IMF Lending Process* (Boulder: Westview P., 1991), p. 38.

⁵⁹ The term was challenged by Richard Feinberg who argued that it was not universally endorsed in Washington, and was thus not a consensus. He suggested that the term 'universal convergence' would be more appropriate. Williamson, J., 'Democracy and the "Washington Consensus",' *World Development*, vol. 21, no. 8, 1993, p. 1329; and Williamson, J., 'What Washington Means by Policy Reform,' in S. Haggard (ed.), *The International Political Economy and the Developing Countries*, vol. 1 (Hants: Edward Elgar, 1995), pp. 514-528.

- 3) tax reform: the tax base should be broadened and marginal tax rate should be decreased;
- 4) financial liberalisation: interest rates should be ultimately determined by the market;
- 5) unified exchange rates;
- 6) trade liberalisation: the replacement of quantitative trade restrictions with tariffs which should in a later stage be progressively reduced;
- 7) foreign direct investment: it should be encouraged through the abolition of barriers to entry and competition on equal terms;
- 8) privatisation of state-owned enterprises;
- 9) deregulation: regulations which create barriers to entry and limit competition should be abolished, unless the regulations are justified on safety and environmental grounds;
- 10) provision of secure property rights in the legal system.

There are main three basic models underlying the above ten policy measures of the 'Washington consensus.'⁶⁰ Of the three, two models are associated with the macroeconomics. The first model focuses on the demand side of the economy and also the growth of money supply, and is used by the IMF in dealing with the balance of payments problems and domestic inflation. On the other hand, the second model adopted by the Bank emphasises the importance of the supply side of the economy as a way of coping with real resource constraints and so promoting economic growth.

The demand-side model of the IMF assumes that the balance of payments and price instability faced by its member countries are primarily caused by the excessive growth of domestic money supply as a way to finance government budget deficits. The excess growth of money supply over the money-demand and output growths generates a problem of inflation via the increase in domestic prices and imports. In the IMF-supported programmes, measures to overcome these problems usually include the reduction of budget deficits, the rise in the interest rates to increase savings and devaluation of the local currency to promote exports and so to improve balance of payments deficits.

In the supply-side model of the Bank, the constraints on the supply side of the economy were identified: there were the two gaps between the investment rate and the savings rate,

⁶⁰ Hunt, *op. cit.*, pp. 18-19.

on the one hand, and between imports and exports, on the other hand. Either of these constraints could impede the targeted growth rate. Thus, according to the Bank, measures have to be undertaken to reduce these gaps in order to promote the growth rate.

The third model which is based on the role of free markets in enhancing allocative efficiency is adopted by both the Bank and the IMF. Both institutions are in favour of the allocative role of markets and hence market liberalisation at both international and domestic levels. At the international level, import restrictions should be abolished and tariffs should be reduced and rationalised. At the domestic level, prices should be determined by markets rather than the governments. To help enhance efficiency, the Bank has also included the privatisation of public sector enterprises in its structural adjustment programmes.

It should be noted that in addition to the above economic policy instruments, there were a number of other matters which had caused concerns in the IFIs and the US government in their relationships with client countries. They included such issues as 'the promotion of democracy and human rights, suppression of the drug trade, preservation of the environment, and control of population growth.' Nonetheless, these concerns have played a minor role in influencing the view of 'the Washington' over their client's economic policies.⁶¹

In sum, the concept of conditionality in practice emerged in the late 1940s following the insistence of the largest creditor country, the US, despite the objections of the Western European countries, the main debtors at the time. It was primarily prompted by the need to ensure the temporary feature of the members' drawings and, thereby, the revolving character of the IMF's use of resources. It was rooted in the view of preventing unjustified drawings, and of ensuring effective repurchase. That is, resources of the Fund should be treated as being for a short-term purpose and had to be paid back within a certain period. One way to ensure this prompt repurchase is to attach policies and measures to resources provided to borrowing countries so as to restore the balance of payments equilibrium.

⁶¹ Williamson, *op. cit.*, 1995, p. 515.

IMF conditionality has steadily evolved throughout its existence. It has been shaped by events at both domestic (the failure of the ISI strategy pursued by many developing countries in generating economic growth) and international levels (the debt crisis, the collapse of the centrally planned economies, and the Asian crisis). Also the rise in the popularity of neo-liberalism in both the academic and the official circles in major industrial countries, particularly the US and the UK, to a large extent, contributed to major changes in the IMF's (and the World Bank's) perception. These factors in turn led to the growing collaboration between the two institutions, their increasing involvement in the developing countries' problems and hence their conditionality convergence or, in Williamson's words, the 'Washington consensus.'

Therefore, over the years IMF conditionality has expanded its scope and extent not only from macroeconomic variables to structural adjustment measures, but its objectives have also increased in number to include economic growth, poverty alleviation and good governance in addition to its traditional objective of balance of payments correction. However, the increasing involvement of IMF conditionality in social and political issues and the growing number of IMF conditions would in turn have implications for the relationship between the IMF and its borrowing member countries in practice, which we now examine.

Section II

2.3 Concern over the Expansion of IMF Conditionality

The proliferation of objectives of IMF conditionality and the expansion of its scope and extent have given rise to several concerns over time. As has already discussed in Chapter One, several criticisms have emerged, including the harshness of IMF conditionality, the lack of socio-economic considerations, and the 'one-solution-fits-all' approach. Such criticisms often boil down to another crucial criticism that IMF conditionality is imposed upon borrowing countries, especially the developing countries. The latter criticism has also received the IMF's response. It is the issue of imposition and the IMF's response which will be discussed in the following section. However, before discussing the controversy over the issue of imposition, one needs to look at another controversial question regarding IMF decision-making on its lending and conditionality. Without an understanding of how decisions are made at the IMF and the nature of IMF

decision-making on its lending and conditionality, one would miss part of the jigsaw to form a better picture of the nature of IMF conditionality.

2.3.1 Controversy over the Issue of the Underlining Motivation of IMF Conditionality

There exist two major opposing views concerning IMF decision-making: the economically-driven and the politically-driven views. They are propounded as attempts to provide an explanation for what determines IMF conditionality towards the borrowing countries.

2.3.1.1 The Economically-Driven Argument

The principle proposition of the economically-driven argument is that IMF conditionality is solely based on a technocratic, economic doctrine of rationality and neutrality. Political factors are, thus, deemed not to have any influence upon the decision-making of IMF lending.

The doctrine of economic neutrality in IMF operations proposed by the economic-driven view has been emphasised, dating back to the preparation years of its establishment. At the Atlantic City Conference held in 1944, the British delegation expressed the British functionalist/technical view towards the role of IMF staff. They stated that:

We want to aim at a governing structure doing a technical job and developing a sense of corporate responsibility to all the members, and not the need to guard the interests of particular countries.⁶²

At the Inaugural Meeting of the Boards of Governors of the IMF and the World Bank at Savannah, Georgia, on 9 March 1946, Lord Keynes expressed the notion of economic neutrality which would determine the lending decision-making of the Bretton Woods' twin institutions. He remarked that:

If these institutions . . . are to win the full confidence of the suspicious world, it must not only be, but appear, that their approach to every problems is absolutely objective and oecumenical, without prejudice or favour If, however . . . the

⁶² Strange, S., 'IMF: Monetary Managers,' in R. W. Cox and H. K. Jacobson (eds.), *The Anatomy of Influence: Decision Making in International Organization* (London: Yale U. P., 1974), p. 267.

devotee of ballet, the malice of the bad fairy Carabosse were to prevail, you two brats shall grow up politicians.⁶³

The neutrality doctrine of the economic-driven view has been embraced in the IMF's Articles of Agreement. Provisions in its Articles of Agreement have prohibited the IMF from intervening in the domestic social or political policies of member countries by objecting to them. The IMF has also been forbidden by the provisions from making decisions based on political considerations. This is reflected in the last sentence of Article 1 in the Articles of Agreement which requires the IMF to be guided 'in all its policies and decisions' by the purposes set forth in Article 1. In addition, Article XII, Section 4 (C) in the Articles of Agreement dealing with the impartiality of IMF staff stipulates that:

The Managing Director and the staff of the Fund, in the discharge of their functions, shall owe their duty entirely to the Fund and to no other authority. Each member of the Fund shall respect the international character of this duty and shall refrain from all attempts to influence any of the staff in the discharge of these functions.⁶⁴

The economic-driven view has mainly been held by a number of IMF officials. Also it is often found in the early literature concerning the Bretton Woods institutions. It can be seen in the works written by Sidney Dell (1981), Joseph Gold (1983), Mason and Asher (1973), Frank A. Southard (1979), and Susan Strange (1974).⁶⁵

The economic-driven view assumes that IMF staff are neutral. Joseph Gold confirmed this assumption by stating that:

The Managing Director and the staff, of which he is the chief, owe their duty entirely to the Fund and to no other authority, nationality or international, in the exercise of their official functions. In conducting negotiations with members and in making recommendations to the Executive Board, the Managing Director abides by the law of the Fund. His role is a major bulwark in defense of the rule of law and the rights of all members.⁶⁶

⁶³ Gold, J., 'Political Considerations are Prohibited by Articles of Agreement when the Fund Considers Requests for Use of Resources,' *IMF Survey*, 23 May 1983, p. 146.

⁶⁴ International Monetary Fund, *Articles of Agreement of the International Monetary Fund* [online], Article 12: Organization and Management, 2003. Available from: <http://www.imf.org/external/pubs/ft/aa/aa12.htm#4> [accessed 7th Oct. 2003]

⁶⁵ Dell, *op. cit.*, 1981; Gold, *op. cit.*, 1983; Mason and Asher, *op. cit.*; Southard, F. A., Jr., 'The Evolution of the International Monetary Fund,' *Essays in International Finance*, no. 135 (Princeton, N. J.: International Finance Sec., Dept. of Economics, Princeton U., Dec. 1979); and Strange, *op. cit.*.

⁶⁶ Gold, *op. cit.*, 1983, p. 148.

Similarly, Susan Strange suggested that 'As civil servants with a concrete job to do, the [senior] staff shows a high standard of responsibility, integrity, and impartiality.'⁶⁷

The Managing Director and the Deputy Managing Director (hereafter refers to as 'the Management') and staff in relation to the Executive Board are, according to this view, relatively autonomous and do not fall under the latter's domination. Frank Southard supported this claim by concluding that 'the Managing Director and staff gradually . . . emerged as an effective organ, highly professional, able to operate with a satisfactory degree of independence from heavy supervision by the Executive Board . . .'⁶⁸

The economic-driven view also assumes that IMF conditionality for particular types of loans is derived from the arithmetic calculation of the economic data which are collected by IMF staff and applied in the IMF's financial-programme formula. Moreover, the economic-driven argument claims that the IMF applies its conditionality in accordance with the doctrine of uniformity in which each member country receives uniform treatment from the IMF. Joseph Gold asserts that the doctrine of uniform treatment had been drawn from the IMF's Articles of Agreement to guarantee that 'the Fund may not discriminate among members in establishing policies under the Articles. In particular, discrimination cannot be justified on the basis of domestic social or political policies. The prohibition of discrimination assures all members of equality before the law.'⁶⁹ He further explains that:

The doctrine of uniformity, when applied to the use of the Fund's resources, does not prevent the Fund from formulating a policy that recognizes a particular balance of payments problem if it can be distinguished in good faith from other such problems. What the Fund cannot do is to define a policy in terms of a particular member or class of members or in terms of all members except a particular member or class of members.⁷⁰

2.3.1.2 The Politically-Driven Argument

The main proposition of the politically-driven argument is that IMF conditionality is primarily determined by political considerations, dictated by geo-political and/or ideological reasons. Political factors gain more weight than economic factors in

⁶⁷ Strange, *op. cit.*, p. 270.

⁶⁸ Southard, *op. cit.*, p. 43. See also Strange, *op. cit.*, p. 267.

⁶⁹ Gold, *op. cit.*, 1983, p. 147.

⁷⁰ *Ibid.*

explaining the decision-making of IMF lending. Thus, IMF decision-making cannot, according to this view, be politically neutral,⁷¹ unlike the claim made by the economically-driven view. The politically-driven argument can be summarised into two main aspects: the first aspect concerns with the structure of the IMF; and the second aspect deals with its function.

A) Structure

The politically-driven view asserts that the IMF's feature of politicising emerges out of the Executive Board.⁷² This view assumes that IMF conditionality is designed by its major members, particularly the US, through the control over their appointed Executive Directors. Fred L. Smith notes that:

That the IMF's fate has rested with the political process has been totally appropriate, for the IMF is itself a political institution. It is managed by politically appointed individuals from member nations, and the political interests of its member influence its decisions.⁷³

This view then further assumes that it is the Executive Board rather than the Management and IMF staff who dominates IMF lending decisions and its conditionality.⁷⁴ The system of weighted voting adopted by the IMF is claimed to contribute to such domination of the Board of Executives over the Management and the staff. A considerable proportion of IMF resources are derived from member countries' subscription payments in accordance with their quotas. The size of a member country's quota also determines its voting power and the amount of IMF resources that a country can borrow. The larger the size of a member country's quota and of its subscription payment, the greater access to IMF resources and the gain in the percentage of votes. As a consequence of the weighted-vote system, the major members through their Executive Directors will, according to this view, dominate the IMF's decision-making process.

⁷¹ Butler, N., 'The IMF: Time for Reform,' *Young Fabian Pamphlet*, no. 50 (London: Young Fabian Group, Jan. 1982), p. 17; and Dag Hammarskjöld Foundation, 'International Monetary System and the New International Order,' *Development Dialogue*, no. 2, 1980, p. 14, cited in Helleiner, G. K., 'The IMF and Africa in the 1980s,' *Essays in International Finance*, no. 152 (Princeton, N. J.: International Finance Sec., Dept. of Economics, Princeton U., July 1983), p. 2.

⁷² Lister, F., 'Decision-Making Strategies for International Organizations: The IMF Model,' *Monograph Series in World Affairs*, vol. 20, Book 4 (Denver, C. O.: U. of Denver, 1984).

⁷³ Smith, F. L., Jr., 'The Politics of IMF Lending,' *Cato Journal*, vol. 4, spring/summer 1984, p. 217.

⁷⁴ See, for example, Russell, B., 'Guess Who Calls the Tune at IMF?,' in L. J. McQuillan and P. C. Montgomery (eds.), *The International Monetary Fund, Financial Medic to the World?: A Primer on Mission, Operations, and Public Policy Issues* (Stanford, C. A.: Hoover Institution P., 1999), p. 89.

Some authors such as Cheryl Payer pointed to the US as the dominant member in the IMF in the early years and despite its relatively decline, this dominance continued to exist through a unilateral veto over a number of important decisions. He states that:

From its inception the Fund has been dominated by the wishes of its largest member, the United States of America . . . [I]n the 1960s, the American dominance has declined relatively, but it is still safe to assume that no major decisions are taken against the strong wish of the United States. The resignation in 1973 of Pierre-Paul Schweitzer as Managing Director, after the US indicated that it did not have confidence in him, is an illustration.⁷⁵

Similarly, Bahram Nowzad concludes that:

Because the Fund's largest members provide the bulk of its resources and thus have a majority of the voting power, there is no question that they exert considerable influence on the direction, policies, and practices of the Fund.⁷⁶

R. S. Eckaus further points out that the way in which decisions were made within the IMF had allowed the richer countries to impose adjustment conditions without the exercise of their majority power in the IMF. IMF decisions were not voted upon. In other words, they were based on the 'sense of the meeting' of the Executive Directors.⁷⁷

B) Function

According to the politically-driven view, the IMF is labelled as a politicised international institution.⁷⁸ It is designed to serve as an instrument of its major members, i.e. Western industrialised countries, particularly the United States, rather than acting as an IFI. Its lending decision is mainly a reflection of economic and geo-political interests of its major members in pursuing their foreign policies in developing countries.⁷⁹ Teresa Hayter in examining the role of aid and several financial institutions argues that the policies of these institutions, including the World Bank and the IMF, formed 'an integral part of the

⁷⁵ Payer, C., *The Debt Trap: The IMF and the Third World* (New York: Monthly Review P., 1974), app. II, p. 217.

⁷⁶ Nowzad, B., 'The IMF and its Critics,' *Essays in International Finance*, no. 146 (Princeton, N. J.: International Finance Sec., Dept. of Economics, Princeton U., Dec. 1981), p. 9.

⁷⁷ Eckaus, R. S., 'How the IMF Lives with its Conditionality,' *Policy Sciences*, vol. 19, no. 3, 1986, pp. 237-252.

⁷⁸ Dag Hammarskjöld Foundation, 1980, p. 14, cited in Helleiner, *op. cit.*, p. 2; and Smith, F. L., *op. cit.*, p. 217.

⁷⁹ Bello, W. and D. Kinley, 'The IMF: An Analysis of the International Monetary Fund's Role in the Third World Debt Crisis, Its Relations to Big Banks, and the Forces Influencing Its Decisions,' *Multinational Monitor*, July 1983, p. 13; and Haggard, S., 'The Politics of Adjustment: Lessons from the IMF's Extended Fund Facility,' *International Organization*, vol. 39, no. 3, summer 1985, pp. 513-515.

foreign policies of Western capitalist nations towards underdeveloped countries.’⁸⁰ Thus, the conditionality, according to this view, tends to be lenient towards the allies of the IMF’s major members.

Furthermore, the political-driven view asserts that another principal function of the IMF is to serve the ideological objective of major members. Its existence and operations are claimed by this view to facilitate the expansion of and to preserve world capitalism with an ultimate goal of ensuring capitalist domination in the world economy.⁸¹ Therefore, according to this view, IMF decision-making is oriented in favour of capitalist countries, regardless of their intention on how to use the loans. Walden Bello and David Kinley notes that:

In choosing preferred clients in the Third World, both the Fund and the banks tried to reduce the ‘political risk factor’-which meant that the biggest loans often went to capitalist countries with superficial signs of stability imposed by authoritarian regimes, like Chile, the Philippines, Argentina, and Brazil. Yet, these were often times the borrowers who were not likely to invest the bulk of the loans in creating productive assets that could generate the wealth from which the loans could be later repaid.⁸²

Similarly, in his paper examining the relationship between the World Bank and Tanzania, James Mittelman concludes that:

The role of the World Bank in Tanzania makes evident that its lending criteria, loan terms, feasibility studies, reports, missions, accounting procedures, and advice are all coloured by the prejudices of American business psychology and capitalism profit-and-loss thinking . . . international institutions can play a prominent role in shaping national policies so that they are consonant with capitalist principles.⁸³

On the other hand, IMF lending decision is taken against countries which adopt a socialist path towards their economic policies and economic development. As Cheryl Payer puts it:

. . . The Fund seems to be much more lenient . . . with some governments than with others . . . there is a plausible political hypothesis: where the most powerful

⁸⁰ Hayter, T., *Aid as Imperialism* (Middlesex: Penguin, 1971), p. 6.

⁸¹ Hayter, *op. cit.*

⁸² Bello and Kinley, *op. cit.*, p. 13.

⁸³ Mittelman, J. H., ‘International Institutions and Policies of Socialism and Self-Reliance: Are They Compatible? The Tanzanian Experience,’ *Social Research*, vol. 47, spring 1980, p. 165.

opposition to the government in power is rightist and friendly to the US . . . , the government is likely to receive more severe treatment from the IMF when it tries to support social reform measures than in countries where the chief rival to the government's power is left nationalism.⁸⁴

Therefore, this view claims that IMF lending decisions are a reflection of the major members' desire and thereby an outcome of political bias.⁸⁵

2.3.2 Contending Views on the Nature of IMF Conditionality

With regard to the nature of IMF conditionality, there are two very different schools of thought which are imposition and "ownership." In the literature concerning aid and IFIs, including the IMF, it is often suggested that IMF conditionality is imposed upon borrowing countries against their will. These included the work of Willy Brandt, Richard Bernal, Ronald T. Libby, Cheryl Payer, Walden Bello and David Kinley, Nick Butler, Roland Vaubel, Mel Watkins, and Mary Soledad Perpinan.⁸⁶ This view can also be found in the literature regarding the World Bank; for example, in the work of Elaine Elinson.⁸⁷

There are a number of assumptions underlying the view of imposition. First of all, there assumes to be a lack of alternatives for borrowing countries, particularly developing countries. There would be no choice for them. Secondly, there would be a lack of freedom or autonomy. The developing countries would lack room to manoeuvre. The policy reform programmes are, thus, forced, coerced or dictated upon the developing countries. This assumption is clearly expressed by Ronald T. Libby:

When the LDC [less developed country] became heavily dependent upon the IGO's [intergovernmental organisations] and creditors for financial assistance to enable the government to survive a disastrous shortfall in foreign exchange earnings, it was forced to accept extreme, and politically dangerous, measures in order to secure assistance.⁸⁸

⁸⁴ Payer, *op. cit.*, 1974, p. 43.

⁸⁵ *Ibid.*, p. 14; and Smith, F. L., *op. cit.*, p. 219.

⁸⁶ Bello and Kinley, *op. cit.*, pp. 11-14; Bernal, R., 'Transnational Banks, the International Monetary Fund and External Debt of Developing Countries,' *Social and Economic Studies*, vol. 31, no. 4, 1982, pp. 71-101; Brandt, W., *North-South: A Programme for Survival, Report of the Independent Commission on International Development Issues* (London: Pan, 1981); Butler, *op. cit.*; Libby, R. T., 'External Co-optation of a Less Developed Country's Policy Making: The Case of Ghana, 1969-1972,' *World Politics*, vol. 29, no. 1, Oct. 1976, pp. 67-89; Payer, *op. cit.*, 1974; Perpinan, M. S., 'The Philippines: Collision Course,' in J. Torrie (ed.), *Banking on Poverty: The Global Impact of the IMF and World Bank* (Toronto, O. N.: Between The Lines, 1983), pp. 169-187; Vaubel, R., 'Bureaucracy at the IMF and the World Bank: A Comparison of the Evidence,' *World Economy*, vol. 19, no. 2, 1996, pp. 195-210; and Watkins, M., 'foreward,' in Torrie, *op. cit.*.

⁸⁷ Elinson, E., 'The Philippines: The Failure of Bank Strategy,' in Torrie, *op. cit.*, pp. 154-168.

⁸⁸ Libby, *op. cit.*, p. 67.

Thirdly, the view of imposition also assumes the hegemony of the IMF. The IMF is often seen as the most powerful institution in relation to the developing countries. As Nick Butler describes the institution:

Of all the international institutions created in the wake of the second world war the IMF is easily the most powerful The IMF's status, as lender of last resort has given it effective political power, power which can be used in a variety of ways producing sharply different results.⁸⁹

Also J. E. Stiglitz shares a similar assumption:

. . . these [the negotiations between the IMF and the borrowing country on the terms of any loan agreement] are one-sided negotiations in which all the power is in the hands of the IMF, largely because many countries seeking IMF help are in desperate need of funds.⁹⁰

Fourthly, the developing countries are, on the other hand, viewed as being weak and passive. They would have no bargaining power. According to this view, there would be no reaction from the developing countries. The latter has always to accept the conditions attached to the IMF's loans. As Mary Soledad Perpinan says in the case of the Philippines that:

The Philippines . . . has . . . gone all the way, bowing and bending to the dictates of the International Monetary Fund and the World Bank We're the sanguine neocolony that is no longer accountable to its people but to the World Bank and IMF.⁹¹

The opposing school of thought, often of the IMF, claims that the IMF neither impose upon nor dictate to, but rather cooperates with the borrowing country in question on the terms of the lending agreement. In its booklet 'Ten Common Misconceptions about the IMF' published in 1988, the IMF responded at length to the criticism that the IMF imposed austerity on member countries. A number of reasons were put forward to rebut such a criticism, including:

- i) What forced a country to adopt austerity measures was not the IMF, but rather balance of payment disequilibrium, arising from inappropriate

⁸⁹ Butler, *op. cit.*, p. 29.

⁹⁰ Stiglitz, J. E., *Globalization and Its Discontents* (London: Penguin, 2002), p. 42.

⁹¹ Perpinan, *op. cit.*, pp. 169-170.

- domestic policies and/or unfavourable external developments, and lack of financing prospects;
- ii) The country could not continue drawing down its foreign exchange reserves or borrowing abroad to finance its payments deficit. Sooner or later, the country would, with or without the Fund, have to adjust;
- iii) All economic adjustment programs involved some sacrifice; and
- iv) The Fund was often used by governments as a scapegoat. They implied that these reforms had been “dictated” by the Fund.⁹²

In defending itself, the IMF often argues that the IMF only has an advisory role in working out the economic policy programme of a borrowing country. Managing Director H. Johannes Witteveen stated in his speech on 8 May 1978 in London that “[t]he Fund can counsel and agree but it assuredly cannot – as it, unfortunately, so often said – “impose” policies and conditions.’⁹³

According to the IMF, IMF conditionality is based on cooperation between the IMF and a borrowing country. Jacques de Larosi re stated in his speech on 15 December 1983 before the Economic Club of Chicago, on ‘Current Policies of the IMF: Fact and Fiction’ that:

One sometimes hears it said that the Fund “imposes” conditions on member countries having recourse to its financing. This notion betrays a basic misconception about the nature of the Fund’s relations with its sovereign member states. When a member wants to borrow from the Fund, *we work together with the authorities* to determine the nature and causes of the economic problems facing the country. And *we examine with them the policy options* that exist for restoring a viable payments position over the medium term, having regard to the domestic social and political objectives of the member and its economic priorities. The aim of these discussions is to reach agreement on a package of measures – an adjustment program – which constitutes a coordinated attack on the problems they face and which can be supported by Fund financing The closeness of relations between the Fund and its member countries and the continuing nature of the association mean that negotiations, though they can be difficult, are normally conducted in an atmosphere of *mutual understanding and trust* [emphasis added].⁹⁴

⁹² International Monetary Fund, *Ten Common Misconceptions about the IMF* (Washington, D. C.: International Monetary Fund, 1988), p. 15.

⁹³ Witteveen, H. J., an address delivered on 8 May 1978 in London before the 1978 Euromarkets Conference on “Financing the LDCs: The Role of Public and Private Institutions,” in International Monetary Fund, *IMF Survey*, 22 May 1978, pp. 149-150.

⁹⁴ de Larosi re, J., an address delivered on 15 December 1983 before the Economic Club of Chicago on “Current Policies of the IMF: Fact and Fiction,” in International Monetary Fund, *IMF Survey*, 9 Jan. 1984, p. 2.

IMF conditionality is also claimed to be “owned” by the borrowing countries as Managing Director Michel Camdessus remarked on 25 January 1990 in Washington, D.C. before the US Catholic Conference and the Episcopal Conference of Mexico that:

The economic program that a country itself draws up with our assistance, is indeed its own. We have learned from experience that a program can only be effective if the authorities are genuinely committed to it, and if it is supported by a broad consensus of the population.⁹⁵

Similarly, in its booklet ‘What is the International Monetary Fund?’ published in 1998, the IMF argues that:

Far from being dictated to by the IMF, the membership itself dictates to the IMF the policies it will follow. The chain of command runs clearly from the governments of member countries to the IMF and not vice versa The specifics of each IMF-supported adjustment program are selected by the member, and hence the program of reform is the member’s, not the IMF’s.⁹⁶

Some defenders of the IMF raise doubt about the idea that IMF conditionality is imposed upon the borrowing countries. As Bahram Nowzad in defending the IMF on the issue of imposition points out:

[The] concept is not always fully explained. Furthermore, it is not clear whether it is based merely on chance encounters between the critics and particular Fund officials or is perceived as a deeper failing affecting the Fund. Fund officials who conduct negotiations with member countries are of course subject to the same failings and mistakes as other humans.⁹⁷

Some observers hold a view against the imposition perspective. Sebastian Edwards asserts that it was ‘incorrect’ to view IMF conditionality as being imposed on developing countries. He remarks that:

One of the many myths that surround the Fund is that its staff travels around the world imposing unnecessarily harsh adjustment policies on the developing

⁹⁵ Camdessus, M., excerpts of remarks delivered on 25 January 1990 in Washington, D. C. before the US Catholic Conference and the Episcopal Conference of Mexico, in International Monetary Fund, ‘Managing Director’s Address . . . Fund’s Experience in Mexico Demonstrates Cooperative Approach,’ *IMF Survey*, 5 Feb. 1990, p. 33.

⁹⁶ International Monetary Fund, ‘What is the International Monetary Fund?’, in McQuillan and Montgomery, *op. cit.*, pp. 11 and 19.

⁹⁷ Nowzad, *op. cit.*, p. 9.

countries. Strictly speaking this is incorrect: the IMF cannot impose any policy on any country.⁹⁸

However, the author did not go on to explain why this would be the case.

In sum, what both schools of thought imply are quite opposed to each other. On the one hand, the imposition school of thought suggests the following points: i) the lack of alternatives and room to manoeuvre of the borrowing countries; ii) a relative weakness and passivity of the borrowing countries; and iii) the lack of the borrowing countries' will in accepting IMF conditionality. On the other hand, the ownership argument is based on the following points: i) the context of power relativity may not be necessary due to the presence of 'mutual understanding and trust'; and ii) there exists the will of the borrowing countries.

2.3.3 Criticisms of the Two Schools of Thought: Are Imposition and Ownership Dichotomous Alternatives?

There are, however, several weaknesses in both schools of thought. First of all, they oversimplify the relationships between the IMF and borrowing countries. Secondly, the imposition perspective is of a static nature. It does not include the dynamics of the relationship between the IMF and the borrowing countries. For instance, this perspective overlooks the economic and political circumstances of the negotiating country. In reality, the situations of the country would not be fixed as the arguments assume. It is expected that changes in the economic or political situations could have an impact on IMF conditionality. Thirdly, the imposition view also assumes a passive role of the borrowing countries in dealing with the IMF. The argument often focuses on the IMF side in an attempt to find out the determinant of IMF conditionality. In dealing with the issues of the relationships between the IMF and the borrowing countries, the latter should not be left out since they may not be passive actors. In fact, they may possibly interplay with the IMF in seeking the best deal for themselves. Last, but not least, both perspectives of imposition and ownership assume unitary actors; the IMF, on one side, and the borrowing country, on the other. This is particularly far from the reality. For example, as has been pointed in Chapter One, the IMF as an organisation consists of several hierarchical actors, namely the Board of Governors, the Executive Board, the Management, and staff. There

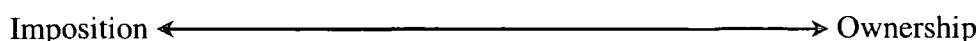
⁹⁸ Edwards, *op. cit.*, p. 7.

are also a number of internal actors in the borrowing countries such as the technocrats, the decision-making bodies and interest groups.

With these criticisms in mind, one could go further by asking an important question regarding the two contending views: are the ideas of imposition and ownership necessarily dichotomous alternatives? If IMF conditionality is imposed by the IMF, how can one explain the complete implementation of economic policy programme by some countries? Surely, among other factors which help facilitate implementation, there must be the element of willingness of the borrowing countries in implementing the policy programmes? On the other hand, if IMF conditionality is owned by the borrowing countries in the first place, why is there a need for the negotiations themselves and why are so many programmes aborted during the programme period?

This study thus argues that the nature of IMF conditionality is characterised by neither absolute imposition nor complete ownership. In this respect, IMF conditionality should be conceived of as being located on a linear spectrum where imposition is situated on one end and ownership at the other (see Figure 2.1). That is, the question that one should ask is not whether IMF conditionality is imposed upon or owned by the borrowing countries. Rather what is the extent of the imposition and of the ownership of IMF conditionality?

Figure 2.1 A Linear Spectrum



As previously discussed above, one of the deficiencies of one of the two schools of thought concerning the nature of IMF conditionality is its static feature. In order to avoid such a deficiency, the study will utilise the process analysis for the purpose of introducing the dynamics needed. The nature of the outcome of the interplay between the two parties can be examined in the context of how the two parties interact during the process by which the outcome is obtained. Thus, in order to understand the nature of IMF

conditionality, one needs to examine it in the context of the relationship between the IMF and the borrowing country in question during the process of lending to determine how conditionality is derived. As discussed in Chapter One, it seems that the idea of a balance of power in the relationship between the IMF and the borrowing country does not exist. However, as it will later be argued, the borrowing countries *do* have the possibility to increase their relative strength within the relationship. The borrowing country is in search of manoeuvrability or ways to improve its relative power.

Section III

2.4 Analytical Framework

This section aims to establish an analytical framework for assessing the nature of IMF conditionality. As suggested above, one way of determining the extent of imposition and ownership of IMF conditionality is to consider the lending process to see how the IMF and the borrowing country interact regarding IMF conditionality. It is then necessary to consider the relative power of the IMF and of the borrowing country as a tool utilised in their interaction. It should be noted that since a lending agreement of a borrowing country with the IMF is not legally binding, the concept of 'authority' would not be appropriate here as a tool of analysis because it is a legal concept. Instead, the term 'power' as a political concept will be employed instead in this study, forming part of the analytical framework.

It has often been pointed out that despite its great capabilities, the IMF is not always able to obtain the full implementation of the policy programmes. Such an inability on the part of the IMF to achieve the fully implemented programmes could be interpreted to mean that the IMF is not as powerful as many think. In addition to this, this study argues that the relative weakness of the IMF vis-à-vis the borrowing countries can be found prior to the implementation, i.e. during the lending process that leads to the signing of agreements. This would depend on a number of factors at play which will be identified in the following section.

The analytical framework of this research is inductively drawn from the literature in several fields. The framework constitutes the concept of power which is inserted in the context of the lending process and also embedded in the background of a triangular relationship, as will be explained below. Section III will begin with the discussions on

the concept of power with an attempt to provide an appropriate conceptualisation of the term to be used in the analysis. Then, the next section will look at the lending procedures of the IMF. This is followed by the notion of a triangular relationship as a network among the two major parties (the IMF and the borrowing country) and third parties. Last, but not least, the final section will identify the possible factors which determine the power of the two major parties.

2.4.1 The Concept of Power

First of all, it should be pointed out that in social sciences the term 'power' is theoretically problematic. There exist several definitions of the term 'power.' The fundamental problem is that there seems to be no single universally satisfactory definition of power in social science studies. As Steven Lukes explains:

It is more likely that the very search for such a definition is a mistake. For the variations in what interests us when we are interested in power run deep . . . and what unites the various views of power is too thin and formal to provide a generally satisfying definition, applicable to all cases.⁹⁹

In International Relations, power is a crucial concept in the realist tradition. Realists understand power to be the sum of capacities (or resources or possessions) held by a state, whether considered in an absolute term (in isolation) or a relative term (relative to the capacities of other states).¹⁰⁰ In assessing power, economic, military, technological, political, and diplomatic factors are often employed. They include natural resources in terms of food and raw materials, industrial capacity, the sizes and skills of population, the size and geographical location of land area, the size and quality of armed forces, the efficiency of government and the quality of diplomacy.¹⁰¹ However, there are several shortcomings of defining power as capacities. First of all, it would provide quite a limited tool of analysis, particularly in a comparative analysis involving different types of actors, not on a state-state basis. Secondly, power is viewed as either immutable or unlikely to be alterable in the short term. From this perspective, it mentions nothing about the interactions between or among actors. Thus, it provides little insight for a dynamic analysis for which the study seeks. Furthermore, viewing power as endowed resources

⁹⁹ Lukes, S. (ed.), *Power* (Oxford: Basil Blackwell, 1987), pp. 4-5.

¹⁰⁰ Viotti, P. R. and M. V. Kauppi, *International Relations Theory: Realism, Pluralism, Globalism*, 2nd ed. (New York: Macmillan, 1993), p. 44.

¹⁰¹ Morgenthau, H. J., *Politics Among Nations: The Struggle for Power and Peace*, brief ed. (Boston, M. A.: McGraw-Hill, 1993), ch. 9, pp. 124-165.



and capacities cannot explain why the strong with their superior resources do not always prevail over the weak.

In explaining the paradox of power as a causal concept, something lying between the cause and the outcome, David Baldwin argues that the degree of fungibility of power resources (i.e. transferability of power resources to be used in lieu of another) is relative and thus both domain (who has power in relation to whom) and scope (with respect to what) need to be specified in analysing power.¹⁰² Power resources which are useful in one policy-contingency framework may not be equally useful in another. Moreover, power resources may be assets in one policy-contingency framework but liabilities in another context.¹⁰³ That is, they can be not only the sources of power but also its constraints, depending on the context in which they exist. Power is, thus, contingent upon context and must be examined in a specific issue area. Drawing from Baldwin's arguments, in conceptualising the term 'power' for the analysis of this study, one needs to place it in the context of the relations between the IMF and the borrowing country regarding IMF conditionality; otherwise, the concept of power would be rather useless in the analysis.

Although endowed resources or capacities are an important element in the causal concept of power, they are not alone in affecting the outcomes of interactions. In the literature concerning international negotiations, outcomes depend not only on absolute or relative capacities, but also the interaction between/among parties, the way in which the resources are organised and utilised.¹⁰⁴

In the context of the relations between the IMF and the borrowing countries, their positions are often said to be or appear to be asymmetrical, as has been pointed out Chapter One. The fact that the IMF holds the credit needed by the borrowing countries to deal with their balance of payments deficits is commonly used to show the asymmetry between the IMF and the borrowing country. From this perspective, the analysis tends to consider power as the sum of capabilities, especially in terms of the sources of power and

¹⁰² Baldwin, D. A., 'Power Analysis and World Politics: New Trends versus Old Tendencies,' *World Politics*, vol. 31, no. 2, Jan. 1979, pp. 161-194.

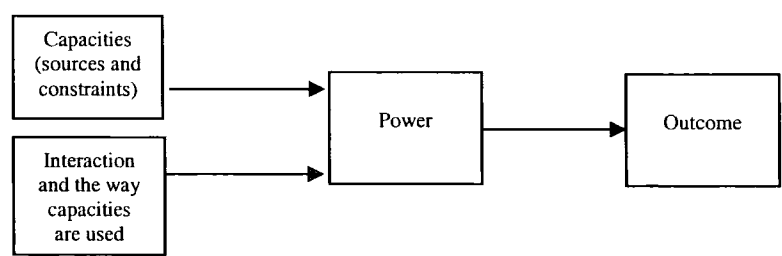
¹⁰³ *Ibid.*

¹⁰⁴ Habeeb, W. M., *Power and Tactics in International Negotiation: How Weak Nations Bargain with Strong Nations* (Baltimore: Johns Hopkins U. P., 1988); and Hopmann, P. T., *The Negotiation Process and the Resolution of International Conflicts* (Columbia, S. C.: U. of South Carolina P., 1996).

then jump to the conclusion, without or with only little reference to the interaction between the two parties and the possible changes arising during the interaction.

In order to capture the interactions of actors in the analytical framework, the concept of power is, in this study, considered to be dynamic. Since it is necessary to specify the scope and domain in analysing power as has been discussed earlier, neither capabilities (as sources of and constraints to power) nor the extent of power are treated as static. They can be varied throughout the process of interactions. The sources of and constraints to power can be either permanent or temporary. The extent of power can, thus, be increased or decreased throughout the process and is not fixed according to what capacities a party is initially endowed, but also depends on circumstances. Nevertheless, it should not be taken to mean that the study rules out the relevance of capacities in the conceptualisation of power. Rather, capacities provide the foundation upon which power can be conceptualised, i.e. they are potential sources of and constraints on power (see Figure 2.2). In this study, power will refer to the ability of a party to affect the interaction outcomes in a specific-issue area.

Figure 2.2 The Causation of Power



2.4.2 The Lending Procedures of the IMF¹⁰⁵

The lending procedures of the IMF are generally preceded by the consultations held regularly between the IMF and its member countries. Eduard Brau (1981) identified three main purposes served by these consultations. Firstly, they were the means by which

¹⁰⁵ The information on the consultations and IMF lending process presented in this section is substantially drawn from Brau, E., 'The Consultation Process of the Fund,' *Finance and Development*, vol. 18, no. 4, Dec. 1981, pp. 13-16; Crockett, A., 'Issues in the Use of the Fund Resources,' *Finance and Development*, vol. 19, no. 2, June 1982, pp. 10-15; and Körner, P. (et al.), *The IMF and the Debt Crisis: A Guide to the Third World's Dilemma* (London: Zed, 1992), pp. 63-65.

the IMF keeps itself informed of economic developments and policies in member countries. Secondly, through the regular consultations, the IMF received the fundamental information for the exercise of surveillance over exchange rate policies. The final purpose was that they helped the IMF fulfil other jurisdictional responsibilities.

Initially, the consultations were arranged with a few countries to discuss the reasons for their restrictions on international payments and transfers. The IMF commenced the consultations with its members in 1952, originated in Article XIV of the original Articles of Agreement. Under Article XIV, members had the right to maintain and to adopt restrictions on payments and transfers on a transitional basis, subject to an annual consultation with the IMF 'as to their further retention.'

However, in 1960 the usefulness of the consultations was recognised by the Executive Directors, who then decided that consultations should be held regularly with members, even though they had abandoned restrictions on payments and transfers. By this time the consultations had shifted their focus from restrictive practices on payments and transfers to a comprehensive review of the member countries' economic situation and policies (both domestic and external). In addition, the Second Amendment of the Articles of Agreement, which entered into force in April 1978, required each member country to hold regular consultations with the IMF on their exchange rate and adjustment policies. Under the new Article IV of the Second Amendment of the Articles of Agreement, members may pursue exchange arrangements of their choice, but they were to collaborate with the IMF to ensure and promote stability in the exchange rate system. To oversee the members' compliance with these obligations, the IMF exercised firm surveillance over members' exchange rate policies through its main tool – the consultation process.

The consultations begin with an annual visit to a member country by an IMF staff team whose main tasks are to collect information concerning the economic and financial situation and policies of the member country before holding discussions with its officials. Following the discussions, the IMF staff team prepares and presents a report, constituting a preliminary assessment of the domestic economic and financial situation and recommendations, to the government officials who are invited to make comments on the staff's assessments. A final draft of the staff report, which provides a basis for a discussion among the Executive Directors, is then submitted to the Executive Board. It

includes a summary of key facts and of recommendations with an aim of maintaining or restoring external financial balance. This is then followed by a discussion conclusion (or a so-called 'summing-up') which is reached by the Executive Board and is then passed on to the member country.

During the consultation visits by the IMF staff team in the member country, discussions regarding the probable terms of an IMF loan may be held. Nevertheless, a request for negotiations on an IMF loan must come from the member country itself. Usually, the officials of the member country address the request to the IMF staff or the Executive Director responsible for the region, who then passes it on to the Managing Director. The request and the negotiations which are carried out by officials of the responsible regional department (who also hold the consultations) are confidential and unpublished.

Prior to the departure of the IMF staff team and also the negotiations themselves, the IMF staff team drafts a so-called briefing paper. This contains a summary of the member country's economic situation, possible policy measures, and the probable amount of the IMF loan. If there is a need to obtain more information, a questionnaire will be sent by the IMF to the government officials. After being reviewed by a number of other IMF departments responsible, the briefing paper is then presented to the Managing Director for his approval.

An IMF staff team, which usually visits the member country for two to three weeks, consists of four to six economists and a secretary, headed by a senior IMF official in the regional department responsible. The rest of the team are normally two staff members from the responsible regional department, specialising in the country concerned, a staff member from the Exchange and Trade Relations Department (now the Policy Development and Review Department), and staff members from other IMF departments (such as the Fiscal Affairs Department). In recent years, an increasing number of missions have also included a staff member from the World Bank.

If a request for an IMF loan has been made by the member country, following the task of data-collection, the IMF staff team will carry out an additional task; that is, bargaining and negotiation on the conditionality. The IMF staff team outlines the conditions attached to the loan agreement. In some cases, the preconditions which a requesting country has to meet in order to be qualified for an IMF loan may be included in the

programmes. On the other hand, the government may try to moderate the conditions. Its ability to do so depends on a number of factors affecting its power. However, if the government can resist the IMF's conditions in the negotiations, the whole procedure comes to an end and the IMF staff team leaves the member country.

However, one critic argues that: 'The standard IMF procedure before visiting a client country is to write a draft report first. The visit is only intended to fine-tune the report and its recommendations, and to catch any glaring mistakes.'¹⁰⁶

However, in the case that an agreement is reached, a Letter of Intent will to be drafted, addressed to the Managing Director, and normally signed by the Minister of Finance and the Central Bank Governor of the member country. The Letter of Intent contains a formal request by the member country for a drawing of a certain amount and a detailed description of policy measures to which the member country commits itself. The Letter of Intent also contains performance criteria which are quantitative economic targets allowing the IMF to check quarterly whether the agreement is being kept.

On their return, the IMF staff produces a so-called 48-hour report which contains a two-page summary of the negotiations presented to the Managing Director. The report attached to the draft Letter of Intent is then circulated to the relevant IMF departments which may propose minor changes in the Letter of Intent. The staff then prepares another report for the Executive Board, containing a comprehensive analysis of the country's economic situations and describes the expected effects of the programme measures. The report accompanied by the already-signed Letter of Intent is presented to the Executive Board which holds discussions and make the final decision. The discussions in the Executive Board themselves may have an impact on how the IMF monitors the implementation of the policy measures. It has been a convention that the Executive Board is likely to follow the Managing Director's recommendations. Finally, the detailed report of the Executive Board discussion is transmitted to the requesting country. Then the loan agreement enters into force with the first instalment of the loan can be withdrawn.

¹⁰⁶ Stiglitz, *op. cit.*, p. 47.

When the extent of imposition and ownership is being analysed, one may think that it would be an ideal to look at the process from which IMF conditionality is initially derived until an agreement is signed, separate from the process on how IMF conditionality is put into practice, i.e. the implementation process. However, the analysis in this study cannot afford to ignore the discussions on the implementation of IMF conditionality. First of all, the separation of the two processes would in practice prove difficult. The negotiation and the implementation processes are in fact intertwined; there is no clear-cut division between the end of the negotiation process on IMF conditionality and the beginning of the implementation process. This is partly due to the usage of pre-conditions (conditions that must be implemented prior to IMF Executive Board's approval for IMF credits), and partly to the idea of phasing, involving periodical reviews, particularly in the EFF. Furthermore, the course of an arrangement with the IMF is sometimes marked with waivers or breakdowns which often lead to renegotiations on IMF conditionality in either the same arrangement or a new arrangement. Thus, there are always negotiations on IMF conditionality taking place through out the period of IMF credits, even after an agreement is reached and signed. More importantly, the interweaving of the two processes itself can have an impact on the course of the relationship between the IMF and a borrowing country in question and thus on IMF conditionality. Therefore, the analysis in this study will include discussions on both the negotiation leading to a conclusion of an arrangement, i.e. the signing of a Letter of Intent, and the implementation processes. In other words, it is necessary to look beyond the period between the informal request for the use of IMF credits and the signing of an agreement by broadening the analytical period until the expiration of each agreement.

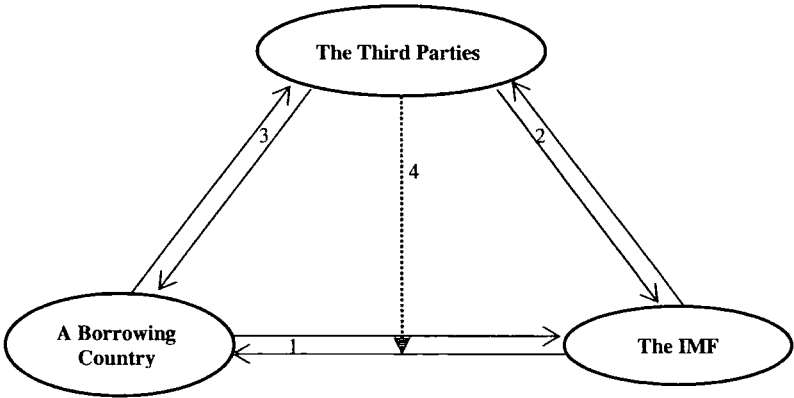
2.4.3 The Notion of a Triangular Relationship

This section aims to construct the idea of a triangular relationship among the three actors: the IMF, the borrowing country and third parties. Before going on to consider the triangular relationship, one may raise the following questions: why does this section deserve a space here or why should the discussions on the role of third parties be left to the next section which will anyway deal with the factors affecting the power of the IMF and the borrowing country? First of all, because one party in the relationship between the IMF and the borrowing country, i.e. the IMF, is not a state, but an international governmental organisation, the characteristics, interests and role of the third parties involved in the relationship are thus diverse. Furthermore, in my opinion the third parties have a great impact upon the way in which the IMF and the borrowing country interact

and their relative power. Thus, I do see a need to create an idea of a triangular relationship in an attempt to provide a clearer picture on the interactions between the IMF and the borrowing country and to highlight the role of the third parties in the interactions, rather than subtly dealing with it in the next section.

Although at a glance, negotiations between the IMF and a borrowing country appear to be bilateral, there may in fact be possibilities for other parties to be involved in the negotiations directly or indirectly. The importance of the third parties in negotiations has been recognised in the literature regarding international negotiations.¹⁰⁷ For example, J. W. Salacuse has concluded that building supportive relationships with strong third parties who are not at the negotiating table was one of the most effective ways for a weaker party to increase its power.¹⁰⁸ As has also been pointed out in Chapter One, in addition to the borrower-lender relationship, there exists a relationship between the IMF and the third parties such as the private commercial banks, the creditor countries, and other IFIs (namely the World Bank). There also exists another type of relationships: one between the borrowing country and the third parties. All these types of relationships form a broader and more complex relationship, which in this study will be called ‘a triangular relationship.’

Figure 2.3 A Triangular Relationship



¹⁰⁷ See, for example, Hopmann, *op. cit.*, ch. 12, pp. 221-243.

¹⁰⁸ Salacuse, J. W., ‘Lessons for Practice,’ in I. W. Zartman and J. Z. Rubin, *Power and Negotiation* (Ann Arbor: U. of Michigan P., 2000), p. 258.

It can thus be useful to conceive of the IMF conditionality negotiations in the wider context of a triangular relationship as summarised in Figure 2.3. From Figure 2.3, the double-head arrows (1, 2 and 3) represent the relationship between two parties in question which is interactive, that is neither party is passive in dealing with the other. The dash arrow (4) represents the impact of the third parties upon the course of the relationship between the IMF and the borrowing country.

The interests of each party in the triangular relationship may not always fall on the same line, although some parties may share similar interests. Neither party is a unitary actor. As for the IMF and the borrowing country, there are several interest groups existing within the two negotiating parties. The internal actors in the borrowing country include decision-making bodies, bureaucratic agencies, interest groups, social classes, and the public. The principal internal actors within the IMF in dealing with the issue of IMF conditionality are the Executive Directors and the Alternates at the Executive Board, the Management (the Managing Director and the Deputy Managing Director(s)) and staff. Due to the existence of various internal actors, the interests of both the borrowing country and the IMF are diverse, and there may be possibilities of internal conflicting interests within each party. The hierarchy of their interests is not immutable; whose interests within each party will prevail depending on who in each party has the final say on the subject matter and their perception and preferences.

The borrowing country's interests include obtaining the IMF's financial support and/or side benefits from reaching agreement with the IMF (such as the gain in international investors' confidence in the country's economy; the restoration of international capital and aid flows; debt rescheduling; and debt cancellation). The borrowing country may simultaneously seek to reduce costs (actual and/or perceived) such as conditions attached to the lending and the perceived adverse consequence of domestic developments arising from agreeing to and adopting the conditions.

As for the IMF, which is a governmental financial organisation, its interests are also broad. Repayment as a way to ensure the revolving nature of its financial resources through the borrowing country's adoption of economic policies forms part of its interests. Other important interests of the IMF can also be found in its functions and purposes assigned to it mainly by the Western industrialised countries. They include lending; surveillance of exchange rate policies; providing technical assistance and publishing; and

ensuring that its member countries pursue their adjustment policies in accordance with its purposes outlined in the Articles of Agreement (see Chapter One).

The third parties are heterogeneous in characteristic; some are private firms, while the others are governments and international financial organisations. For private creditors, namely commercial banks, their involvement in negotiations is motivated by a desire for repayment. The official creditors, the majority of who coordinate their rescheduling negotiations through the Paris Club, also share the similar interest. Since the official creditors are also the governments of states, their interests are multiple and extend beyond the repayment to include the pursuit of foreign policy objectives. When they are in conflict, the official creditors often subordinate the former to the latter. The borrowing country may, if in a position to do so, manipulate/play on the conflicting interests of creditors to their advantage in relation to the IMF. Similar to the IMF, the World Bank has also broad interests, including lending and repayment. With the shared origins and similar organisational structure, the two institutions often cooperate with each other in dealing with the borrowing countries particularly since the 1980s, although at times tensions between them may arise (see Chapter One).

For a similar reason, the third parties do not always form a unified coalition among themselves. How the third parties could have an impact on the power of the IMF and of the borrowing countries will be elaborated on in the following section which will be dealt with the factors affecting the power of the negotiating parties. With the pursuit of their own interests, the third parties may shift in their strategies throughout the course of the negotiations between the IMF and the borrowing country in accordance with their prevailing interests at a particular time.

2.4.4 Factors Affecting the Power of the Parties

To determine the extent of imposition and ownership, one would also need to identify the possible factors affecting the power of each party. By examining the relationship between the IMF and the borrowing country in a broader context of a triangular relationship, a number of factors which have an impact upon the two major parties' power can be identified.

In this study, the factors which could have an effect on the power of each party can be divided into three main 'levels of analysis': individual negotiators; internal factors; and

international factors. In addition to these three level-of-analysis factors, there are also additional factors which do not fall into one of these categories but are crucial elements, constituting part of the determinants of each party's power. Besides their effects upon the power of the parties, these factors may be related to one another; one may have an impact upon another or other factors. We now consider each of these factors in turn.

2.4.4.1 Three Level-of-Analysis Factors

A) Individual Negotiators (The First Level of Analysis)

At the level of the role of individuals, negotiating skills of negotiators can have an impact on the power during negotiations. Good negotiating skills can be a source of power in negotiations. Fred C. Iklé identifies a number of 'rules of accommodation,' which constitute negotiating skills, including avoiding emotionalism and rudeness, and maintaining flexibility.¹⁰⁹ On the other hand, the insufficiency or lack of negotiating skills represents a weakness of or constraint on the negotiating party, respectively.

B) Internal Considerations (The Second Level of Analysis)

Factors Affecting the IMF's Power – Creditors/Donors' Political Influence

The major donors and creditors of the borrowing countries are also the major creditor countries to the IMF, namely the five members whose quotas and also votes are the largest (the US, Japan, Germany, France and the UK). With the largest quotas and votes, they are in a position to exert their influence on decision on IMF conditionality through informal discussions. As John Loxley points out: 'In practice, in the Executive Board, decisions are usually arrived at by consensus and hence informal influence and lobbying is more important there than the exercise of formal voting power.'¹¹⁰ Whether the donor/creditor political influence will act as a source of or a constraint on the power of the IMF depends upon the relationships between the donors/creditors and the borrowing country.

Some commentators argue that the role of the IMF in debt rescheduling had 'undermined its capacity to perform its policy role.' It was asserted that 'creditor government concern

¹⁰⁹ Iklé, F. C., *How Nations Negotiate* (New York: Frederick A. Praeger, 1967), ch. 7, pp. 87-121.

¹¹⁰ Loxley, J., *Debt and Disorder: External Financing for Development* (Boulder: Westview P., 1986), p. 89.

with speedy debt relief can, in some instances, bring pressure to bear on the IMF to reach a credit agreement without insisting on the usual policy conditionality, or to draw up a programme that it knows is unlikely to be carried out by the debtor government.’¹¹¹

Factors Affecting the Borrowing Country’s Power

i) Internal Reactions: Political Development, Socio-Economic Impact and Internal Unrest

The importance of domestic considerations in international negotiations is highlighted by Robert Putnam in his model of ‘two-level games’ which seeks to account for the interaction of diplomacy and domestic politics.¹¹² Here, he argues that when engaging in international negotiations, a party has to negotiate not only with its counterpart negotiating party in question, but also simultaneously with its own internal actors. The Putnam model conjectures that negotiating parties can benefit from their domestic constraints by exploiting the latter. The domestic constraints can, thus, act as a source of the power to the exploiting party: ‘I’d like to accept your proposal, but I could never get it accepted at home.’¹¹³

Although they are meant to be beneficial in the long term, economic policy measures containing in IMF conditionality often have certain adverse effects, at least in the short-term, on various groups in the society. The distribution of such effects are various among different sectors of the economy and different groups of the society. For instance, the poor and workers are likely to be worse off as a result of a cut in government spending in areas such as subsidies and an increase in the price of imported foodstuff arising from devaluation. Trimming government budget through a reduction in public wages and salaries and privatisation will affect public employees. Such policy measures could provide the conditions for the occurrence of social protests and violent riots. Such social resistance is, among others, one of the hurdles to the successful implementation of IMF conditionality. This is likely to be used by the borrowing country as an argument for less

¹¹¹ Brown, R. P., ‘The IMF and Paris Club Debt Rescheduling: A Conflicting Role?’, *Journal of International Development*, vol. 4, no. 3, 1992, p. 292.

¹¹² Putnam, R. D., ‘Diplomacy and Domestic Politics: The Logic of Two-Level Games,’ in P. B. Evans, H. K. Jacobson, and R. D. Putnam, *Double-Edged Diplomacy: International Bargaining and Domestic Politics* (Berkeley: U. of California P., 1993), pp. 431-468. See also Putnam, R. D., ‘Diplomacy and Domestic Politics: The Logic of Two-Level Games,’ *International Organization*, vol. 42, summer 1988, pp. 427-460.

¹¹³ Putnam, *op. cit.*, 1993, pp. 441-442.

severe IMF conditionality. In particular, the previous occurrence of social unrest is likely to provide a stronger ground and thus add to the borrowing country's power in conditionality negotiations. This factor can be more effective when it works in conjunction with the donors/creditors political influence within the IMF. Therefore, the power of the borrowing countries can be enhanced by previous or perceived domestic reactions to economic policy measures.

ii) Economic Circumstances

The power of the borrowing country can also be affected by its economic circumstances. By and large, the borrowing countries approach the IMF after their balance of payments deficits have become unmanageable. However, in some cases, the talks with the IMF are precautionary, even though there are no obvious signs of balance of payments crises. The severity of an economic crisis experienced by the borrowing country represents a constraint on the power of the borrowing country. The more severe the initial economic situation of the borrowing country, the less power it is likely to have. An improvement in economic circumstances can, on the other hand, act as a positive input to its power.

Several good indicators of the borrowing countries' economic circumstances include the level of foreign reserves and/or the import cover (i.e. the ratio of the level of their non-gold foreign reserves to imports expressed in terms of the number of months). This is because foreign reserves can be used to settle balance of payments deficits and also have an impact on imports of the borrowing country. Other economic indicators are current and capital balance of payments, inflation, unemployment, and government budget deficit.

C) The International Context (The Third Level of Analysis)

The international context (which includes regional issues) within which negotiations are taking place can also alter on the power of the parties. The parties involved both directly and indirectly in the negotiations are not completely independent actors but form integral parts of the international system which is subject to constant change. The major developments in the contemporary international relations are likely to have an impact on perceptions and interests of these parties and also on other factors affecting the power of the negotiating parties such as economic circumstances. Through such an impact, the power of the negotiating parties is in turn likely to change.

Barbara Stallings points out that the condition of the international economy, and thus the degree of constraints they face, are fluctuating factors that will be relevant for the developing countries in determining their bargaining stances.¹¹⁴ However, Stallings' argument represents only part of the story since the changing condition of the international economy may also have a positive effect upon the countries' bargaining stances; i.e. it becomes a source of their power, and at the same time, has effectively a negative impact upon the IMF – it acts as a constraint on its power. Therefore, the broader context may act in favour to the parties, or provide the basis upon which the parties themselves may be able to exploit to their advantage. It may, on the other hand, act against the parties' power.

2.4.4.2 Additional Factors

In the context of conditionality negotiations, however, there remain some factors contributing to the relative power of the negotiating parties that do not sit comfortably within such clearly demarcated levels of analysis. I refer to these as 'additional factors,' which nonetheless can be linked to the level-of-analysis factors.

A) Additional Factors for the IMF

i) Cooperation among Creditors/Donors: Cross-Conditionality

The ability of creditors to cooperate in making their lending decision for the borrowing/debtor countries can increase the power of the IMF. Particularly there is at the same time a lack of coordination among debtor countries, due in part to strategic side payments by creditors to the key debtor countries and those who refuse to participate in a debtor cartel.¹¹⁵ This results in all negotiations over debt rescheduling and also adjustment programmes conducted on a case-by-case basis and, thus, weakens the negotiation stance of the borrowing/debtor countries.

The method commonly used by creditors in reinforcing their position is cross-conditionality. This was developed particularly since the 1980s following coordination among creditors in dealing with the borrowing/debtor countries regarding the issue of indebtedness. Stephany Griffith-Jones defines the term 'cross-conditionality'

¹¹⁴ Stallings, B., 'International Influence on Economic Policy: Debt, Stabilization, and Structural Reform,' in S. Haggard and R. Kaufman, *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts, and the State* (Princeton, N. J.: Princeton U. P., 1992), p. 57.

¹¹⁵ *Ibid.*, p. 67.

to exist where 'acceptance by the borrowing country of the conditionality of one financial agency is made a pre-condition for financial support by the others.'¹¹⁶ It is the acceptance of IMF conditionality which is most often set as a pre-condition before the borrowing country is able to obtain financial resources from other financial agencies.¹¹⁷ The IMF's 'seal of approval' is often required by other creditors and donors before the latter grant their own. This means that unless the borrowing country first agrees to a package of economic policy measures with the IMF, other creditors are reluctant to provide financial support in terms of new loans, debt rescheduling and debt relief to the developing countries in debt arrears. Therefore, coordination among creditors and cross-conditionality help strengthen the power of the IMF. At the same time, they weaken the borrowing country's power since it results in a reduction in the room to manoeuvre of the borrowing countries.

ii) 'Social Learning' and Technocratic Alliances

Miles Kahler has pointed out the significance of 'social learning' which can affect the beliefs, interests and perceptions of the internal actors within the borrowing country, particularly the negotiators themselves. The IFIs and other external agencies may be able to shape the process of learning by the government in directions that will lead to greater alignment with their economic policy preferences, for example, through the government technocrats, particularly who trained as economists at American or European universities.¹¹⁸ However, it should be pointed out that how successful the technocratic alliances in shaping the outcomes depends on the autonomy of economist technocrats delegated to them by the political leadership or on whether they manage to obtain support from the decision-making bodies such as their cabinet colleagues and the president.

B) Additional Factors for the Borrowing Countries

In addition to the three-level factors, a number of factors, which mostly involve political influence of the third parties, can affect the power of the borrowing country. They include: the size of debts; geopolitics; colonial past; and the availability of non-conditional financial resources.

¹¹⁶ Griffith-Jones, S., 'Cross-conditionality or the Spread of Obligatory Adjustment: A Review of the Issues and Questions for Research,' in E. Rodríguez and S. Griffith-Jones (eds.), *Cross-Conditionality Banking Regulation and Third-World Debt* (Basingstoke: MacMillan P., 1992), pp. 53-54.

¹¹⁷ *Ibid.*, p. 60.

¹¹⁸ Kahler, M., 'External Influence, Conditionality, and the Politics of Adjustment,' in Haggard and Kaufman, *op. cit.*, 1992, pp. 123-131.

i) The Size of Debts

Because the effect of the borrowing country's debt size upon its relative power may be different from economic circumstances in general, it deserves to be looked at separately from the section of economic circumstances. As previously discussed, the worsening of economic indicators other than the size of debt is likely to have a negative impact on the borrowing country's power. On the contrary, the borrowing country may actually benefit from its large size of debts. Stephan Haggard and Robert Kaufman found that the large debtors fare better than smaller ones in the interest rates, maturities, and grace periods they receive, and in securing additional forms of relief and unorthodox rescheduling agreements and adjustment packages.¹¹⁹ This factor is linked with the relationship between the borrowing country and the third parties, particularly the official creditors. The latter can put pressure on the IMF to reach an agreement with a particular borrowing country, often a large debtor, due partly to concern over their national financial institutions.¹²⁰ In other words, a small size of debts is a country's problem; but if the size of debts is large, then it is the lender's problem since this threatens the lenders', especially commercial banks', solvency. As H. James points out in the case of Mexico:

Any Mexican action threatened bank's solvency, since if there were no agreement, and interest payments on loans were to be suspended, the loans would have to be reclassified as nonaccruing. The lenders had every interest in avoiding such a step, and could in consequence be coerced into being compliant over additional lending.¹²¹

ii) Geopolitics

Similarly to the size of debts, geopolitics is also linked to the borrowing country's relationship with the third parties. However, it is specifically related to the official creditors, namely those which are the major creditor governments of the IMF. Special relationships between the borrowing country and the official donors or creditors, especially the US, can provide a source of power to the former vis-à-vis the IMF. The borrowing country's power can be augmented by direct and/or indirect support provided to them by the official creditors. Direct support is through their dominant power within the IMF. The IMF is said to be sometimes prevented from applying the principle of

¹¹⁹ Haggard, S. and R. Kaufman, 'The Politics of Stabilization and Structural Adjustment,' in J. D. Sachs, (ed.), *Developing Countries Debt and the World Economy* (Chicago: U. of Chicago P., 1989), pp. 264-265.

¹²⁰ Kahler, *op. cit.*, 1992, p. 113.

¹²¹ James, H., *International Monetary Cooperation Since Bretton Woods* (Washington, D. C.: International Monetary Fund; New York: Oxford U. P., 1996), p. 366.

uniformity of treatment by the lobbying of its major creditors (industrial country governments) to secure easy terms for favoured borrowing countries, in pursuit of foreign policy and security goals.¹²² Indirectly the official creditors can provide their support to the borrowing country through the provision of financial assistance to the latter. Stephan Haggard and Robert Kaufman, by pointing to countries such as Zaire and Turkey, argue that a number of states have manipulated their strategic position or concern about domestic political instability to gain additional assistance.¹²³ On the other hand, the soured relationship of the borrowing countries and the major shareholders of the IMF can have an adverse impact on their power. The left-wing government of Tanzania in the early 1980s faced an IMF mission instructed to take a tough line.¹²⁴

iii) Colonial Past

Many developing countries, especially the Francophone countries in Africa, are closely linked with their former colonies. They peg the exchange rates of their domestic currencies to those of their former colonial powers and their trade are carried out mainly with them. The former colonial powers have the significant voting power in the IMF's Executive Board. The support from the former colonial powers to the borrowing country would strengthen the latter's power in relation to the IMF.

iv) The Availability of Non-Conditional Financial Resources

The availability of non-conditional financial resources can reinforce the power of the borrowing country during the negotiations. It helps lessen the severity of the borrowing country's balance of payments deficit and also reduce its need for the IMF's financial and policy package. Stephan Haggard and Robert Kaufman point out the importance of 'nonconditional resources,' which help shift the bargaining power towards the debtor countries and make them less likely to accept IMF conditionality.¹²⁵ The possible sources of alternative financial resources include the sudden improvement in the borrowing country's exports and its export earnings, financial assistance from the third parties as well as private capital flows.

¹²² Killick, T., *IMF Programmes in Developing Countries: Design and Impact* (London: Routledge, 1995), p. 118.

¹²³ Haggard and Kaufman, *op. cit.*, 1989, pp. 265-266.

¹²⁴ Killick, *op. cit.*, 1995, p. 119.

¹²⁵ Haggard and Kaufman, *op. cit.*, 1989, pp. 266-267.

Barbara Stallings argues that if a country has a large market and valuable natural resources, private-sector firms will require fewer incentives to enter.¹²⁶ While the availability of such international capital flows can provide additional resources to the borrowing country's bargaining power, the lack of them represents constraints. To some developing countries, access to alternative sources of lending, especially from private commercial banks, could be limited. As Irving Friedman clearly explains:

[B]ecause they depend upon full and prompt servicing of their loans for their financial profitability and viability, private banks (in contrast to the Fund and the Bank) understandably tend to focus their activities upon the best managed countries, and, within these countries, the best managed firms in the most advanced sectors of the economy.¹²⁷

Summary

This chapter has examined the evolution of IMF conditionality and the major concern raised regarding the nature of IMF conditionality. It has also developed an analytical framework which consists of the concept of power, the lending process, the notion of a triangular relationship, and the power determinants. The framework suggests that it is unhelpful and insufficient to consider the two schools of thought (imposition and ownership) solely as dichotomous or mutually exclusive alternatives. The following chapters will demonstrate that, in any set of negotiations and resulting agreements, between the IMF and the borrowing country, there will be a process of bargaining, based on relative power, that results in a combination of imposed and "owned" elements, which leads to the conclusion that these exist along a spectrum between imposition and ownership.

Thus, this chapter has argued that although there appears to be an imbalance of power (as endowed resources) between the IMF and the borrowing country, discussed in Chapter One, there may exist room to manoeuvre for the borrowing country which can alter its position along the spectrum. This depends on the availability of factors affecting the power of each party and the tactics used by parties in utilising these factors to their advantage. The framework built up in this chapter will provide direction and guidelines in analysing the nature of IMF conditionality in the case of Egypt.

¹²⁶ Stallings, *op. cit.*, p. 57.

¹²⁷ Friedman, I. S., 'Evaluation of Risk in International Lending: A Lender's Perspective,' in Federal Reserve Bank of Boston, *Key Issues in International Banking* (Boston: Federal Reserve Bank of Boston, 1977), p. 119. Cited in James, *op. cit.*, 1996, p. 360.

PART II

The Nature of IMF Conditionality in the Case of Egypt: 1960-1998

Introduction

Egypt has had a long relationship with the IMF, which can be traced back to when it was one of 44 countries represented at the Bretton Woods Conference in July 1944. 29 countries, including Egypt, joined the IMF by signing the Articles of Agreement on 27 December 1945.¹ Despite the long-standing relationship between the two parties, the relationship between the IMF and Egypt (and also many other borrowing countries) with regard to the upper credit tranche lending (with conditionality attached) is in fact episodic in character. The IMF's upper credit tranche lending to Egypt, similar to the lending to many of its member countries, occurred at irregular intervals. This sporadic feature of IMF lending is partly due to its focus on dealing with difficulties of balance of payments. It also depends upon the demand factors: the timing of the balance of payments problems faced by the member countries and their subsequent requests for IMF lending. Table II.1 summarises the upper credit tranche arrangements of the IMF to Egypt since the latter joined the IMF in December 1945. Between the 1960s and 1990s, Egypt concluded six SBAs and two EFFs. The four decades were marked by several failures on the part of Egypt to fully implement the policy programmes reached with the IMF. Out of eight policy programmes, six were abandoned without completion: the SBAs of 1962, 1964, 1977, and 1987; and the EFFs of 1978 and 1993. Thus, in its long history with the IMF, only the policy programmes under the 1991 and 1996 SBAs were fully implemented.

¹ Horsefield, J. K., *The International Monetary Fund 1945-65: Twenty Years of International Monetary Cooperation*, vol. 1: *Chronicle* (Washington, D. C.: International Monetary Fund, 1969), p. 116.

Table II.1 Egypt's Agreements with the IMF (in millions of SDRs, otherwise stated)

Types of Facility	Date of Inception (Effective Date)	Date of Expiration or Cancellation	Period of Agreement	Amount Agreed	Amount Drawn	Implementation
1960s						
SBA	7 May 1962	6 May 1963	1 year	US\$ 42.5 million ^a	US\$ 38 million ^a	Not fully implemented
SBA	23 May 1964	22 May 1965	1 year	US\$ 40 million ^a	US\$ 25 million ^a	Not fully implemented
1970s						
SBA	20 April 1977	19 April 1978	1 year	125	105	Not fully implemented
EFF	28 July 1978	27 July 1981	3 years	600	75	Not fully implemented, suspension of the second tranche
1980s						
SBA	15 May 1987	30 November 1988	1 ½ years	250	116	Not fully implemented, suspension of the second tranche
1990s						
SBA	17 May 1991	31 May 1993 ^b	2 years ^c	234.4 ^d	147.2	Fully implemented
EFF	20 September 1993	19 September 1996	3 years	400	0 ^e	Not fully implemented
SBA	11 October 1996	30 September 1998	2 years	271.4	0 ^e	Fully implemented

Sources: Most of information for the 1980s and 1990s is drawn from International Monetary Fund, 'Egypt: History of Lending Arrangements [online],' 31st Mar. 2001. Available from: <http://www.imf.org/np/tre/tad/extra...?key=2001%2D03%2D31%2000%3A00%3A00> [accessed 3rd May 2001]; and IMF, *Annual Report*, various years. For the earlier period, the information is drawn from IMF, *International Financial Statistics Yearbook*, various years; IMF, 'Press Release,' in *IMF Survey*; and the IMF's confidential documents.

Note: ^a at that time, SDRs had not come into existence;

^b extended from 30 November 1992, 1 March 1993, and 22 March 1993;

^c extended from the initial period of 1 ½ years;

^d decreased from SDR 278.00 million; and

^e the authorities indicated their intention not to draw under the arrangements.

SBA = Stand-By Arrangement; EFF = Extended Fund Facility

The following chapters examine the nature of IMF conditionality in the case of Egypt. Although the study covers the period since the 1960s, the focus will be on the period of the 1970s onward. This is due largely to the fact, as has been pointed out in Chapter Two, that it is in the second half of the 1970s that IMF conditionality has become internationally controversial.

The study of the nature of IMF conditionality in the case of Egypt is divided into four major periods: the 1960s; 1974-1979; 1985-1988; and 1989-1998. These periods will be dealt with in Chapters Three-Six, respectively. The period of the 1960s is distinct from the other periods in many major aspects. First of all, this period is characterised by a different domestic environment. It was set in the pre-Open Door policy with the pursuit of ISI and populist/socialist policies under Nasser's regime. Moreover, as has been pointed out in Chapter Two, IMF conditionality at that time was rather limited in scope, focusing largely on stabilisation policy. Thus, it was by-and-large less controversial. The second period witnessed the development of controversy over IMF conditionality. Also, during the period 1974-1979, Egypt underwent both political and economic changes: the change in its leadership from Nasser to Sadat following the former's death in 1970; and the introduction of the Open Door (*Infitah*) policy in 1974. The main features of the following period (1985-1988) are the international debt crisis of the 1980s and another change in the leadership in Egypt to Mubarak following the death of Sadat in 1981. It was during the final period that, for the first time since the 1964 agreement, Egypt remained on course with an agreement with the IMF for its full term (the 1991 SBA) and, more importantly, that the policy programme under that agreement was fully put into practice, again for the first time in its history. In addition, the international environment had altered in this period, namely the end of the Cold War. In this regard, it would, therefore, be appropriate and helpful to consider the subject matter into the four main periods.

Chapters Three, Four, Five, and Six will be divided into three major sections. They will begin with a background on why Egypt needed the IMF and the relevant context. The second section provides a narrative of the interaction between Egypt and the IMF regarding IMF conditionality in the upper credit tranche loans. As has previously argued in Chapter Two, by merely focusing on the process until an agreement is concluded and ignoring the subsequent implementation, the picture obtained from the

study would be rather narrow and may even be distorted. The broadening of the period of coverage would allow one to apprehend more accurately the nature of IMF conditionality. Therefore, the study attempts to remedy this shortcoming by including in the discussions the period after the signing of the agreement in the narrative section dealing with the case of Egypt. Last, but not least, the relative power held by the two parties will be determined in the final section. Here the nature of IMF conditionality regarding the question of imposition-ownership will also be assessed.

Chapter Three

Nasser's Great Reluctance: The 1960s

Introduction

Chapter Three is concerned with the nature of IMF conditionality in the case of Egypt during the 1960s. This period witnessed Egypt's continuing efforts to seek the upper credit tranche loans from the IMF. The balance of payments crises had forced the country to resort to IMF financial assistance, culminating in two SBAs of 1962 and 1964. The second half of the 1960s was marked by several failed attempts to conclude another SBA. Following the two SBAs, subsequent attempts to gain financial assistance from the IMF were also made by the Egyptian governments, but the two parties were unable to reach any formal agreement. Although another agreement was almost reached in 1967, due to the outbreak of the 1967 war against Israel, Egypt's request for a SBA was withdrawn.

Prior to the second half of the 1950s, Egypt's drawings from the IMF were very limited, amounting to only SDR 3 million during the period 1947-55.¹ Table 3.1 shows the position of Egypt in the IMF during the period 1956-69. It indicates that Egypt made total drawings (or purchases) of SDR 273.7 million. The drawings from the IMF became intense during the period 1960-65. They amounted to SDR 173.2 million, representing about 63.3 per cent of the total drawings. During the period between the 1950s and 1967, most of the drawings were the ordinary credit tranche drawings, with some exceptions of SBAs in 1962 and 1964, and Compensatory Financing Facility (CFF) drawings of SDR 16 million during the period 1963-67. Egypt was one of the three countries (Brazil and Egypt in 1963, and Sudan in 1965) to use the CFF during the first three years of its existence.²

¹ International Monetary Fund, *International Financial Statistics Yearbook*, 1981, p. 12.

² de Vries, M. G., *The International Monetary Fund, 1966-1971: The System Under Stress*, vol. 1: *Narrative* (Washington, D. C.: International Monetary Fund, 1976), p. 263; and Horsefield, J. K. (ed.), *The International Monetary Fund 1945-65: Twenty Years of International Monetary Cooperation*, vol. 2: *Analysis* (Washington, D. C.: International Monetary Fund, 1969), p. 423.

Table 3.1 Egypt's Financial Position in the IMF, 1956-1969 (in millions of SDRs)

Years	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
All drawings	15	15	-	-	34.8	10	67.4	21	25	15	7.5	-	63	-
Repayments by repurchase	-	-	-	2.7	9.6	12.7	10	2.5	12	28.5	28	-	69.2	24
Use of Fund credit	-	15	15	12	30	27	85	103	109	95	70	74	72	51
Of which														
Ordinary credit tranche drawings	-	15	15	12	30	27	85	87	93	79	51	51	38	14
Compensatory Financing Facility	-	-	-	-	-	-	-	16	16	16	16	16	23	23
Standby Arrangements: Amount drawn	-	-	-	-	-	-	38	-	25	-	-	-	-	-
Undrawn balance	-	-	-	-	-	-	5	-	15	-	-	-	-	-
Extended Fund Facility: Amount drawn	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Undrawn balance	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Oil Facility	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Trust Fund Loans Outstanding	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Quota	60	60	60	60	90	90	90	90	120	120	150	150	150	150
Fund holdings of currency	60	75	75	72	120	117	175	193	229	215	220	224	222	201
Per cent of quota	100	125	125	120	133	130	194	215	191	179	147	149	148	134

Sources: International Monetary Fund, *International Financial Statistics Yearbook*, 1981, pp. 12-13, 16-17, 26-27, and 1983, pp. 202-203.

Section A: Background

During the last decade prior to Egypt's approach to the IMF, Egypt's balance of payments was characterised by trade deficits, which were financed in part by surpluses in services account and, at times, by net transfer and capital inflows. The overall balance of payments was persistently in deficit throughout this period (see Table 3.2). Nonetheless, Egypt encountered little difficulty in meeting its balance of payments deficits, which were financed mainly out of net gold and foreign exchange reserves accumulated during the Second World War. Therefore, prior to the early 1960s, there was little need for Egypt to negotiate an upper-credit tranche loan with the IMF.

The depletion of Egypt's foreign exchange reserves served as a catalyst for the first-time negotiations between Egypt and the IMF over the use of IMF credit under an SBA. By 1961, it had become clear that Egypt's foreign exchange reserves accumulated during the Second World War were exhausted. Its net gold and foreign exchange reserves declined from LE 379 million in 1945 to LE 16 million in 1961, and even

turned into a negative value of LE -7 million at the end of 1962.³ Several developments further caused the Egyptian government to run down its foreign exchange reserves. Unlike its moderate development efforts in the 1950s, the Egyptian government engaged in a large development programme, particularly the building of the Aswan High Dam which incurred a high level of financing not only for the building itself but for the resulting displacement of Nubians. Also, the poor performance of Egypt's major commodity exports in the early 1960s contributed to the loss of its income in terms of foreign currencies. This was due partly to the failure of the cotton crop caused by cotton leaf worm and partly to the reduction in rice supply caused by a low flood of the Nile.

Table 3.2 Egypt: Balance of Payments, 1950-1969 (in millions of Egyptian pounds)^a

Year	Exports ^b (f.o.b.)	Imports (c.i.f.)	Trade Balance	Net Service	Net Trade and Services	Net Transfers	Net Capital Inflow ^c	Net Transfers and Capital ^c	Overall Balance
1950	190.2	-208.9	-18.7	8.3	-10.4	--	-1.5	-1.5	-11.9
1951	204.5	-233.8	-29.3	12.9	-16.4	--	-1.4	-1.4	-17.8
1952	148.8	-208.2	-59.4	6.0	-53.4	--	-3.8	-3.8	-57.2
1953	137.7	-166.7	-29.0	21.1	-7.9	--	-1.4	-1.4	-9.3
1954	144.2	-156.2	-12.0	14.2	2.2	--	-2.8	-2.8	-0.6
1955	139.1	-201.3	-62.2	18.1	-44.1	--	12.3	12.3	-31.8
1956	132.5	-206.3	-73.8	24.2	-49.6	10.5	2.2	12.7	-36.9
1957	167.0	-218.9	-51.9	18.3	-33.6	3.7	-19.8	-16.1	-49.7
1958	163.1	-215.8	-52.7	31.6	-21.1	0.1	-1.3	-1.2	-22.3
1959	167.3	-240.6	-73.3	26.2	-47.1	4.8	19.6	24.4	-22.7
1960	203.7	-269.0	-65.3	30.7	-34.6	4.4	10.8	15.2	-19.4
1961	164.9	-248.6	-83.7	22.3	-61.4	4.5	31.6	36.3	-25.3
1962	145.2	-308.5	-163.3	30.8	-132.5	12.8	78.8	91.6	-40.9
1963	228.8	-405.8	-177.0	50.2	-126.8	-0.4	97.2	96.8	-30.0
1964	227.6	-402.8	-175.2	47.5	-127.7	5.4	113.0	118.4	-9.3
1965	246.8	-417.0	-170.2	56.5	-113.7	8.7	67.9	76.6	-37.1
1966	259.5	-414.3	-154.8	74.3	-80.5	5.2	50.4	50.6	-24.9
1967	258.7	-415.2	-156.5	26.9	-129.6	58.3	39.6	97.9	-31.7
1968	288.7	-369.1	-80.4	-27.4	-107.8	110.4	6.1	116.5	8.7
1969	319.7	-418.4	-98.7	-33.6	-132.3	128.8	-37.0	91.8	-40.5

Source: International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Acting Secretary, *Arab Republic of Egypt – Recent Economic Developments*, SM/76/183, confidential, 18 Aug. 1976, app. II, Table 45, p. 98.

a. LE 1 = SDR 2.87 before 1963; SDR 2.30 between 1963 and 1969.

b. From 1962 exports include transit trade; before 1962 transit trade was included in services.

c. Includes net errors and omissions and SDR allocations.

³ Hansen, B. and G. A. Marzouk, *Development and Economic Policy in the UAR (Egypt)*, (Amsterdam: North-Holland, 1965), pp. 189-190.

In addition to the domestic circumstances, the military and political developments of Egypt's foreign relations during Nasser's regime brought about a further loss in Egypt's foreign exchange reserves. The international context during the second half of the 1950s was characterised by the Cold War between the West and the USSR and the Non-aligned Movement in the Third World. The West's attempts to bring Egypt into the Baghdad Pact (part of the West's policy to contain Soviet expansion) met with Nasser's refusal to join in. He believed that this would lead to growing Western influence in the Middle East, especially given that its members included Britain, and would also keep the Arab world divided.⁴ When the US proved reluctant to sell arms to Egypt, the latter formed closer ties with the USSR and the Eastern Bloc. It received military and industrial aid as well as finance for the Aswan High Dam from the USSR. The refusal of the US and Britain to finance the Aswan High Dam, in the light of Egypt's arms purchase from Czechoslovakia in September 1955 and its recognition of communist China in the spring of 1956, was followed by Egypt's response of nationalising the Suez Canal. The incident further deteriorated Egypt's relations with the West, culminating in the 1956 war. Several of the Egyptian government's reactions to such developments incurred heavy obligations in the form of compensation payments to the relevant parties, namely the shareholders in the nationalised Suez Canal Company and foreign owners of nationalised property. As a result, the Egyptian government decided to resort to IMF financial assistance.

By the early 1960s, Egypt had become one of the heaviest users of IMF financial resources. In 1960, Egypt's quota in the IMF was raised to SDR 90 million from SDR 60 million in the previous year. Despite the increase in its quota, the IMF's holdings of its currency as a percentage of quota went up from 120 per cent to 133 per cent, with a rise of IMF credit used from SDR 12 million to SDR 30 million during the same period (see Table 3.1).

Since 1952, it had been IMF policy that a restriction should be placed on the period for which its members would have continuous use of its financial resources. According to this policy, the repurchase of drawings was to be undertaken within three to five years and any further drawing before the complete repurchase of a present drawing required a

⁴ Heikal, M., *Nasser: The Cairo Documents* (London: New English Library, 1972), p. 56; and Manfield, P., *Nasser's Egypt* (Harmondsworth: Penguin, 1965), p. 84. See also Alterman, J. B., 'American Aid to Egypt in the 1950s: From Hope to Hostility,' *Middle East Journal*, vol. 52, no. 1, winter 1998, pp. 51-69.

justification (see Chapter Two). However, during the period 1946-65, there were nine countries (including Egypt) which made continuous use of the IMF's financial resources and of whose currencies the IMF held more than 100 per cent of their quotas for more than sixty consecutive months. As for Egypt, the IMF held more than 100 per cent of its quota for 106 months which was the top figure on the list.⁵

Section B: Narrative

3.1 The May 1962 Stand-By Arrangement

In order to alleviate its balance of payments problems, Egypt approached the IMF for its first SBA. The negotiation process for the 1962 SBA between Egypt and the IMF began as early as the second half of April 1961 when a round of informal discussions was held in Cairo on the possibility of a stabilisation programme. After one year of negotiations, agreement was reached between the two parties in the second half of April 1962 and a Letter of Intent was drafted. Ultimately, this led to the IMF Executive Board's approval on 4 May 1962 of Egypt's request for a one-year SBA in an amount equivalent to US\$ 42.5 million.⁶ The Board approved the requested SBA on the condition that drawings would not exceed US\$ 20 million in the first three months, US\$ 30 million in the first six months, and US\$ 37.5 million in the first nine months. The repurchase of the drawings would be made over a three-year period.⁷

In the Letter of Intent, the Egyptian government pledged to implement an economic programme with several measures and policies.⁸ Monetary policy was to be tightened with a number of credit ceilings, a rise of the Central Bank of Egypt (CBE)'s discount rate from 3 to 5 per cent, and an increase in the reserve requirements for commercial banks from 12 ½ per cent to 17 ½ per cent. The latter two were to be implemented no later than 15 May 1962. Price controls were to be dismantled with the aim of eventual elimination. With regard to the exchange rate reform, the practice of premiums was to be abandoned. In addition, a new exchange rate of US\$ 2.30 per Egyptian pound for all

⁵ Horsefield, *op. cit.*, vol. 2, pp. 446-447. The other eight countries were Argentina, Turkey, Brazil, Yugoslavia, Bolivia, Paraguay, Syrian, and Honduras.

⁶ IMF Central Files, C/U.A.R./1760, Stand-by Arrangement, 1952-1963, 'United Arab Republic – 1961 Article XIV Consultations, Request for Stand-By Arrangement, and Change in Terms of Previous Drawings,' EBM/62/21, 4 May 1962, p. 17.

⁷ Horsefield, J. K., *The International Monetary Fund 1945-65: Twenty Years of International Monetary Cooperation*, vol. 1: *Chronicle* (Washington, D. C.: International Monetary Fund, 1969), pp. 525-526.

⁸ For more details on IMF conditionality under the 1962 SBA, see Appendix A.

exchange transactions was to be announced no later than 15 May 1962 and prior to any request for a drawing under the SBA. Export taxes were to be imposed temporarily in order to prevent windfall profits from exports following the introduction of a new exchange rate. To facilitate price adjustment, subsidies on essential foodstuffs such as wheat, flour, kerosene, edible oil, and sugar, were retained, but their amount would be gradually reduced. There were also import policies including the establishment of an open general license no later than 1 July 1962 for a substantial proportion of permitted imports. The use of import duties was to be increased whereas the use of quotas and outright prohibitions on nonessential goods was to be decreased. Also state owned or controlled importing agencies were to be allowed to make import decisions on a commercial basis and given freedom to choose sources of supply. Bilateral payments agreements with IMF members were to be terminated at the earliest possible date and not later than present termination dates. There would be neither introduction and intensification of any restrictions on current payments and transfers, nor introduction of any multiple currency practice.

An outline of a stabilisation programme was first proposed by the IMF team, mainly dealing with the fiscal, monetary, and external sector and with exchange rate policies. It included: a limitation of an increase in bank credit for the public and the private sectors; fiscal measures to reduce government expenditures or to increase its revenues; an increase in the interest rate structure; gradual steps towards import liberalisation to allow importers to make a decision on what to import and how much with a preference of tariffs over restrictions; a reduction in dependence on bilateral arrangements; and a realistic exchange rate policy.⁹

During the negotiations, a discrepancy between the two sides emerged over the extent of the needed policy programme, rather than its merits. On the one hand, although the Egyptian team agreed to the need for a policy programme proposed by the IMF, it viewed the IMF staff's proposal as being unnecessarily severe. On the other hand, the IMF team stressed that a considerable reorientation of policy in Egypt was needed and felt that Egypt's proposals were insufficient to justify a SBA. The gap lay in several key issues, including credit control, devaluation, the elimination of bilateral payments

⁹ IMF Central Files, C/U.A.R./810, Mission John W. Gunter, Apr. 1961, 'Notes on a Stabilization Program for the Egyptian Region,' in International Monetary Fund, *Minutes of Meetings*, held in Cairo, Egypt, confidential, 17 and 20 Apr. 1961.

agreements, and limiting import restrictions.¹⁰ With regard to credit control, the credit limitation to an annual rate of LE 20 million proposed by the IMF team was unacceptable to the Egyptian team in the light of Egypt's need to continue its development programme. Concerning the exchange rate policy, the Egyptian team counter-proposed to reduce the number of effective rates and to establish one rate involving a depreciation of about 19 per cent. However, this was regarded as inadequate by the IMF team which argued for an effective devaluation from the par value of approximately 30 per cent. As for the other issues, the Egyptian team agreed to eliminate most, but not all, of their bilateral agreements with IMF members. Also it was not prepared to make any substantial relaxation of import restrictions.

Such reluctance on the part of the Egyptian team to accept IMF demands was reflective of the extent of the cost that the Egyptian government expected to deal with. The Egyptian team was apparently concerned that such IMF demands would create several short-term economic problems such as a severe limitation on its ambitious development programme, especially the industrial programme, hindered economic growth and a substantial rise in prices. More importantly, a greater concern seemed to be that IMF conditionality was associated not only with economic, but also political costs. The fear was that IMF conditionality could carry political costs itself or that its economic costs might easily feed into the political costs.

Egypt's request for IMF financial assistance came at the time when the Nasser regime followed the socialist/populist path and the ISI strategy in its economic development. The regime's economic approach was largely driven by notions of national unity in terms of minimum class conflict, and Egypt's independence. The economic policies adopted during Nasser's era were, to a large extent, to serve as a tool for political control and as a way to maintain political stability. The Nasser regime aimed at both getting rid of the economic base of political opposition and also at establishing support and legitimacy of its own. The substantial relaxation of import restrictions would not only work against its ISI strategy, but would also mean loosening the regime's grip over the Egyptian economy. Also, economic hardship arising from a rise in the cost of

¹⁰ IMF Central Files, C/U.A.R./810, Mission John W. Gunter, Apr. 1961, *op. cit.*, 17 and 20 Apr. 1961; and IMF Records, C/Egypt/810, Mission Bengur-Gunter and Staff, Aug.-Sept. 1961, a memorandum, To the Managing Director, From John W. Gunter, *Mission to the U.A.R.*, 14 Sept. 1961.

imports which would in turn encourage inflation could lead to domestic unrest and violence. Thus, these measures would in turn jeopardise the regime's political aims.

While it was reluctant to accept the terms demanded by the IMF, the Egyptian government adopted a tactic that would enable it to draw on IMF finance but avoid the negative effects of IMF conditionality, and would at the same time allow it extra time in negotiations so as to reduce the sense of urgency. Its tactic was to secure drawings from the IMF with an offer of gold of an equivalent value as collateral security in place of the adoption of IMF conditionality. In January 1962, Egypt requested a drawing of US\$ 22.4 million against gold collateral,¹¹ with an offer to repay the drawing within one year. As the drawing extended beyond the first credit tranche, the IMF would normally have required the adoption of a 'sound programme aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange.'¹² However, such a programme was still not forthcoming. Despite the abstention of some Executive Directors (such as those representing France and Belgium) and hesitation expressed by others (such as those representing the Netherlands and the US), the majority of the Executive Board approved the drawing with the acceptance of gold collateral as a substitute for a stabilisation programme. The decision was based on the grounds that there existed an emergency situation in Egypt arising from an extensive damage of the cotton crop caused by the cotton leaf worm and a rapid reduction in the supply of rice caused by a low flood by the Nile in the previous year.¹³ Two months later, Egypt applied for the second drawing of US\$ 7.5 million to offset a repurchase and again with an offer of gold collateral. Concern was again expressed by some Executive Directors (such as those representing Belgium, France and the UK) who insisted on the need for an understanding that Egypt was prepared to negotiate and agree on a stabilisation programme. However, the Executive Board as a whole finally agreed to the drawing.¹⁴

The implementation of the 1962 SBA programme was disappointing, largely mirroring a high degree of Egypt's unwillingness to accept IMF conditionality. Certain

¹¹ It should be noted that there was an earlier case of Egypt's request for IMF credits (US\$ 4.3 million) against gold collateral in December 1958. Nevertheless, although an approval had been granted, the request was subsequently withdrawn. Horsefield, *op. cit.*, vol. 1, pp. 523-524.

¹² International Monetary Fund, *Annual Report*, 1959, p. 22. Cited in Horsefield, *op. cit.*, vol. 1, p. 524.

¹³ Horsefield, *op. cit.*, vol. 1, pp. 524-525.

¹⁴ *Ibid.*, p. 525.

conditions attached to the 1962 stand-by arrangement were adopted by the Egyptian government. However, the underlying reason for their implementation seemed to go far beyond Egypt's willingness. During the implementation period, Egypt tried to maintain its eligibility of drawing under the 1962 SBA while simultaneously minimising its observance of IMF conditions. Conditions, which would enable Egypt to continue to draw on IMF credit,¹⁵ namely all three credit ceilings and conditions concerning restrictions on current payments and transfers and multiple currency practice, were all observed.¹⁶ In addition, a unified rate of US\$ 2.30 per Egyptian pound was, in early May 1962, introduced to all external transactions, except Egyptian dealings with the IMF, students' scholarship abroad and Suez Canal dues.¹⁷ The latter remained to be based on the old parity of US\$ 2.87 per Egyptian pound until January 1963.¹⁸ In effect, the Egyptian pound was devaluated from US\$ 2.84 per Egyptian pound to a unified exchange rate of US\$ 2.30 per Egyptian pound. The change represented a 19 per cent devaluation of the par value of the Egyptian pound; this was the amount the Egyptian team had argued for, whereas the foreign exchange rates increased by approximately 23 per cent in comparison with the old rate.¹⁹ The CBE's discount rate was raised from 3 to 5 per cent effective as from 15 May 1962. The reserve ratio of the commercial banks was increased from 12 ½ to 17 ½ per cent on the same date.²⁰

Nonetheless, there was hardly any gesture on part of the Egyptian government indicating a willingness to adopt the entire economic programme. The Egyptian government's intention to trim domestic demand and public investment proved illusory. The outlays for the military expedition in Yemen were stepped up.²¹ Indeed, there was a credit expansion outside of the ceilings set under the SBA programme in terms of overdraft facilities for government organisations. Also, little or no progress was made on a number of other measures and policies which the Egyptian team was initially

¹⁵ The amount equivalent to US\$ 42.5 million was fully disbursed to Egypt. However, according to the published International Financial Statistics Yearbook, there was an undrawn balance of US\$ 5 million.

¹⁶ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements Progress Reports, 1962-1978, various memoranda concerning IMF staff's reports on the U.A.R.'s performance under the May-1962 SBA.

¹⁷ IMF Central Files, C/U.A.R./810, Mission J. Gunter, May 1962, a letter from Ali Bengur to John W. Gunter, 11 May 1962; and Central Bank of Egypt, *Economic Review*, vol. 2, no. 9, 1962, p. 172.

¹⁸ *The Times*, 3 Jan. 1963.

¹⁹ Hansen, B., and K. Nashashibi, *Foreign Trade Regimes and Economic Development: Egypt* (New York: Columbia U. P., 1975), p. 90; Hansen and Marzouk, *op. cit.*, p. 198; and Mead, D. C., *Growth and Structural Change in the Egyptian Economy* (Homewood, I. L.: Richard D. Irwin, 1967), p. 175.

²⁰ Central Bank of Egypt, *Economic Review*, vol. 2, no. 9, 1962, pp. 171-172.

²¹ Waterbury, J., *The Egypt of Nasser and Sadat: The Political Economy of Two Regimes* (Princeton, N. J.: Princeton U. P., 1983), p. 408.

reluctant to accept. They included import and pricing policies and the termination of bilateral payments agreements.²² The implementation of IMF conditionality under the 1962 SBA, therefore, seemed to reveal a substantial degree of Egyptian reluctance in adopting certain policies set under the SBA.

3.2 The May 1964 Stand-By Arrangement

With its persistent balance of payments problems, Egypt's need to obtain financial assistance continued following the expiration of the 1962 SBA. Thus, the process of negotiations with the IMF for another SBA began as soon as the 1962 SBA ended on 6 May 1963. The issue of a new SBA with the IMF was preliminarily raised during an informal visit by an IMF mission in the second half of May 1963.²³ By early June 1963, Egypt requested IMF's help to prepare a new SBA programme.²⁴

Following several rounds of the negotiations lasting less than one year, in mid-April 1964 agreement was reached between the two sides and a Letter of Intent was drafted. The objectives of the economic programme under the May 1964 SBA were threefold: first, to substantially reduce reliance on restrictions; second, to restore foreign exchange reserves to a satisfactory working level; and third, to improve the external debt structure by reducing the proportion of short- and medium-term credits as well as the level of such credits in absolute terms.²⁵ To achieve the above objectives, a number of policies were set such as monetary, fiscal, pricing, and external sector policies.²⁶ On monetary policy, borrowing by the public and the non-government sectors and the level of cotton financing were to be limited. Fiscal policy involved expenditure and revenue measures, ceilings on the level of investment expenditures by the public sector and an increase in

²² IMF Central Files, C/U.A.R./1760, Stand-by Arrangement, 1952-1963, a memorandum, To Per Jacobsson (Managing Director), From John W. Gunter, *Assessment of Developments in the U.A.R. Since the Stand-By Arrangement Became Effective*, confidential, 13 Dec. 1962; and IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Mar. 1963, a memorandum, To Per Jacobsson, From John W. Gunter, *Mission to the United Arab Republic*, confidential, 1 Apr. 1963.

²³ IMF Records, C/U.A.R./810, Visit J. Gunter, May 1963, a memorandum, To the Acting Managing Director, From John W. Gunter, *Informal Discussions in Cairo*, confidential, 27 May 1963.

²⁴ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Nov.-Dec. 1963, a letter from Ahmed Zaki Saad (Executive Director representing Egypt) to Ahmed Zando (Minister of Economy), 21 June 1963.

²⁵ United Arab Republic, 'Stabilisation Program of the United Arab Republic,' 18 Apr. 1964, in IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1964, International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Member of the Executive Board, From the Secretary, *United Arab Republic – Stand-By Arrangement*, EBS/64/69 Supplement 1, confidential, 25 May 1964, p. 5.

²⁶ For more details on IMF conditionality under the 1964 SBA, see Appendix B.

social taxes. The policy on pricing was to re-examine the formulae for fixing prices of domestically produced manufactures to ensure a profit margin, and to review the prices for electricity, transportation and other public utilities. External sector policy dealt with the external borrowing, imports and exports. The levels of short- and medium-term external borrowing were to be subject to ceilings. An additional 5 per cent "statistical" tax on imports and a 5 per cent tax on invisible transactions with certain exceptions were to be introduced. A general export policy was to be established by 1 January 1965. Other policies included a ban on new bilateral payments agreements with IMF members and the elimination of existing ones. Neither were new restrictions on payments and transfers for current international transactions to be introduced nor the existing ones to be intensified.

With an aim of keeping the economic and political costs of borrowing low, Egypt's initial position was that it did not want to undertake any new policy commitments other than credit ceilings, and that the new ceilings – particularly the one for the public sector – would have to be considerably more generous than provided under the last SBA.²⁷ What Egypt would like to gain from its negotiations with the IMF was the latter's seal of approval rather than its credit which would be small in relation to its needs. An agreement with the IMF would facilitate Egypt in justifying its case for gaining money from other creditors, including creditor countries such as the US and Germany, and foreign commercial banks. Indeed Egypt, during the negotiations, indicated that it was prepared to accept no use of IMF credit but IMF conditions had to be less strict.²⁸ However, the IMF Management and staff held that 'a thorough-going new programme' was needed for Egypt, particularly in the light of its disappointing performance of the previous SBA programme.²⁹ Therefore, pressure was imposed upon Egypt by not only its initial economic problems but also the perceived catalysing effect of concluding an agreement with the IMF. The IMF's relative strength in the negotiations was, on the other hand, well enhanced by these factors.

²⁷ IMF Records, C/U.A.R./810, Visit J. Gunter, May 1963, *op. cit.*, 27 May 1963.

²⁸ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Jan. 1964, a memorandum, To Pierre-Paul Schweitzer (Managing Director), From John W. Gunter, *Mission to the United Arab Republic*, confidential, 30 Jan. 1964.

²⁹ IMF Central Files, C/U.A.R./1760, Stand-by Arrangement, 1952-1963, Memorandum for Files, From Frank A. Southard, Jr., (Deputy Managing Director), *Position on U.A.R.*, 19 Sept. 1963.

The IMF team first outlined the elements of a stabilisation programme. The proposed programme included an introduction of new taxes; increases in interest rates; adjustments in pricing policy for manufactured goods, food items and kerosene, and public utilities; adjustment of the exchange system; domestic and foreign credit ceilings; and a policy on the restrictive system such as import control and bilateral payments agreements.³⁰ The Egyptian team was, however, unwilling to consider new tax proposals and to undertake any significant modification of pricing policy, and also refused to consider a devaluation of the Egyptian pound and any alternative means to the devaluation.³¹ As for the exchange rate policy, the Egyptian team denigrated its usefulness in a socialist state-controlled economy. They argued that a practice of directly linking export earnings to the release of foreign exchange needed by most industrial enterprises was better than the exchange rate policy on two grounds. Firstly, a failure on the export performance would affect their entire production programme through the lack of foreign exchange earned. Secondly, profitability was a secondary consideration for state-owned undertakings.³² However, the underlying reasons seemed to go beyond the economic. The measures that Egypt was reluctant to accept would have a profound impact upon the Egyptians' cost of living in terms of additional tax burdens and also an increase in prices, which would, in turn, seem to the Nasser regime to undermine its political control and stability. Furthermore, there was a unique implication of the policy adjustments in the case of Egypt. The domestic costs of these measures and, in particular, an action on the exchange rate itself would damage Egypt's position of leadership in the Arab World. In fact, the original Egyptian proposals were based merely on credit ceilings for the government and the non-government sectors and were, thus, regarded by the IMF team as unacceptable as a basis for a SBA.³³

During the negotiation process, an improvement in the economic situation in Egypt and the international economic development lent some weight to Egypt's relative strength vis-à-vis the IMF. The principal favourable development was an improvement in the terms of trade. Prices for long-staple cotton in the international markets were particularly improved in 1963 and 1964, partly due to two successive failures in the

³⁰ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Nov.-Dec. 1963, *Elements of a Proposed Stabilization Program for the United Arab Republic*, confidential, 27 Nov. 1963.

³¹ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Jan. 1964, a memorandum, To Mr. Schweitzer, From John W. Gunter, *Mission to the United Arab Republic*, confidential, 30 Jan. 1964.

³² IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1964, a memorandum, To John W. Gunter, From A. F. Mohammed, *Note on Negotiations with U.A.R.*, confidential, 28 Feb. 1964.

³³ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Jan. 1964, *op. cit.*, 30 Jan. 1964.

cotton harvest in Sudan. Other exports moved favourably, namely rice and petroleum. Foreign exchange earnings from the Suez Canal and tourism also increased.³⁴ The Suez Canal tolls suddenly increased between 1962 and 1963, rising from LE 53.7 million in 1962 to LE 71.1 million in 1963 and LE 77.0 million in 1964.³⁵ This was partly due to the implementation of IMF conditionality under the previous agreement (the 1962 SBA), in which Suez Canal receipts were, from January 1963, converted at a new rate of US\$ 2.30 per Egyptian pound. Such favourable developments contributed to some improvement in the balance of payments on current account, which would in turn lessen the pressure to reach a policy agreement with the IMF and provided the Egyptian team some room to manoeuvre.

Nevertheless, Egypt's desperate need for IMF assistance remained. In spite of these favourable economic developments, Egypt's balance of payments problem continued to be under pressure due largely to a heavy debt service burden because of the large element of short- and medium-term debt.³⁶ Peter Manfield notes that:

The gravest consequence of Egypt's chronic balance of payments difficulties is that the country has acquired a bad reputation for the payment of commercial debts . . . the delays [in debt repayments] were becoming longer, until some creditors became exasperated. One small but significant example was that many foreign booksellers stopped shipments to Egypt in 1964 because payments were two or three years behind Meanwhile Egypt's liabilities from interest charges and repayment of principle were piling up at an alarming rate [T]here remained compensation for British, French, Belgian, Swiss, Lebanese and other nationalized and sequestered property . . . it was persistent delay in making these payments which caused the I.B.R.D. to announce that it was making no more loans to Egypt.³⁷

In addition to Egypt's debt problem, there was also an increasing expenditure burden arising from its prolonged military support to the republicans against the royalists (who were backed by Saudi Arabia) in Yemen after the Yemeni revolution took place in September 1962.

³⁴ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Nov.-Dec. 1963, a memorandum, To Pierre-Paul Schweitzer, From John W. Gunter, *Mission to the United Arab Republic*, confidential, 10 Dec. 1963; IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Jan. 1964, *Preliminary Assessment by the IMF Mission*; and Manfield, *op. cit.*, pp. 160-161.

³⁵ Manfield, *op. cit.*, p. 161.

³⁶ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Nov.-Dec. 1963, *op. cit.*, 10 Dec. 1963; and IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Jan. 1964, *Preliminary Assessment by the IMF Mission*.

³⁷ Manfield, *op. cit.*, pp. 162-163.

With a great deal of reluctance, Egypt agreed to a number of issues proposed by the IMF where its commitments could easily be evaded and especially without penalty in terms of subsequent ineligibility to draw on IMF credit. These included the policy on bilateral payments agreements, non-discrimination on trade, and pricing policy. Some compromises were made by both sides, namely credit ceilings and exchange rate policy.³⁸ Although Egypt rejected the idea of a general sales tax proposed by the IMF,³⁹ it accepted the introduction of certain new taxes, including a 5 per cent tax on imports in addition to an existing tax of 5 per cent and of a 5 per cent tax on invisible payments as measures to raise the government revenues. On the other hand, attempts had been made by the IMF to gain a stronger commitment from Egypt on the issue of the exchange system by pressing for alternative measures having the same effect as devaluation, if not devaluation per se. The IMF Management and staff had argued for an increase of a tax on invisible payments from 5 per cent to 10 per cent to bring it equal to a total 10 per cent tax on imports, and for a uniform export premium of 10 per cent applied to all exports except cotton, oil, rice and onion in lieu of devaluation.⁴⁰ Nevertheless, Egypt refused to accept such changes proposed by the IMF at that time, but merely placed them for future consideration which was left rather uncertain. Egypt's negotiation team appeared to lack the support of the Egyptian cabinet and, more importantly, President Nasser himself. Abdel-Moneim el-Kaissouni, Deputy Prime Minister for Financial and Economic Affairs, implicitly argued that:

At the present time it would be most difficult and politically inappropriate to agree to proposed change[s]. We may . . . consider the matter later on in light of experience which will be gained.⁴¹

The government's acceptance of the import tax without the export subsidy seems to reflect their interest in finding a way to raise its revenue rather than the exchange reform. More importantly, the government's refusal to accept the policy of an export subsidy was understandable in the light of the pursuit of its ISI strategy.

³⁸ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1964, *op. cit.*, 28 Feb. 1964.

³⁹ *Ibid.*

⁴⁰ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1964, a memorandum, To Pierre-Paul Schweitzer, From John W. Gunter, *Proposed Stand-By Arrangement with the United Arab Republic*, confidential, 6 Apr. 1964; and IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1964, a cable (1) from Pierre-Paul Schweitzer to Ahmed Zando (Governor of the Central Bank of Egypt), 9 Apr. 1964.

⁴¹ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1964, a cable from Abdel-Moneim el-Kaissouni (Deputy Prime Minister for Financial and Economic Affairs) to Pierre-Paul Schweitzer, 12 Apr. 1964.

With Egypt's continuous resistance to the outright devaluation and to stronger terms of alternative measures, the IMF eventually showed a certain degree of flexibility. In the actual programme under the May 1964 SBA, the export policy, which in conjunction with the import tax formed an alternative to devaluation, turned out to be vague. The programme provided no more than an export policy, involving an export subsidy, to be worked out by 1 January 1965 and also no level of export subsidy was specified, unlike the import policy.

Such flexibility of the IMF came from the Management and the staff, rather than the Executive Board. Prior to the Executive Board meeting to decide on the case of Egypt's request for a SBA, disagreement had emerged over the SBA programme for Egypt between Executive Directors and Alternate Executive Directors representing some Western European countries (including Belgium, Germany, the Netherlands, and the UK), on the one hand, and the IMF Management and staff, on the other hand. Doubts were raised by the former over the adequacy of the proposed programme; in particular, the lack of a realistic exchange rate, in relation to the use of the upper credit tranches, and over a long-term approach to stabilisation envisaged in the programme. They asked for the reconsideration of the proposed programme. Yet, the IMF Management, in defending their readiness to support Egypt's case, argued for the opposite case by holding that a great deal had been achieved in view of Egypt's agreeing to take further steps than it had at first been prepared to do such as the 5 per cent taxes on imports and invisibles. They added that the programme was also respectable, particularly in terms of drastic steps in the budget and investment, new pricing policy, and very severe credit ceilings.⁴² After long discussions among the Executive Directors at the Board, on 13 May 1964 the approval of Egypt's request for a one-year SBA in an amount equivalent to US\$ 40 million was finally granted without any programme reconsideration.⁴³ It would be difficult to know exactly why the Management and the staff became flexible on these issues and whether there was any political interference by a third party. With the available information, the conjectural explanation is that IMF flexibility during the 1963-1964 negotiations was largely a consequence of Egypt's resistance to IMF demands on such issues.

⁴² IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1964, Memorandum for Files, From Frank A. Southard, Jr., *Developments Respecting UAR Stand-By Arrangement*, 7 May 1964.

⁴³ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1964, 'United Arab Republic – 1963 Article XIV Consultations and Stand-By Arrangement,' EBM/64/24, 11 May 1964, pp. 3-20, and EBM/64/25, 13 May 1964, pp. 3-32.

It should be noticed that the reluctant position of the Western Executive Directors regarding Egypt's requests for drawings occurred during a period in which the relationship between the West and Egypt was deteriorating. Differences between the West, particularly the US under the Johnson Administration, and Egypt began to rise during the early 1964 regarding the Arab-Israeli conflict and Nasser's increasing attacks on Western interests in the Arab world and in Africa. Johnson's apparent pro-Israeli approach, Egypt's continuous involvement in Yemen, Nasser's campaign to expel the US Air Force from Wheelus Air Base in Libya in February 1964, and the resumption of Egypt's involvement in the Congolese civil war in the spring of 1964 through arms support to leftist guerrillas, provided the grounds for a deep rift between the two sides. In addition, Egypt's growing economic and military dependence on the Soviet Union imposed further strains on its relationship with the West. In May 1964, the same month when the Executive Board took place, Nikita Krushchev paid an official visit to Egypt to celebrate the completion of the first stage of the Aswan High Dam. Krushchev promised to provide Egypt with a further US\$ 277 million in economic assistance, and to meet Egyptian arms requests. This came 'at a time when there was much talk in the West about reducing aid and 'getting tough' with the Nasser regime.'⁴⁴ However, in the context of Egypt's negotiations with the IMF, the Soviet aid pledge did not enhance Egypt's negotiating position since this came after agreement was reached and a letter of intent had been drafted in the previous month (April 1964).

How did Egypt fare in implementing IMF conditionality under the 1964 agreement? Similar to the 1962 SBA, the implementation of the 1964 SBA programme was not fully completed. Egypt only observed the conditions which would allow it to maintain access to IMF credit under the 1964 SBA, namely the credit and investment ceilings and the policy concerning restrictions on payments and transfers. This enabled Egypt to draw the full amount of US\$ 40 million by early April 1965.⁴⁵ Nevertheless, there was a substantial credit expansion resulting from items outside credit ceilings under the SBA. With regard to other measures and policies, little progress was made on implementing policies on bilateral payments agreements and pricing. While Egypt

⁴⁴ Burns, W. J., *Economic Aid and American Policy toward Egypt, 1955-1981* (Albany, N. Y.: State U. of New York P., 1985), p. 154.

⁴⁵ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements Progress Reports, 1962-1978, a memorandum, To the Managing Director, From John W. Gunter, *United Arab Republic - Stand-By Performance*, 27 May 1965. However, according to *International Financial Statistics Yearbook* which made available to the public, there was an undrawn balance of US\$ 15 million.

notified the IMF members (except Yugoslavia) its desire to terminate bilateral agreements payments, there appeared to have been no further progress. Also, while the number of bilateral payments agreements with IMF members had not been increased, many existing agreements had in fact been renewed such as those with the Sudan, Somalia, and Ethiopia. Neither did progress appear to have been made in establishing the policy of a uniform export subsidy.⁴⁶

Furthermore, after the 1964 SBA had expired on 22 May 1965 and, more importantly, the credit had been fully disbursed, Egypt's efforts to observe the credit ceilings, which extended beyond the expired date of the SBA (until the end of June 1965), became lax. The net claims of the banking system on the government sector during the April-June quarter exceeded the ceiling for the end of June 1965.⁴⁷ This partly seems to further indicate the limited extent of Egypt's willingness to accept IMF conditions under the May 1964 SBA.

3.3 Abortive Attempts to Reach a New Agreement: 1966-1969

Following the expiration of the 1964 SBA, Egypt's desire to reach a new agreement with the IMF persisted. The deficit problem was aggravated in part by its continuous involvement in the Yemeni civil war and in part by the decline in medium- and long-term bilateral economic assistance, in particular from the two superpowers. In the case of the USSR, when Egypt needed assistance most, the annual increment of its economic aid to Egypt dropped from US\$ 126 million in 1965 to US\$ 7 million in 1966.⁴⁸ There was also pressure exerted by the West upon Egypt in terms of the possibility of reduced Public Law (PL) 480 assistance from the US and a general cut in financial aid from other Western countries. Abdel-Moneim el-Kaissouni, Deputy Prime Minister for Financial and Economic Affairs, implicitly referred to this in his 1965/66 budget speech in June 1965:

The U.A.R. [United Arab Republic] pressed on and scored great victories year after year and once more there was feverish propaganda launched against it

⁴⁶ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements Progress Reports, 1962-1978, a memorandum, To Pierre-Paul Schweitzer, From John W. Gunter, *United Arab Republic – Stand-By Performance*, 24 June 1964.

⁴⁷ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements Progress Reports, 1962-1978, a memorandum, To the Managing Director, From John W. Gunter, *United Arab Republic – Stand-By Performance*, 23 July 1965.

⁴⁸ Mabro, R., 'Egypt's Economic Relations with the Socialist Countries,' *World Development*, vol. 3, no. 5, May 1975, p. 310.

when in 1964 we concluded an agreement with the IMF under which the Fund was to extend a loan of \$40 million to the U.A.R. so that it might face a deficit in its balance of payments. Those who attack us seem to forget that the U.S. and the U.K. themselves had got loans from the Fund to face similar deficits. This year particularly we are facing another campaign of this type. Some countries are threatening to stop extending loans to us and cease their economic co-operation with us.⁴⁹

The US shipments of PL 480 wheat to Egypt were indeed suspended in the first half of 1965, after the anti-American actions in Egypt in November-December 1964 (the burning down of the US Information Service Library in Cairo and the shooting down of an unarmed private plane near Alexandria by the Egyptian Air force). This forced Egypt to purchase a large amount of wheat in convertible currency at the time when its foreign exchange reserves were drained. By 1965, the balance of payments crisis reached a point where Egypt was unable to meet contractual debt service obligations.⁵⁰ This led to another series of negotiations during the period 1966-1969 for a new SBA between Egypt and the IMF. The period of 1966-1969 was characterised by Egypt's several attempts to reach a new deal after the 1964 SBA had come to an end. However, the prolonged negotiations, which lasted for about three years until the end of 1969 (interrupted by the June 1967 war), yielded no success in concluding a formal agreement.

By 1965, the realisation of increasing economic and financial difficulties, particularly the acute shortage of foreign exchange which ensued from the prolonged severe balance of payments deficits on current account since 1962 (see Table 3.2), had brought the Egyptian authorities' recognition of the need for retrenchment and also a change in government. A new government was headed by Prime Minister Zakariyya Mohi ed-Din (former Minister of the Interior), appointed by Nasser to replace Ali Sabri in September 1965. It was believed that Zakariyya Mohi ed-Din was to the right of his predecessor, and thus would be more acceptable to the West and the IMF.⁵¹ In December 1965, the new government introduced its own policy programme, entailing several austerity measures in line with ones that had been suggested by the IMF. They were designed to improve the fiscal situation, including reducing government expenditures and increase-revenue measures such as higher income taxation, higher domestic prices (for example,

⁴⁹ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a memorandum, To Pierre-Paul Schweitzer, From John W. Gunter, *United Arab Republic 1965/66 Budget*, 8 June 1965.

⁵⁰ Waterbury, *op. cit.*, 1983, p. 95; and Hansen and Nashashibi, *op. cit.*, p. 108.

⁵¹ Woodward, P., *Nasser* (London: Longman, 1992), p. 95.

prices of bread, sugar, tea, rice, corn, consumer durables, textiles, butane gas and fertilisers), and higher customs and excise duties. Others included a sharp cut of credit to the agricultural sector through collection of arrears and reduced cash loans, a re-examination of investment priorities, particularly in the industrial sector, and a limitation of external borrowing for financing investment. Such a programme was expected to result in savings of about LE 100 million in the 1965/1966 fiscal year (ending in June), and LE 150 million in the following fiscal year.⁵²

Egypt's own recognition of the severity of its economic problems was also evident during the discussions with the IMF. As early as the first half of December 1965, Egypt expressed its desire to have a new SBA with the IMF during Article XIV Consultation discussions. During the discussions, the IMF team found that the Egyptian team became more forthcoming in discussing policy problems than they had previously been, and noted a high degree of policy co-ordination in the economic field in contrast to previous inconsistencies of policy.⁵³ In April 1966, the negotiation process between the two sides began. Initially, the Egyptian team had an expectation that the IMF team would accept the measures taken in December 1965, as well as a reduction in military expenditures resulting from the partial withdrawal of the Egyptian troops from Yemen, as constituting satisfactory stabilisation measures.⁵⁴ However, the IMF team made it clear that a radical programme based on an 'adequate' adjustment of the exchange rate was indispensable for a satisfactory stabilisation programme.⁵⁵

In its first programme proposals, the Egypt team agreed to the need for most of what the IMF team viewed as constituting a suitable stabilisation programme, including the issues of prices, credit, foreign indebtedness, and bilateral payments agreements.⁵⁶ Nonetheless, the major hurdle during the negotiations lay in the issue of the exchange

⁵² IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Dec. 1965, Office Memorandum, To Pierre-Paul Schweitzer and Frank A. Southard, Jr., From M. M. Hassanein, *New Economic and Financial Policies of the United Arab Republic*, 14 Dec. 1965; and IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Dec. 1965, a memorandum, To the Managing Director, From John W. Gunter, *Mission to the United Arab Republic*, confidential, 23 Dec. 1965.

⁵³ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Dec. 1965, *op. cit.*, 23 Dec. 1965.

⁵⁴ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Apr. 1966, a memorandum, To Pierre-Paul Schweitzer and Frank A. Southard, Jr., From John W. Gunter, *Mission to the United Arab Republic*, 3 May 1966.

⁵⁵ *Ibid.*

⁵⁶ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Apr. 1966, United Arab Republic, *Memorandum*, confidential, 26 Apr. 1966. This was a memorandum containing Egypt's proposed stabilisation programme as a basis for a SBA handed by the Egyptian team to the IMF mission during their discussions in April 1966.

rate. The IMF team initially proposed a 30-per-cent devaluation of the Egyptian pound to the rate of US\$ 1.60 per Egyptian pound.⁵⁷ Yet, the Egyptian team considered devaluation, an outright action on the exchange rate, neither economically useful nor politically possible in the circumstances at that time. Abdel-Moneim el-Kaissouni, the head of the Egyptian team and Deputy Prime Minister for Financial and Economic Affairs, was apparently well aware that the outright devaluation would not be accepted by his colleagues and President Nasser, and thus disagreed with the IMF team on this matter. In lieu of devaluation, the Egyptian team hastily proposed a 'price-increase' approach after the IMF team determined not to agree to any programme without some type of exchange rate action. This proposal involved a gradual rise in prices of imported raw materials and intermediate goods, with the exception of essential supply goods, by 20 per cent, and subsidisation of exports of manufactured goods through the proceeds gained from the increase in import prices.⁵⁸

Yet, the IMF Management and staff viewed this price increase measure, instead of devaluation, as inadequate in terms of its magnitude and a lack of action on invisibles. Despite its strong preference for devaluation,⁵⁹ the IMF Management and staff showed a certain degree of flexibility; they did not rule out an alternative action on the exchange rate. They insisted that a satisfactory alternative would involve a uniform tax on foreign exchange payments with a limited number of exceptions (essential imports by the Ministry of Supply and debt service payments by the Treasury), and a uniform subsidy which would be applied to all exports, except certain traditional ones (cotton, rice, onion, petroleum and Suez Canal dues), and to invisible receipts except Suez Canal dues.⁶⁰ They insisted on their initial proposal concerning the extent of the effective depreciation; the degree of the import price increase; and the export subsidy should be equivalent to the effect of a 30 per cent devaluation to US\$ 1.60 per Egyptian pound.

⁵⁷ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Apr. 1966, *op. cit.*, 3 May 1966.

⁵⁸ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Apr. 1966, United Arab Republic, *op. cit.*, 26 Apr. 1966.

⁵⁹ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a cable from Pierre-Paul Schweitzer to Abdel-Moneim el-Kaissouni, 5 May 1966.

⁶⁰ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Aug.-Sept. 1966, International Monetary Fund, *United Arab Republic: Briefing Paper – Negotiations Relating to Possible Stand-By Arrangement*, prepared by the Middle Eastern Department and the Exchange and Trade Relations Department, approved by Ernest Sturc and John W. Gunter, confidential, 5 Aug. 1966, p. 3.

This would mean an import tax of 43.5 per cent (with an elimination of a 'statistical' tax of 10 per cent applying to imports) and an export subsidy of the same magnitude.⁶¹

After several months of dispute, a tentative agreement for a stabilisation programme was subsequently reached between the two negotiating teams during the negotiations in August-September 1966. However, the main issue left undecided concerned the extent of the effective exchange policy. During this round of negotiations, both parties moved to make their compromises. On the one hand, the Egyptian team increased their proposal on the extent of the effective depreciation from a 25 per cent to 30 per cent tax with the elimination of the 'statistical' tax. On the other hand, the IMF team reduced its initial 43.5 per cent tax (with the elimination of a 'statistical' tax of 10 per cent) to a 35 per cent tax (with the retention of the statistical tax at the level of 5 per cent).⁶² Since the Egyptian team was unable to offer more than a 30 per cent tax with a 5 per cent statistical tax, the issue was left pending until a decision was made on the home front.

Although a compromise had been made by both sides, it is doubtful whether the change in Egypt's attitude towards the exchange rate policy, or at least over the extent of the effective depreciation, was drawn from its conviction of the need for such a policy or the degree of change considered necessary by the IMF. Egypt's relative power in bargaining with the IMF was at this time weak due partly to growing difficulties that Egypt was experiencing in meeting its international payments and also partly to uncertainty regarding the receipt of PL 480 assistance from the US. Substantial arrears were accumulated and negotiations to reschedule debt repayments met with only limited success.⁶³ Additional pressure on Egypt also came from its deteriorating relationship with the US in 1966. Convinced that the US's Central Intelligence Agency (CIA) was plotting to topple him, Nasser's hostility towards the US grew during the 1966, marked by his anti-American speeches in Cairo and the permission for the opening of the Vietnamese National Liberation Front's office in Cairo. By 1966, the Johnson Administration was preoccupied with the Vietnam War. Also, with diminishing American agricultural surpluses and a retrenchment period of the PL 480 programme, a

⁶¹ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, Office Memorandum, To Frank A. Southard, Jr., From John W. Gunter, *Comments on the U.A.R. Memorandum*, confidential, 10 May 1966; and IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Aug.-Sept. 1966, a memorandum, To the Managing Director, From John W. Gunter, *U.A.R. - Discussions of Stabilization Program*, 13 Sept. 1966.

⁶² IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Aug.-Sept. 1966, *op. cit.*, 13 Sept. 1966.

⁶³ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Aug.-Sept. 1966, *op. cit.*, 5 Aug. 1966.

selective approach in its food aid policy had been adopted. In the light of the growing Egyptian-US differences, the renewal of the 6-month PL 480 accord with the US in January 1966 came under threat when the latter did not respond to Nasser's April 1966 request for the extension.⁶⁴

The IMF team was well aware of its greater negotiating strength. John Gunter, the head of the IMF negotiating team, writes: 'The U.A.R. needs a stand-by with the Fund very much and our refusal would force reconsideration of direct action on the exchange rate.'⁶⁵ Thus, the Egyptian team appeared to accept the term with great reluctance when its bargaining power vis-à-vis the IMF was at a low ebb.

However, due to political difficulty on the domestic front, the magnitude of effective exchange policy proposed by the IMF team (a 35 per cent tax plus the retention of a statistical tax at 5 per cent) was not accepted by the Egyptian government. Abdel-Moneim el-Kaissouni was reportedly unable to obtain any action on the issue from the Egyptian cabinet.⁶⁶ More important, Egypt's political resistance to the exchange rate policy apparently went beyond the cabinet level of decision-making. As John Waterbury points out: '[T]he devaluation, advocated by Muhi al-Din, was too bitter a pill for Nasser to swallow . . . [the latter] was incensed at the idea of further devaluation and refused to comply.'⁶⁷ This was clearly illustrated by the fact that the change in government in the first half of September 1966, two days following the final day of negotiations in August-September 1966, brought no alteration in the Egyptian government's attitude towards the exchange policy and thus no hope of concluding an agreement. Mohi ed-Din was replaced by Sidqi Sulaiman as Prime Minister. The new government headed by Sulaiman continued to refuse to accept the extent of action on exchange policy agreed earlier.⁶⁸ This mirrors at least two points: first, the Egyptian team failed to convince the decision makers, particularly President Nasser, of the need for the extent of the exchange rate policy; and second, the economic policy-making in

⁶⁴ Burns, *op. cit.*, pp. 165-169.

⁶⁵ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Apr. 1966, *op. cit.*, 3 May 1966.

⁶⁶ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Aug.-Sept. 1966, *op. cit.*, 13 Sept. 1966.

⁶⁷ Waterbury, *op. cit.*, 1983, pp. 96 and 409.

⁶⁸ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, Memorandum for the File, From John W. Gunter, *Discussions with the Deputy Governor of the Central Bank of Egypt*, confidential, 9 Dec. 1966.

Egypt was largely dominated by the President,⁶⁹ who in practice appointed and removed Prime Ministers and his cabinet, not parliament (the People's Assembly and the Consultative Council), especially over such controversial issues as the exchange rate.

On the other hand, the IMF Management, in insisting on its demand, claimed that they too had faced difficulty on the internal front in dealing with the case of Egypt. The Managing Director, Pierre-Paul Schweitzer, stated:

He had had more personal difficulty with his Executive Board over the U.A.R. than with any other member. He felt that the Fund could be of a great deal of help to the U.A.R., but that his hands were tied unless the U.A.R. was prepared to take adequate action on exchange rate policy . . . [which] was an essential condition for approaching the Executive Board within the framework of existing Fund policies.⁷⁰

While the gap between the two sides over the issue of the exchange rate policy could not be narrowed, there remained pressure upon Egypt to reach an arrangement with the IMF caused by its serious financial problems. The two factors continued to lessen Egypt's relative power in the negotiations. With an accumulation of substantial arrears, Egypt experienced growing difficulties in meeting its international payments. By December 1966, the Egyptian government was concerned about Egypt's ability to meet the repurchase commitments regarding the IMF's credit made available under the May 1962 SBA.⁷¹ Due to the five-year rule, it would not be possible to rearrange further Egypt's repurchase schedule. Egypt's failure to meet these obligations would be damaging to not only its credit standing with the IMF but also to the international financial confidence towards Egypt. Furthermore, Egypt's deteriorating relations with the US since 1966 persisted in 1967 and continued to put pressure on Egypt to reach an agreement with the IMF. The US's refusal to reply to the request for a new PL 480 accord eventually forced Egypt to withdraw its request in the spring of 1967. This had a negative impact on Egypt's foreign exchange requirement to pay for imported wheat and flour. In addition, there was also a decline in cotton production due to pests, which

⁶⁹ The second point implicitly presents in the conversations between the Egyptian officials to the IMF officials. See, for example, IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, *op. cit.*, 9 Dec. 1966; and IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, Memorandum for Files, *Discussion with U.A.R. Ambassador*, confidential, 21 Dec. 1966.

⁷⁰ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, *op. cit.*, 9 Dec. 1966.

⁷¹ *Ibid.*

was anticipated to lead to a shortfall in cotton export proceeds, putting additional pressure on Egypt's foreign exchange reserves.⁷²

Despite financial pressure, Egypt did not give in to the IMF demand on the exchange rate policy in order to obtain IMF credit. Instead, Egypt opted to remain in arrears regarding its repurchases with the IMF since December 1966 and at the end of September 1967 these arrears totalled US\$ 40 million.⁷³

Egypt's resistance to give in to the IMF's demand eventually paid off. By the second half of May 1967, agreement between the two sides was reached and a letter of intent was drafted. A compromise was made by both parties with a greater concession from the IMF concerning the exchange policy. The import and export taxes contained in the draft programme dated 21 May 1967 was a uniform rate of 15 per cent with the retention of the 'statistical' tax of 5 per cent (on items covered by the operations of the Ministry of Supply) and 10 per cent (on all other items).⁷⁴ This was considerably less than the IMF's original and subsequent proposals (43.5 and 35 per cent with the retention of a 5 per cent statistical tax, respectively), and also even less than what the previous team had initially argued for in August-September 1966 (25 per cent).⁷⁵ However, due to the outbreak of the June 1967 war, Egypt's request for a SBA had to be postponed,⁷⁶ despite the IMF Management's preparation to support its request at the IMF's Executive Board.⁷⁷ No agreement was, thus, ultimately concluded with the IMF.

In the aftermath of the June 1967 war, Egypt's economic situation was further weakened by the temporary loss of its major sources of foreign exchange in Suez Canal receipts, tourist earnings, and oil revenues. However, the June 1967 war transformed the hostile relations between Nasser's revolutionary regime and monarchical regimes,

⁷² IMF Central Files, C/U.A.R./810, Mission Rudolf Kroc, Jan.-Feb. 1967, United Arab Republic, *Aide Memoire*, 8 Feb. 1967, p. 3.

⁷³ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Nov. 1967, *Briefing Paper – Article XIV Consultation and Discussions Relating to Possible Stand-By Arrangement*, confidential, 24 Oct. 1967, p. 2.

⁷⁴ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, United Arab Republic, *Stabilization Program of the United Arab Republic* [a memorandum setting forth a stabilisation programme attached to a letter of intent], 21 May 1967.

⁷⁵ IMF Central Files, C/U.A.R./810, Mission Gunter and Staff, Aug.-Sept. 1966, *op. cit.*, 13 Sept. 1966.

⁷⁶ On 3 June 1967, a cable was sent from Nazmy Abdel-Hamid (Governor of the Central Bank of Egypt) to Pierre-Paul Schweitzer to request the postponement of all actions relating to Egypt's request for a SBA. IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a cable from Pierre-Paul Schweitzer to Nazmy Abdel-Hamid, 6 June 1967.

⁷⁷ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a cable from John W. Gunter to Nazmy Abdel-Hamid, 24 Apr. 1967.

especially with the oil-rich Arab states. The balance of payments position, although continuing to be difficult with imports being held at a comparatively low level, seemed to be under control, due largely to a partial compensation in terms of cash aid received from Kuwait, Saudi Arabia, and Libya totalling £ 95 million.⁷⁸

After the end of the June 1967 war, Egypt's efforts to obtain a SBA from the IMF continued in the light of its persistent financial problem. At Egypt's request in September 1967,⁷⁹ negotiations were resumed in the following month but did not lead to the conclusion of an agreement with the IMF due mainly to disagreement over the exchange policy. Although it admitted that an adjustment in exchange policy was necessary, the Egyptian government refused to carry it out under the present circumstances until the impact of severe austerity measures was absorbed.⁸⁰

Meanwhile, the search for a solution to its continuing shortage of foreign exchange made it desirable for Egypt to improve its relations with the West and in December 1967 diplomatic relations with Britain were resumed. A bridging loan from British, West German and Italian banks obtained in February 1968, enabled Egypt to make repayments to the IMF which had been outstanding since December 1966.⁸¹ Although it would not pull Egypt out of its economic problems, it at least provided Egypt with some room for manoeuvre on a temporary basis.

Again in August 1969, the Egyptian government made another request for the use of IMF credit.⁸² Negotiations continued until the end of 1969 without reaching an agreement. The difficulty remained over the issue of establishing a parallel exchange arrangement. Although the Egyptian negotiators agreed to this condition, due to the delay in the government's decision regarding the proposed parallel exchange

⁷⁸ IMF Central Files, C/U.A.R./810 Mission Gunter and Staff, Nov. 1967, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *Mission to the United Arab Republic*, confidential, 16 Nov. 1967.

⁷⁹ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, Memorandum for Files, From Frank A. Southard, Jr., *Meeting with UAR Delegation*, confidential, 28 Sept. 1967.

⁸⁰ IMF Central Files, C/U.A.R./810 Mission Gunter and Staff, Nov. 1967, *op. cit.*, 16 Nov. 1967.

⁸¹ *Middle East and North Africa 2000*, 46th ed. (London: Europa, 1999), p. 410.

⁸² IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a cable from Nazmy Abdel-Hamid to John W. Gunter, 23 Aug. 1969.

arrangement, involving a premium of 35 per cent charged over the official rate,⁸³ apparently the request for a SBA was not officially submitted to the IMF.

Section C: Assessment of Relative Power and the Imposition-Ownership Nature of IMF Conditionality

After the long narrative of Egypt's relations with the IMF, what does this tell us about the relative power of both parties during the 1960s? To begin with, Egypt was initially forced by its economic circumstances to approach the IMF. Its relative power at the beginning of the negotiations was weak in terms of its balance of payments difficulties and the lack of sufficient non-conditional financial resources. This in turn strengthened the IMF's bargaining position. This was reflected in the fact that it was the IMF who initiated the proposals or demands for the stabilisation programmes whereas the Egyptian team had to react to the IMF's expectations. This is partly because the IMF was in a stronger position prior to the negotiations. Also, this reflects a lack of preparation on the Egyptian side,⁸⁴ which was largely due to the lack of coordination among the Egyptian ministries who guarded their own areas of responsibility against the involvement of others.

Despite its weak initial position in the negotiations, Egypt demonstrated that it was not a passive party in conducting its relations with the IMF. In the light of possible negative socio-economic and political effects of IMF conditionality, Egypt tried its best to avoid concluding an agreement with the IMF, reflected by its tactic of drawings twice from the IMF with a gold offer as collateral security during the negotiations leading to the 1962 SBA.

During the 1960s, Egypt was still under the socialist system, although the second half of the 1960s saw the move away from socialism. The appointment of the senior officials, including Prime Minister and Ministers, was in the hands of President Nasser. An attempt had been made by Nasser to appoint those whose thinking was believed to be in line with that of the IMF to facilitate the negotiations. However, the final decision on

⁸³ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *U.A.R. Request for Stand-by Arrangement*, 15 Dec. 1969.

⁸⁴ Gunter, J., unpublished paper, p. 37. Here, Gunter describes some of his activities as an IMF staff member. See Appendix I for a section on Egypt.

important issues of the negotiations remained with President. John Gunter, the head of the IMF negotiators, noted:

What bothered me most in the early years of our discussions with Egypt was that Kaisouni made little effort to defend the lack of action to correct the situation. It became increasingly clear that Kaisouni and the group around him understood the situation quite well, but were unwilling or unable to do much about it. I pressed on several occasions for discussions at the political level, and this understandably was resented by Kaisouni as a minister. In any event, I was careful to leave a written statement about the dangers in the situation, at the conclusion of each consultation mission. (I learned years later when I accompanied Mr. Schweitzer to met [sic] President Nasser that the President had seen my statements regularly).⁸⁵

Thus, in this regard, it could be said that the technocratic alliances did not lend much support to the IMF in the negotiations. At the same time, the lack of support within the Egyptian cabinet and, more significant, President Nasser himself, allowed the Egyptian team to take a tougher stand towards the IMF's proposals. As illustrated in the above narrative, following Egypt's resistance as a result of the lack of such support, IMF demands regarding the exchange rate were, on several occasions, lessened.

Throughout the negotiations during this period, economic circumstances were at times favourable to Egypt's strength in negotiations such as temporary improvements in the terms of trade. But this seemed to be insufficient to outweigh the negative impact of other economic circumstances upon its relative negotiating power, namely its debt. Egypt's negotiating position was considerably weakened by its growing debt, which served as a constraint rather than acting as a resource to enable it to alter the outcome of the negotiations. The deficit in the balance of payments current account during the 1960s was mainly with Western Europe and the United States and thus a deficit in convertible currency. During the period 1963-1966, the trade deficit with these countries ranged approximately between LE 150 million and LE 200 million.⁸⁶ Particularly, its inability to pay its obligation to the IMF revealed a considerable weakness in Egypt's relative power as the failure to meet this debt would damage international financial confidence and thus it should be the first obligation that Egypt would need to make if it could. Yet, it was unable to do. Thus, Egypt's decision to

⁸⁵ Gunter, J., *op. cit.*, pp. 35-36.

⁸⁶ Hansen and Nashashibi, *op. cit.*, pp. 119-120.

remain in arrears with the IMF was a good reflection of the lack of non-conditional financial resources that it could turn to.

As for the IMF, much of its relative strength in negotiations stemmed from the perceived catalysing effect of concluding a programme agreement. There seemed to be enormous pressure on Egypt regarding cross-conditionality: the need to obtain other financial sources of money from creditor countries such as the US and Germany and foreign commercial banks.

Its colonial history with France and Britain did not seem to provide favourable support to Egypt during its negotiations on IMF conditionality. Instead, the hostile relationship between Egypt and the West in the Cold War atmosphere produced the opposite effect as illustrated by the reservations made by several Western Executive Directors at their discussions on Egypt's requests for SBAs. Egypt's negotiations with the IMF in the 1960s were very much operating in the atmosphere of the rivalry between the two superpowers. The Cold War context of the negotiations between the IMF and Egypt was in theory favourable to Egypt. However, to a large extent, Egypt was seemingly unable to exploit the competition between the two superpowers to its own advantage regarding IMF conditionality negotiations, as one may expect. Thus, one could say that Egypt during the 1960s could have been in a stronger position than it was if it had used such a potential capability to alter IMF conditionality. Egypt could have capitalised upon its strategic and political significance in the region to bring substantial change to the outcomes. Yet, it seems that Egypt did not use it effectively. This seems to reflect that there were other issues which the Nasser regime regarded as more important and should have a priority over the outcome of the negotiations with the IMF, namely its foreign policy over the issue of the Arab-Israeli conflict, Nasser's support for revolutionary movements, and his anti-foreign domination stance.

It remains to be said that some factors are difficult to assess due to the lack of information such as the role of individual negotiators. Due to the unavailability of data, the relative power at the level of individual negotiators during this period cannot, thus, be assessed.

In sum, the relative bargaining strength of the two parties constantly changed throughout the negotiations in the 1960s. The alterations in the relative strength of the two parties in turn affected the position of IMF conditionality along the imposition-ownership spectrum. With Egypt's initial relative weakness, inability to put forward its own proposals and unwillingness to accept IMF demands as reflected by its resistance to IMF proposals, initially IMF conditionality can be said to be located closer to the imposition end of the spectrum than the ownership end. Despite Egypt's initial relative weakness, its subsequent resistance to IMF demands and the certain degree of flexibility of the Management helped yield some changes in IMF conditionality such as the extent of the exchange rate policy. Thus, this seemed to suggest that the degree of imposition and ownership had been altered along the spectrum since the beginning of negotiations and that it had moved away from the imposition end towards the ownership end.

However, such a movement was trivial. Overall, Egypt seemingly remained to be in a weaker negotiating position in relation to the IMF during the 1960s. The record of its negotiations with the IMF and programme implementation indicated that Egypt seemed to be in a desperate need for IMF lending. Also, the record of the implementation of the policy programmes under the 1962 and 1964 SBAs suggested a high degree of the Egyptian government's unwillingness to accept and adopt IMF conditionality. It chose to implement only conditions which were necessary for gaining access to the drawings, whereas the rest of the programme, some of which it initially resisted, remained unimplemented. The high degree of unwillingness, together with the relatively stronger power of the IMF, seemingly suggest a high overall degree of imposition of IMF conditionality during this period, despite some flexibility of the IMF (e.g. in terms of an alternative measure to devaluation), and compromises made on certain issues.

Chapter Four

Sadat's Continuity of Unwillingness: 1974-1979

Introduction

The period 1974-1979 saw intense negotiations between the Egyptian government and the IMF. This resulted in the conclusion of two agreements between the two parties in the second half of the 1970s: a SBA of 1977; and an EFF of 1978. Given the severity of Egypt's economic difficulties in the mid-1970s, an EFF was initially viewed by both parties as more appropriate than a SBA in dealing with such problems. However, due to disagreement over the extent of the policy programme, agreement could not be reached between both parties on the contents of the medium-term programme required under the EFF. As a consequence, a SBA was concluded in 1977 instead as an interim arrangement, forming part of a reform process that would extend over several years. A series of negotiations took place during the operation of the 1977 SBA, leading to the conclusion of another lending agreement under an EFF, in the following year. In both occasions, the withdrawal of IMF credits was only partial (see Table 4.1) and the agreements were abandoned, reflecting the low degree of Egypt's implementation of IMF conditionality.

This chapter aims to analyse the nature of IMF conditionality in the Egyptian case during the period between 1974 and 1979 under President Sadat's era. Similarly to Chapter Three, the outline of the chapter will be divided into three major sections. The first section will provide the background, covering the period of the early 1970s (the period leading to the negotiations for the 1977 SBA). This will be followed by a section of narrative of the negotiations for both 1977 SBA and 1978 EFF. Finally, the chapter will end with an assessment of the relative power of Egypt and the IMF and the nature of IMF conditionality.

Table 4.1 Egypt's Financial Position in the IMF, 1970-1981 (in millions of SDRs)

Years	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
All drawings	17.5	32	-	47	40	-	125.7	105	75	-	-	-
Repayments by repurchase	9	11.5	45	9	9	24.5	16	28	35	51.2	78.9	77.9
Use of Fund credit	49	70	24	62	93	68	178	255	296	246	139	85
Of which												
Ordinary credit tranche drawings	14	35	3	3	34	9	-	98	82	58	35	25
Compensatory Financing Facility	23	23	9	47	47	47	141	113	94	72	24	-
Standby Arrangements: Amount drawn	-	-	-	-	-	-	-	105	-	-	-	-
Undrawn balance	-	-	-	-	-	-	-	20	-	-	-	-
Extended Fund Facility: Amount drawn	-	-	-	-	-	-	-	-	75	75	75	-
Undrawn balance	-	-	-	-	-	-	-	-	525	525	525	-
Oil Facility	-	-	-	-	-	-	32	32	32	26	19	11
Trust Fund Loans Outstanding	-	-	-	-	-	-	-	20	78	135	183	184
Quota	188	188	188	188	188	188	188	188	228	228	342	342
Fund holdings of currency	237	258	212	250	281	256	366	443	524	474	481	403
Per cent of quota	126	137	113	133	149	136	195	236	230	208	141	118

Source: International Monetary Fund, *International Financial Statistics Yearbook*, 1985, pp. 20-21, 24-25, and 273.

Section A: Background

During the 1970s, Egypt underwent several developments on the domestic (political and economic), and on the foreign fronts. After the death of Nasser in 1970, Sadat took office as the president of Egypt. At the beginning of Sadat's regime, there was little change in Egypt's economic policy. Sadat spent the first few years consolidating his political power. He sought to expand his power base by outmanoeuvring his internal opponents, such as Ali Sabri who staged an abortive coup in May 1971 in protest against the proposed federation of Egypt, Libya and Syria, and who tried to mobilise the mass in the Arab Socialist Union (ASU) and the police force to oppose Sadat. Also, Sadat gradually reinforced his position in power within the army and purged his regime of those who he termed 'Centres of Powers', referring to a number of senior officers in the army, the intelligence units, and the police force who owed their allegiance to the previous regime.

Following the October 1973 war, Sadat introduced a new idea towards economic development which to some extent departed from that of Nasser. The principle concept of the Open Door Policy (*infitah*), Sadat's new economic policy, was laid out in the October Paper of 1974. It called for an investment programme which would mobilise Egyptian domestic capital and Arab and foreign resources, and would stimulate a greater role of the private sector in the economy.

A number of factors which influenced Sadat's initiative of the *infitah policy* can be identified at three distinct levels: the domestic, the regional, and the international. At the domestic level, the socialist experience during Nasser's era proved to be a manifest failure. Sadat's critical attitude towards the socialist ideas and policies of Nasser and his more liberal views had been showed as early as December 1970 when he lifted the sequestration order on private property. The October 1973 war and the popular sense of victory further provided Sadat with the needed power and legitimacy in his own right and so an opportunity to further reveal his critical views towards Nasser's socialist policies.

At the regional level, there was an opportunity for Egypt to attract extensive capital from Arab oil-producing countries generated by the oil price booms during the 1970s. The oil price shock ultimately brought a vast amount of resources to the Egyptian economy. It enhanced the opportunities for employment and capital flow to Egypt through not only labour migration to the Arab oil-producing countries, but also through Arab tourists, Arab journalism, broadcasting, and television. Foreign policy and relations factors, namely peace with Israel and alliance with the West also played a significant role in encouraging the Open-Door policy. Unlike Nasser who was devoted to revolution, anti-colonialism, social equity, and socialism, Sadat put his emphasis on the intangible values of love, peace, and faith.¹ As early as February 1971 Sadat introduced a peace initiative, which indicated his willingness to sign a peace treaty with Israel and re-open the Suez Canal in return for a partial Israeli withdrawal and the re-crossing of the Egyptian troops into Sinai. However, his peace initiative faced a setback when the Israelis were not persuaded. Partly in an attempt to bring back the balance in negotiations which he believed to have been lacking in the previous peace attempts,

¹ Dessouki, A. E. H., 'Ideology and Legitimacy in Egypt: The Search for a 'Hybrid Formula'', in Öncü, A., Ç. Keyder, and S. E. Ibrahim (eds.), *Developmentalism and Beyond: Society and Politics in Egypt and Turkey* (Cairo: Amer. U. in Cairo P., 1994), p. 85.

Sadat decided to wage war in October 1973 with Israel. Sadat's policies towards the domestic economy and towards Israel were interlinked. Sadat put an emphasis on peace with Israel which he believed would be beneficial to the pursuit of economic development in Egypt. Peace with Israel would provide a more stable and secure environment, which would in turn encourage foreign investment, and would also reduce defence expenditures. Also in relation to this, the decision to wage a war in part represented an attempt to solve or distract attention from domestic problems confronted by Sadat's regime in its earlier years. Pressure was mounting during the period 1972-1973 prior to the October 1973 war, which witnessed violent demonstrations by students who demanded both domestic reform and action against Israel to end the continuation of the state of 'no war, no peace,' as well as frequent violence between the Coptic and Muslim communities and criticism over the Egyptian government's economic policies.

Further political considerations lay in the international context of the détente period and in the change in Egypt's foreign policy towards a rapprochement with the West, particularly the US, further pushing Egypt towards a new set of economic policies. At the international level, the Soviet-US détente had a significant implication for Egypt. It indicated that during the détente period, Egypt would no longer have an opportunity to exploit the hostility between the two superpowers by playing one against the other for the purpose of receiving their assistance. This became clear when one considers Egypt's relations with the USSR during Sadat's regime which were initially uneasy and later turned sour. The late 1960s and early 1970s saw growing Soviet involvement in Egypt's defence and Egypt becoming increasingly dependent on the USSR, both militarily and economically. Despite the signing of a Treaty of Friendship and Cooperation with the Soviet Union in May 1971, disagreement between the two countries emerged over the supply of Soviet weapons. Sadat complained that the Soviet Union never delivered the most advanced equipment. In addition to such Soviet behaviour, the coup attempt to topple Sadat led by Ali Sabri and a group of pro-Soviet officials in May 1971 did not help lessen Sadat's frustration with the USSR. The worsened relationship between the two countries reached its peak in July 1972 when there were delays in arms deliveries. In the eyes of the Egyptian ruling elite, it looked as if the Soviet Union would not help Egypt regain the Sinai from Israeli occupation. This culminated in Sadat's ordering of all Soviet military experts to leave Egypt.

Despite this incident, Egypt's contacts with the USSR continued since a sudden rupture in its relationship with the USSR was neither possible when there were too many Soviet sympathisers in the Egyptian armed forces and administration, nor desirable as this would repeat Nasser's mistake in rebuffing the US.² While the Egyptian-Soviet relationship began to deteriorate, the relationship with the West, particularly with the US started to improve. Sadat put his trust on the US, which he believed to be the only state able to put pressure on Israel. Egypt began to turn to the West and the US for aid which was partly aimed at facilitating the expansion of the private sector in the Egyptian economy. This aim was reflected in the key element of the USAID mission growth strategy for Egypt which had been to provide the incentives to increase production and to expand the role of the private sector.³

However, Sadat's initiative of the *infitah* policy was 'not a major economic turnaround but a ruse intended to maintain the flow of rents into Egypt.'⁴ Furthermore, despite some liberal elements where the regime was open to foreign investment, there remained the retention of tight state control over the economy. For instance, under Law No. 43 of 1974 concerning the investment of Arab and foreign capital and the free zones, the General Authority for Arab and Foreign Investment and Free Zones (the so-called Investment Authority) was created with the authority to check and select the applications for all projects and then obtain the approval of all other relevant government agencies for those selected projects. The establishment of the Investment Authority seems to suggest that the Egyptian government was still unwilling to curtail its control as well as the degree of intervention in the economy. Thus, the *infitah* policy, together with such tight state control over the economy, would be insufficient in dealing with its balance of payments problems, according to the IMF standard.

Similar to the 1960s negotiations, the negotiations between Egypt and the IMF during the 1970s began as a result of alarming problems in Egypt's balance of payments. The overall balance of payments deficit during the early 1970s, prior to Egypt's informal

² Fernandez-Armesto, F., *Sadat and His Statecraft*, 2nd ed. (Windsor Forest, Berkshire: Kensal P., 1983), p. 124.

³ Ali, A. M. S., 'The International System and State Policies: The Case of Egypt,' in Öncü, Keyder, and Ibrahim, *op. cit.*, pp. 191-192.

⁴ Harik, I., *Economic Policy Reform in Egypt* (Gainesville: U. P. of Florida, 1997), p. 199. See also Hamed, O., 'Egypt's Open Door Economic Policy: An Attempt at Economic Integration in the Middle East,' *International Journal of Middle East Studies*, vol. 13, 1981, pp. 1-9.

request for IMF credit, was on a constant rise from only US\$ 12 million in 1970 to US\$ 489 million and US\$ 1,217 million in 1973 and 1974, respectively (see Table 4.2).

The rapid rise in balance of payments deficits during the early 1970s was mainly due to a rapid increase in the demand for imports. Although the value of merchandise exports did increase substantially during 1970-1974 by 104.65 per cent in four years, the value of merchandise imports rose much more rapidly, by 168.82 per cent in the same period. As a result, deficits in trade and current account balances dramatically increased from US\$ 267 million and US\$ 148 million in 1970 to US\$ 1,242 million and US\$ 1,320 million in 1974, respectively (see Table 4.2). Part of the rapid import growth stemmed from the sudden introduction of a more liberal trade system, allowing a rapid rise in imports of not only capital and intermediate goods but also consumer goods. This, together with the high annual population growth of over 2.2 per cent, in part led to a higher growth in imports than that of exports. Military expenditures on the October 1973 war represented a further drain on the Egyptian economy.

It cannot be denied that external conditions could have an adverse impact on Egypt's balance of payments position. Food imports upon which Egypt was heavily dependent had to be purchased at the time when the international price of wheat (its major imported commodity) rose considerably. The deterioration in Egypt's terms of trade in relation to cotton (its main export item) and wheat in part contributed to the worsening of the trade balance. During the first half of the 1970s the world price of wheat increased 4.5 times (from LE 25 to LE 112 per ton), whereas that of cotton rose only about 100 per cent (from LE 530 to LE 1,068 per ton). This resulted in a rapid decline in the capacity of cotton exports to finance wheat imports: a ton of cotton exported in 1975 bought less than half of the amount of wheat that Egypt had bought in 1969.⁵

⁵ Ikram, K., *Egypt: Economic Management in a Period of Transition* (Baltimore: Johns Hopkins U. P., 1980), p. 224.

Table 4.2 Egypt's Economic Indicators, 1970-1980

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
GNP (LE million)	2,927	3,086	3,403	3,634	4,085	4,738	6,409	8,643	10,765	13,260	...
GDP at market prices (LE million)	2,971	3,146	3,417	3,663	4,197	4,886	6,276	8,210	9,782	12,475	...
GDP (LE million) 1975 prices	3,784	3,968	4,121	4,089	4,297	4,886	5,266	5,682	6,258	6,801	...
GDP per capita (LE)	89.14	92.31	98.08	102.84	115.24	131.24	165.72	211.65	245.66	304.42	...
Real GDP per capita (LE)	113.53	116.43	118.28	114.80	117.98	131.24	139.05	146.48	157.16	165.96	...
GDP growth (%)	10.20	5.89	8.61	7.20	14.58	16.42	28.45	30.82	19.15	27.53	...
Real GDP growth (%)	1.83	4.86	3.86	-0.78	5.09	13.71	7.78	7.90	10.14	8.68	...
Consumer prices index number	74.9	77.2	78.8	82.2	91.1	100	110.3	124.3	138.1	151.8	183.1
Consumer price inflation (%)	3.88	3.07	2.07	4.31	10.83	9.77	10.3	12.69	11.10	9.92	20.62
Budget deficit (LE million)	...	...	...	...	...	-938	-1,557	-1,114	-1,246	-1,964	...
Total debt service (US\$ million)	...	224.70	364.00	441.80	301.60	305.40	266.80	498.20	583.00	518.50	1,235.20
Total debt service ratio (% of exports of goods and services)	...	21.77	32.46	31.09	11.94	10.34	6.44	10.17	9.71	6.36	13.41
Export (fob) (US\$ million)	817	851	813	1,000	1,672	1,567	1,609	1,974	1,939	2,424	3,854
Import (fob) (US\$ million)	-1,084	-1,131	-1,170	-1,429	-2,914	-3,941	-3,842	-4,038	-4,743	-6,002	-6,814
Trade balance (fob) (US\$ million)	-267	-280	-357	-429	-1,242	-2,374	-2,233	-2,064	-2,804	-3,578	-2,960
Current balance (US\$ million)	-148	-207	-464	-558	-1,320	-2,383	-1,430	-1,200	-1,220	-1,542	-438
Overall balance of payments (US\$ million)	-12	-58	-295	-489	-1,217	-2,868	-1,306	-1,906	-1,064	-16	610
Foreign exchange (US\$ million)	74	49	41	222	214	177	216	402	481	529	1,046
Population (millions)	33.33	34.08	34.84	35.62	36.42	37.23	37.87	38.79	39.82	40.98	42.29
Population growth	2.55	2.25	2.23	2.24	2.25	2.22	1.72	2.43	2.66	2.91	3.20

Sources: International Monetary Fund, *International Financial Statistics Yearbook* (IFS), 1981, pp. 170-173, and 1983, pp. 202-205. For balance of payments, International Monetary Fund, *IFS Yearbook*, 1992, pp. 330-331. For total debt service and total debt service ratio, World Bank, *World Development Indicators* [CD-Rom], 2000.

However, the blame for the deficit burden could not solely be placed on external conditions. As G. Amin argues that '... one must raise the question why domestic production failed so badly in meeting domestic requirements ... much of this failure must be due to lower investment in agriculture in earlier years, partly due ... to the impact of the 1967 war.'⁶

After the October 1973 war, substantial deficits on the current account were largely financed by official loans and grants and, until 1976, by short-term commercial borrowing. Post-October 1973 saw the rapid growth of official Arab financial assistance in several forms such as cash loans, grants, project and programme loans, and deposits with the CBE. The total amount of main types of Arab assistance to Egypt (grants, cash loans and deposits, and project and programme loans) rose from US\$ 905 million in 1973 to a peak of US\$ 2,774 million in 1975.⁷ As a result, foreign exchange reserves rose from less than US\$ 50 million in 1971-1972 to above US\$ 200 million in 1973-1974 (see Table 4.2). In addition to official grants and loans, to meet the higher cost of food imports, Egypt was obliged to resort heavily to short-term borrowing from foreign commercial banks at high interest rates after the period of controlling its overall use during 1967-71.⁸ However, despite the increasing flow of money after the October 1973 war, there remained the need for Egypt to seek financial assistance from elsewhere, including from the IMF.

Section B: Narrative

4.1 The April 1977 Stand-By Arrangement

With the deterioration of its external economic situation, Egypt began its negotiations for an upper credit tranche arrangement with the IMF in the mid-1970s. In late April 1974, the Egyptian government approached the IMF to request the latter's assistance in drawing up a stabilisation programme for a SBA.⁹ The two visits by the IMF team to Cairo in June-July 1974 and November-December 1974 led to no final conclusion. The efforts continued throughout 1975 and 1976 but still no formal agreement could be reached.

⁶ Amin, G., *Egypt's Economic Predicament: A Study in the Interaction of External Pressure, Political Folly and Social Tension in Egypt, 1960-1990* (Leiden: E. J. Brill, 1995), p. 8.

⁷ Ikram, *op. cit.*, pp. 349-351.

⁸ *Ibid.*, p. 363.

⁹ IMF Central Files, C/Egypt/810, Mission Paul Dickie, June-July 1974, a letter from Abdel-Aziz Higazy (First Deputy Prime Minister) to H. Johannes Witteveen (Managing Director), 28 Apr. 1974.

After prolonged negotiations of nearly 3 years, by early March 1977 agreement was reached between the two parties. This was followed by the IMF Executive Board's approval on 20 April 1977 of a SDR 125 million SBA for Egypt to be drawn over a twelve month period until April 1978.¹⁰ The major aim of the economic programme for the April 1977 SBA was 'to restructure relative prices so as to develop the external sector.'¹¹ To achieve this aim, a number of policy measures and targets were set under several policy areas, including exchange reform and external trade policy, domestic price liberalisation, fiscal policy, monetary and credit policy, and external debt policy and arrears.¹²

An outline of IMF conditionality was first drafted by the IMF team in a lengthy memorandum, describing its concept of a suitable programme. It dealt with a list of reform policies similar to the one above, including the exchange and trade system, pricing policy, fiscal policy, monetary and credit policy, external debt policy and administrative reform.¹³ Throughout a series of discussions, differences between the two sides emerged over the pace of reform rather than what should be included in the programme.¹⁴ While generally accepting the IMF staff's proposal on the economic programme, the Egyptian side, including those at the top, namely, President Sadat and Prime Minister Mamdouh Salem, insisted that the programme had to be implemented only gradually.¹⁵ With frequent occurrences of demonstrations and violent riots against the rising cost of living, there was a great deal of reluctance on the Egyptian side to undertake IMF-proposed measures having a substantial effect on prices,¹⁶ namely exchange rate reform and pricing policies through a cut in subsidies and an increase in public sector prices.

¹⁰ IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, IMF Executive Board's Decision no. 5375-(77/59), 20 Apr. 1977.

¹¹ Arab Republic of Egypt, *Annex to Stand-By Arrangement* [the Letter of Intent], 4 Mar. 1977, in IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Acting Secretary, *Arab Republic of Egypt – Stand-By Arrangement*, EBS/77/90 Supplement 1, confidential, 21 Apr. 1977, p. 5.

¹² For more details on IMF conditionality under the 1977 SBA, see Appendix C.

¹³ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Nov.-Dec. 1974, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *Mission to Egypt Concerning the Extended Fund Facility*, confidential, 10 Dec. 1974.

¹⁴ *Ibid.*

¹⁵ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a memorandum, To the Managing Director and the Deputy Managing Director, John W. Gunter, *Mission to Egypt on Use of the Fund's Resources*, confidential, 25 Nov. 1975.

¹⁶ *Ibid.*; and IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Apr. 1975, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *Mission to Egypt*, confidential, 1 May 1975.

4.1.1 Demonstrations and Riots as Domestic Pressure

While the negotiations with the IMF were under way, the Egyptian government faced severe domestic constraints in accepting the IMF-proposed measures. Besides the balance of payments problem, Egypt was faced with other mounting economic difficulties. The population growth of over 2.2 per cent during the first half of the 1970s put a strain on its already-run-down infrastructure and overburdened its food production which in turn created an increasing reliance on imported food stuffs. The inflation rate substantially rose from a range of 2-4 per cent during 1970-1973 to nearly 11 per cent in 1974 (see Table 4.2).

The frequent outbreak of demonstrations and riots during the mid-1970s, which appeared to have been caused by public dissatisfaction with Egypt's state of economy in terms of deteriorating urban infrastructures and rising inflation, placed more pressure upon the Egyptian government in addition to the economic and financial problems. In October 1974, a bus station in Cairo was set on fire in a protest against the inadequacy of public transport. The following month witnessed a public outcry over the state of Cairo's drinking water, which ran brown from the taps. Demonstrations in Helwan at the end of September 1974 by industrial workers from Helwan and Shoubra al-Khaima against the rising cost of living and low wages re-erupted in Cairo on New Year's Day of 1975.¹⁷ It was only two months after the January 1975 riots that another set of demonstrations by textile workers at Mehalla el-Koubra (the centre of Egypt's textile industry 80 miles north of Cairo) took place and led to violent three-day riots.¹⁸ Against the background of domestic riots, it is understandable why the Egyptian government could not accept the extent of the IMF-proposed measures on prices which would have an adverse impact upon the cost of living and political stability, which would in turn undermine the regime's political survival.

As a way to ensure domestic political stability, President Sadat, in the wake of the January 1975 riots in Cairo, responded by issuing a Presidential Decree of emergency measures to alleviate the shortages and high prices of basic food commodities.¹⁹ The measures pledged by President Sadat included the allocation of additional money for the importing of basic food items (such as wheat, flour, maize, lentils, beans, sugar, tea,

¹⁷ *MEED*, 18 Apr. 1975, p. 4.

¹⁸ *Ibid.*; and EIU, *Egypt: Quarterly Economic Review* (hereafter called *QER*), no. 2, 1975, p. 2.

¹⁹ *MEED*, 10 Jan. 1975, p. 7.

meat, and cheese), and wages increases and promotion for public-sector employees.²⁰ Due to the stalled process of the Arab-Israeli peace settlement, Egypt was able to get a substantial inflow of financial aid from Saudi Arabia, helping Sadat fulfil his promises. During his visit to Egypt on 19-20 January 1975 as part of a tour aimed at maintaining Arab unity in dealing with the issue of the Arab-Israeli dispute, King Faisal of Saudi Arabia gave Egypt a pledge of an immediate assistance of US\$ 100 million, which would cover the purchase of essential commodities.²¹ In the following month, Egypt received this financial aid.²²

Moreover, with the forthcoming presidential referendum scheduled for 2 October 1976, an increase in food subsidies was announced in the 1976 budget with an aim of gaining popular support and also reducing the public outcry at home, particularly at the time when widespread unrest had frequently taken place. In addition, other measures were adopted in a hope that the regime would be seen to be carrying the burden of giving more money to the population. They included reducing extravagant government spending by LE 100 million through a cut in the public sector entertainment budget by 20 per cent, a halt of purchasing government limousines, and leasing construction of large-scale government buildings.²³ The money saved from the government's lavish spending was diverted to raise subsidies on basic foodstuff to a total of LE 700 million, representing an increase of LE 58 million on the 1975 allocation.²⁴

4.1.2 Seeking a Coalition: Tactics Employed by Both Parties

While they were unable to reach agreement, each party sought third parties' assistance to enhance their relative power vis-à-vis the other. On the IMF's side, there had been a close collaboration of its staff with the World Bank's staff since the outset of the negotiation process between Egypt and the IMF.²⁵ The World Bank's staff had indicated to the Egyptian government that in the World Bank's lending policy on a programme loan, importance was attached by the Bank to an agreement being reached

²⁰ *MEED*, 10 Jan. 1975, p. 8.

²¹ *MEED*, 24 Jan. 1975, p. 9.

²² EIU, *Egypt: QER*, no. 1, 1975, p. 8.

²³ EIU, *Egypt: QER*, no. 1, 1976, p. 2.

²⁴ *MEED*, 30 Jan. 1976, p. 16.

²⁵ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Apr.-May 1974, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *Egypt: Mission for Article XIV Consultation Discussions and Use of Fund Resources*, confidential, 10 May 1974.

with the IMF.²⁶ In the negotiations between Egypt and the World Bank on a programme loan of about US\$ 70 million during 1974, the World Bank lent its support for the IMF staff's view that the parallel market of exchange rate should be expanded by requiring Egypt to use most of the funds at this parallel market rate.²⁷ Also, efforts were made to avoid disagreement between the two institutions, which might act against the IMF's negotiating power. There had been an exchange of the two institutions' staff members to work with each other's mission in negotiations with Egypt such as over the issue of external debt.²⁸ The World Bank's co-operation with the IMF was sought with the objective of strengthening the IMF's bargaining power vis-à-vis Egypt. This was clearly reflected in the IMF staff's view: 'The hope of getting effective action by Egypt depended greatly . . . on a coordinated approach by our two institutions.'²⁹ In their discussions in May 1975, Munir Benjenk (Vice President of the World Bank for Europe, the Middle East and North Africa) assured John W. Gunter (the staff in the IMF's Middle East Department and the head of the IMF's negotiating team) of the Bank's position towards the negotiations between the IMF and Egypt. As Gunter noted in his memorandum:

[T]he Bank would . . . emphasize strongly to the Egyptians the importance that the Bank attaches to there being an agreement between Egypt and the Fund and that if there were no such agreement the detailed conditionality that would be required by the Bank for further lending would have to be expanded greatly as compared to last year.³⁰

Similar to the IMF, Egypt sought to reinforce its bargaining power through gathering counter-support from 'friendly' states. The international political conditions in the post-October 1973 war era were conducive for Egypt to use its strategic importance in pursuing such a tactic vis-à-vis the IMF. Egypt's negotiations during 1974-early 1977 with the IMF coincided with the US's desire to induce Egypt's commitment to the Egyptian-Israeli Sinai disengagement agreements and also with its efforts in the Arab-Israeli peace initiatives in general. Seemingly being aware of what the post-war

²⁶ IMF Central Files, C/Egypt/801, Relations with Missions of Other Organizations in the Area of Fund Interests and Jurisdiction, Office Memorandum, To the Managing Director, From John W. Gunter, *Egypt: Bank/Fund Cooperation*, 8 Nov. 1974.

²⁷ *Ibid.*

²⁸ *Ibid.*

²⁹ IMF Central Files, C/Egypt/801, Relations with Missions of Other Organizations in the Area of Fund Interests and Jurisdiction, Memorandum for the Files, From John W. Gunter, *Meeting with the Regional Vice-President of the IBRD for EMENA [Europe, Middle East and North Africa] on Tuesday afternoon, May 20, 21 May 1975.*

³⁰ *Ibid.*

situation might bring, the Egypt government approached the US in a hope to gain the latter's support for its position in negotiations with the IMF. In May 1975, Egypt officials had reportedly made strongly-worded complaints to the US Embassy in Cairo over the IMF mission urging for economic policies that were politically impossible. In addition to the complaints, Egypt also sought from the US substantial balance of payments assistance, with an annual amount of US\$ 1 billion.³¹ With its dominant political motive, the US approached countries such as Saudi Arabia, Iran, Kuwait, Germany and Japan, to take part in a package of aid to Egypt, admitting that this amount was larger than would be feasible from the US alone.³² In addition to the US economic aid and support, Egypt tried to secure aid inflows from the Arab world. By January 1976, Prime Minister Mamdouh Salem was reportedly on a tour of Saudi Arabia, Kuwait and the United Arab Emirates to raise about US\$ 3-5 billion a year on at least a five-year basis.³³

Therefore, both parties, especially the Egyptian government, remained active during the negotiations regarding IMF conditionality. They were in search of the possibility of increasing their relative power to ensure that the outcome of their negotiations would be what they preferred.

4.1.3 Technocratic Alliances versus Cabinet Division

During the negotiations with the IMF, there emerged substantial disagreements within the Egyptian team which apparently developed into tensions within the Egyptian cabinet.³⁴ Far from being united, the Egyptian team and also the Egyptian cabinet were divided over the politically sensitive issues, namely exchange reform which could have a great impact upon domestic prices. On the one hand, the IMF's analysis and proposals gained support from Mohamed Zaki Shafei, Minister of Economy and Economic Co-operation, and Ibrahim Helmi Abdel-Rahman, Minister of Planning and Administration. However, the two ministers appeared to be unable to press for policy

³¹ IMF Central Files, C/Egypt/801, Relations with Missions of Other Organizations in the Area of Fund Interests and Jurisdiction, *op. cit.*, 21 May 1975.

³² *Ibid.*; and IMF Central Files, C/Egypt/801, Relations with Missions of Other Organizations in the Area of Fund Interests and Jurisdiction, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *New Aid Package for Egypt being Organized by the U.S.*, confidential, 30 May 1975.

³³ IMF Central Files, Witteveen and Staff, Mar. 1976, Office Memorandum of the World Bank/International Finance Corporation, To Mr. Hollis B. Chenery (VP, Development Policy), From Mahbub ul Hag (Director, PP & PP), *Visit to Egypt*, 27 Jan. 1976.

³⁴ *MEED*, 28 May 1976, p. 16.

changes in the government. On the other hand, Minister of Finance Ahmed Abu Ismail and other important officials in the Ministry of Finance strongly opposed some parts of the exchange reform which the IMF had pressed for, the establishment of the commercial exchange market with a floating rate to unify the parallel and 'own exchange' rates and a shift of a large proportion of public sector imports from the official to the commercial rate, as a path towards achieving the ultimate objective of a unitary exchange rate. Other ministers such as Issa Chahine (Industry), Ahmed Izzedin Hasan Hilal (Petroleum) and Abdel Rahman el-Chazli (Supply) were not prepared to take an active role in the policy reform.³⁵

In this regard, it can be said that there existed technocratic alliances between the IMF and some figures in the Egyptian negotiating team and government. Yet, such technocratic alliances were rather ineffective in reinforcing the IMF's relative power. Its potential effect was undermined by the division within the Egyptian team and cabinet. Especially, those ministers and also negotiators whose view on the policy programme was in line with that of the IMF were not in a position to make the final decision or at least to convince their colleagues and superior of IMF demands. As Gunter, the head of the IMF team puts it:

Soon thereafter, Kaisouni dropped out of the picture for a number of years. We dealt with several Ministers of Economy, all of whom were bright and seeking to do a good job [One] was Professor Zaki Shafei of the University of Cairo, an able economist and a good friend of Shaalan [an IMF staff]. He understood the issues very well and made a substantial effort at reform. However, ultimately the "politics" were too much for him to cope with.³⁶

Instead, the outcome of these negotiations suggested that the division in the Egyptian cabinet partly helped strengthen Egypt's bargaining power vis-à-vis the IMF. In the end, the Egyptian team was successful in obtaining some concessions from the IMF counterpart. Some exceptions were allowed such as imports of wheat flour and raw materials for pharmaceuticals which would continue at the official rate.³⁷ By mid-May 1976, following the talks in mid-March and April-May 1976, agreement on an

³⁵ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, *op. cit.*, 25 Nov. 1975.

³⁶ Gunter, J., unpublished paper, pp. 37-38.

³⁷ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Apr.-May 1976, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *Mission to Egypt*, confidential, 20 May 1976.

economic programme for a SBA was reached and a Letter of Intent was drafted. In addition to the exchange rate reform, other measures included ones to improve monetary and fiscal position, for example, credit ceilings; an increase in the interest rates by two percentage points, making a total of three during 1976 (the interest rates had already been increased by one percentage point in January 1976); the elimination of subsidies on a large number of foodstuff items, except basic food commodities such as wheat, rice and sugar; an upward wage adjustment to cushion the negative impact of the price increases; an adjustment of custom duties valuation to the commercial rate for imports for which that rate applied; administrative reforms to increase the freedom of enterprises to make decisions such as the abolition of the Public Economic Organisation (the holding companies for the public-sector companies); and new legislation in the taxation field. Regarding external sector policy, multiple currency practices, restrictions on payments and transfers for international transactions and bilateral payments arrangements were to be curtailed. There were also provisions on external debt designed to reduce reliance on short-term external borrowing and eliminate arrears, and on an establishment of an administrative unit in the Ministry of Economy to manage the external debt.³⁸

Nonetheless, Egypt did not submit the official request for a SBA, even though the Managing Director was, by early June 1976, prepared to support Egypt's request on the basis of the draft letter.³⁹ In mid-July 1976, it was reported that Egypt had withdrawn its request for a SBA with the IMF, even though substantial elements of the economic program had already been implemented. They included considerable transfers of imports from the official rate to the more realistic parallel market rate and valuing of imports for customs purposes at the parallel market rate.⁴⁰ Also, an attempt was made to reduce subsidies. In May 1976, subsidies on flour, corn, sesame, meat and coffee were abrogated with savings of LE 55 million in 1976.⁴¹ However, the Egyptian government found it not feasible to fully implement other elements of the economic

³⁸ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *Egypt: Draft Letter of Intent for Stand-By Arrangement*, 1 June 1976. This memorandum contained a draft Letter of Intent dated 15 May 1976 (Revision II).

³⁹ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a cable from John W. Gunter to Zaki Shafei (Minister of Economy and Economic Co-operation), 2 June 1976.

⁴⁰ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a cable from John W. Gunter to Abdel-Aziz al-Quraishi (Governor of the Saudi Arabian Monetary Agency), 14 July 1976.

⁴¹ Ikram, *op. cit.*, p. 322.

programme reached in April-May 1976,⁴² namely the floating of the Egyptian pound. Even though at the end of April 1976 the Egyptian government had announced plans to introduce a new floating commercial market rate,⁴³ the decision on the matter was later postponed.⁴⁴ Egypt argued for no phasing of the IMF credit and for the availability of the whole amount (SDR 125 million) when the new commercial exchange market became effective. With the IMF's insistence on phasing the credit as a way to ensure the implementation of IMF conditions, Egypt rejected the terms attached to the SBA arranged with the IMF to underwrite the floating of the Egyptian pound on the grounds that Egypt would not risk floating the pound when there would be inadequate stabilisation fund.⁴⁵ Furthermore, public borrowing and deficit financing increased in 1976.⁴⁶ Therefore, the whole package of the IMF's financial assistance was turned down by Egypt since it was considered to be unacceptable, leading to rises in import prices at a time when inflation was already a sensitive political issue.

What enabled Egypt to prolong negotiations for about two years since June 1974, gain concessions from the IMF and subsequently withdraw its request in July 1976? A pledged and actual large package of aid organised by the US in conjunction with other contributors coupled with the Gulf Organisation for the Development in Egypt's⁴⁷ (GODE) pledge of US\$ 2 billion announced in mid-July 1976 near the time of Egypt's withdrawal appear to provide the answer. Indeed, Egypt's efforts in obtaining the US's backing paid off. Following the October 1973 war, the US economic aid to Egypt, which had been practically ceased after the 1967 war, had been revived with an aim to provide support to the Sadat regime's interest in a policy of rapprochement with the US and conciliation with Israel, and also to its ability to convince its own population that such a policy was beneficial and thus worth taking. When the Egyptian government signed the Sinai I disengagement accord in January 1974, the US immediately released

⁴² IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, *op. cit.*, 14 July 1976.

⁴³ *MEED*, 30 Apr. 1976, p. 15.

⁴⁴ *MEED*, 12 Nov. 1976, p. 17.

⁴⁵ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, two cables from Zaki Shafei to John W. Gunter, 5 June 1976, and 10 June 1976, and a cable from John W. Gunter to Zaki Shafei, 8 June 1976.

⁴⁶ Waterbury, J., *The Egypt of Nasser and Sadat: The Political Economy of Two Regimes* (Princeton, N. J.: Princeton U. P., 1983), p. 410.

⁴⁷ The GODE was established in April 1976, comprising four Arab Gulf members: Saudi Arabia; Kuwait; Qatar and the United Arab Emirates. The headquarters of the GODE was located in Riyadh. The president of the Board of Governors was the Saudi Finance Minister and the remainder of the board consisted of the finance ministers of the rest of the member countries. EIU, *Egypt: QER*, no. 4, 1976, p. 7.

US\$ 85 million to fund the offered reconstruction of the Suez Canal area. To strengthen Sadat's interest in the pursuit of a broader Sinai disengagement agreement, the Nixon Administration decided in March 1974 to request US\$ 250 million from Congress to finance Egyptian development projects in fiscal year 1975. President Nixon informed Sadat of this request during his June 1974 trip to Egypt and the fund was finally appropriated in December 1974. More importantly, this was followed by a substantial expansion of the US economic aid to Egypt during 1975-1976. To reward Sadat following the signing of the Sinai II disengagement agreement, the Ford Administration pledged in the fall of 1975 to provide Egypt with nearly US\$ 1 billion in economic assistance, comprising US\$ 750 million in grants and concessionary loans and US\$ 200 million in PL 480 Title I food aid.⁴⁸ The top priority of the US aid programmes in 1975-1976 was Egypt's serious foreign exchange shortage, dealt with mainly through the financing of food, industrial raw materials, and spare parts.⁴⁹ This would in turn help lessen the need for Egypt to conclude a policy programme with the IMF.

Furthermore, it seemed that little pressure had been exerted by the US upon Egypt in reaching an agreement with the IMF. On the one hand, the US informed the Egyptian government that in relation to its aid package, importance was attached to appropriate understandings being reached between Egypt and the IMF and the World Bank. However, it was doubtful whether the US took the matter seriously. Both the IMF and the WB were well aware of this point. In the light of the US's ongoing peacemaking efforts in the Egyptian-Israeli conflict, in particular, and in the Arab-Israeli conflict in general, the US State and Treasury officials acknowledged to both the IMF and the World Bank that they did not consider it politically feasible to make the new aid package in any sense conditional on such understanding, in spite of being aware that the aid package would substantially reduce pressure for Egypt to reach an agreement with the IMF.⁵⁰

As has previously been pointed out, in addition to the IMF and the US, Egypt also sought financial assistance elsewhere, particularly from Arab states. Its efforts paid off

⁴⁸ Burns, W. J., *Economic Aid and American Policy Toward Egypt, 1955-1981* (Albany, N. Y.: State U. of New York P., 1985), pp. 180-181, and 184.

⁴⁹ Weinbaum, M. G., *Egypt and the Politics of U.S. Economic Aid* (Boulder: Westview P., 1986), p. 37.

⁵⁰ IMF Central Files, C/Egypt/801, Relations with Missions of Other Organizations in the Area of Fund Interests and Jurisdiction, *op. cit.*, 30 May 1975; and IMF Central Files, C/Egypt/801, Relations with Missions of Other Organizations in the Area of Fund Interests and Jurisdiction, *op. cit.*, 21 May 1975.

when by mid-July 1976, the GODE agreed to provide US\$ 2,000 million for investment projects in Egypt. A protocol was signed in Cairo on 18 July 1976.⁵¹ It is questionable whether Egypt turned down the SBA because it thought the whole US\$ 2 billion would be coming from the GODE or whether the Egyptian government was unaware of the cross-conditional of the GODE's economic aid. For certain, the disbursement of the GODE fund to Egypt was reported to be conditional upon Egypt's acceptance of IMF conditionality.⁵² Perhaps Egypt decided to take the risk of withdrawing its request for a SBA in the hope that its strategic and political importance in the Middle East at such favourable time would make creditors other than the IMF re-consider their cross-conditional.

Therefore, both the US-organised aid package and the GODE's promise seemed to substantially strengthen Egypt's relative power vis-à-vis the IMF. Due to Egypt's effective tactic, there were non-conditional financial resources available or expected to be available. This largely enabled Egypt to afford avoiding IMF conditionality through its mid-July 1976 withdrawal of the request for IMF lending. Egypt seemed to withdraw its request for IMF credit in anticipation that money from elsewhere would soon be available to it. Nonetheless, this tactic worked only on a temporary basis as Egypt later discovered that there remained pressure for it to reach an agreement with the IMF.

4.1.4 External Pressure from the GODE

Despite money flowing in from the US, Egypt's financial situation in the summer of 1976 was approaching a crisis. The balance of payments situation was becoming increasingly difficult with overdue payments continuing to rise and the placing of import orders being delayed.⁵³ By 1976, Egypt experienced a difficulty in repaying its short-term debt. After the October 1973 war, Egypt's short-term borrowing (bearing interest rates of 15-17 per cent with a repayment period of 90 to 180 days) was about US\$ 1.5 billion. These short-term credits resulted in aggregate debt service which reached 40 per cent of all visible and invisible exports in 1975.⁵⁴ The arrears on its short-term repayments rapidly accumulated from US\$ 32.9 million in December 1975

⁵¹ EIU, *Egypt: QER*, no. 3, 1976, p. 3; and *MEED*, 23 July 1976, p. 13.

⁵² *MEED*, 30 July 1976, p. 12.

⁵³ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, a cable from John W. Gunter to Abdel-Aziz al-Quraishi, 18 Aug. 1976.

⁵⁴ Waterbury, *op. cit.*, 1983, p. 409.

to US\$ 452.9 million by December 1976.⁵⁵ This situation was largely a consequence of the continuous growth of the import bill of grain due to high prices at the world market (caused by large purchases of US grain from the USSR). In an attempt to pay for its import bill, the government resorted to short-term commercial bank loans and suppliers' credits at high interest rates. The sizeable inflows of cash aid from the Arab Gulf states in 1973 temporarily alleviated Egypt's short-term debt burden by enabling it to pay for the due payments, and also to meet its import requirements.⁵⁶ However, 1976 saw the accumulation of arrears on its short-term repayments as well as a decline in the inflows of financial resources, particularly those from the Arab Gulf states. Between 1975 and 1976, total Arab assistance to Egypt fell considerably from US\$ 2,774 million to US\$ 1,072 million.⁵⁷

Moreover, the amount of aid pledged by the GODE in mid-July 1976 fell far behind what Egypt had envisaged. President Sadat remarked in an address at Alexandria University on 26 July 1976: 'What Egypt wanted from the Development Fund [GODE] was not 2,000 million dollars over five years but 10,000 to 12,000 million over the same period.'⁵⁸ He added: 'I say to our friends, with all the gratitude, recognition and respect that we owe them, that the fund must take a different form than that which they want it to take . . . I hope our friends will not become upset over this.'⁵⁹ In his speech on the anniversary of Nasser's death on 29 August 1976, President Sadat reiterated his appeal to the Arab Gulf states for US\$ 10,000 million development aid to Egypt.⁶⁰ The reiteration of Sadat's public criticism of Arab aid seemed to reflect Egypt's increasing financial difficulty and at the same time represented his tactical move to rally more financial support from the Arab Gulf states.

Although there was cross-conditionality attached to the GODE fund, part of it was released to provide Egypt with balance of payments assistance despite Egypt's continuous rejection of IMF terms. This came after Saudi Arabia, the largest

⁵⁵ Ikram, *op. cit.*, p. 364.

⁵⁶ Waterbury, *op. cit.*, 1983, p. 409.

⁵⁷ Ikram, *op. cit.*, p. 351.

⁵⁸ *Summary of World Broadcast* (hereafter called *SWB*), ME/5271, 28 July 1976, p. A/2. See also *MEED*, 30 July 1976, p. 12.

⁵⁹ EIU, *Egypt: QER*, no. 3, 1976, p. 4.

⁶⁰ *MEED*, 8 Oct. 1976, pp. 13-14.

contributor of the GODE fund,⁶¹ had learned of the severity of Egypt's financial situation and of Egypt's seeming unwillingness to push economic measures recommended by the IMF, particularly during the run-up to the parliamentary elections scheduled in October 1976 to avoid jeopardising the regime's political survival.⁶² By early September 1976, negotiations were under way for US\$ 500 million of balance of payments assistance to Egypt from the GODE.⁶³ Half of the amount was in the form of a guarantee by the GODE to commercial banks agreed in late November 1976. The other half, agreed in early January 1977, was a cash loan from the GODE itself with concessional terms of a 5 per cent interest rate and a repayment period of ten years plus a three-year grace period.⁶⁴ However, the amount of cash provided by the GODE to Egypt was far from covering its needs. In effect, the GODE's cash aid would only allow Egypt to buy time in dealing with its chronic economic problem, at least until the forthcoming parliamentary elections came to an end.

The Egyptian government was well aware that further aid to Egypt from Saudi Arabia and other Arab countries was made contingent upon the conclusion of an arrangement with the IMF.⁶⁵ The flexible attitude of the oil-rich Arab countries towards Egypt as a result of their solidarity in the October 1973 war against Israel evaporated when the Egyptian government kept dragging its feet over the policy programme. The GODE was reportedly concerned that Egypt had not implemented the economic stabilisation programme worked out earlier in the year, including a reduction in the budget deficit by cutting back the subsidies on consumer goods, the introduction of a new commercial exchange rate and the levying of customs duties at the commercial rather than the official rate.⁶⁶ In mid-October 1976, the GODE rejected Egypt's request for a US\$ 1,250 million loan to support its balance of payments deficit.⁶⁷ Furthermore, to ensure that its funds made available to Egypt would be used appropriately, Saudi Arabia originally proposed to the IMF the idea of linking disbursement of its money to the

⁶¹ The GODE fund was set up by its members in the following proportions: Saudi Arabia, 40 per cent; Kuwait, 30 per cent; and the UAE and Qatar, 15 per cent each. EIU, *Egypt: QER*, no. 3, 1976, p. 3; and *MEED*, 30 July 1976, p. 12.

⁶² IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, *op. cit.*, 18 Aug. 1976.

⁶³ IMF Central Files, C/U.A.R./1760, Stand-by Arrangements, 1965-1976, Memorandum for Files, From John W. Gunter, *Balance of Payments Assistance for Egypt*, confidential, 9 Sept. 1976.

⁶⁴ EIU, *Egypt: QER*, no. 1, 1977, p. 9; and *MEED*, 26 Nov. 1976, p. 16, and 7 Jan. 1977, p. 14.

⁶⁵ IMF Central Files, C/Egypt/810, Gunter and Staff, Jan.-Feb. 1977, Office Memorandum, To the Managing Director, From Ernest Sturc, *Mr. Gunter's Cable re Saudi Arabia Aid to Egypt*, 11 Feb. 1977.

⁶⁶ EIU, *Egypt: QER*, no. 4, 1976, p. 7-8.

⁶⁷ *MEED*, 15 Oct. 1976, p. 14.

phasing of drawings under the SBA through a medium of a Trust Fund administered by the IMF. However, owing to its concern over the potential pressure from the third party to ease its conditionality, the IMF was unwilling to be directly involved in the disbursement of Saudi Arabia's funds to Egypt.⁶⁸ It was only after Egypt had reached agreement with the IMF in early March 1977 that the GODE agreed later in the same month to provide further lending to Egypt in an amount of US\$ 1,500 million to cover its balance of payments deficit. The US\$ 1,500 million loan carried similar concessional terms to those of the US\$ 250 million loan agreed earlier.⁶⁹ It seemed that the cross-conditionality called for by the GODE added immense pressure on Egypt to pursue the negotiations with the IMF.

4.1.5 Resumption of Negotiations with the IMF

By December 1976, Egypt's negotiations with the IMF had to be resumed over the policy programme which would provide the basis for a SBA or an EFF preferred by the Egyptian government. Following the parliamentary elections in October 1976, a new cabinet was formed in the following month. The new Egyptian team was led by Abdel-Moneim el-Kaissouni, a newly appointed Deputy Prime Minister for Finance and Economic Affairs (the same position he held during the mid-1960s). As it turned out, the IMF had made certain concessions by acceding to the government's insistence that the Egyptian pound was too weak to be floated. According to Hamed Abdel-Latif al-Sayih Sayih, Minister of Economy and Economic Co-operation, the Egyptian pound was not a convertible currency, given the huge current deficit, and the demand for foreign exchange was out of proportion to supply, so that the question of floating 'was not a question at all.'⁷⁰ The IMF's initial demand for the establishment of a commercial market to unify the parallel market and 'own exchange' rates was dropped. In a tentative agreement reached in December 1976, the IMF team agreed to the policy of widening the parallel market to cover the transactions of a number of items at the official rate such as exports of cotton yarn and textiles, cement, potatoes, raw onion and garlic, and all imports of raw materials and intermediate goods, except wheat, wheat flour, edible oils, sugar, tea, fertilizers, insecticides and the non-capital imports of the petroleum sector.⁷¹ Also, the timing of an increase in interest rates by 3 percentage

⁶⁸ IMF Central Files, C/Egypt/810, Gunter and Staff, Jan.-Feb. 1977, *op. cit.*, 11 Feb. 1977.

⁶⁹ *MEED*, 1 Apr. 1977, p. 17.

⁷⁰ *MEED*, 17 Dec. 1976, p. 20.

⁷¹ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Dec. 1976, *Memorandum on Program Related to Use of Fund Resource*, prepared by IMF mission, confidential, 19 Dec. 1976.

points originally proposed by the IMF staff as a prior action⁷² (which was a condition needed to be met before the Executive Board's approval) was extended by the Managing Director. This meant that there would be an immediate increase of 1 per cent with a further correction to be considered not later than the mid-term review.⁷³ Based on the available information, it is uncertain why the IMF changed its position. However, this at least illustrates that being able to prolong negotiations and not yielding to the IMF demand easily, Egypt managed to obtain concessions from the IMF and more importantly, to direct IMF conditionality closer its preference in terms of a gradual pace of reform.

Furthermore, prior actions put forward by the IMF negotiating team, were numerous. They were contained in the first paragraph of Section 12 of a memorandum on the policy programme prepared by the IMF staff mission which read:

Certain steps will need to be taken before the stand-by agreement becomes effective, such as shift of items from official to parallel market rate . . . ; steps taken so that higher costs are reflected in prices from shifts to parallel market, reduction in subsidies and other fiscal measures, and adjustment of interest rates.⁷⁴

However, the number of prior conditions was later reduced in the actual IMF conditionality under the April 1977 SBA. The change in the IMF's view over the number of the prior conditions to be included in the SBA was largely influenced by concern raised by Muhammed al-Atrash, Executive Director representing a group of fourteen countries,⁷⁵ including Egypt. In his memorandum to Gunter, Muhammed al-Atrash strongly argued against the need for a large number of prior conditions that:

I believe that these measures could be among the ones to be taken during the course of the stand-by and inter alia, in support of which the stand-by would be granted, and not before the stand-by becomes effective. Otherwise, I am inclined to believe that the staff may run the risk of seeming uneven-handed, particularly in view of the fact that in practice the Fund does not normally

⁷² IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Dec. 1976, *op. cit.*, 19 Dec. 1976.

⁷³ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, a cable from H. Johannes Witteveen to Mohammed Abdel-Fattah Ibrahim (Governor of the Central Bank of Egypt), 27 Dec. 1976.

⁷⁴ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Dec. 1976, *op. cit.*, 19 Dec. 1976.

⁷⁵ The other thirteen countries were Bahrain, Iraq, Jordan, Kuwait, Lebanon, Libya, Pakistan, Qatar, Saudi Arabia, Somalia, Syrian Arab Republic, United Arab Emirates, and Yemen Arab Republic. International Monetary Fund, *International Financial Statistics, 1978 Supplement: Annual Data 1953-1977*, vol. 31, no. 5, May 1978, p. 2.

impose so many prior conditions before a stand-by becomes effective [original emphasis].⁷⁶

Nevertheless, the major difference remained over the issues of price adjustments in relation to the exchange reform. After having considered IMF conditions which had tentatively been reached in December 1976, the Egyptian government asserted that the elimination of the subsidies together with the partial unification of the exchange rates would have 'an unbearable impact on prices' and argued for 'a flexible and more prolonged approach.'⁷⁷ However, when the riots broke out in Egypt in January 1977, the prospect of reaching an agreement was cast in doubt.

4.1.6 The January 1977 Riots and Their Repercussions on Negotiations

The Egyptian government's attempts to tackle Egypt's chronic debt problems in line with what the IMF had been pressing for led to another major incident indicating popular discontent over the government's economic policy. Just prior to a new round of discussions between the two parties scheduled in the second half of January 1977, riots broke out throughout Egypt on 18 and 19 January after the government announced price increases in the 1977 budget. The 1977 budget announcement involved price increases of 12-46 per cent⁷⁸ for a number of important goods resulting from shifts to the parallel market and from cuts in subsidies such as bottled gas, gasoline, refined white bread (not the popular loaves consumed by the masses), rice and sugar. The budget also provided for large rises (to a maximum of 250 per cent) in customs duties on luxury goods such as electrical household goods, cars and textiles, and increases in excise duties on cigarettes and alcoholic drinks. The formulation of the economic programme was placed in jeopardy by the riots, which immediately prompted the Egyptian government to rescind subsidy measures by Presidential Decree (although the custom duties measures were retained) and subsequently to review the budget.⁷⁹

⁷⁶ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Dec. 1976, a memorandum, To John W. Gunter (Acting Director of the IMF's Middle East Department), From Muhammed al-Atrash, 10 Jan. 1977.

⁷⁷ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, a cable from Abdel-Moneim el-Kaissouni (Deputy Prime Minister for Financial and Economic Affairs) to H. Johannes Witteveen, 12 Jan. 1977.

⁷⁸ Rivlin, P., *The Dynamics of Economic Policy Making in Egypt* (New York: Praeger, 1985), p. 178.

⁷⁹ EIU, *Egypt: QER*, no. 1, 1977, pp. 8 and 16; *MEED*, 21 Jan. 1977, p. 18; and IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, 'A Note on the Staff Mission to Cairo in Jan. 1977,' in Office Memorandum, To William B. Dale, From A. S. Ray, *Egypt – Staff Mission, January 1977*, 10 Jan. 1978, pp. 1-2.

There were also the government's political reactions to the January 1977 riots. The cabinet, which had been formed only three months before, was reshuffled in early February and involved the change of the Minister of Interior, the post of which was taken over by Prime Minister himself. However, economic portfolios remained the same which seemed to reflect Sadat's confidence in Abdel-Moneim el-Kaissouni and his economic team in handling Egypt's economic problems and also dealing with the IMF, despite Kaissouni's refusal following the riots to withdraw from his view that price increases of some kind would have to be introduced.⁸⁰ Furthermore, in addition to the change of Minister of Interior, repressive laws were introduced on 3 February 1977 in an attempt to further reinforce the regime's political control over the population for its own purposes. They involved the imposition of imprisonment for life with hard labour for offences such as forming a political group outside the three legal political parties, the holding of strikes, sit-ins and demonstrations, vandalism, a failure to submit an accurate statement of earnings and property, and tax evasion.⁸¹

However, the effects of the January 1977 riots on the government's economic and political policies were merely one side of the coin. Although these riots lessened the government's room to manoeuvre in the domestic economic arena, on the one hand, they helped enhance Egypt's negotiating strength with the IMF, on the other hand. Ironically, the way the price rises had been announced was rather politically insensitive. The government left out the announcement of compensation for the price increases such as a wage increase which the IMF team had suggested in their discussions,⁸² even though they had planned to include it in the original budget.⁸³ Whether this was a deliberate tactical act planned by the government, the incident had clear repercussions on IMF demands. In informal discussions between the two parties slightly before the January 1977 riots took place, the Egyptian government asked for three main issues to be reconsidered. First of all, import commodities of broad popular consumption, which were to be included among those shifted from the official to the parallel exchange rate, were politically too sensitive for such a shift, unless the price impact could be fully mitigated by additional provisions in the price adjustment fund. Second, a commitment to establish a unitary exchange rate system by the beginning of 1978 was not possible.

⁸⁰ *MEED*, 28 Jan. 1977, p. 16, and 4 Feb. 1977, p. 18.

⁸¹ *EIU, Egypt: QER*, no. 1, 1977, p. 4-5; and *MEED*, 11 Feb. 1977, p. 16.

⁸² IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, *op. cit.*, 10 Jan. 1978.

⁸³ Interviewee 24 (a former Egyptian official), personal interview, Cairo, 20 Mar. 2001.

Third, the valuation of IMF accounts would have to be continued for the time being at the official exchange rate.⁸⁴ In the immediate aftermath of the riots, the IMF had to make further concessions in negotiations with Egypt. By insisting on its pre-1977 riots demands, the IMF would only do harm rather than good to its credibility. It, thus, agreed that it would accept the need to provide for additional funds to mitigate temporarily the price impact of shifting imports to the parallel market, which Egypt had previously asked for but had faced the IMF's resistance.⁸⁵ The price adjustment fund, previously set at LE 200 million, would be increased to a maximum of LE 300 million in 1977. It also temporarily left out the requirements for the termination of the price adjustment fund and for the full attainment of exchange rate unification by the end of 1977, but these issues would be subject to discussions at a later stage (hopefully, at the mid-term review of the SBA).⁸⁶ In addition, due to the riots, bank financing of the government deficit was re-projected in the revised budget for 1977 at LE 400 million, as compared to LE 150 million in the original budget.⁸⁷

Furthermore, to show its support for Sadat's regime, immediately after the January 1977 riots, the US shifted US\$ 190 million in already committed capital development funds to commodities that would have a quicker impact upon the Egyptian economy.⁸⁸ In addition to the shift in the type of funds, the US at the beginning of February agreed to provide Egypt with an additional US\$ 60 million in food loans for wheat, flour, tobacco, and beans. This brought the US concessional lending to Egypt in 1977 to US\$ 960 million.⁸⁹

Following another visit by the IMF mission in the second half of February 1977, in early March 1977 a visit to Washington by a delegation headed by Abdel-Moneim el-Kaissouni led to the conclusion of an agreement and the signing of a Letter of Intent.

⁸⁴ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Jan.-Feb. 1977, Office Memorandum, To the Managing Director and the Deputy Managing Director, From Hans W. Gerhard, *Egypt – Resumed Discussions Concerning Use of Fund Resources*, confidential, 27 Jan. 1977.

⁸⁵ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, *op. cit.*, 27 Dec. 1976.

⁸⁶ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Jan.-Feb. 1977, *op. cit.*, 27 Jan. 1977.

⁸⁷ IMF Central Files, C/Egypt/810, Mission Gunter and Staff, Jan.-Feb. 1977, a memorandum, To the Managing Director and the Deputy Managing Director, From John W. Gunter, *Mission to Egypt: Continuation of Discussions Concerning Stand-By Arrangement*, confidential, 2 Mar. 1977.

⁸⁸ Weinbaum, *op. cit.*, 1986b, p. 37.

⁸⁹ EIU, *Egypt: QER*, no. 1, 1977, p. 8.

It should be pointed out that Egypt's decision to seek an agreement with the IMF was not simply to obtain the needed additional IMF credits for its balance of payments and debt problems. There was also a desire to attract the financing of sources other than that of the IMF through the latter's seal of approval. Certainly, the size of the IMF direct contribution alone could not meet Egypt's overall requirements but their availability could pave the path towards other potential sources of funds. Shortly after the agreement with the IMF, in May 1977, the first meeting of the Consultative Group was convened in Paris to discuss the rescheduling of Egypt's debt payments and the provision of further financial resources. The Consultative Group was created under the chairmanship of the World Bank, consisting of Arab and Organisation for Economic Cooperation and Development (OECD) countries as well as private creditors. At the meeting, the Consultative Group pledged US\$ 3.6 billion in credits of which a large proportion was provided by the Gulf states and Saudi Arabia.⁹⁰

4.1.7 Implementation of IMF Conditionality

When it comes down to the question of implementation, IMF conditionality under the 1977 SBA was not wholeheartedly put into practice by the Egyptian government. By the end of August 1977, it was clear that the main ceilings for the end of June 1977 on credit expansion to the Government and on the overall domestic credit expansion were observed while the ceilings on cotton financing, external debt, and external payments arrears had been exceeded. However, the excesses were largely the result of technical and timing factors beyond the government's control. For instance, the ceiling on cotton financing was exceeded because of the delay in export shipments to the Soviet Union and Czechoslovakia brought about by the failure to reach an agreement with them.⁹¹ Following Egypt's request and the IMF Management and staff's recommendation, in September 1977 the Executive Board granted a waiver of the three ceilings and thereby permitted the drawing of the second tranche (worth SDR 21 million) under the 1977 SBA.⁹²

⁹⁰ Waterbury, *op. cit.*, 1983, pp. 412-413.

⁹¹ IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, Office Memorandum, To the Managing Director, From A. S. Shaalan (Director of the IMF's Middle Eastern Department), *Egypt – Developments under the Stand-By Arrangement*, 31 Aug. 1977.

⁹² IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, IMF Executive Board's Decision no. 5549-(77/140), 19 Sept. 1977.

This was followed by a further slippage on the ceiling for cotton but the main concern raised by the IMF staff was over the slow progress on the fiscal and the price adjustment policies. Between late October and early November 1977, a mid-term review over the progress made in implementing the economic programme was carried out in conjunction with Article XIV consultation discussions. There were also preliminary discussions on the possibility of an EFF following the end of the April 1977 SBA (see the following section). Almost all of the ceilings, including ceilings on bank financing of budget deficit, external debt and external arrears for the end of September 1977 were observed, except the ceiling on cotton financing. More importantly, most of the fiscal and public sector pricing measures were not implemented due to the fear of popular resistance. Besides the improvements in tax collection, no additional measures were taken. The subsidy on higher-grade textiles was not eliminated, which largely accounted for the non-observance of cotton finance. Concerning the public sector pricing policy, most of the increased cost to the public sector companies arising from transferring their imported inputs to the parallel market rate was not reflected in the form of higher prices passed on to consumers.⁹³ Another request was, as a result, made by the Egyptian government for a waiver of the June 1977 cotton ceiling.⁹⁴ The IMF again showed its sympathetic flexibility when the Executive Board, following the staff's recommendation, granted another waiver of performance criterion on grounds of Egypt's promise to take action to correct the problem of the exceeding cotton finance in the 1978 budget, and permitted Egypt to purchase the amount of SDR 21 million.⁹⁵

It seemed that the factors that enabled the Egyptian government to meet most of the September 1977 ceilings, despite its lack of action in implementing fiscal and pricing measures, went beyond a very few measures taken such as the improvements of tax collection. This included the receipt of US\$ 47 million in grants in September 1977 under the Rabat Agreement.⁹⁶ There were also substantial earnings from oil, tourism,

⁹³ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Oct.-Nov. 1977, Office Memorandum, To the Managing Director and the Deputy Managing Director, From A. S. Shaalan, *Egypt - Article XIV Consultations and Review of Stand-By*, confidential, 10 Nov. 1977.

⁹⁴ IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, a cable from Mohammed Abdel-Fattah Ibrahim to the Managing Director, 16 Nov. 1977, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, *Arab Republic of Egypt - Request for Waiver of Performance Criterion Under Stand-by Arrangement*, EBS/77/417, confidential, 18 Nov. 1977, pp. 4-5.

⁹⁵ IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, IMF Executive Board's Decision no. 5581-(77/160), 28 Nov. 1977.

⁹⁶ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Oct.-Nov. 1977, *op. cit.*, 10 Nov. 1977.

and expatriate workers' remittances combined with the disbursement of GODE economic aid.⁹⁷ This led to a substantial improvement in its balance of payments with a dramatic rise in foreign exchange reserves in 1977-1978 to over US\$ 400 million (see Table 4.2).

In addition to the second waiver of performance criterion granted to Egypt, the Executive Board's sympathetic support was evident in the language of its decision on a review of the 1977 SBA and the 1977 Article XIV consultation with Egypt. After lengthy discussions at the IMF's Executive Board in early February 1978, the decision adopted by the Board was toned down from the decision proposed by the IMF staff. In particular, the phrase 'over a period of several years' was added and the phrase 'without delay' was replaced by the vague 'in the near future,' as strongly suggested by Mohammed al-Atrash, Executive Director representing a group of fourteen countries, including Egypt.⁹⁸ They appeared in the two last sentences in the final version of the Executive Board's decision which stated:

[T]he Fund notes that the Egyptian authorities remain committed, in the context of a restructuring extending *over a period of several years* [emphasis added], to the pricing and budgetary objectives set forth in the economic program supported by the stand-by arrangement. The Fund notes with satisfaction the recent decision by the Egyptian authorities to extend the scope for public sector companies to determine prices in accordance with real costs, and notes their intention to take further measures in this direction *in the near future* [emphasis added].⁹⁹

This can be compared with the stern wording of the originally proposed decision by the IMF staff as follows:

[T]he Fund expects the Egyptian authorities to take *substantive* [emphasis added] measures to implement the pricing and budgetary objectives set forth in the economic program supported by the stand-by arrangement. The Fund notes that the Egyptian authorities remain committed to these objectives and

⁹⁷ MEED, 17 Feb. 1978, p. 6.

⁹⁸ IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, 'Arab Republic of Egypt - 1977 Article XIV Consultation and Review under Stand-By Arrangement,' EBM/78/15 and EBM/78/16, 3 Feb. 1978, pp. 3-19 and 3-17.

⁹⁹ IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, Executive Board's Decision no. 5647-(78/16), 3 Feb. 1978.

considers that it would be in the best interest of the Egyptian economy for the necessary measures to be taken *without delay* [emphasis added].¹⁰⁰

The 1977 SBA was eventually not fully completed. Only three tranches were drawn, while the final tranche was left undrawn due to the failure to meet some performance criteria. According to the IMF staff's report, the overall credit ceiling in December 1977 exceeded by LE 80 million which was accounted for largely by an increase in lending to the private sector. As a result, the IMF staff recommended the Egyptian government not to request another waiver since only part of the public sector pricing and other fiscal measures had been implemented, and suggested a new arrangement with the IMF, either a one-year SBA or an EFF.¹⁰¹ Therefore, instead of working on the existing SBA which came to an end in April 1978, the focus was shifted towards the negotiations for a new agreement.

4.2 The July 1978 Extended Fund Facility

As has been mentioned, the April 1977 SBA was concluded in a hope that another financial programme under an EFF could later be negotiated. The July 1978 EFF, thus, formed part of a medium-term approach starting with the April 1977 SBA. The negotiation process for the 1978 agreement was taking place while the 1977 SBA was still operative. On 28 July 1978, the IMF's Executive Board approved a three-year EFF for Egypt in an amount of SDR 600 million. The economic programme under the July 1978 EFF aimed at:¹⁰²

- i) achieving a high and sustained rate of economic growth of at least 8 per cent over the three years under the programme;
- ii) reducing the rate of inflation to less than 10 per cent by the end of the programme;
- iii) further strengthening the balance of payments.

¹⁰⁰ IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, International Monetary Fund, Document of International Monetary Fund, and Not for Public Use, To Members of the Executive Board, From the Secretary, *Arab Republic of Egypt: Staff Report for the 1977 Article XIV Consultation and Review of Stand-By Arrangement*, SM/78/9, confidential, 6 Jan. 1978, p. 17.

¹⁰¹ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, a memorandum, To the Managing Director and the Deputy Managing Director, From A. D. Crockett, *Egypt – Use of Resources*, confidential, 2 Mar. 1978.

¹⁰² IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Secretary, *Arab Republic of Egypt – Extended Arrangement*, EBS/78/358 Supplement 1, confidential, 2 Aug. 1978.

Since the EFF was a medium-term lending arrangement, economic circumstances of the borrowing country were likely to change during the EFF period. In this regard, policies and measures were set for only the first year of the programme whereas conditions for the rest of the period were subject to the future discussions during the reviews of the programme. The policy areas in the first-year programme included exchange reform, pricing policy, fiscal policy, monetary and credit policy, and external debt policy.¹⁰³

4.2.1 Disagreement over the Extent and Pace of Reform

By the time that the 1977 SBA lapsed following the slippage in implementing the economic programme, the two sides had already begun their negotiations for a new agreement. In May 1977, an outline of measures proposed by the IMF team was given to the Egyptian officials at a meeting of the Consultative Group for Egypt.¹⁰⁴ The two sides commenced their preliminary discussions on the possibility of a new agreement during late October-early November 1977 in Cairo in conjunction with the mid-term review under the April 1977 SBA. In a further round of discussions held in the second half of February 1978 in Cairo, it became clear that differences existed over a number of issues including price adjustments in the public sector, interest rates, and credit ceilings. Although both sides agreed to the need for reform in these policy areas, the disagreement remained over the extent and pace of reform.

Not surprisingly, among these issues, price adjustments appeared to be the most difficult in view of the January 1977 riots. The difference lay in the degree and pace of the increase in commodity prices to be undertaken during 1978. During the February 1978 discussions, facing the objections from the Egyptian team and more importantly the US's lobbying in January 1978 (see Section 4.2.4 US Interference), the IMF staff's proposal for the public sector pricing was modified twice, but the gap between the two sides could still not be closed. The IMF staff's final proposal in the discussions was that in addition to LE 50 million and LE 107 million of price increase measures already taken in 1977 and early 1978, respectively, a further LE 50 million of price increase measures would be taken as a prior action, and an additional LE 150 million would be phased in during the first year of the programme. The Egyptian team agreed to the first

¹⁰³ For more details on IMF conditionality under the 1978 EFF, see Appendix D.

¹⁰⁴ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, Office Memorandum, To the Acting Managing Director, From A. S. Shaalan and Subimal Mookerjee, *Egypt – Forthcoming Discussions on Further Use of Fund Resources*, confidential, 6 Jan. 1978.

part of the proposal but rejected the latter. They pointed to the domestic constraints that they had faced in the past as an attempt to gain more concession from the IMF team. They argued that they had promised in 1977 more than they could realistically achieve and were determined not to repeat the same thing.¹⁰⁵ Abdel-Moneim el-Kaissouni, who led Egypt's negotiation team, asserted that:

[W]e have gone to the furthest extent possible in accomodating [sic] IMF conditionality and believe that a further acceptance of price increases on our part could be dangerously harmful socialy [sic], politicaly [sic] and economically.¹⁰⁶

However, it should be noted that the IMF team claimed that 'at no time [during the discussions in February 1978] did the mission suggest price adjustments for subsidized staple commodities. The only specific items which were discussed were prices for cigarettes, gasoline and public transport, and these items were brought up by the authorities in the context of possible future measures they were considering.'¹⁰⁷

As for the issue of interest rates, a substantial increase of 4 per cent was initially proposed by the IMF staff, but later dropped their demand to a rise of 2 per cent (1 per cent immediately and 1 per cent later in the year) after the Egyptian team strongly rejected the first proposal. However, the Egyptian team argued for an initial 1 per cent increase, with the possibility of review later. In the area of credit ceilings, the difference was over the amount of ceilings. For instance, the IMF pressed for a ceiling of LE 400 million on the government's borrowing from the bank system while the Egyptian team argued for an upward adjustment to LE 500 million.¹⁰⁸

In this regard, there was room for bargaining and a certain degree of flexibility and compromises coming from the IMF team which seemed to be partly influenced by the US's interference regarding the extent of proposed measures. However, in the Egyptian team's view, this evident degree of the IMF team's flexibility was still insufficient. The reluctance to take significant measures was understandable when it is viewed in the

¹⁰⁵ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, *op. cit.*, 2 Mar. 1978, p. 3.

¹⁰⁶ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, a cable from Abdel-Moneim el-Kaissouni to Mohammed al-Atrash (Executive Director representing a group of 14 countries, including Egypt), 27 Feb. 1978, in Memorandum to Files, From William B. Dale (Deputy Managing Director), *Egypt*, 2 Mar. 1978.

¹⁰⁷ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, *op. cit.*, 2 Mar. 1978.

¹⁰⁸ *Ibid.*

context of political developments in the region and of President Sadat's need for domestic support for his efforts to achieve a peace agreement with Israel. Sadat's peace efforts marked by his November 1977 visit to Jerusalem could be jeopardised if his regime was threatened by political instability at the domestic front. It seemed that from the Egyptian government's perspective the time was not right for major measures to deal with the budget deficits which might undermine the domestic backing to attain the overriding political objective. Moreover, it was possible that the Egyptian team might hope that the ongoing peace efforts in the Middle East would somehow act to their own advantage in negotiating with the IMF and bring about further concessions from the IMF, as had occurred during the negotiations leading to the previous agreement. Thus, the Egyptian team was unwilling to give in to the IMF team's demands very easily.

4.2.2 Bypassing Negotiations with IMF Staff

Without success in closing the gap with the IMF staff, the Egyptian government adopted a tactic of bypassing the negotiation procedures with them. Instead the Egyptian government tried to shift the negotiations to be held at a higher hierarchical level of the IMF, the IMF Management, in a hope that more lenient terms than those insisted by the IMF staff could be secured. Immediately following the end of discussions in February 1978, the Egyptian government sought support for their gradual approach towards price increases, from the IMF Management via the Executive Director representing Egypt.¹⁰⁹ In his cable on 27 February 1978 to Mohammed al-Atrash (Executive Director representing fourteen countries, including Egypt), Abdel-Moneim el-Kaissouni stated that:

[T]here have been considerable difficulties in reconciling our views with those of IMF mission regarding the absolute amounts by which commodity prices are to be increased in 1978 We, therefore, appreciate using your good offices in clarifing [sic] our difficulties in accepting higher and tougher conditionality . . .¹¹⁰

This was followed by intensive negotiations through an exchange of cables between Abdel-Moneim el-Kaissouni and William B. Dale, Deputy Managing Director, which took place during the end of February-March 1978. In effect, the Egyptian government

¹⁰⁹ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, *op. cit.*, 27 Feb. 1978; and IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, Memorandum to Files, From William B. Dale, *Egypt*, 2 Mar. 1978.

¹¹⁰ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, *op. cit.*, 27 Feb. 1978.

managed to achieve a temporary postponement of negotiations with the IMF staff until further consideration by the IMF Management. As it turned out, some concessions had been made by the Management who were prepared to accept and recommend for the Executive Board's approval changes in the timing of implementation of measures as recommended by the staff. This included the issues of price increase measures and interest rates. Regarding the issue of price increase measures, the Management proposed that in addition to the LE 107 million of price increases already introduced, and the additional LE 50 million Egypt agreed to implement as a prior action, approximately half of the further LE 150 million of prices increases recommended by the staff would be implemented during the first year of the programme. The remainder of the LE 150 million would be taken during the first quarter of the second year. Interest rates would be raised by 2 per cent by the end of 1978 and this could be done in two stages.¹¹¹

Nevertheless, the difference over the issue of price increases could not be narrowed. Abdel-Moneim el-Kaissouni, while insisting that the Egyptian government did not depart from the IMF on the necessity for price adjustments, argued for 'more understanding and flexibility' on the issue of price adjustments and for a more gradual approach on grounds that 'the action taken so far is already causing a great deal of controversy in cabinet, parliament and among the people.'¹¹² On the other hand, the IMF Management insisted on its proposals, having felt that what the Egyptian team had argued for (which was taking price adjustments as a prior action but without any further action during the period of the EFF) would weaken the measures to the extent that they would be inconsistent with the decision of the Executive Board regarding the EFF.¹¹³

Once again from the Egyptian government's perspective, the IMF Management's flexibility did not live up to their expectation. However, the domestic constraints faced by the Egyptian government seemed not to assist the Egyptian team in arguing for softer terms over the issue of price adjustments. By adhering to the IMF's own principle in order to ensure neutrality in its decision regarding IMF conditionality, the IMF

¹¹¹ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, a cable from William B. Dale (Acting Managing Director) to Abdel-Moneim el-Kaissouni, 16 Mar. 1978.

¹¹² IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, a cable from Abdel-Moneim el-Kaissouni to William B. Dale (Deputy Managing Director), 23 Mar. 1978.

¹¹³ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, a cable from William B. Dale to Abdel-Moneim el-Kaissouni, 24 Mar. 1978.

Management and staff effectively underestimated the significance of the political and economic circumstances in the borrowing country. Although they differed in their proposals regarding IMF conditionality, the similarity shared by the negotiating teams on both sides was that they had to face internal constraints. They needed to take into account such factors in coming up with what they could offer to the other party. These will now be assessed.

4.2.3 Cabinet Division over the Issue of Price Adjustments

The issue of price adjustments was not only the major hurdle in the negotiations between the IMF and Egypt but also created substantial problems on the domestic front. The measures proposed by the IMF Management in March 1978 were discussed in the Egyptian cabinet. However, it was reported in early April 1978 that there was a cabinet split over measures to implement the proposed price increases. Differences emerged in the cabinet between Abdel-Moneim el-Kaissouni, on the one hand, and Prime Minister Mamdouh Salem and Zakariya Tawfiq Abdel-Fattah (Minister of Trade and Supply), on the other. The latter opposed Kaissouni's proposal to raise the price of utility services such as water, electricity and rail travel.¹¹⁴ However, these specific items seemed to have been chosen by Kaissouni since, according to the IMF staff, in their discussions with the Egyptian team, they had not themselves specifically recommend increases of such items.¹¹⁵

The division within the cabinet further deepened and, in combination with his poor health, brought about Abdel-Moneim el-Kaissouni's resignation. This came after the government had approved new public sector wage rises without consulting his ministry.¹¹⁶ He was also reported to have been upset that his recommendation to increase public utility charges was rejected by the cabinet.¹¹⁷ According to Hamed el-Sayeh, Minister of Economy and Economic Co-operation, Kaissouni's submission of his resignation was accompanied by a detailed statement to Prime Minister on the need to take measures in accordance with what the IMF had been proposing.¹¹⁸ The cabinet

¹¹⁴ *MEED*, 7 Apr. 1978, p. 20.

¹¹⁵ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Apr.-May 1978, Office Memorandum, To the Managing Director and the Deputy Managing Director, From A. S. Shaalan, *Egypt - reported Cabinet Split over proposed price increases*, 20 Apr. 1978.

¹¹⁶ EIU, *Egypt: QER*, no. 2, 1978, p. 4; and *MEED*, 27 Apr. 1978, p. 24.

¹¹⁷ *MEED*, 27 Apr. 1978, p. 24.

division was important not only in the sense that the Egyptian negotiators could use it as a constraint factor in justifying its inability to accept IMF demands, but also that it drew attention of the third parties to intervene in the Egyptian-IMF negotiations.

4.2.4 US Interference

On the IMF side, there emerged difference between the US Executive Director, on the one hand, and the IMF Management and staff, on the other, over the issue of pricing policy in Egypt. In the first half of May 1978 following the forming of the new Egyptian cabinet, Sam Y. Cross, US Executive Director, and Thomas Leddy, US Alternate, approached the IMF Management regarding price adjustments of public enterprises in Egypt. The former, whose view mirrored the prevailing attitudes in the US Congress,¹¹⁹ contended that it was inappropriate for the IMF to press for price adjustments since this might be seen as interference with the social prerogatives of the Egyptian government. Cross added that the IMF should confine itself to macroeconomic targets, and should leave the country to decide what measures should be adopted to achieve the budgetary objective.¹²⁰ Although this was perhaps a sound argument which could in general apply to other countries, the fact that the US Executive Director lobbied the Management particularly in the case of Egypt highlighted Egypt's bargaining strength and how politics could involve in shaping IMF conditionality in certain countries such as Egypt.

This was not the first attempt by the US to influence IMF conditionality towards Egypt during the negotiations for the 1978 EFF. Upon their return from the October-November 1977 discussions with the Egyptian officials, the IMF staff, as requested by the US Executive Director, fully briefed US government officials (from the US State Department, the USAID and the Treasury Department) on the outcome of the discussions.¹²¹ Following the briefing, in mid-January 1978 Hans Binnendijk, the staff

¹¹⁸ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Apr.-May 1978, Office Memorandum, To the Acting Managing Director and the Managing Director (on return), From A. S. Shaalan, *Egypt – Informal Visit*, 8 May 1978.

¹¹⁹ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Apr.-May 1978, Office Memorandum, To the Managing Director, From Ernest Sturc, *Fund Approach to Prices*, urgent, 24 May 1978.

¹²⁰ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Apr.-May 1978, Memorandum for Files, From S. Mookerjee (Senior Advisor, Exchange and Trade Relations Department), *Meeting with Mr. Cross and Mr. Leddy*, 11 May 1978.

¹²¹ This had always been the practice in the Middle Eastern Department to brief US government officials. IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Oct.-Nov. 1977, Office Memorandum, To the Managing Director and the Deputy Managing Director, From A. S. Shaalan, *Briefing of U.S. Government Officials*, confidential, 9 Dec. 1977.

of the Foreign Assistance Subcommittee of the US Senate Foreign Relations Committee, in his conversation with one of the IMF staff, emphasised that it was a mistake to press for austerity measures in Egypt at the present time. This was because they would undermine the Government and because the problems would be solved in the medium term in any case as a result of expanded oil production and other factors. He added that on the subject of subsidies, they were extremely important for social and political stability and made reference to the January 1977 riots.¹²² This had an effective impact upon the IMF staff's demands since the IMF team, as previously discussed, reduced its demands during the February 1978 discussions following the US lobbying.

In retrospect, the US's interference in the Egyptian-IMF negotiations and its sympathy to Egypt came at the time between Sadat's November 1977 trip to Jerusalem, which indicated his willingness to make peace with Israel, and peace talks culminating in the signing of the Camp David Accords and of the Egyptian-Israeli peace treaty in September 1978 and March 1979, respectively. To ensure that Sadat's regime would survive to sustain its partnership with the US in the peace process in the Middle East, such US support within the IMF for Egypt's negotiating position was to be expected. IMF conditionality in Egypt was too costly in the short term for the US to stay aloof since its implementation could undermine political stability of the regime and thus its ongoing peace initiatives launched after the October 1973 war.

4.2.5 Resumption of Negotiations with the IMF

President Sadat was seemingly aware of the lack of alternatives and thus recognized that there was an urgent economic need to deal with Egypt's chronic problems. Following Kaissouni's resignation, President Sadat reportedly issued instructions to continue negotiations with the IMF along the lines Abdel-Moneim el-Kaissouni had recommended.¹²³ Such a position of Sadat towards this issue seemed to be highlighted by the fact that in the forming of a new cabinet on 7 May 1978, there was little alteration in the portfolios of the economic ministers, except the departure of Abdel-Moneim el-Kaissouni. The negotiations with the IMF then resumed in the second half of May 1978 after a new cabinet had been formed, and agreement between the two sides was finally reached.

¹²² IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Feb. 1978, Memorandum for Files, From James E. Blalock, *Telephone Conversation with Mr. Hans Binnendijk*, 24 Jan. 1978.

¹²³ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Apr.-May 1978, *op. cit.*, 8 May 1978.

As the results of the negotiations turned out, it seemed that the US's interference in May 1978, through its Executive Director, came too late. During the discussions, price adjustments were no longer the issue of dispute since the Egyptian team finally accepted the March 1978 proposals made by the IMF Management. As the IMF staff reported:

Price adjustments already undertaken by public sector companies were sufficient to meet the target figure the staff suggested should be implemented prior to the establishment of the extended arrangement. The further pricing measures proposed by the staff (of LE 75 million before the end of the first year of the program, and a further LE 75 million in the first quarter of the second year of the program) were accepted by the [Egyptian] authorities without discussion.¹²⁴

Consequently, the US's interference in May 1978 had no bearing on IMF conditionality, namely the issue of price adjustments for Egypt. In fact, Egypt's acceptance of price adjustments was, to a large extent, influenced by the GODE. It was reported in the IMF staff's report that the GODE had played a constructive role in stressing the need for the Egyptian government to present a realistic program that would obtain the IMF's support.¹²⁵ Agreement was also reached on other issues, including the degree of reduction of the bank-financed deficit by at least LE 200 million in the 1979 budget, and credit and external debt ceilings.

4.2.6 Implementation of IMF Conditionality

In second half of November and early December 1978, an IMF mission visited Cairo to carry out Article IV consultation discussions and to review Egypt's economic performance under the 1978 EFF programme. The main purpose of the review was to reach understandings on exchange rate and budgetary policy for 1979. The review was not completed during the November-December 1978 visit since the 1979 budget was not finalised. To complete the review, two additional IMF missions visited Cairo in February and April 1979.

Under the July 1978 EFF, IMF conditionality was implemented in a piece-meal fashion. This seems to reflect the extent of Egypt's unwillingness to accepting certain terms of

¹²⁴ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Apr.-May 1978, Office Memorandum, To the Managing Director and the Deputy Managing Director, From A. S. Shaalan, *Egypt – Extended Fund Facility Discussions*, 5 June 1978.

¹²⁵ *Ibid.*

IMF conditionality. In some areas, conditions were met which included the unification of the official and the parallel exchange rates by 1 January 1979, and increases in the interest rates by 2 per cent. Prices of some non-essential goods, such as beer, cigarettes, soft drinks and petrol, were raised by 15-50 per cent as a result of increases in excise duties. Telephone installation charges, train and taxi fares, airport taxes as well as locally produced cement and steel reinforcing bars were also increased.¹²⁶

Nonetheless, only two months after the SBA became effective in July 1978, Egypt's problems with the IMF emerged over the issues of credit ceilings and the 1979 budget. Under the 1978 EFF, the Egyptian government would limit its budget deficits and its reliance on bank financing. According to the IMF staff's report, the net credit to the public sector exceeded the September 1978 ceiling of LE 60 million by a vast amount (the actual increase was LE 243 million) due to laxity in controlling expenditures and a slow progress in implementing price increases in the public sector, although the ceilings on net domestic assets and foreign debt were observed.¹²⁷ Government expenditures on consumer subsidies actually rose from LE 710 million in 1978 to LE 1,279 million in 1980.¹²⁸ This was followed by slippages in other areas. Not only the bank credit to the public sector but also the net domestic assets of the banking system expanded by more than their ceilings for the end of December and March 1978.¹²⁹ Furthermore, in the 1979 budget, as approved by the People's Assembly, the planned overall deficit amounting to about LE 2,581 million was in excess of LE 331 million over the programme target of LE 2,250 million.¹³⁰

In the first half of April 1979, at the Egyptian government's request, an IMF mission visited Cairo to reach new understandings which could allow Egypt to resume drawings

¹²⁶ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, *Arab Republic of Egypt: Review of Extended Fund Facility Arrangement*, prepared by the Middle Eastern Department, the Exchange and Trade Relations Department and the Fiscal Affairs Department, approved by A. S. Shaalan, Subimal Mookerjee and Richard Goode, confidential, 8 May 1979; and EIU, *QER: Egypt*, no. 1, 1979, p. 14.

¹²⁷ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Nov.-Dec. 1978, Office Memorandum, To the Managing Director and the Deputy Managing Director, From A. S. Shaalan, *Egypt: Article IV Consultation and Review of Extended Fund Facility*, confidential, 6 Dec. 1978.

¹²⁸ Waterbury, *op. cit.*, 1983, p. 214.

¹²⁹ IMF Central Files, C/Egypt/810, Mission Goode and Staff, Apr. 1979, *Egypt: Briefing Paper – Use of Fund Resources*, prepared by the Middle Eastern Department, the Exchange and Trade Relations Department, and the Fiscal Affairs Department, approved by A. S. Shaalan and Subimal Mookerjee, confidential, 16 Mar. 1979, p. 2; and IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, 'Arab Republic of Egypt – 1978 Article IV Consultation, and Review of Extended Arrangement,' EBM/79/84, 1 June 1979, p. 5.

¹³⁰ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, *op. cit.*, 8 May 1979, p. 10.

under the 1978 EFF. However, understandings could not be worked out. The major hurdles still remained over the IMF's dissatisfaction over the pace of structural reforms in fiscal areas such as price increases, and over the discrepancy on the estimates of the 1979 budget deficit. Concerning the budget deficit estimates, the Egyptian government argued that due to expected reductions in expenditures on investment and subsidies and additional revenues from small items, the budget deficit would be close to the LE 2,250 million target.¹³¹ Following the non-observance of credit ceilings and the limit on overall budget deficit since September 1978, few attempts had been made by the Egyptian government to close the gaps, including excise tax increases, improvements in customs and tax administration and subsidy rationalisation.¹³² However, the IMF considered these measures, which were based on Egypt's gradualism, inadequate to achieve the fiscal objectives.

While the importance of the measures adopted by the authorities was recognized, it was noted that these measures have not been sufficient to prevent a further serious deterioration in the fiscal outlook, and an unsustainable acceleration in the rate of monetary expansion.¹³³

On the other hand, the Egyptian government felt that their efforts towards further measures to improve the fiscal situation and to carry forward structural reforms, particularly price increases in the public sector was constrained by domestic circumstances. Concern about the inflationary pressure had made the Egyptian government reluctant to allow the price increases which might have adverse effects upon the cost of living.

Following an informal visit by an IMF staff in mid-June 1979, it became clear that the 1978 EFF was to be aborted¹³⁴ and negotiations for a new agreement began as early as

¹³¹ IMF Central Files, C/Egypt/810, Mission Goode and Staff, Apr. 1979, Office Memorandum, To the Managing Director and the Deputy Managing Director, From Richard Goode, *Egypt – Review under Extended Arrangement*, confidential, 18 Apr. 1979.

¹³² IMF Central Files, C/Egypt/810, Mission Crockett and Staff, Feb. 1979, Office Memorandum, To the Managing Director and the Deputy Managing Director, From A. D. Crockett, *Egypt – Review of Extended Arrangement*, confidential, 21 Feb. 1979; and IMF Central Files, C/Egypt/810, Mission Goode and Staff, Apr. 1979, a cable from Hamed el-Sayeh (Minister of Economy, Foreign Trade and Economic Co-operation) to A. S. Shaalan, 14 Mar. 1979. The cable outlined the measures and various policy decisions taken since the approval of the 1979 budget in order to improve Egypt's fiscal situation and public sector enterprises' performance.

¹³³ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, *op. cit.*, 1 June 1979, pp. 16-17.

¹³⁴ IMF Central Files, C/Egypt/810, Mission Shaalan and Staff, Sept. 1979, *Egypt: Briefing Paper – Use of Fund Resources*, prepared by the Middle Eastern Department and the Exchange and Trade Relations Department, approved by A. S. Shaalan and C. David Finch, confidential, 24 Aug. 1979, p. 2.

September 1979. Therefore, under the April 1978 EFF, only the first tranche of SDR 75 million was drawn while the remaining tranches were suspended and the programme was abandoned by the Egyptian government.

Gaining economic strength during the implementation period had, to a great extent, allowed Egypt room to manoeuvre. Some macroeconomic indicators, which pointed to the improvement of Egypt's external economic situation, were evident. Egypt's balance of payments position in 1978 was considerably more favourable than in 1977 and than had been anticipated. The actual overall balance of payments deficit for 1977 was said to be US\$ 742 million, and the overall payments deficit for 1978 was, at the time the 1978 EFF programme was formulated, projected at US\$ 825 million, when compared with a substantial lower figure of the provisional overall payments deficit for 1978 of US\$ 215 million, as revised in May 1979.¹³⁵ A reduction in imports and a substantial rise in expatriate workers' remittances,¹³⁶ combined with inflows of aid gave Egypt such a strong balance of payments position. The sudden rise in such export earnings would lead to a high level of foreign exchange which reduced Egypt's need to draw from the IMF under the 1978 EFF. The full amount of the GODE's capital of US\$ 2,000 million was drawn by Egypt to finance its balance of payments deficits.¹³⁷ The short-term debt had been reduced from US\$ 1.4 billion in 1976 to US\$ 550 million by the end of 1977 and all arrears had been paid off. The medium- and long-term debt had been raised to US\$ 8.1 billion but no further rescheduling of the foreign debt appeared to be required during the next two to three years.¹³⁸

In addition to the improvement in its economic situation, Egypt had developed new sources of financial assistance owing to its rapprochement with the West and the alteration in its foreign policy regarding the Arab-Israeli conflict marked by Sadat's visit to Jerusalem in November 1977. To provide Sadat with an incentive to negotiate a peace treaty in 1977-1979, US economic aid was promised. In the period between the Camp David Summit (September 1978) and the signing of the Egyptian-Israeli Treaty (March 1979), the Carter Administration increased its aid, pledging US\$ 300 million in post-treaty economic assistance to supplement the ongoing billion-a-year programme.

¹³⁵ IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, *op. cit.*, 8 May 1979, Table 4: Summary Balance of Payments, 1977-1979, p. 17.

¹³⁶ *Ibid.*, p. 16.

¹³⁷ The remaining amount of US\$ 25 million was for the GODE's expenses. *MEED*, 11 Aug. 1978, p. 7.

¹³⁸ EIU, *Egypt: QER*, no. 3, 1978, p. 6.

The US government also promised a supplemental package of US\$ 1.5 billion in military aid, to be spread over three years.¹³⁹ Egypt began to rely increasingly on financial aid from the US, Western European countries, and Japan, particularly after nineteen Arab countries had imposed economic sanctions against Egypt at a meeting of the Arab League in Baghdad at the end of March 1979 swiftly following the signing of Egypt's peace treaty with Israel. Therefore, pressure on Egypt to implement some of the politically sensitive policies in the 1978 EFF economic programme was eased.

Section C: Assessment of Relative Power and the Imposition-Ownership Nature of IMF Conditionality

The period 1974-1979 saw two major successful efforts by both parties to conclude an agreement. The power balance at the start of the negotiations on both occasions was tilted towards the IMF, reflecting its issue-specific capabilities. However, the power balance shifted throughout the negotiations since neither party was inactive in the negotiations and also circumstances changed favourably or unfavourably towards the parties.

Similar to the 1960s negotiations (as shown at the end of Chapter Three), the beginning of negotiations leading to both agreements was characterised by unbalanced power between Egypt and the IMF. The IMF entered the negotiations with several issue-specific advantages. First of all, the IMF possessed credit needed by Egypt, even though it was ultimately inadequate. Secondly, although the IMF might have felt obliged to conclude an agreement due to its role to provide lending to a member country facing a balance of payments problem, Egypt was not the only member country of the IMF which needed its financial assistance. The IMF had a vast number of its member countries, particularly developing countries, who were also in need of its credit. On the other hand, Egypt had initially limited alternatives to IMF financial assistance. It was aware that it might need the IMF's 'seal of approval' to gain or facilitate access to other sources of finance. Thirdly and more importantly, the IMF was in the control of the policy issues to be included in the policy programmes, although the details (such as the extent of policy measures and the timing of their implementation) were subject to discussions. It was the IMF team who first determined the issue list for IMF conditionality discussions for both the 1977 SBA and 1978 EFF. On the other hand, the

¹³⁹ Burns, *op. cit.*, p. 192.

Egyptian team had never been in a position to do so and only responded to the IMF team's proposed policy issues by either rejecting or accepting them and then negotiating over their details. Part of the explanation is that, unlike the IMF team which was guided by procedures of the IMF's lending policy, the Egyptian team was weakened in its own initial negotiating position through the absence of coordination among their members. Egypt's negotiating team normally consisted of Ministers in the economic groups such as Ministries of Economy, of Finance, of Planning and of Supply, and the Governor of the CBE. The institutional instability of Ministries in the economic group (as indicated by the abolition and merger of ministries and their disappearance) often resulted in a great deal of overlapping, repetition and competition in the assigned and specialised areas.¹⁴⁰ Thus, the lack of coordination among the members of the team partly explained why the Egyptian team was in too weak a position to come up with the proposals regarding the policy programme first. On this basis, at the commencement of the negotiations, the IMF, therefore, held a considerable degree of negotiating power vis-à-vis Egypt and thus the relationship began closer to the imposition end of the spectrum than to Egyptian ownership.

Despite the initial imbalance in relative power, neither proved to be passive. Each party always sought to improve their relative power vis-à-vis the other. The sources of relative power of each party were various throughout the negotiation period. During the first set of negotiations leading to the 1977 SBA, the IMF gained its additional power from its tactical move in securing cross-conditionality of the World Bank at the early stage of negotiations and also from cross-conditionality that other creditors required Egypt to fulfil before granting their own financial assistance in terms of new loans and also the rescheduling of Egypt's debt repayments.

However, some factors on the IMF side appeared to be ineffective in altering the outcome of the negotiations. These included the individual negotiators' flexibility from both the IMF Management and the IMF staff negotiators, and the technocratic alliances. During the 1970s, the IMF staff and the Management did show some degree of flexibility, although the former tended to be more rigid and take a tougher line

¹⁴⁰ See, for example, Qandil, A., 'Analyses of the Economic Group of the Government and the Relationship between Its Members,' in M. Shimizu, A. Qandil, and S. S. Imam, 'Pressure Groups and Economic Policies in Egypt,' *Middle East Studies Series*, no. 21 (Tokyo: Institute of Developing Economics, 1988), ch. 4, pp. 265-303.

regarding IMF conditionality than the latter. However, such flexibility of the IMF personnel seemed not to add much to the relative power of the IMF as it did not help to alter the position of the Egyptian team and thus the outcome of the negotiations. Also, for some Egyptians, the tough line of the IMF staff would rather aggravate the sense of imposition of IMF conditionality. With regard to the technocratic alliances between the IMF and the Egyptian negotiating team and government, although some Egyptian negotiators did share a similar view over the analysis and solution of Egypt's economic problems, the idea of technocratic alliances did not lend much support for the IMF's relative power in the negotiations. Indeed, its positive effect upon the IMF's bargaining power was outweighed by the negative impact of the division in the Egyptian cabinet.

On the Egyptian side, there were several tactics used by Egypt during the negotiations leading to the 1977 SBA. They included its requests for the US's direct and indirect support in terms of the US's influence within the IMF and its economic aid to finance Egypt's balance of payments deficits, and also for the Arab Gulf states' direct support in terms of their financial assistance. Such tactics were enabled by a combination of both Egypt's geopolitical significance in the region and the favourable aftermath of the October 1973 war. The indirect support from both the US and the Arab Gulf states allowed Egypt to prolong its negotiations, not to give in to the IMF's demands easily and brought about the IMF's concessions and thus certain changes in the outcome of negotiations.

Besides the above tactics, Egypt in part improved its relative power during the negotiations from two types of its domestic constraints: the socio-economic impact of its initial economic difficulties and of the implementation of policies advocated by the IMF; and the division within the Egyptian cabinet. Both were effective in extracting the IMF's concessions. After the occurrence of the January 1977 riots, the IMF was obliged to give more concessions to Egypt. As for the cabinet division, it allowed Egypt more time to resist the IMF's demands and also altered the outcome of negotiations. Moreover, at the individual level, having an influential representative in the IMF (Mohammed al-Atrash), who strongly argued in favour of Egypt, provided Egypt with greater degree of power in gaining more lenient terms than it would have been achieved without one.

During the second set of negotiations leading to the 1978 EFF, Egypt's relative power was reinforced by the US's interference in January 1978 and Egypt's own tactic to negotiate with the IMF Management instead of the IMF staff. Both factors led to certain changes in the IMF's demands. After the US had intervened in January 1978, the IMF staff showed its flexibility regarding the extent of policy measures. Egypt also attempted to bypass negotiations with the IMF team, whose view over the policy programme was rather rigid than what the Egyptian team would accepted, and managed to gain small concessions from the IMF Management. Thus, both Egypt's tactics and the above factors enabled the degree of imposition and ownership to change towards the direction of ownership.

Nonetheless, on the Egyptian side there were several factors which were ineffective in bringing about changes in the outcome of the negotiations. The use of domestic constraints and the occurrence of the cabinet division did not change the IMF's demands. Also the US's direct support within the IMF in May 1978 resulted in few of the intended consequences due to the timing of its interference. Not only did it not produce the intended result, but also the US's interference in IMF conditionality negotiations did harm to the IMF's principle of neutrality regarding the use of financial resources.

On the IMF side, the US's emphasis on the importance of reaching understanding with the IMF and the World Bank played only a minor role in enhancing the IMF's relative bargaining power due to the overriding political aim of the ongoing peace talks between Egypt and Israel. It was the cross-conditionality of the GODE which played an overwhelmingly important role in getting Egypt to agree with the IMF reluctantly. Cross-conditionality, thus, seems to work at times. The creditors who placed cross-conditionality on their financial assistance did not always adhere to such a condition, depending on their overriding objective. There was some leniency regarding cross-conditionality of creditors other than the IMF and this at times allowed Egypt room to manoeuvre in dealing with the IMF.

In sum, during this period, Egypt demonstrated that to the extent that it gained some concessions from the IMF, it was able to exploit its political and strategic importance to its advantage in conducting the negotiations with the IMF regarding IMF conditionality. Egypt's ability to utilise such an asset was largely facilitated by its embarking on the

1973 war. The rapid flow of substantial US economic aid in 1975-1976 provided Egypt with 'breathing space' which Egypt badly needed, enabling Egypt to refuse the IMF demands during 1975-76.

Overall, during the period, 1974-1979, Egypt managed to gain some concessions from the IMF regarding the details of IMF conditionality. However, it seemed to show the weaker overall negotiation strength in relation to that of the IMF, especially the GODE's cross-conditionality added a greater weight to the IMF's power. The cancellation of both programmes under the 1977 SBA and the 1978 EFF when its economic condition improved reflected Egypt's unwillingness to follow IMF conditionality. Egypt's relatively weaker power in negotiations, together with the unwillingness to adopt the whole programmes, did reveal the low degree of the programme ownership. Similar to the previous period, IMF conditionality during this period, thus, involved a high degree of imposition while the sense of ownership of the programmes was rather limited. Egypt accepted IMF conditionality after prolonged resistance just because it was under pressure from the GODE to do so, even though the support provided by the US helped to ease the pressure and to prolong the negotiations. Therefore, in this period, Egypt strived to resist IMF conditionality and utilised various tactics. However, despite some IMF concessions gained, it was overall unable to move significantly along the spectrum towards ownership.

Chapter Five

Mubarak's Gaining the Upper Hand: 1985-1988

Introduction

As discussed in Chapter Four, relations with the IMF were worsened when Egypt exceeded credit and budgetary ceilings a few months after a three-year facility had been agreed in July 1978. However, talks still continued between the two sides in late 1978 and 1979 with regard to the possibility of drawing on the second tranche of the July 1978 EFF but the parties failed to resolve their differences. Immediately following the collapse of the 1978 EFF, the two parties, especially the Egyptian government, attempted to conclude a new arrangement. However, due to the improvement in the balance of payments situation in 1980, reaching agreement with the IMF became irrelevant since IMF credit was to support countries in balance of payments deficits, not balance of payments surpluses.

The second half of the 1980s witnessed the conclusion of another SBA in May 1987 after prolonged negotiations between the Egyptian government and the IMF beginning in the mid-1980s. Similar to the previous period, there seemed to be US involvement in the IMF's decision-making regarding IMF conditionality in the case of Egypt in this period. This greatly enabled Egypt to obtain the vague terms under the 1987 SBA, which in turn caused the effective division of the negotiations over IMF conditionality into two major phases. The first phase took place during the period 1985-May 1987. The second phase was after May 1987 until mid-1988 when the 1987 SBA eventually collapsed as no agreement could be reached between the two parties on the economic programme for this phase.

Section A: Background

During the 1980s, a major change in political leadership took place in Egypt but without any dramatic changes in the new regime's economic policy and in its foreign policy towards Israel and the US. Muhammed Husni Mubarak took presidential office following the assassination of his predecessor (Anwar Sadat) by a group of Islamic militants during the military parade in October 1981. Unlike Nasser who eliminated the

monarchy and Sadat who defeated the Left, Mubarak inherited power rather than seized it.¹ At the outset of his office, Mubarak made it clear that the Egyptian economy would not be reversed to the socialist system pursued during the Nasser's regime. The *infitah* policy initiated by Sadat would continue. However, he stressed that economic benefits would be shared among all society and not merely the 'fat cats' who had proliferated during Sadat's *infitah*. Thus, what Mubarak had in mind regarding economic policy seemed to be the synthesis of Nasser's and Sadat's policies, an *infitah* of production rather than consumption, from which the poor could also benefit. Subsidies on essential foodstuffs would be retained whereas luxury imports would be reduced in order to bring down the level of conspicuous consumption of the rich.²

Egypt's foreign policy under Mubarak did not fundamentally depart from that of Sadat. Mubarak made it plain from the start that he was not going to scrap Sadat's legacies in foreign affairs, which essentially meant the peace treaty with Israel and a close alliance with the US.³ Severing relations with these two countries would only serve to undermine Egypt's hope for the return of Sinai under the Camp David accord agreed with Israel, which eventually withdrew from the area on 25 April 1982, and to create at least the risk of sharp curtailment of US civil and military aid upon which Egypt had greatly relied after the October 1973 war.⁴ In addition, it was likely that a rupture of the peace treaty might bring about the possibility of war with Israel, which would in turn lead to the threatened loss of essential foreign exchange earnings, namely the Suez Canal dues and revenues from the Sinai oilfields.⁵ In this regard, despite strains in its relationship with Israel, Egypt was thus keen to adhere to the peace treaty with Israel and to keep good terms with the US, even after the return of Sinai. For instance, the Israeli invasion of Lebanon in June 1982 did not lead to the withdrawal of the Egyptian ambassador to Israel until September in protest against the massacres of Palestinians at the Sabra and Shatila refugee camps on the outskirts of Beirut.

Whilst Egypt under Mubarak maintained its rapprochement with the US, it also sought improved relations with the USSR. In the later years of Sadat's rule, Egypt's relations

¹ McDermott, A., *Egypt from Nasser to Mubarak: A Flawed Revolution* (London: Croom Helm, 1988), p. 75.

² Hopwood, D., *Egypt: Politics and Society, 1945-1990*, 3rd ed. (London: Routledge, 1993), p. 184.

³ McDermott, *op. cit.*, pp. 82-83.

⁴ *Ibid.*, p. 83.

⁵ Tripp, C., 'Egypt and the Region in the 1980s,' in C. Tripp and R. Owen (eds.), *Egypt under Mubarak* (London: Routledge, 1989), p. 164.

with the USSR had deteriorated, culminating in the expulsion of the Soviet Ambassador to Egypt and at least 1,000 Soviet 'experts' in the summer of 1981. With the aim of restoring a balance in relations by reducing Egypt's heavy reliance on the US,⁶ Mubarak allowed the Soviet experts to return and signed trade and cultural agreements with the USSR. In 1984, the full resumption of diplomatic relations with the USSR was achieved.

Egypt's relationship with the Arab world gradually began to improve due in part to the circumstances which some Arab countries faced and in part to Egypt's stance on the Iran-Iraq war. In December 1983, Yasser Arafat, the chairman of the Palestine Liberation Organisation (PLO), who had been expelled from Lebanon under Syrian pressure, visited Egypt in order to gather support for the Palestinian fighters in Lebanon. Egypt's diplomatic relations with Jordan were resumed in September 1984 since Jordan had to deal with Israel and also had close links with the US. In January 1984, Egypt was readmitted to the Organisation of the Islamic Conference (OIC). Also, Egypt's support for Iraq in the Iran-Iraq war, which began in September 1980, in part helped bring about the rehabilitation of Egypt after its isolation in the Arab world as a result of the Camp David agreements and the subsequent peace treaty with Israel. At the Amman conference of the Arab League in November 1987, a resolution was passed to establish diplomatic links with Egypt at the discretion of member governments. This was in recognition of Egypt's support for Iraq in its war against Iran and of its populous and military power in dealing with the problems of the region. By 1989, Egypt's diplomatic relations with most Arab countries were restored with the readmission of Egypt to the Arab League in May. A further sign of the rehabilitation of Egypt in the Arab world was also manifest in economic affairs. February 1989 saw the formation of the Arab Cooperation Council (ACC), which was an economic association with a major aim to remove trade barriers and encourage investment among the member countries. Among four Arab member countries were Egypt, Iraq, Jordan and North Yemen. However, the ACC came to a prompt end after the invasion of Kuwait due to the withdrawal of Egypt as a protest against the Iraqi action in 1990.

Although peace with Israel in the late 1970s had raised hopes of economic prosperity in Egypt, by the middle of the next decade such optimism was dim. In the mid-1980s,

⁶ Hopwood, *op. cit.*, p. 192.

Egypt's external economic situation deteriorated dramatically. The Egyptian economy was hit by another major balance of payments problem. The long-standing structural problems in Egypt's balance of payments in terms of deficits in trade and current accounts were exacerbated by the sudden decline in oil prices after 1981 and thus Egypt's oil revenues, and also by the falls in workers' remittances. As a consequence, the trade deficit had widened, the current account deficit was increasing, and the overall balance of payments was in deficit (see Table 5.1). This in turn affected the ability of Egypt to pay off its annual debt repayments.

David Butter has identified four factors to explain Egypt's heavy debt,⁷ which also explain its balance of payments crisis. In addition to the dramatic fall in oil prices, another factor was the shift from the Soviet Union to the US as the main source of military procurement after the 1973 war. Re-equipping the Egyptian armed forces with weapons from the US and Western Europe was highly expensive. Like many developing countries, Egypt contracted much of its military debt to the US at the time of high interest rates prevailing in the late 1970s and early 1980s, which was a consequence of the anti-inflationary policy of major industrial countries, particularly the US, as has been pointed out in Chapter One. The third reason was the substantial investment made in infrastructure projects. Sectors such as sewerage, telecommunications, irrigation, and housing had been neglected during Nasser's era since the emphasis was on heavy industry and an ambitious political strategy. Neither did Sadat's regime pay much attention. Thus, the major task of rehabilitating infrastructure was simply left to Mubarak's regime. Last, but not least, the failure of agricultural production to keep pace with the growth of population contributed to Egypt's debt. Food production grew at about two per cent annually while the annual rate of population growth was 2.7 per cent. This meant that the food gap had to be filled by imports purchased with scarce foreign exchange earnings or foreign borrowing.

⁷ Butter, D., 'Debt and Egypt's Financial Policies,' in Tripp and Owen, *op. cit.*, pp. 126-128.

Table 5.1 Egypt's Economic Indicators, 1980-1990

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
GNP (LE million)	17,231	17,892	21,327	26,051	30,605	35,892	39,397	46,818	...	...	...
GDP at market prices (LE million)	15,470	17,150	20,753	25,895	31,547	37,240	42,563	51,500	61,600	76,800	96,100
GDP (LE million) 1984/85 prices	...	...	29,436	31,331	33,212	37,240	40,616	43,216	45,565	47,831	50,558
GDP per capita (LE)	367.20	411.57	484.43	588.26	697.48	801.38	890.25	1,049.95	1,225.38	1,510.03	1,851.28
Real GDP per capita (LE)	...	...	687.11	711.74	734.29	801.38	849.53	881.06	906.41	940.44	973.95
GDP growth (%)	24.01	10.86	21.01	24.78	21.83	18.05	14.29	21.00	19.61	24.68	25.13
Real GDP growth (%)	...	...	...	6.44	6.00	12.13	9.07	6.40	5.44	4.97	5.70
Consumer prices index number	51.8	57.2	65.7	76.2	89.2	100	123.9	148.3	174.4	211.5	247.0
Consumer price inflation (%)	20.47	10.42	14.86	15.98	17.06	12.11	23.9	19.69	17.60	21.27	16.78
Unemployment (% of total labour force)	5.20	5.40	5.70	6.60	...	...	...	...	...	6.90	8.60
Budget deficit (LE million)		-1,096	-3,554	-2,364	-3,258	-3,439	-4,655	-2,613	-4,716	-4,126	-5,494
Total external debt (US\$ billion)	...	...	...	...	...	40.07	46.05	50.78	52.49	51.69	40.44
Total debt service (US\$ billion)	1.24	1.55	1.71	2.08	2.42	2.82	2.70	1.66	2.47	2.91	3.07
Total debt service ratio (% of exports of goods and services)	13.41	17.01	19.29	20.14	21.37	25.77	27.05	17.84	21.97	23.31	22.46
Export (fob) (US\$ million)	3,854	3,999	4,018	3,693	3,864	3,836	2,632	3,115	2,770	3,119	3,924
Import (fob) (US\$ million)	-6,814	-7,918	-7,733	-8,251	-10,080	-9,050	-7,170	-8,095	-9,378	-8,841	-10,303
Trade balance (fob) (US\$ million)	-2,960	-3,919	-3,715	-4,558	-6,216	-5,215	-4,538	-4,980	-6,608	-5,722	-6,379
Current balance (US\$ million)	-438	-2,136	-1,851	-330	-1,988	-2,166	-1,811	-246	-1,048	-1,309	185
Overall Balance of Payments (US\$ million)	610	53	-245	87	-247	-200	-31	315	-102	-533	-10,224
Foreign exchange (US\$ million)	1,046	688	698	739	736	792	829	1,378	1,263	1,520	2,683
Population (million)	42.13	41.67	42.84	44.02	45.23	46.47	47.81	49.05	50.27	50.86	51.91
Population growth	2.81	-1.09	2.81	2.75	2.75	2.74	2.88	2.59	2.49	1.17	2.06

Sources: International Monetary Fund, *International Financial Statistics (IFS) Yearbook*, 2000, pp. 424-427. For consumer price index numbers and GDP and GNP figures, International Monetary Fund, *IFS Yearbook*, 1993, pp. 332-333. For total debt service, total debt ratio and unemployment, World Bank, *World Development Indicators* [CD-Rom], 2000. For total external debt, EIU, *Egypt: Country Report*, various issues.

The worsening state of the Egyptian economy raised the IMF's concern. In its June 1985 report, the IMF warned Egypt of a 'substantial deterioration' in the balance of payments and the possibility of an overall balance of payments deficit in 1984-85 of US\$ 1.3 billion.⁸ It also concluded that Egypt's total international debt amounted to no less than US\$ 31 billion.⁹ By the end of 1985, it became clear that this amount had been underestimated. Egypt appeared to owe at least US\$ 32 billion.¹⁰

Section B: Narrative

The May 1987 Stand-By Arrangement

Despite the failure on the part of Egypt to complete the 1978 EFF, the Egyptian government subsequently attempted to reach a new agreement during the late 1970s and the first half of the 1980s. Nonetheless, it appeared that during the period prior to 1985 the Egyptian government was not in dire need of reaching an agreement with the IMF. Mahmoud Salah Hamed, Minister of Finance, pointed out that there was no urgency to secure another stand-by facility from the IMF for the balance of payments support. It was mainly intended to give Egypt a 'health certificate' to improve its creditworthiness with the IFIs.¹¹ Indeed, Egypt's external economic position had substantially improved during the early 1980s. In particular, Egypt declared a balance of payments surplus in 1980, owing to large capital inflows that it had received after 1979 as a result of the signing of the 1979 peace treaty with Israel, as well as the second rise in oil prices in 1979-80. As a result, the Egyptian government could not draw on IMF credit. Ali Abdel-Razzaq Abdel-Magid, Deputy Prime Minister and Minister for Economic and Financial Affairs, stated in July 1980 that: 'If we sign an agreement with the fund for us to draw on it, our balance of payments will have to be in deficit, but we have a surplus of well over \$ 400 million.'¹² In December, he further explained: 'The fund is not advising us to reach agreement. As long as we have a balance of payments surplus we cannot draw.'¹³ The overall payments surplus, thus, transformed Egypt's relationship with the IMF by preventing the former to reach an agreement with the latter at least temporarily.

⁸ *Financial Times*, 3 Aug. 1985; and *MEED*, 10 Aug. 1985, p. 7.

⁹ EIU, *Egypt: Country Report*, no. 1, 1986, p. 15; and *MEED*, 19 Oct. 1985, p. 21.

¹⁰ EIU, *Egypt: Country Report*, no. 1, 1986, p. 15.

¹¹ *Financial Times*, 7 Dec. 1983, p. 4; and *MEED*, 9 Dec. 1983, p. 11.

¹² *MEED*, 18 July 1980, p. 20.

¹³ *MEED*, 12 Dec. 1980, p. 24.

It was not until the mid-1980s when Egypt faced severe economic problems that the process of negotiations started to be seriously revived. With chronic economic conditions, the Egyptian government looked to the IMF for financial assistance. In the autumn of 1985, it was reported that the Egyptian government had requested US\$ 1.5 billion from the IMF to help cover the expected balance of payments deficit.¹⁴

5.1 Differences between the Two Parties

According to Prime Minister Ali Lutfi, it was the Egyptians who themselves prepared the economic programme and then invited the IMF to advise them in this regard.¹⁵ The parties did not have differences in economic orientation.¹⁶ They agreed on the measures needed to be taken in dealing with Egypt's economic problems.¹⁷ However, there was a major point of disagreement over the pace of economic policies; the Egyptian team preferred gradualism whereas the IMF team emphasised a faster pace of economic adjustment.¹⁸

By the second half of 1986, talks between the Egyptian government and the IMF continued without reaching an agreement. It became clear that there were still major differences between the two sides with regard to the pace and extent of the economic reforms. The IMF urged for conditions such as an immediate unification of exchange rates within 12 months, a considerable rise in domestic interest rates (from a range of 11-16 per cent to about 20 per cent), an abolition of food subsidies, an increase in energy prices, and a rise in producer prices for agricultural products. However, the Egyptian government only agreed to the two latter conditions, while the three former issues remained contentious. The government, which had, in mid-October 1986, proposed unifying the official floating rate of US\$ 1 = LE 1.36 with the free market rate of US\$ 1 = LE 1.90 within 18 months, rejected the 12-month deadline favoured by the IMF on the grounds that it lacked foreign exchange reserves to deal with sudden

¹⁴ EIU, *Egypt: Country Report*, no. 4, 1985, pp. 19-20; *Financial Times*, 16 Oct. 1985; and *MEED*, 19 Oct. 1985, p. 21.

¹⁵ Lutfi, Ali (Prime Minister during 1985-1986), personal interview, Cairo, 3 Feb. 2001.

¹⁶ Interviewee 6 (a former Egyptian official), personal interview, Cairo, 4 Feb. 2001.

¹⁷ Lutfi, Ali, *op. cit.*, 3 Feb. 2001.

¹⁸ *Ibid.*; Interviewee 6, *op. cit.*, 4 Feb. 2001; and International Monetary Fund, *Arab Republic of Egypt: Request for Stand-By Arrangement*, prepared by the Middle Eastern Department and the Exchange and Trade Relations Department, in consultation with the Fiscal Affairs, Legal, Research, and Treasurer's Departments, approved by A. S. Shaalan and J. T. Boorman, 29 Apr. 1987, p. 5, in International Monetary Fund, Document of International Monetary Fund and not for Public Use, To Members of the Executive Board, From The Secretary, *Arab Republic of Egypt - Request for Stand-By Arrangement*, EBS/87/93, confidential, 29 Apr. 1987.

changes in the market. Concerning the increase in interest rates, it found this unnecessary, especially at the time of recession, and was concerned that such a move would restrict investment and economic growth. As for the food subsidy removal, the government insisted that this was impossible to achieve overnight and a gradual approach should be followed to raise both prices and wages.¹⁹ President Mubarak, in an interview with the West German weekly *Der Spiegel* in late July 1986 said: 'There is a threshold which we cannot cross. The IMF does not seem to care about that.' He stressed that if IMF conditions were implemented, prices of basic commodities would rise sharply: 'There would be unrest. The people would get out of control.'²⁰

5.2 Tactic I: Seeking Indirect Support – Financial Assistance from 'Friends'

While the process of its negotiations with the IMF was taking place, Egypt was simultaneously seeking alternative or supplementary assistance from its 'friends,' particularly the US, in an attempt to strengthen its bargaining position vis-à-vis the IMF. For instance, during his visit to Washington in March 1985, President Mubarak requested additional emergency funds for balance of payments support.²¹

Following the signing of the Egyptian-Israeli peace treaty, the US peace efforts in the Middle East began to subside and the Egyptian-US relationship became less intense. However, it remained a key interest of the West, in particular the US, to sustain the treaty and also to maintain Egypt's support for the broader Arab-Israeli peace process. It was not until 1985 that the US's peace efforts were revived. During the period between 1979 after the signing of the Egyptian-Israeli peace treaty and 1985, the issue of the Arab-Israeli conflict was largely overshadowed by three main developments: Carter's re-election campaign; the American hostages held in Tehran in November 1979; and the pro-Israeli views of the administration of Ronald Reagan. The adverse impact of the Israeli invasion of Lebanon in June 1982 on US-Arab relations was one of the reasons why Reagan's administration decided to launch its own peace initiative. However, there was little movement prior to 1985 partly because 1984 was the US's election year.²² Egypt's role in promoting the rapprochement between Jordan and the

¹⁹ EIU, *Egypt: Country Report*, no. 4, 1986, p. 9; and *MEED*, 5 July 1986, p. 7, 18 Oct. 1986, p. 8, and 1 Nov. 1986, p. 8.

²⁰ Mubarak, H., interview, *Der Spiegel*, July 1986. Cited in *MEED*, 2 Aug. 1986, p. 8.

²¹ EIU, *Egypt: Country Report*, no. 2, 1985, p. 11; *Financial Times*, 4 May 1985, p. 3; and *MEED*, 1 Mar. 1985, p. 11.

²² Quandt, W. B., *The United States and Egypt: An Essay on Policy for the 1990s* (Washington, D. C.: Brookings Institution, 1990), pp. 17-21.

PLO so as to facilitate ultimate negotiations between the Arabs and Israel led to a joint statement outlining an approach to peace signed by King Hussein of Jordan and Yasser Arafat of the PLO in February 1985. By the second half of 1985, the Jordanian-PLO peace initiative had virtually failed since a series of terrorist incidents (such as the *Achille Lauro* affairs), in which factions of the PLO were implicated, damaged the PLO's credibility as a participant in peace negotiations. As that peace process stalled, the US remained committed to sustaining Egypt's support for its own peace initiative.

To this end, the US Congress's approval was, in the summer of 1985, granted to increase the US's allocation to Egypt in the fiscal years 1985 and 1986. Egypt managed to secure the US's additional emergency assistance worth US\$ 500 million, which was smaller than the amount Egypt had originally requested. The additional US\$ 500 million assistance was divided into two halves: the first half was to be disbursed in 1985/86 and the other half in 1986/87.²³

5.3 Cross-Conditionality of Creditors and Donors and Its Laxity

Although the tactic described above was successful for Egypt in obtaining additional financial support from the US, the latter (in the form of the US Agency for International Development (USAID)), as well as other creditors and donors, including the World Bank, at the same time tried to impose cross-conditionality upon the former. For instance, attempts were made by the US to put pressure on Egypt to accelerate its economic reform by delaying the disbursement of the final tranche of the US\$ 500 million additional funds (worth US\$ 150 million) approved in 1985 and of US\$ 115 million of the cash transfer portion of the US\$ 815 million economic support fund for US fiscal 1986 (ending in September).²⁴ The US's action was mainly due to its disappointment with Egypt's sluggish pace of economic reform. The reforms sought by the US included: reaching agreement with the IMF; implementing a second round of cuts in electricity subsidies; introducing more effective management of the public debt; and granting more support to the private sector.²⁵

²³ EIU, *Egypt: Country Report*, no. 4, 1985, p. 19.

²⁴ MEED, 1 Mar. 1986, p. 13. The US president had been authorised by Congress to disburse economic support funds to Egypt as cash transfer, on condition that this would yield additional development activities or economic reforms. Congress must receive advance notification of the additional reforms or activities to be undertaken. EIU, *Egypt: Country Report*, no. 2, 1985, p. 11.

²⁵ MEED, 1 Mar. 1986, p. 13.

Nevertheless, US pressure proved temporary and thus less effective when economic and socio-political tensions in Egypt were high. On 25-26 February 1986, riots by the conscripts of the Central Security Force (CSF) (which had been created by Sadat after the January 1977 riots to deal with demonstrations without summoning the army) took place. When the CSF conscripts, who were mostly poor and illiterate and had already been dissatisfied with their living conditions during their service, heard a rumour that their term of conscription might be extended from three to four years, they went on the rampage and began burning casinos and tourist hotels. Subsequently, the conscript riots had to be suppressed by the army.

Such an incident not only threatened the political stability of Mubarak's regime but also could damage the US's efforts in the Middle East peace process. The fear that the achievements of the Camp David accords and the Egyptian-Israeli peace treaty might be endangered by the political instability of Mubarak's regime, which could in turn produce severe drawbacks on the on-going peace process in the Middle East, kept ensuring that the West's interest in stabilising Mubarak's regime lived on. Therefore, in the following month after the February riots, the US decided to provide Egypt with its support by releasing the last US\$ 150 million tranche of its 1985 cash supplement to the existing aid programme.²⁶

Furthermore, the US seemed to be concerned about Egypt's economic problems posed by the decline in oil prices, particularly over its US military debt.²⁷ In 1986, Egypt's total military debt to the US was about US\$ 4,550 million and its annual interest payments stood at approximately US\$ 500 million. According to the Brooke Amendment, all US aid would be suspended if Egypt fell more than 12 months behind in meeting interest payments on US military debt. In order to ease Egypt's problem of military debt owed to the US, the Reagan's administration decided to release the withheld cash aid of US\$ 115 million in the summer of 1986.²⁸ Even though the leniency of US cross-conditionality did not do away with Egypt's debt problem, this portion of cash aid at least enabled Egypt to avoid such a penalty.

²⁶ EIU, *Egypt: Country Report*, no. 2, 1986, p. 19; and *MEED*, 15 Mar. 1986, p. 17.

²⁷ *Ibid.*

²⁸ *MEED*, 15 Mar. 1986, p. 17, and 5 July 1986, p. 7.

As the process of negotiations with the IMF got underway, Egypt's difficulty in meeting the high fixed interest charges (12-14 per cent) on its military debt owed to the US continued. However, once again pressure over its US military debt was lessened when the US, as part of its broad refinancing programme, agreed to refinance Egypt's military debt. In late 1986, Reagan's administration decided to provide a refinancing package for military debt to countries which had suffered from the burden of high fixed interest rates on their US military loans and had faced difficulty in servicing their US military debt. The refinancing package included reducing interest charges to a uniform rate of 7 ½ per cent for a four-year period.²⁹ Both the laxity of the US over its cross-conditionality and Reagan's refinancing package helped lessen financial pressure upon Egypt and thus provided it with some room to manoeuvre in dealing with the IMF. However, there remained the need for Egypt to tackle the rest of its mounting debt, which was mainly owed to several Western country creditors other than the US.

5.4 Tactic II: Seeking Indirect Support – Attempts at Reaching a Separate Deal with an Individual Creditor

In order to reduce the pressure generated by its debt problem and at the same time reinforce its relative bargaining strength vis-à-vis the IMF, Egypt adopted another tactic by trying to secure separate debt rescheduling deals with its creditors. This was evident in President Mubarak's and Egyptian officials' several trips to Western European countries in order to rally their support. During mid-July 1986, President Mubarak visited four Western European capitals (Rome, Paris, Bonn, and London). The purpose of his visit was reportedly to discuss bilateral debt with each of the European countries and to request new flows of aid from Europe. Moreover, he was to seek help from these countries to persuade the IMF to soften its conditions for the provision of a stand-by credit.³⁰ On the whole, President Mubarak received statements of sympathy.³¹ According to the Cairo press, during his European visit, President Mubarak received pledges of support for Egypt's position in negotiations with the IMF concerning a stand-by credit.³² Even before his tour in Europe, sympathetic remarks were expressed by Claude Cheysson, Commissioner of the European Economic Community (EEC), who called for urgent international action to ease Egypt's external debt problem during

²⁹ *MEED*, 20 Dec. 1986, p. 6.

³⁰ *MEED*, 19 July 1986, p. 9.

³¹ McDermott, *op. cit.*, p. 90.

³² *MEED*, 26 July 1986, p. 6.

his talks with President Mubarak in Cairo. Cheysson said an agreement with the IMF should not entail unbearable sacrifices for the Egyptian people.³³ However, concerning bilateral aid negotiations, President Mubarak received no firm promise of support during his visit to the four Western European capitals.³⁴ Instead, he was said to receive from Margaret Thatcher of the UK a lecture on the merits of putting one's economy in order.³⁵

Egypt's attempts at bilateral debt rescheduling with each of its Western creditors failed to generate results. At first, some Western European countries seemed to be willing to reach a bilateral debt deal with Egypt. However, their preference finally shifted towards a multilateral deal in order to strengthen their position in dealing with those debts owed to them by Egypt. For instance, Spain had initially expressed its willingness to assist Egypt over the arrears accumulating on military orders worth more than US\$ 1 billion made by Egypt. By mid-October 1986, it was reported that the Spanish government was considering taking the issue to the Paris Club.³⁶ Instead, the IMF and the Western creditors represented in the Paris Club asked for a multilateral debt rescheduling agreement. Furthermore, this would be possible only after the Egyptian government had agreed to the terms of an IMF economic adjustment programme.³⁷ This meant that there would be no rescheduling of outstanding debt repayments unless the IMF approved a SBA with IMF conditionality attached. Thus, the imposition of cross-conditionality by Western country creditors augmented the relative power of the IMF while acting against that of Egypt.

Indeed, the Paris Club debt rescheduling was cross-conditional upon the agreement with the IMF. It was only immediately following the IMF's approval of the SBA that the debt rescheduling with the Paris Club was allowed to take place. On 18 May 1987, an Egyptian economic team headed by Salah Hamed, Governor of the CBE, left for Paris

³³ *MEED*, 19 July 1986, p. 9

³⁴ EIU, *Egypt: Country Report*, no. 3, 1986, p. 19.

³⁵ McDermott, *op. cit.*, p. 90.

³⁶ EIU, *Egypt: Country Report*, no. 4, 1986, p. 18. The Paris Club was formed in 1977, comprising major official creditors. However, the Paris Club is not an international organisation and thus, has no a fixed membership. Instead it 'represents a set of procedures . . . used for negotiating arrangements to defer payment obligations' on official debts. Rieffel, A., 'The Role of The Paris Club in Managing Debt Problems,' *Essays in International Finance*, no. 161 (Princeton, N. J.: International Finance Sec., Dept. of Economics, Princeton U., Dec. 1985), p. 3. In the case of Egypt, they included Austria, Australia, Belgium, Canada, Denmark, Finland, France, Italy, Japan, Kuwait, the Netherlands, Norway, Spain, Sweden, Switzerland, the UK, the US, and West Germany. *MEED*, 30 May 1987, p. 5.

³⁷ EIU, *Egypt: Country Report*, no. 4, 1986, p. 18.

to prepare for rescheduling debt service payments. On 22 May 1987, the Paris Club agreed on a framework for rescheduling debt service payments. Under the agreement, Egypt's debt repayments (i.e. arrears due up to the end of 1986 and interest and principal payments between January 1987 and June 1988 on official and government guaranteed debts), worth approximately US\$ 12 billion including both civilian and military debt, were consolidated and spread over a 10-year period. Originally, Egypt asked for a repayment period over 15 years. The deal also included a five-year grace period on debt payments, allowing the Egyptian government to undertake IMF reforms. During the grace period, interest would be calculated on neither the original loan nor on the unpaid interest.³⁸

5.5 Tactic III: Seeking Direct Support from 'Friends'

Egypt's efforts to gain support among 'friends' went on, while disagreement with the IMF over the pace of policy measures remained a major obstacle to gaining access to the needed financial assistance. Mubarak's July visit to Europe was followed by a series of visits by senior Egyptian ministers to various European capitals in September 1986.³⁹ Egypt's efforts in seeking support for its protracted negotiations for the standby credit continued through early 1987, when President Mubarak made additional trips to Europe in December 1986 and January 1987.⁴⁰ His December 1986 European tour (France, West Germany, Romania, Italy and Greece) appeared to be successful. The French, West German, and Italian leaders pledged their full support for Egypt's position in negotiations with the IMF. Following his tour, the atmosphere of the discussions was said to be substantially improved and the IMF agreed to modify its demands for rapid economic reforms.⁴¹

5.6 Cabinet Division versus Technocratic Alliances

The negotiation process between Egypt and the IMF was briefly disrupted by a sudden Egyptian cabinet reshuffle in November 1986. This was initiated by, among other things, the failure of Ali Lutfi's government to regulate Islamic investment companies and the subsequent financial crisis in relation to al-Rayan (an Islamic investment

³⁸ EIU, *Egypt: Country Report*, no. 2, 1987, p. 8; *Financial Times*, 23 May 1987; and *MEED*, 30 May 1987, p. 5.

³⁹ EIU, *Egypt: Country Report*, no. 4, 1986, p. 18.

⁴⁰ EIU, *Egypt: Country Report*, no. 1, 1987, p. 8; and *MEED*, 20 Dec. 1986, p. 6.

⁴¹ *MEED*, 20 Dec. 1986, p. 6.

company).⁴² The sharp division within the cabinet over the economic reform programme also contributed to the departure of the two main figures who had been responsible for the economic policy and at the same time the Egyptian negotiators. One was Prime Minister Ali Lutfi himself, former Minister of Finance and a leading Egyptian economist whom President Mubarak had appointed to push forward economic reform in September 1985 and to deal with Egypt's economic problems, following the resignation of Kamal Hassan Ali. The other was Ali Negm, Governor of the CBE. The two Egyptian officials appear to have been more willing to make compromises with the IMF than were some of their powerful cabinet colleagues and, more importantly, President Mubarak himself.⁴³ For instance, to reduce the subsidy burden on the government budget in fiscal year 1986/87, Ali Lutfi proposed moving away from the subsidy system of selling a range of basic commodities at subsidised prices to a system of cash benefits which would target only those in need.⁴⁴ Ali Negm, in an interview with Reuters on 29 October 1986, said that although he disagreed with the IMF about the need to increase domestic interest rates, he was prepared to be flexible.⁴⁵ In this regard, such a political move on the domestic front by President Mubarak greatly signalled the unwillingness of non-sympathisers of the IMF's proposals among the Egyptian political elite, and especially President Mubarak himself, to yield to the IMF's pressure and also their effort to resist it.

Instead, Atef Sidqi and Mohammed Saleh ed-din Hamid were appointed as a new prime minister and a new governor of the CBE, respectively. The arrival of a new cabinet had an impact on the course of the negotiations with the IMF, in particular on the attitudes of the Egyptian officials towards IMF conditionality. This cabinet took a tougher stand towards IMF conditions, which was also in line with and thus reinforced by President Mubarak's view. In his lengthy speech at the opening of the People's Assembly following the forming of the new government in mid-November 1986, President Mubarak made clear that Egypt would not accept outside interference in its economic management. He remarked: 'We do not accept that a foreign institution should intervene in directing our economic policy or take decisions on the manner of its

⁴² See Springborg, R., *Mubarak's Egypt: Fragmentation of the Political Order* (Boulder: Westview P., 1989), pp. 53-58.

⁴³ According to the weekly *El-Musawwar*, whose editor-in-chief Makram Mohamed Ahmed was seen as being close to President Mubarak, the negotiating Egyptian team under Ali Lutfi's government went too far in accommodating the IMF's demands. *MEED*, 22 Nov. 1986, p. 10.

⁴⁴ *MEED*, 21 June 1986, p. 13.

⁴⁵ *MEED*, 1 Nov. 1986, p. 8.

implementation.'⁴⁶ Along a similar line to Mubarak's message, Atef Sidqi told reporters on 12 November 1986 that several of the IMF conditions were unacceptable, in particular the call for the abolition of consumer subsidies and for a unification of Egypt's exchange rates. He argued that 'a unification of the exchange system in one go is not possible.'⁴⁷ Concerning the issue of subsidies, Atef Sidqi insisted that the government did not consider drastic reductions. He claimed that, while subsidies were his first priority, he did not believe they could or should be ended. Unlike his predecessor's government which was more amenable to phase out subsidies on many items, including bread and electricity, Sidqi believed that subsidies should be retained but should be selective, targeting only poorer sections of the population.⁴⁸

Following the cabinet reshuffle, the talks with the IMF resumed in Cairo in mid-November 1986.⁴⁹ By early February 1987, negotiations with the IMF still continued since a gap between the two parties over a key issue of the pace of the exchange rate unification could not be narrowed. In an interview with the Cairo weekly *Al-Ahram Al-Ikhtisadi*, Youssri Mustapha, Minister of Economy, said that the unification of Egypt's various exchange rates within a period of 18 months pressed for by the IMF was impossible. The process of the exchange rate unification would require a number of stages, the first of which could not start until May 1988. A swift unification of the exchange rates would bring about an adverse impact on domestic prices and investment as well as foreign debt arrangements. Mustapha then emphasised the necessity of a gradual approach towards the unification.⁵⁰

5.7 The May 1987 Stand-By Arrangement and 'Soft' IMF Conditionality

After a prolonged period of negotiations, an agreement was finally concluded between the IMF and the Egyptian government. On 15 May 1987, the IMF's Executive Board approved a SDR 250 million (US\$ 325 million) SBA for Egypt, to be drawn over an 18-month period to November 1988. Immediately a SDR 116 million (US\$ 152 million) first tranche of the total stand-by credit was drawn. The IMF's credit available was substantially less than what the Egyptian government originally had in mind (US\$ 1.5

⁴⁶ *MEED*, 15 Nov. 1986, pp. 9 and 12.

⁴⁷ EIU, *Egypt: Country Report*, no. 4, 1986, p. 9; *Financial Times*, 13 Nov. 1986; and *MEED*, 15 Nov. 1986, p. 12.

⁴⁸ EIU, *Egypt: Country Report*, no. 4, 1986, p. 9.

⁴⁹ *Financial Times*, 18 Nov. 1986; and *MEED*, 22 Nov. 1986, p. 9.

⁵⁰ *MEED*, 7 Feb. 1987, p. 8.

billion). This was voiced by Ali Negm, former Governor of the CBE and a major negotiator with the IMF until November 1986, when he said that 'The amount available from the fund may not be sufficient to support the range of reforms being enacted.'⁵¹ This reflects, at least, the desire of the Egyptians to maximise its gain in terms of the amount of IMF credit that it could obtain with the given costs incurred to them in terms of IMF conditionality.

The economic reform programme attached to the SBA fundamentally aimed to 'make possible over the medium term a sustainable level of economic growth consistent with a manageable balance of payments position and an improved price performance,' and to increase 'the contribution of the private sector to the growth of the economy' and 'the interaction of market forces.'⁵² However, it should be noticed that the aim of the programme stated in a press release published in *IMF Survey*, which was available to the public, was put slightly different. In addition to the aim of sustained economic growth, the phrase of 'ensuring that a safety net is provided to the least-favored members of society through the maintenance of current social policies' was added.⁵³ This would not be surprising in the light of the 1977 'Bread Riots' that had occurred in Egypt. The emphasis of the idea of a safety net by including it in the aim of the policy programme reflected the IMF's awareness of the negative impact that IMF conditionality could have upon the views of the public in Egypt (and also in other borrowing countries) regarding its role and lending policy. To ensure the successful implementation of IMF conditionality in a borrowing country as well as at the same time to protect its reputation and credibility in the eyes of the public, the IMF considered that there was a need for the support of the public in the borrowing country in question.

The major objectives of the programme were: i) to bring about a recovery of real economic activity; ii) to reduce the rate of inflation; iii) to stabilise the current account deficit; and iv) to improve the net international reserve position of the banking system.⁵⁴

⁵¹ *MEED*, 23 May 1987, p. 9.

⁵² Arab Republic of Egypt, 'Statement by the Government of Egypt on its Economic and Financial Policies,' 25 Feb. 1987, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Secretary, *Arab Republic of Egypt – Stand-By Arrangement*, EBS/87/93 Supplement 1, confidential, 20 May 1987, p. 7.

⁵³ International Monetary Fund, 'Egypt: Stand-By Arrangement,' *Press Release*, no. 87/122, 15 May 1987, in International Monetary Fund, *IMF Survey*, 1 June 1987, p. 174.

⁵⁴ *Ibid.*

To achieve the above objectives, a number of policy measures and targets covering both supply-oriented and demand management policies were set. On the supply side, they included adjustments in the exchange system, energy prices, interest rates, and agricultural prices. These policies were at the same time to be accompanied by demand restraint through reductions in fiscal deficit, limits on credit expansion, and targets on external debt, external borrowing and net international reserves. There were also provisions with regard to multiple currency practices, payment and trade restrictions, and bilateral payments agreements.⁵⁵

Egypt's efforts to rally support from the US and Western European countries, with regard to negotiations with the IMF, appeared to pay off in terms of the 'soft' conditions for the stand-by credit. A dispute among the members of the IMF's Executive Board prior to the signing of Egypt's stand-by agreement with the IMF and its culmination in the resignation of C. David Finch, a senior IMF official, in mid-March 1987, seemed to confirm US support for Egypt's view that IMF proposals for economic reform programme had been too severe. Finch believed that the US had placed undue pressure on the IMF to approve credits for Egypt (and also Zaire).⁵⁶ He stated in his paper 'Let the IMF be the IMF' that:

[T]he Egyptian government, fearing a domestic political backlash, refused to take the required action. Instead, it sought protection from other governments. *The Fund was told to reach 'agreement' with Egypt without insisting on the necessary policy changes* [emphasis added].⁵⁷

The relative leniency of IMF conditionality for Egypt was well illustrated by the IMF's generous flexibility on the pace of economic reform. In particular, IMF concessions were apparent over the controversial issue of the exchange system. Instead of a rapid float of exchange rates, a step-by-step approach was adopted, the first stage of which had already been introduced prior to the signing of the May-1987 SBA as one of the prior conditions (the so-called prior actions). Furthermore, the wording of the agreement was remarkably vague, i.e. in several issues of the programme the agreement

⁵⁵ For more details on IMF conditionality under the 1987 SBA, see Appendix E.

⁵⁶ *MEED*, 28 Mar. 1987, p. 5. See also Sadowski, Y., 'The Sphinx's New Riddle: Why Does Egypt Delay Economic Reform?', *American-Arab Affairs*, no. 22, fall 1987, p. 37.

⁵⁷ Finch, D., 'Let the IMF be the IMF,' *The International Economy*, Jan./Feb. 1988, p. 127. Cited in Brown, R. P. C., 'The IMF and Paris Club Debt Rescheduling: A Conflicting Role?,' *Journal of International Development*, vol. 4, no. 3, 1992, p. 304.

laid down only general policy guidelines without specific measures, targets or schedules. These issues were instead subject to the future discussions. They included:

- i) the unification of all exchange rate markets;
- ii) the increase in nominal interest rates on domestic currency deposits and loans to levels that were positive in real terms; and
- iii) the reduction of subsidies on energy prices and the liberalisation of procurement prices for agricultural goods (cotton and rice) for crop year 1988/89.⁵⁸

For instance, a term on the interest rate policies was loosely stipulated to achieve positive real interest rates by the end of the programme period (i.e. November 1988). A schedule of interest rate adjustment to meet such an objective was not set and would be worked out during the first review of the programme (which was scheduled to be in September 1987).⁵⁹

5.8 A Short-Lived 1987 Agreement: Disagreement over the Second Phase of the Policy Reform Programme

By late 1987, the relationship between the Egyptian government and the IMF had been aggravated by disagreement over how to proceed with the economic reform programme agreed in May 1987. In early November 1987, an IMF team arrived in Cairo to carry out the first review of Egypt's economic reform performance.⁶⁰ The review also included the objective of establishing policy targets and schedules for the second period of the economic reform programme which the May 1987 agreement had left unspecified.

During the first review, little progress was made on reaching agreement over the economic reform programme of the second period. Consequently, the disbursement of the second tranche of the SDR 250 million stand-by credit was not approved by the IMF's Executive Board in late November 1987 and had to be re-scheduled for March 1988. In the meantime, talks continued but the two sides still failed to narrow the differences on the increase in domestic interest rates, the timing of exchange rate reform, the rise in energy prices, as well as the cut in budget deficit. Regarding the

⁵⁸ Arab Republic of Egypt, 'Technical Memorandum of Understanding,' 31 Mar. 1987, in International Monetary Fund, *op. cit.*, 20 May 1987, p. 17.

⁵⁹ Arab Republic of Egypt, 'Statement by the Government of Egypt on its Economic and Financial Policies,' 25 Feb. 1987, in International Monetary Fund, *op. cit.*, 20 May 1987, p. 9.

⁶⁰ EIU, *Egypt: Country Report*, no. 4, 1987, p. 9.

issue of interest rate policy, disputes emerged over interpretation of the policy and the methods used to determine Egypt's current economic position. In an effort to reduce inflation and encourage savings, the IMF urged for an increase in interest rates to levels that were positive in real terms. In effect this would mean that the new interest rates had to rise above the inflation rate. The official inflation rate was claimed to be 18 per cent⁶¹ which was substantially lower than one estimated by the IMF and other independent observers at approximately 28-30 per cent.⁶² The Egyptian government resisted the IMF demands on the grounds that a rise in domestic interest rates based on the higher estimate of the inflation rate would be seriously damaging to the expansion of domestic investment. Instead, Egypt reportedly suggested restrictions on credit through direct instructions given to the commercial banks as an alternative.⁶³

As for the other issues, the disputes between the two sides arose over the pace of the economic reforms. The rapid reform of exchange rates preferred by the IMF was rejected by the Egyptian government, which criticised the IMF for wanting 'everything at once.'⁶⁴ As a result, the timing of the exchange rate reform could not be concluded. According to Prime Minister Atef Sidqi, the Egyptian government considered that implementing such a reform would need five to ten years, rather than the one year originally demanded by the IMF. The Egyptian government was, thus, determined to keep the fixed official exchange rate of US\$ 1 = LE 0.70, which was used to finance and subsidise imported foods. As for the issues of energy subsidies and the budget deficit, the IMF viewed that steps taken to raise energy prices and to cut the budget deficit were inadequate⁶⁵ while the Egyptian government viewed the energy price increase and the budget deficit cut required by the IMF as having been too sharp.⁶⁶

With their previous support lent to Egypt during the negotiations of 1985-1987, one might anticipate that Egypt's major creditors, such as the US and Western European countries, would put pressure on the IMF to be lenient in its demands. Claude Cheysson, European Community (EC) commissioner for North-South relations, spoke

⁶¹ Critics of the methods used by the Egyptian government pointed out that the official inflation rate was based on food prices in Cairo and Alexandria only, and on a range of other goods, including items sold at the government-controlled prices. *MEED*, 2 Jan. 1988, p. 9.

⁶² EIU, *Egypt: Country Report*, no. 1, 1988, p. 9; and *MEED*, 2 Jan. 1988, p. 9.

⁶³ EIU, *Egypt: Country Report*, no. 1, 1988, p. 9.

⁶⁴ This was the remark of Prime Minister Atef Sidqi, in an interview with *El-Musawwar*. Cited in *MEED*, 6 May 1988, p. 5.

⁶⁵ *MEED*, 2 Jan. 1988, p. 9.

⁶⁶ *MEED*, 6 May 1988, p. 5.

of 'the impossibility of brutally applying' IMF terms during his visit to Egypt in early March 1988. He asked how a cost of living could be imposed on a population that would be way beyond its means.⁶⁷ Nevertheless, this concern seemed to be merely sympathetic rhetoric since the second tranche of the May 1987 stand-by credit was in fact never released.

During the three-year period of negotiations, sympathetic support from the official creditors for Egypt's position in negotiating with the IMF had been abundant for political reasons, as has been previously discussed. However, the sympathy of the official creditors virtually evaporated during the implementation of IMF conditionality. Such a shift of the official creditors can be understood in the light of their simultaneously existing characteristics: states (political entities) and creditors (financial entities). As a result, these official creditors in dealing with Egypt were of two main contradictory objectives: first, their foreign policy goals which indicated that their support should be given to Egypt; and second, their longing for repayments of debt owed to them which signalled that their support should be given to the IMF. To reconcile both objectives, they adopted a 'stick-and-carrot' approach. However, the degree of the 'stick' which was motivated by their desire for debt repayments and that of the 'carrot' by their foreign policy goal varied. To make IMF conditionality more acceptable to Egypt and thus to induce Egypt to enter into an agreement with the IMF, their political support to Egypt during the 1985-1987 negotiations, which was driven by Egypt's political and strategic importance in the Middle East, gained more significance over their financial objective. Nevertheless, Egypt's tactic of dragging its feet on implementing the economic reform, which the official creditors had hoped would put right the Egyptian economic problems and, more importantly, would restore the ability of Egypt to repay the debt owed to them, worked against their second objective. Therefore, during the implementation period, the political support of the official creditors simply had to give way to their desire for debt repayments.

Consequently, instead of their support, Egypt received pressure from its creditors asking for an increase of energy prices to match world prices within the next five years. The release of the World Bank loans to Egypt's energy and agricultural sectors were delayed due to the World Bank's co-ordinating with the IMF. Also the US, through the USAID,

⁶⁷ EIU, *Egypt: Country Report*, no. 2, 1988, p. 11.

held up its finance to increase Egypt's electricity generating capacity.⁶⁸ However, since Egypt's major financial problem, i.e. its vast debt, had temporarily been resolved through the rescheduling with the Paris Club, such pressure produced no effect in forcing Egypt to agree to the IMF's demands.

After several months of talks between the November 1987 review and the first half of 1988, no agreement could be reached on the second stage of the reform programme and the second tranche of the May 1987 stand-by credit was never disbursed. Only SDR 116 million of the agreed SDR 250 million in balance of payments support was drawn (see Table II.1 on p. 120). Although prior actions, which were required before the IMF Executive Board's approval of an agreement, were implemented, the budget deficit for fiscal 1988/89 appeared to exceed the target of 11 per cent of Gross Domestic Product (GDP)⁶⁹ and no action seemed to be envisaged on cutting consumer subsidies or on raising agricultural prices.⁷⁰ Eventually, the May 1987 reform programme was aborted by the Egyptian government.

Section C: Assessment of Relative Power and the Imposition-Ownership Nature of IMF Conditionality

The above discussions shows that the balance of power between Egypt and the IMF was subject to constant change due to a combination of Egypt's tactics and factors affecting the relative power of both parties. Similar to the two previous periods of the study, there was at the start of the negotiations unbalanced power in favour of the IMF. When it entered into the negotiations with the IMF, Egypt was in a weaker economic and financial position and had less choice in dealing with its problems. However, unlike the two earlier periods, at the outset of the negotiations the Egyptian team seemed to be able to come up with its own draft of the economic reform programme to be attached to the IMF's financial package. Perhaps part of the explanation was Mubarak's appointment of reformers in the cabinet, reflecting the priority he attached to tackling Egypt's long-standing economic problems, which enabled the Egyptian team to initiate the first proposals of IMF conditionality. This was also due in part to the familiarity of

⁶⁸ EIU, *Egypt: Country Report*, no. 1, 1988, p. 8.

⁶⁹ *MEED*, 17 June 1988, pp. 3-4.

⁷⁰ Niblock, T., 'International and Domestic Factors in the Economic Liberalization Process in Arab Countries,' in T. Niblock and E. Murphy (eds.), *Economic and Political Liberalization in the Middle East* (London: British Academic P., 1993), p. 61.

the Egyptians with the contents of IMF conditionality after their experiences in dealing with the IMF in the two previous decades. Despite its ability to put forward the first proposals, the control of Egypt over the policy issues included in IMF conditionality was weakened by the initially stronger position of the IMF, which from the start did not completely agree with Egypt's own proposals. Therefore, at the beginning of the negotiations, the degree of imposition could be said to be equal to that of ownership, i.e. lying approximately in the middle of the imposition-ownership spectrum (described in Chapter Two, Section 2.3.3).

During the 1985-1987 negotiations, Egypt proved itself to be an active negotiating party. Aware of its initial weaknesses but at the same time its political and strategic importance in the region, Egypt was continuously searching for ways to improve its relative bargaining strength. Together with its geopolitical significance, Egypt's tactics largely worked to great effect in enhancing its relative negotiating power and thus extracting concessions from the IMF in terms of several lenient IMF conditions.

In addition to its tactics, part of Egypt's gain in its relative power during the 1985-1987 negotiations stemmed from domestic riots by the CSF conscripts of February 1986, coupled with its political and strategic importance in the region to the US. In the light of the latter's interest and efforts in the on-going Arab-Israeli peace process, ensuring the political survival of Mubarak's regime had become a vital goal in conducting its foreign relations. In this regard, the availability of resources other than those of the IMF, such as the increase in the US financial aid and the US refinancing package, allowed Egypt to drag on the negotiations as financial pressure had lessened, even though the total amount of assistance was too small for Egypt to avoid agreement with the IMF entirely.

As for the IMF, it gained its relative power during the negotiations from the cooperation among Egypt's donors and creditors through their cross-conditionality and insistence on multilateral debt rescheduling. The US, the USAID, and the World Bank tied the release of their funds to agreement with the IMF or to similar conditions that the IMF would ask for. Other Western creditors demanded debt rescheduling to be carried out on a multilateral rather than bilateral basis and linked debt rescheduling to agreement with the IMF. By refusing to engage in bilateral debt rescheduling agreements with

Egypt and instead insisting on a multilateral one, the official creditors of the Paris Club effectively pressured Egypt to resort to the IMF.

Yet, their cross-conditionality and the extensive coordination between them did not guarantee that Egypt would lack room to manoeuvre in negotiating with the IMF regarding IMF conditionality. Egypt was able to prolong the negotiations, for example, when the US released its withheld aid in March 1986 at the time Mubarak's regime was under threat of political instability on the domestic front. Also, Egypt's geopolitical significance and political circumstances at domestic and regional levels ensured that there remained sufficient opportunities for Egypt to instigate divisions within the donors and creditors, as marked by the split within the IMF's Executive Board over IMF conditionality under the 1987 SBA. With such divisions, Egypt was thus able to manoeuvre between them and altered the outcome of the negotiations closer to its preferences.

Besides the cooperation between the donors and creditors, the role of other factors in strengthening the IMF's relative negotiating power appeared insignificant since they hardly brought about any change in the outcome of the negotiations. These included the technocratic alliances between the IMF and the Egyptian negotiators, and factors at the level of the individual negotiators. Concerning the technocratic alliances, they provided only little support to the IMF. Their effectiveness in enhancing the IMF's relative negotiating power was undermined by the failure of Ali Lutfi's negotiating teams to convince their powerful cabinet colleagues and, more significantly, President Mubarak himself and also by the latter's control in the decision-making, as evident in the removal of two major political figures (the Prime Minister and the Governor of the CBE) and a tougher stand adopted by the new figures towards IMF conditionality.

At the level of individual negotiators, at least two elements can be assessed: the language used by and the flexibility of the IMF negotiating team. According to Prime Minister Ali Lutfi, the language used by the IMF staff was 'not an order . . . [but] a kind of recommendation, not obliged' and the IMF negotiating team was 'flexible . . . but they were not flexible enough.'⁷¹ However, both the language used by and the flexibility of the IMF negotiating team appeared to play only a minor role in altering the

⁷¹ Lutfi, Ali, *op. cit.*, 3 Feb. 2001.

outcome of the negotiations since the Egyptian team's views on the pace of economic reform were more or less unchanged.

In sum, as the negotiations got underway, Egypt made substantial gains in its relative power. The considerable augmentation of its relative power, which was best reflected by the leniency of IMF conditionality reached under the 1987 SBA, was due largely to apparent US pressure on the IMF. Despite the relatively greater power of the IMF at the start of the negotiations, the moderate economic programme under the 1987 SBA in line with Egypt's preference indicated that over the negotiation period the relative power of Egypt had grown and had exceeded that of the IMF by the time agreement was reached. As IMF conditionality came close to what Egypt had proposed, IMF conditionality reached under the 1987 SBA cannot be said to have been completely imposed and there was a greater element of ownership than imposition. Thus, Egypt's resistance to IMF demands was successful in moving the degree of imposition and ownership along the spectrum from its starting point (the mid-point) towards the ownership end. What 'soft' IMF conditionality also suggested was that Egypt's relative power and the degree of ownership of IMF conditions were greater than in the two previous periods due to its greater relative power vis-à-vis the IMF. In retrospect, the vague terms regarding the interest rates and the exchange rate policy were simply awaiting the abandon of the economic programme when Egypt's economic and financial situations were improved following the rescheduling agreement with the Paris Club was reached.

Chapter Six

Moving towards a New Stance on Economic Reform: 1989-1998

Introduction

During the period 1989-1998, IMF conditionality was substantially more comprehensive than in any previous period, due mainly to the enlargement of the IMF's focus since the 1980s to include structural adjustment policies in addition to its traditional stabilisation policies (see Chapter Two). Ironically, the two parties managed to conclude three agreements, despite numerous conditions involved; and of the three agreements, the Egyptian government successfully stayed on course with two. The period between 1989 and 1998 saw the successful conclusion of three agreements: the two SBAs of May 1991 and October 1996; and an EFF in September 1993. The negotiations held immediately following the collapse of the 1987 SBA had been protracted for three years before the 1991 agreement was reached. However, in the new international environment after the end of the Cold War and following the Gulf crisis of 1990-1991, the periods of negotiations leading to the two subsequent agreements were considerably shorter than that of the 1991 agreement. In the post-Gulf crisis, the IMF credit made available under the 1991 agreement was not fully drawn on and those under the subsequent agreements were unused due partly to the financial gains as a result of Egypt's eventual stand in the Gulf crisis and partly to the substantial improvement in Egypt's external economy as a result of having undertaken economic reform. All of the agreements remained effective until their expiry dates, with the exception of the 1993 EFF which had to be abandoned following major disputes over devaluation and the pace of reform.

This chapter will assess the nature of IMF conditionality in the case of Egypt during the final period of the study, i.e. the period of 1989-1998. However, before moving on to that task, we need to consider the background and narrative of the negotiations between Egypt and the IMF. It needs to be pointed out that these negotiations took place immediately after the 1987 SBA had lapsed; hence the background section in this chapter will be dealing with the major changes that took place during the period 1989-

1998, rather than the changes occurred in the pre-negotiation period as has been done in the three previous chapters.

Section A: Background

During the period 1989-1998, several major changes took place at both domestic and international levels which helped shape the course of the relationship between Egypt and the IMF. They included the end of the 'Cold War,' the Gulf crisis of 1990-1991, and the conflicts between Mubarak's regime and various Islamist groups and the former's increasingly repressive and/or restrictive policy in dealing with actual and/or potential domestic resistance.

The period 1989-1998 witnessed a major event in the international system, the declining and eventual collapse of the Soviet Union and the Eastern bloc. As it became increasingly preoccupied with domestic matters, including its economic problems, the commitments and influence of the Soviet Union in the region were on a decline during the late 1980s, particularly after its withdrawal from Afghanistan in 1988.¹ The year 1989 saw the crumbling of Communist regimes and the victories of non-Communists in several Eastern European countries. The declaration of independence of nearly all the Soviet republics at the end of 1991 brought about the decisive moment of the collapse of the Soviet Union and its role of the superpower. With the fall of the Soviet Union, the US was left as the sole superpower in the world. The East-West tension and the hostility between the two superpowers (the US and the Soviet Union) became past history. In other words, the Cold War came to an end, which was officially declared by President Bush of the US and President Yeltsin of Russia in February 1992. However, the end of the Cold War did not result in the termination of interests of the US and the former Soviet Union (Russia) in the region, as clearly illustrated by their involvements, particularly that of the US, in the Middle East peace process during the 1990s and the Gulf crisis of 1990-1991. Yet, during the post-Cold War period, their interactions were transformed from hostility into a partnership in dealing with the above matters.

¹ Yapp, M. E., *The Near East Since the First World War: A History to 1995*, 2nd ed. (Harlow: Longman, 1996), p. 499.

Table 6.1 Egypt's Economic Indicators, 1989-1999

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
GDP at market prices (LE million)	76,800	96,100	111,200	139,100	157,300	175,000	205,000	228,300	256,250	280,220	302,300
GDP growth (%)	24.68	25.13	15.71	25.09	13.08	11.25	17.14	11.37	12.24	9.35	7.88
Real GDP growth (%)	4.91	5.68	1.11	4.48	2.90	3.97	4.64	4.99	5.49	5.60	6.04
Consumer prices index number	44.9	52.4	62.7	71.3	79.9	86.4	100	107.2	112.1	116.8	120.4
Consumer price inflation (%)	21.35	16.70	19.66	13.72	12.06	8.14	15.74	7.20	4.57	4.19	3.08
Unemployment (% of total labour force)	6.90	8.60	9.60	9.00	10.90	11.00	11.30	...	8.4	8.2	8.1
Budget deficit (-) or surplus (LE million)	-4,126	-5,494	-1,067	-4,831	2,681	589	1,828	-4,411 ^a	-5,178	-2,591	...
Total external debt (US\$ billion)	51.69	40.44	33.0	31.6	30.6	32.3	33.3	31.3	29.8	32.0	30.4
Total debt service (US\$ billion)	2.91	3.07	2.61	2.70	2.18	2.24	2.38	2.28	1.93	1.81	1.73 ^b
Total debt service ratio (% of exports of goods and services)	23.31	22.46	17.00	15.94	11.23	14.90	13.37	12.65	9.72	9.49	9.0 ^b
Export (fob) (US\$ million)	3,119	3,924	4,164	3,670	3,545	4,044	4,670	4,779	5,525	4,403	5,237
Import (fob) (US\$ million)	-8,841	-10,303	-9,831	-8,901	-9,923	-9,997	-12,267	-13,169	-14,157	-14,617	-15,165
Trade balance (fob) (US\$ million)	-5,722	-6,379	-5,667	-5,231	-6,378	-5,953	-7,597	-8,390	-8,632	-10,214	-9,928
Current account balance (US\$ million)	-1,309	185	1,903	2,812	2,299	31	-254	-192	-711	-2,566	-1,635
Overall Balance of Payments (US\$ million)	-533	-10,224	-2,073	3,360	18	-1,164	-1,827	-1,725	-635	-1,387	-4,614
Foreign exchange (US\$ million)	1,520	2,683	5,324	10,677	12,761	13,316	15,998	17,198	18,479	17,888	14,278
Population (millions)	50.86	51.91	52.99	54.08	55.20	56.34	57.51	59.31	60.07	61.34	62.65
Population growth	1.17	2.06	2.08	2.06	2.07	2.07	2.08	3.13	1.28	2.11	2.14

Sources: International Monetary Fund, *International Financial Statistics Yearbook*, 2001, pp. 434-437, and 2002, pp. 438-439. For total debt service, total debt service ratio and unemployment, World Bank, *World Development Indicators* [CD-Rom], 2000. For total external debt, EIU, *Egypt: Country Report*, various issues.

Notes:

^a Prior to 1996, data include the operations of the Public Authority for Insurance and Pensions and the Public Authority for Social Insurance, which were incorrectly included as social security funds. Prior to 1996, data also exclude the operations of the General Authority for Supply of Commodities (GASC).

^b EIU, *Egypt: Country Profile*, 2001.

During the process towards the end of the Cold War and the post-Cold War period, Egypt's foreign policy objectives were to draw closer to the US in order to obtain economic and military benefits and to sustain its leadership in the Arab world which was linked to the former objective. On the other hand, Egypt served US interests by becoming an interlocutor with all of the Arab states after Egypt's rehabilitation into the Arab world.² This position concerned not only the Middle East peace process (as Egypt was so far the only Arab state which held a peace treaty with Israel), but also the Gulf crisis of 1990-1991.

During the second half of the 1980s and 1990s, Egypt sought to play an active role of facilitator in the peace process. As the peace process stalled in 1990 following the internal division within the Israeli Unity government and retaliatory violence in the occupied territories following the killing of seven Palestinians by an Israeli in Rishon LeZion, Egypt's ability and role in the peace process declined.³ The Palestinians became increasingly dissatisfied with Egypt's role and began to look to Iraq which had emerged as a rival to Egypt's bid for Arab leadership after the Iran-Iraq war of 1980-1988. Meanwhile, regional developments in other areas provided further evidence on Egypt's relative decline of Arab leadership and the growing conflict with Iraq for this role. Such developments included the creation of regional organisations during the 1980s such as the Gulf Cooperation Council (GCC) in May 1981, the Arab Cooperation Council (ACC), and the Arab Maghreb Union (AMU) in February 1989. Saddam Hussein's mistreatment of some two million Egyptian migrant workers in Iraq led to a crisis in Egyptian-Iraqi relations in November-December 1989 with the return of thousands of Egyptian workers from Iraq whose savings were blocked.⁴ At the first annual meeting of the ACC in Amman in February 1990, animosity between Saddam Hussein and Mubarak was apparent when Saddam called those cooperating with the US 'cowards,' and President Mubarak and his delegation stormed out of the meeting.⁵

Egypt's relative decline of influence in the region as well as the adverse consequences of the Gulf crisis in terms of loss of revenues from oil transit dues through the Suez

² Cantori, L., 'Unipolarity and Egyptian Hegemony in the Middle East,' in R. O. Freedman (ed.), *The Middle East after Iraq's Invasion of Kuwait* (Gainesville: U. P. of Florida, 1993), p. 340.

³ *Ibid.*, p. 344.

⁴ Vatikiotis, P. J., *The Middle East: From the End of Empire to the End of the Cold War* (London: Routledge, 1997), pp. 174-175.

⁵ Cantori, *op. cit.*, p. 345.

Canal, tourism and the remittances of Egyptian workers in Kuwait and other oil-rich Gulf states, led to its wish to pursue its regional leadership role in the crisis. Initially, Egypt acted as a mediator in the Gulf crisis between Iraq (which Egypt had assisted during the Iran-Iraq war by providing military equipment and advisors) and Kuwait, in a hope that an Arab solution would be found. Prior to Iraq's invasion and subsequent annexation of Kuwait in August 1990, Egypt sought a dialogue between the two parties in the interests of Arab solidarity. However, the Arab solution which Egypt had hoped for did not materialise. As its diplomatic efforts failed, in the light of its economic and financial difficulties, the Egyptian government sided with the US-led UN coalition forces in the Gulf war in a speculation that there would be a large portion of its debt cancelled (perhaps 50 per cent).⁶ At the Arab League summit in Cairo on 10 August 1990, twelve (including Egypt) of twenty-one members voted for a call for the withdrawal of the Iraqi troops from Kuwait and to send an Arab force to the Gulf in support of the US's effort to deter an Iraqi invasion of another Arab oil-rich state, Saudi Arabia. Egypt joined the coalition forces against Saddam Hussain during the 1990-1991 Gulf war by contributing its 30,000 troops (the second largest force in the coalition after the US) to Saudi Arabia.

On the domestic front, over the years there was a growing influence of various Islamist oppositional groups in Egypt, and the subsequent development of conflicts between such groups and Mubarak's regime. Before further discussions, it should be noted briefly that Islamist groups in Egypt are pluralistic in nature,⁷ and thus the conflicts between the regime and different Islamist groups were not identical.⁸ For the purpose of the following discussions, a distinction should be made at least between armed Islamist groups which resorted to violence in achieving their objectives (such as the Islamic Jihad and the Jama'a Islamiyya), and unarmed Islamist groups which did not (epitomised by the Muslim Brotherhood).

The early 1990s, particularly from February 1992, saw the proliferation of violent actions involving armed Islamist groups in several districts in Cairo and the

⁶ Haseeb, D. and Malak S. Souchdy, 'Egypt's Speculations in the Gulf Crisis: The Government's Policies and the Opposition Movements,' in H. Bresheeth and N. Yuval-Davis (eds.), *The Gulf War and the New World Order* (London: Zed, 1991), p. 75.

⁷ See Sullivan, D. J. and Sana Abed-Kotob, *Islam in Contemporary Egypt: Civil Society vs. the State* (Boulder: Lynne Rienner, 1999).

⁸ Kienle, E., *A Grand Delusion: Democracy and Economic Reform in Egypt* (London: I. B. Tauris, 2001), pp. 132-133.

governorates of Upper and Central Egypt. These included the assassinations of ministers and writers, armed attacks, bombings and other armed incidents against Copts and foreign tourists. Unlike the armed Islamist groups, the increasing influence of the unarmed Islamist groups was expressed in a non-violent manner. They gained increasing popularity and influence in many Egyptian institutions such as state administrations, the judiciary, professional syndicates, trade unions, and universities among students.

For Mubarak's regime, such growing influence and/or popularity of Islamist groups, regardless of whether they armed or unarmed, represented increasing threats to its control and political survival, as well as the economic reform programmes after 1991. Moreover, there were dangers that armed (and also unarmed) Islamist groups might take an opportunity of economic hardship to mobilise certain groups of actors or even the public mass to challenge the regime's control, its economic policy and ultimately its political survival. Nevertheless, this, by no means, represents the only possible motive behind the repressive measures of Mubarak's regime (see below). Eberhart Kienle has identified a number of the regime's possible motives behind its repressive measures against the armed Islamist groups. They included a concern for the security of its 'citizens,' a threat to national unity in the light of the aggravated tension between Muslims and Copts, the fear of discontinuation of American aid (which the US Congress liked to link to the absence of religious persecution), and the fear of foreign tourists deserting the country particularly after the Luxor massacre in autumn 1997, when 58 tourists were killed out of 62.⁹

The measures adopted by the regime in response to these potential threats were often repressive and/or restrictive. The measures adopted against the armed Islamist militants includes arms confrontations, arrests, detention under the state of emergency, frequent trials of civilians in military courts after December 1992, and severe sentences such as capital punishment. The frequent use of such repressive measures was facilitated by the introduction of Law No. 97 of July 1992 and the extension of the state of emergency in 1994, 1997 and 2000 for three years consecutively. Law No. 97 of 1992 involved the amendments to the penal code and the law on State Security Courts, including those

⁹ Kienle, *op. cit.*, 2001, pp. 135-136.

which defined terrorist crimes, and extended the application of the death penalty and the jurisdiction of the State Security Courts.

Although such repressive measures were primarily driven by the regime's aim to crack down on political violence, their application was not merely restricted to armed Islamist groups. The regime seemed to exploit the existence of Islamist militant groups and the conflict with them to justify its confrontation with other potential challengers, such as Islamist opponents who did not resort to violence.¹⁰ In an attempt to reduce the influence of the unarmed Islamists (namely, those belonged to the Muslim Brotherhood and the Labour Party) and their sympathisers, Mubarak's regime resorted to some similar repressive measures used with armed Islamists such as arrests, detention, trials of civilians in military courts, interrogations and incarceration. There were also other measures which were specifically aimed at reducing the influence and ability to mobilise of unarmed Islamist groups. They included legislative measures such as Law No. 100 of 1993 which required minimum levels of turnouts for the elections in professional syndicates to be valid to prevent the Islamists from dominating these syndicates. Also, there were attempts to manipulate the results of elections to the Student Federations (the representative bodies of university students) in favour of candidates closer to the regime, for example, through the rejection by university authorities of candidates who were usually believed to be Islamist or left-wing sympathisers. Other methods of interference included tampering with ballot boxes, miscounting of votes, and arrest of candidates.¹¹

Over time, the conflicts between the regime and both types of Islamists groups had in part led to further expansion of the list of restrictions. For instance, Law No. 238 of 1996, which required preachers and teachers of any mosque to obtain the authorisation granted by the Ministry of Religious Affairs, was introduced to target the preachers and teachers who were of sympathy for Islamist opposition groups. To an attempt to reduce the opposition within al-Azhar, the board of the Front of the 'Ulamas of al-Azhar which seemed to move closer to the Muslim Brotherhood was dissolved in 1998. There were also accusations and campaigns of harassment by the regime against human rights

¹⁰ See Kienle, *op. cit.*, 2001, pp. 134, and 137; and Sullivan and Abed-Kotob, *op. cit.*, p. 11.

¹¹ Kienle, *op. cit.*, 2001, p. 87.

organisations from the mid-1990s in forms of bans on their activities, arrests, interrogations and confiscations of documents and notes.

Moreover, as the economic reform programmes were put into practice, additional restrictions were introduced as a way to prevent criticisms against the regime and its economic policies. The economic crisis of the mid-1980s and also the reforms pursued to overcome it since then had had an impact upon the redistribution of resources. The latter had in turn produced adverse effects upon many of the Egyptians, who appeared to be the losers such as public employees, beneficiaries of many subsidies, and young graduates seeking recruitment into the civil service. On the other hand, there were also winners as a result of the redistribution such as the owners of capital. Demands and reactions of some potential losers or winners towards the resource redistribution could in turn represent additional threats to the regime's control over several actors and areas including the economic reforms. Such a fear was reinforced by protests, which were reflective of organised mobilisation, despite their small scale and geographical limit, such as those by workers and by an upward trend of the number of strikes and stoppages during the 1990s.¹²

In an attempt to compensate the loss of control, the regime resorted to numerous repressive and/or restrictive measures. Among the targets were the media, which were one of the major potential sources of criticisms regarding the regime and the economic reforms. Under Law No. 93 of 1995 which redefined and newly defined the majority of criminal offences and introduced tougher punishments, the definition of crimes was widened substantially to cover the propagation of 'false information.'¹³ In effect, it made it easier for the regime to suppress information which contained accusations of corruption, particularly in relation to the economic reforms like the privatisation of public enterprises. Other measures to control the media were those against Egyptian periodicals which had been registered abroad, including the decision of the Minister of Information in October 1997 to cease the distribution of 41 Egyptian periodicals registered abroad and the decision in February 1998 to prevent the distribution of the weekly *Al-Dustur*. In January 1998, the amendment to the company law was passed,

¹² See Kienle, *op. cit.*, 2001, p. 153.

¹³ However, following a mobilisation of journalists and human right organisations and opposition parties, Law No. 93 was subsequently abrogated at the end of June 1996.

which required the explicit consent of the Council of Ministers for the creation of any new company which sought to publish periodicals or to broadcast satellite television.

In addition to the media, another major target of the regime's restrictive measures was workers, who were one of the major losers of the economic reforms, particularly of privatisation. Under the amendments of 1995 to the provisions of the trade union law governing the right to vote as well as eligibility for union elections, workers employed on the basis of temporary contracts lost the right to vote in union elections. The 1995 amendments also extended the right to join the unions to almost all ranks of management (with the exception of chief executives). This meant that the workers on temporary contracts, who were most prone to redundancies arising from the reform of the public sector and privatisation, would have no representation at union level. On the other hand, the 1995 amendments helped incorporate those who welcomed such economic reforms into the unions. Therefore, the amendments of 1995 can be seen as attempts by the regime to minimise potential resistance and simultaneously build up the number of those who would provide potential support to the economic reforms or at least would refrain from anti-economic reforms. In addition to the 1995 amendments, there were also several other measures which were seemingly intended to achieve the same results. These included the 1995 amendments which facilitated the re-election of former union leaders who, in practice, belonged to the ruling National Democratic Party (NDP), and the decree which required candidates to have their papers signed by the president of their branch union.

Section B: Narrative

6.1 The May 1991 Stand-By Arrangement

Despite its failure to complete the May 1987 SBA programme, there remained a need for Egypt to reach agreement with the IMF. The Egyptian government had indicated that it wanted to extend the period of its debt rescheduling covered by the May 1987 Paris Club agreement (which would end in June 1988) by 12 months to June 1989.¹⁴ Talks with the IMF then continued from the first half of 1988. With the desire for more time to implement IMF conditionality, Egypt requested from the IMF an EFF, a larger

¹⁴ *MEED*, 9 Dec. 1988, p. 14.

and longer-term credit facility than a SBA, with a preferred amount of US\$ 600 million.¹⁵

6.1.1 Difficulty in Reaching an Agreed Pace of Economic Reform

Both parties appeared to agree over some areas of the economic reform programme but the major hurdle still lay in the differences between them in terms of pace and extent of reform. On the one hand, the IMF persistently argued for a tighter deadline, continuing to urge for key reforms to be carried out within one or two years. In its report issued in late 1988, the IMF justified its preferred pace on grounds that a sluggish rate of the economic reforms 'might well be more costly subsequently' and might necessitate 'even stronger and less socially acceptable actions' later.¹⁶ The IMF's insistence on its demand was apparent in comments made by Abdel-Shakour Shaalan, Director of the IMF's Middle East Department, in November 1988: 'Egypt is like an employee who earns 100 pounds a month, but spends 122 pounds.' He repeatedly used the phrase '*mush ma'oul*' (translated as 'incredible' or '(something) beyond reasoning') to criticise the government policy. He gave an example of the tax issue, saying that the only people who pay taxes in Egypt were government employees, small farmers and other low-income groups, while the rentiers and big traders drew all the benefits.¹⁷

On the other hand, the Egyptian government seemed to accept the validity of at least some areas of IMF conditions, including a reduction of the budget deficit, a cut in energy prices, unification of the exchange rates, and an increase in bank interest rates. However, Egypt insisted that such measures should be put into practice gradually. According to Maurice Makramallah, Minister of State for International Co-operation, the Egyptian government believed that the timetable for enacting the economic reforms should be three to four years.¹⁸ Egyptian officials repeatedly argued that carrying out economic reforms in a hurry would result in popular unrest, similar to the riots that occurred in Algeria in October 1988. Egypt's frustration with IMF demands was well illustrated by President Mubarak's speech which seemed to aim at gaining local popular support in reinforcing the Egyptian government's negotiating position vis-à-vis the IMF. President Mubarak, in a rally in Minufiya province on 8 September 1988,

¹⁵ EIU, *Egypt: Country Report*, no. 3, 1988, p. 11; and *MEED*, 3 June 1988, p. 10, and 11 Nov. 1988, p. 16.

¹⁶ EIU, *Egypt: Country Report*, no. 1, 1989, p. 23.

¹⁷ *MEED*, 11 Nov. 1988, p. 16; and *The Middle East*, Dec. 1988, p. 31.

¹⁸ *MEED*, 16 Dec. 1988, p. 10.

expressed his severe criticism of the IMF at the time when his government was engaged in negotiations in Cairo with IMF officials. He likened the IMF to an unqualified doctor:

The IMF acts like someone in the rural areas in the past who made himself a wise man – doctor. He is not a doctor or anything. A patient, for example, needs a treatment for one month. Instead of this doctor telling the patient to take this medicine daily for one month, he tells him to take all the medicine today and tomorrow and you will recover the day after. Of course, he will take the medicine to go to sleep at night and will not wake up in the morning. He dies . . . It [the IMF] writes a prescription for those who require prolonged treatment, just as for those who require short treatment. It says increase the price of electricity by 45 %, increase this . . . by 80 %. If I did this, we would all die.¹⁹

However, despite his criticism of the IMF, he pointed out that economic reforms were crucial. He admitted that foreign government lending money for a power station needed to ensure that the electricity authorities would earn enough from tariffs to be able to service the loan. Simultaneously, he tried to reassure the public by emphasising that price increases should take into account the ability of people to pay.²⁰

6.1.2 External Pressure from Egypt's Creditors

There was immense pressure put upon Egypt by Western creditors reluctant to provide further lending to Egypt. A number of Western countries and lending institutions had held back on their lending due to Egypt's poor repayment record and its unwillingness to move forward in economic reform. The Australian government decided to eliminate credit sales of wheat to Egypt by 1992. Both the World Bank and the USAID also made an energy price increase of 30-40 per cent a condition for the disbursement of their loans. In effect, the World Bank and the USAID continued to delay US\$ 250 million in soft loans for structural reforms, and US\$ 330 million in aid for additional power projects, respectively. In addition, in August 1988, at a board meeting of the African Development Bank, the US as a board member refused to provide Egypt a US\$ 270 million loan for expansion of the Cairo West power station.²¹

¹⁹ *Summary of World Broadcast* (hereafter called *SWB*): *Weekly Economic Report*, ME/W0044, 20 Sept. 1988, pp. A1/2-3. See also *MEED*, 23 Sept. 1988, p. 14.

²⁰ *MEED*, 23 Sept. 1988, p. 14.

²¹ EIU, *Egypt: Country Report*, no. 4, 1988, p. 28.

It appeared that foreign aid to Egypt had, to some degree, been curtailed. However, Egypt was not completely cut off from receiving foreign aid. It continued to receive some external financial assistance. For instance, it was reported in March 1989 that the European Investment Bank had agreed to provide Ecu 28 million (US\$ 33 million) to the Export Development Bank of Egypt to finance industrial and tourism projects, and that France had agreed to extend Fr 955 million (US\$ 154 million) in soft loans for financing rural communications, improving irrigation systems and building the second stage of the Cairo metro. In February 1989, Italy provisionally approved an aid package worth US\$ 500 million to finance the extension of the Assiut power station and supplies for a section of Greater Cairo Wastewater Project. It comprised grants of US\$ 150 million and the remainder was in forms of government loans and export credits. Finland also granted US\$ 2.4 million to a primary health care scheme in Beni Suef (south of Cairo).²² Nonetheless, these small amounts of financial grants and loans would not be sufficient to meet Egypt's financial problems. More importantly, they were tied to particular purposes other than financing its balance of payments deficit and debt.

Furthermore, an additional source of constraint came from Egypt's obligation to resume payments on its military debt owed to the US in July 1989. The total debt was about US\$ 4,550 million, and the interest repayments stood at US\$ 500-600 million per annum.²³ However, Egypt had not been servicing this debt since June 1988. If Egypt failed to fulfil this obligation in July 1989 when its arrears reached 12 months, it had to face severe penalties according to the Brooke amendment which stipulated that all US aid would be halted if the arrears exceeded one year.²⁴

6.1.3 The Egyptian Government's Tactics

While the negotiations with the IMF were taking place, the Egyptian government intensively sought support from outside, as highlighted by a series of foreign visits by Egyptian officials, particularly to Western European countries and the US in the late 1988 and throughout 1989. During his visit to European capitals towards the end of September 1988, President Mubarak appeared not only to ask Western leaders for their support on the issue of the Middle East peace, but also to appeal for their assistance in

²² EIU, *Egypt: Country Report*, no. 1, 1989, pp. 23-24.

²³ *MEED*, 9 Dec. 1988, pp. 14-15.

²⁴ *MEED*, 3 Mar. 1989, p. 22.

Egypt's prolonged difficulties with the IMF. President Mubarak claimed that he had found 'co-operation and complete understanding' in London, Paris, Bonn, and Belgrade. However, it was only France and West Germany which publicly announced their explicit support for Egypt vis-à-vis the IMF.²⁵ In early March 1989, President Mubarak's trip to Western Europe (Belgium, the Netherlands, and West Germany) and the US appeared to be for similar purposes. There were mixed responses from these countries. Considerable sympathy came in his talks with EC officials and the leaders of Belgium, the Netherlands, and West Germany. On the other hand, the UK held its hard line position towards the issue. Other EC states appeared to be exasperated at the large amount of project financing which Egypt had held over from year to year, and also resisted the Egyptian requests for a conversion of such funds into cash aid.²⁶ This was followed by a tour to Paris and Bonn by a senior Egyptian official team led by Abdel-Halim Abu Ghazala, presidential assistant and former defence minister, and Atef Obeid, Cabinet Affairs Minister.²⁷ In a meeting with President François Mitterrand in Paris in late September 1989 on his way to New York and Washington, President Mubarak reportedly sought French support for its negotiations with the IMF.²⁸

As for the US, it took a tougher line towards Egypt by making a stand-by agreement with the IMF a condition for releasing its funds. President Mubarak's tour in early March 1989 appeared to fail to obtain US support for Egypt vis-à-vis the IMF. Following his tour, it was announced that for the second consecutive year Washington would hold back the US\$ 115 million cash portion of the annual US\$ 815 million in its economic aid to Egypt. US officials said that only if Egypt accepted economic reforms along the lines of those supported by the IMF, would it receive cash aid, worth US\$ 230 million which had been withheld for two years.²⁹ It was only after Egypt showed its willingness in accommodating such economic reforms by increasing its electricity tariffs at the end of March 1989 (see the following section) that the US then reversed this decision in mid-April 1989 in addition to the release of part of its funds for projects in the energy sector. The US also offered Egypt additional credits of US\$ 150 million for agricultural purchases and of US\$ 100 million under the Commodity Import

²⁵ EIU, *Egypt: Country Report*, no. 4, 1988, p. 11.

²⁶ EIU, *Egypt: Country Report*, no. 2, 1989, pp. 5-6; and *Financial Times*, 9 Mar. 1989.

²⁷ *Financial Times*, 5 Sept. 1989; and *MEED*, 15 Sept. 1989, p. 15.

²⁸ *Financial Times*, 28 Sept. 1989.

²⁹ EIU, *Egypt: Country Report*, no. 2, 1989, p. 5.

Programme, which assisted private sector business in importing raw materials and capital goods.³⁰

Under pressure from its high level of debts which needed to be rescheduled, and in prolonged struggle with the IMF as well as with little Western support, Egypt turned to the Soviet Union, Arab countries and Arab funding organisations for financial assistance in coping with the debt problem. Its efforts proved to have been worthwhile when returning from a visit to the Soviet Union in August 1988, Boutros Boutros Ghali, Minister of States for Foreign Affairs, announced that the Soviet Union had agreed to forgo interest on repayment of Egypt's US\$ 2-3 billion military debt, incurred during the 1960s and early 1970s. It also agreed on a long grace period and a payment reschedule.³¹ It was reported that President Mubarak, in his talks with Arab leaders, emphasised that the stability of Egypt was crucial to the stability of the region as a whole and this could only be assured by flows of money coming to help Egypt out of its severe economic crisis.³² However, Egypt's hope for large scale Arab aid, in terms of grants and concessional loans, as provided by the GODE during the 1970s, was not fulfilled.

Furthermore, similar to its previous moves made during the negotiations leading to the 1987 agreement, Egypt made failed attempts to circumvent the procedure, whereby an agreement with the IMF was a precondition for any rescheduling of payments to the Paris Club creditors, by approaching its foreign creditors directly. To avoid concluding a multilateral agreement, Egypt tried to extend earlier bilateral agreements which would cover the payments worth US\$ 4 billion due between July 1988 and June 1989. Egypt had sent its Paris Club creditors a memorandum outlining economic policies which were likely to govern the drafting of the 1989/90 budget due to come into effect in July 1989. The memorandum referred to a number of specific measures some of which would increase revenue and some of which would reduce public expenditure. The revenue-raising measures included a proposed new round of price increases for petroleum products and electricity, raising additional taxes and improving tax collection as well as increasing postal charges, railways fares, and car insurance rates. The memorandum claimed that these measures would bring in LE 1,630 million a year, with

³⁰ EIU, *Egypt: Country Report*, no. 2, 1989, pp. 8-9.

³¹ EIU, *Egypt: Country Report*, no. 4, 1988, p. 28.

³² *Ibid.*, p. 29.

the largest single amount (LE 270 million) coming from the increase in the price of electricity.³³

6.1.4 Concessions by Both Sides

Under intense pressure from some Western countries and particularly the US, the Egyptian government seemed to have little room to manoeuvre. Prior to another round of negotiations with the IMF held at the end of April 1989, the Egyptian government began to make some concessions by implementing a series of economic reforms for which the IMF had urged. The reforms included a substantial rise in electricity tariffs, starting from 24 March 1989. Small consumers would face an increase in charges of 7 per cent while larger consumers like industries would face a rise of 35-66 per cent. However, despite the large increases, the average prices would be only 30 per cent of the actual cost of production. Prices for kerosene, diesel and fuel oil were also increased, although gasoline prices (which were raised in May 1988) remained unchanged.³⁴ Fearful of sparking demonstrations and riots, the reforms were introduced by stealth without public announcement.³⁵ In this way, consumers would not notice the significant increase in the prices of petroleum products and electricity until the reforms had actually come into effect.

Further areas of Egypt's concessions were an increase in interest rates and a planned reduction in budget deficit. Shortly following the April 1989 talks with the IMF, the CBE announced in mid-May 1989 an overhaul in the interest rate structure. As an attempt to attract more savings into the banking system, deposit interest rates were to be raised by three to 16 per cent, with the new rates ranged from 5 per cent (on short-term local currency deposits) to 16 per cent (on more-than-seven-year deposits). Interest rates on various categories of loans were to be increased by two per cent, with a minimum of 18 per cent.³⁶ In June 1989, the Egyptian government released its planned budget for 1989/90 with a reduction of the budget deficit to the level urged by the IMF, 10 per cent of GDP.³⁷ To increase government revenues and reduce its deficits, a law

³³ EIU, *Egypt: Country Report*, no. 1, 1989, p. 10.

³⁴ EIU, *Egypt: Country Report*, no. 2, 1989, p. 8; and *MEED*, 21 Apr. 1989, p. 11.

³⁵ EIU, *Egypt: Country Report*, no. 2, 1989, p. 8.

³⁶ *Ibid.*; and *MEED*, 26 May 1989, p. 29. The lending rates were varied according to the sector and lending time and thus, the structure of lending rates had not been altered. The range of interest rates for loans for agriculture and industry was 13-15 per cent for less than one year; 14-16 per cent for one to two years; and 15-17 per cent for more than two years. For the services sector, the rates were 15-17 per cent, 16-18 per cent and 17-19 per cent, respectively.

³⁷ *MEED*, 16 June 1989, p. 14.

was passed to tax the earnings of public sector employees working abroad. Tolls were to be introduced on major highways, and fees for visits to archaeological sites and museums would be raised by as much as 400 per cent. Measures were also taken to trim government spending on luxuries such as car telephones for ministers and diplomatic travel.³⁸

In addition to reforms on energy prices and interest rates, and its planned deficit reduction, the Egyptian government took further steps to reform the economy in relation to the move towards unifying the multiple exchange rate system and the reduction of the budget deficit. On 15 August 1989, the fixed Central Bank exchange rate was altered to US\$ 1 = LE 1.10 from its previous rate of US\$ 1 = LE 0.70, representing a devaluation of 57 per cent.³⁹ Earlier in the same month, the government had announced the abolition of the special rate (US\$ 1 = LE 1.89) applied to customs duties. Instead, it was replaced by the commercial bank rate (at that time approximately US\$ 1 = LE 2.59). This meant a rise of 37 per cent in the local currency value of imports for customs purposes. However, in an effort to reassure the public that the devaluation would not produce higher prices for consumers, this rise had been offset by cuts in tariff rates and 35 per cent reduction in consumption tax on imports.⁴⁰

Perhaps indicators of Mubarak's concessions to the IMF went beyond economic reforms in the light of the removal of Muhammad 'Abdal-Halim Abu Ghazala, Minister of Defence and Military Production, from his post at the end of April 1989. Although the factors which brought about his removal may be complex, it was widely interpreted as being caused by the minister's refusal to cut the defence budget which was necessary if the IMF-proposed budget targets were to be met.⁴¹ Unlike Abu Ghazala, the new minister, Yusif Sabri Abu Talib, announced that it would be his first objective to lessen the burden of the defence sector on the state.⁴²

³⁸ EIU, *Egypt: Country Report*, no. 3, 1989, pp. 10-11.

³⁹ The Central Bank exchange rate was used for calculating exports of petroleum, raw cotton and rice; revenues from the Suez Canal and the Suez-Mediterranean (SUMED) pipeline; and imports of essential commodities such as wheat, flour, cooking oil, tea and sugar.

⁴⁰ EIU, *Egypt: Country Report*, no. 3, 1989, p. 10.

⁴¹ Niblock, T., 'International and Domestic Factors in the Economic Liberalization Process in Arab Countries,' in T. Niblock and E. Murphy (eds.), *Economic and Political Liberalization in the Middle East* (London: British Academic P., 1993), p. 64.

⁴² *Ibid.*

In return for Egypt's concessions over economic reforms during the summer of 1989, both the US and the IMF made their own concessional moves. With frequent riots over IMF-inspired austerity measures that had taken place in Algeria in October 1988, Venezuela in March 1989, and Jordan in April 1989, both seemed to be concerned about the spill-over of riots, which would in turn shake Egypt's political stability and thus the US's ongoing peace efforts in the Middle East. Domestically, the possibility of the recurrence of riots in Egypt on a similar scale to those happened in January 1977 and February 1986 was alarmingly high in view of the Coptic-Muslim tension, particularly in Upper Egypt and the extension of Islamic militant influence as well as popular discontent over price increases and food shortages. Against this background, the US decided to waive the Brooke amendment which threatened to halt all US aid if Egypt could not repay a US\$ 41 million instalment on its military debt in July 1989. The July deadline was postponed until November 1989 when Washington provided indirect debt relief by drawing on an account, which was set up in 1987 for moratorium interest on rescheduled US military debt payments, to meet outstanding interest payments on the military debt until November 1989. Also in August 1989, the US finally released half the US\$ 230 million in cash aid to Egypt. The IMF meanwhile withheld its insistence on the abolition of subsidies on basic foodstuffs. Instead, it reduced its demand to the reorganisation of Egypt's subsidy system in such a way that subsidised goods were channelled only to protect the poor. Abdel-Shakour Shaalan, Director of the IMF's Middle East Department, pointed out that:

I have come with clear instructions from the director-general [Managing Director] of the IMF to take care to preserve the living standards of low-income groups in the context of any measures applied. The IMF is not against subsidies, but it does recommend looking for new measures to ensure that support reaches those who need it – in particular state-sector employees- for example through income support replacing commodity subsidies.⁴³

However, the IMF still regarded the reforms introduced in the spring and summer of 1989 as inadequate. In September 1989, the Egyptian government submitted a letter of intent to the IMF. It included the removal of all remaining subsidies (except for goods sold via ration cards) by the fiscal year 1991-1992; increases in the range of 30-100 per cent on agricultural land taxes, railway fares, postage, car insurance rates and land transfer fees; an increase in energy prices by 30 per cent annually until 1994/95; an

⁴³ *MEED*, 14 July 1989, pp. 4-5.

increase in prices of agricultural inputs to match the price of imports; the abolition of the Central Bank Pool rate within three years; studying a further 4 per cent increase in deposit interest rates (after a 3 per cent rise in May); and a pledge to reduce its stake in joint ventures with the private sector, and to sell off some small public sector concerns.⁴⁴ However, it was rejected by the IMF as insufficient.⁴⁵ Despite several rounds of talks between the two sides after September 1989, an agreement could not be reached. The IMF still sought commitments from the Egyptian government to come up with schedules for cutting energy subsidies and for liberalising the exchange rate system, and a concrete proposal for increasing interest rates.⁴⁶ The IMF's tough stand could perhaps be understood in the light of the lapsed 1987 SBA through which Egypt gained debt rescheduling but did not complete the agreement. IMF officials repeatedly insisted that they did not want to grant backing for debt rescheduling i.e. to allow Egypt to abandon the economic reform programme once a new Paris Club rescheduling agreement was agreed.⁴⁷ The negotiations on the economic reform programme dragged on until the 1990-91 Gulf crisis.

While their agreement could not be reached, the IMF's leverage was enhanced when the World Bank began its study to assess the prospects of providing its lending to support Egypt's economic reform programme. The World Bank team was sent to Cairo in October 1989.⁴⁸ Additional pressure was subsequently placed upon Egypt by the World Bank through the latter's cross conditionality. The World Bank's loan would be released to Egypt, once the latter reached an agreement with the IMF concerning economic reforms.⁴⁹ Indeed, the World Bank held to this condition until Egypt reached an agreement with the IMF. Although Egypt signed a memorandum of understanding with the World Bank for a US\$ 300 million Structural Adjustment Loan (SAL) in March 1991,⁵⁰ its loan was released only following Egypt's conclusion of an agreement

⁴⁴ *Middle East Economic Survey*, 9 Oct. 1989.

⁴⁵ Posusney, M. P., *Labour and the State in Egypt: Workers, Unions, and Economic Restructuring* (New York: Columbia U. P., 1997), pp. 210 and 212.

⁴⁶ *MEED*, 15 Sept. 1989, p. 15, 13 Oct. 1989, p. 15, 2 Feb. 1990, p. 14, and 23 Mar. 1990, p. 25.

⁴⁷ *MEED*, 14 July 1989, p. 4.

⁴⁸ *MEED*, 22 Sept. 1989, p. 15.

⁴⁹ *MEED*, 28 Sept. 1990, p. 6.

⁵⁰ The memorandum, which outlined reforms advocated by the IMF, called for the restructuring of the Egyptian economy on the basis of market forces. Under the March 1991 Structural Adjustment Loan agreement with the World Bank, the terms included greater independence for public sector companies and freeing restrictions on the private sector (including changes in investment regulations), trade liberalisation, and the establishment and operation of a social fund. EIU, *Egypt: Country Report*, no. 2, 1991, pp. 12-13.

with the IMF in May 1991. On 24 June 1991, the World Bank approved the SAL with repayment over 20 years, including a five-year grace period, and a variable interest rate, depending on the World Bank's own borrowing interest rate, to be disbursed in two equal tranches.⁵¹

6.1.5 Egypt's Altering Stance on Economic Reform

The Gulf crisis of 1990-91 highlighted to industrialised countries the significance of Egypt as their ally in a volatile region of the Middle East. Its decisive stand against Iraq immediately brought Egypt substantial benefits. They included:

- i) The cancellation by the six-member GCC of about US\$ 7.7 billion in debts owed by Egypt.
- ii) A collective aid package from the GCC. It was expected to comprise around US\$ 1-2 billion annually, with a further US\$ 2-3 billion to be spent on development projects.
- iii) A write-off by the US of Egypt's US\$ 7.1 billion military debt in early November 1990. Most of the remaining debt to the US was, after the US military debt cancellation, on concessional loans for development projects and food imports. President Bush stated that the write-off recognised Egypt's 'unique contribution in galvanising international support against Iraqi aggression.'⁵²
- iv) Japan, as part of its programme to assist the countries affected by the Gulf crisis, offered Egypt a US\$ 176 million soft loan, repayable over 20 years with a ten-year grace period and a concessional interest rate of 1 per cent, to finance commodity imports.⁵³

Moreover, President Bush, after a fund raising tour in early September 1990, announced the establishment of a multinational group of Gulf and industrialised countries to co-ordinate financial aid to countries economically affected by the Gulf crisis. The three frontline states (which included Egypt, Jordan and Turkey) were the main beneficiaries of US\$ 13 billion provided by the Gulf Financial Crisis Coordination.⁵⁴ Overall, the compensation Egypt received from the US and its allies was many multiples of its net

⁵¹ Weiss, D. and U. Wurzel, *The Economics and Politics of Transition to an Open Market Economy: Egypt* (Paris: OECD, 1998), p. 47.

⁵² EIU, *Egypt: Country Report*, no. 4, 1990, p. 17.

⁵³ EIU, *Egypt: Country Report*, no. 2, 1991, p. 20.

⁵⁴ EIU, *Egypt: Country Report*, no. 4, 1990, pp. 18-19.

loss (about US\$ 2.5 billion) arising from decreases in Suez Canal tolls, tourism revenues and workers' remittances less an increase in oil export revenues due to higher oil prices triggered by the war).⁵⁵

With regard to the impact of the Gulf crisis on the relationship between Egypt and the IMF, such aid flows helped ease Egypt's financial pressure immensely. Ironically, Egypt seemed to be determined to use the aid flows for economic reform purposes rather than to abandon its negotiations with the IMF (The question of what explained such an irony will be dealt with later). There were indications that the Egyptian government was suddenly willing to take further steps in reforming its economy in line with what the IMF (and also the World Bank) had been calling for, as reflected in speeches made by senior Egyptian officials. At the opening of the People's Assembly in December 1990, President Mubarak called for a '1,000 day project to liberate the Egyptian economy.' However, the Egyptian cabinet was not united behind the idea of economic liberalisation, particularly privatisation.⁵⁶ Within the Egyptian cabinet, advocates of privatisation such as Fouad Sultan, Minister of Tourism and Civil Aviation, were confronted by adversaries such as Muhammad Farag Abdel-Wahhab, Minister of Industry, who had denied in public that there were any preparations for the sale of public sector enterprises.⁵⁷ To avoid political opposition as indicated, for example, by a lack of consensus within the Egyptian cabinet over the issue of privatisation, details of the plan were not made public, but the measures to be taken over a three-year period were said to involve promoting the private sector, curtailing bureaucracy, and transforming Egypt into a 'Korean-style economic powerhouse.'⁵⁸ They seemingly included the complete removal of all government subsidies on basis foodstuffs; annual energy price rises to bring these prices into alignment with international prices by 1994; the abolition of the system of compulsory sale of particular agricultural products (e.g. wheat, cotton, sugar cane, rice and maize) to the state at set

⁵⁵ Kanovsky, E., 'The Economic Consequences of the Persian Gulf War: Accelerating OPEC's Demise,' *Washington Institute Policy Papers*, no. 30 (Washington, D. C.: Washington Institute for Near East Policy, 1992), p. 49.

⁵⁶ Hinnebusch, R. A., 'The Politics of Economic Reform in Egypt,' *Third World Quarterly*, vol. 14, no. 1, 1993, p. 163; Al-Sayyid, M. K., 'Privatization: The Egyptian Debate,' *Cairo Papers in Social Science*, vol. 13, monograph 4 (Cairo: Amer. U. in Cairo P., 1990), pp. 28-30 and 34; Springborg, R., 'Egypt,' in T. Niblock and E. Murphy (eds.), *Economic and Political Liberalization in the Middle East* (London: British Academic P., 1993), p. 161; and Sullivan, D. J., 'Extra-State Actors and Privatization in Egypt,' in H. Iliya and D. J. Sullivan (eds.), *Privatization and Liberalization in the Middle East* (Bloomington and Indianapolis: Indiana U. P., 1992), p. 25.

⁵⁷ Weiss and Wurzel, *op. cit.*, p. 42.

⁵⁸ *Ibid.*; and Niblock, *op. cit.*, p. 69.

prices; the abolition of the central bank exchange rate, leading to the convertibility of the Egyptian pound; and the undertaking that there would be no new government investment in economic ventures.⁵⁹ Following the call for a '1,000 day project,' Prime Minister Atef Sidqi in his speech to the People's Assembly on 28 January 1991, talked about Egypt's economic reform programme. He described the government as committed to the implementation of a market driven economy, pledging more privatisation and a relaxation of controls, the opening up of new areas for private interests, and further moves towards a single unified exchange rate. He also announced plans to replace the fixed charge consumer tax with a percentage based sales tax, to be introduced gradually over three years.⁶⁰

Protracted negotiations of over three years eventually resulted in the IMF Executive Board's approval of a SBA for Egypt on 17 May 1991. Under the agreement, Egypt was enabled to draw SDR 278 million (about US\$ 372 million) in stand-by credits from the IMF over an 18-month period. The primary objective of the 1991 economic programme was to 'create, over the medium term, a decentralized market-based, outward oriented economy that will restore noninflationary growth and Egypt's creditworthiness.' The programme also envisaged 'a rapidly growing private sector operating in a free, competitive and stable environment, with the scaled down public sector operating in the same competitive environment and under the same rules, with autonomy from government intervention.'⁶¹

IMF conditionality under the May 1991 SBA was considerably more comprehensive than under any previous agreements. It involved structural as well as macroeconomic adjustment, containing numerous policy measures and targets. The programme entailed several areas of economic reform, including public enterprise reform, price liberalisation, investment decontrol, the reform of foreign exchange system, trade liberalisation, fiscal policies, monetary and credit policies, and also social policies supported by the Social Fund for Development to help mitigate the negative impact of the economic programme.⁶²

⁵⁹ Niblock, *op. cit.*, p. 69.

⁶⁰ EIU, *Egypt: Country Report*, no. 1, 1991, pp. 10-11.

⁶¹ Arab Republic of Egypt, 'Memorandum on Economic Policy of the Egyptian Government,' 19 Apr. 1991, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Secretary, *Arab Republic of Egypt – Request for Stand-By Arrangement – Letter of Intent*, EBS/91/70, confidential, 22 Apr. 1991, pp. 3-4.

⁶² For more details on IMF conditionality under the 1991 SBA, see Appendix F.

It should be noted that the 1991 SBA was concluded after three years of negotiations, but only about nine months after the Gulf crisis had broken out. It can be questioned whether the successful conclusion of the 1991 SBA can be largely explained by the IMF's lenient stance towards Egypt after the Gulf war (that is, whether it was subject to political influence or not). Certainly, the policy programme under the 1991 agreement, which contained numerous conditions, was more comprehensive than any previous ones. This, together with Egypt's long-standing resistance to IMF demands prior to the Gulf crisis, seem to indicate that it was the Egyptian government which made most of concessional moves during its negotiations with the IMF after the Gulf war.

Shortly following the conclusion of the May 1991 agreement with the IMF, Egypt received the cancellation and rescheduling of an estimated US\$ 27-28 billion in Egyptian official and government-guaranteed civilian and military debts owed to the Paris Club, which had earlier been made contingent upon agreement with the IMF.⁶³ The Paris Club creditors agreed to write off 50 per cent of Egypt's official bilateral debts in three phases:

- i) a reduction of 15 per cent from 1 July 1991;
- ii) a further reduction of 15 per cent scheduled in December 1992; and
- iii) a final reduction of 20 per cent scheduled in July 1994.⁶⁴

The agreement also provided for a 30 per cent reduction in interest payments in non-concessional official debt, with the remaining 50 per cent of Paris Club debt to be rescheduled over 25 years with 3-4 year's grace.⁶⁵

However, the deal was reportedly below the Egyptian government's expectation (30 per cent of its debts to be written off immediately, and 20 per cent after 2 years). On the other hand, the creditors rejected this and insisted that IMF targets must be met.⁶⁶ By increasing the number of the debt cancellation phases, the creditors had in effect enhanced the IMF's leverage vis-à-vis Egypt.

One crucial question remains to be answered: why did Mubarak's regime seemingly welcome economic liberalisation and subsequently conclude an economic programme

⁶³ EIU, *Egypt: Country Report*, no. 2, 1991, p. 19.

⁶⁴ MEED, 7 June 1991, p. 24.

⁶⁵ *Ibid.*; and EIU, *Egypt: Country Report*, no. 4, 1996, pp. 39-40.

⁶⁶ MEED, 7 June 1991, p. 24.

with the IMF, despite its earlier protracted resistance and its failure to implement the previous economic programme under the 1987 SBA, which was even less comprehensive than that under the 1991 SBA? There was a combination of coincident factors at various levels which assisted such a move. As has been pointed out earlier, the Gulf crisis provided Egypt an opportunity to benefit enormously from its geopolitical significance in terms of debt write-off and new aid flows. Such financial benefits, in particular the debt relief, created a more favourable environment among members of the political elite for accepting IMF demands.⁶⁷ However, these were by no means sufficient since there would be no urgent need for Egypt to adopt economic reform when its economic circumstances were improving,⁶⁸ as had repeatedly occurred in the previous periods. Thus, another important factor needs to be considered. The collapse of the Soviet Union and the end of the Cold War, which came at around the same time, ensured that such an opportunity of gaining substantial financial benefits was indeed rare. With the end of the Cold War, Egypt was no longer in a position to play one superpower against the other. Thus, it lost a possible source of power in negotiating with the IMF. Also, the collapse of the Soviet Union and its Eastern bloc signified the triumph of the market economy and the failure of the centrally-planned economy, which in turn limited its options in pursuing economic development. Moreover, such a shift was partly motivated by domestic considerations. The call for economic liberalisation by Mubarak's regime was seen as an attempt to secure its social and economic base of support from among the classes that had been stifled during Nasser's years and that were not entirely provided for by Sadat. They included those who were likely to benefit from economic liberalisation entailed in the 1991 SBA such as finance capital, construction, and services interests.⁶⁹

6.1.6 Implementation of IMF Conditionality

The IMF approval of the 1991 SBA came after Egypt had implemented measures which were set in the form of prior actions. In early May 1991, prices of electricity and petroleum products were substantially increased. Prices of electricity, petrol, cooking gas, and kerosene were raised by 10-25 per cent, 33 per cent, 66 per cent and 50 per cent, respectively. On 3 May 1991, the sales tax law was passed, aiming at raising

⁶⁷ Ayubi, N. N., *Over-Stating the Arab State: Politics and Society in the Middle East* (London: I. B., 1995), p. 346; and Hinnebusch, *op. cit.*, p. 164.

⁶⁸ Löfgren, H., 'Economic Policy in Egypt: A Breakdown in Reform Resistance?', *International Journal of Middle East Studies*, vol. 25, 1993, pp. 411-412.

⁶⁹ Bush, R., *Economic Crisis and the Policies of Reform in Egypt* (Boulder: Westview, 1999), pp. 32-33.

government revenues and thereby reducing the budget deficit. A 5 per cent sales tax was imposed on essentials while non-essentials would be taxed in the range of 10-30 per cent, with a 10 per cent norm. Customs duties were considerably raised, after having been reduced in 1989 to offset the increase in the prices in the local currency of imports arising from devaluation (see Chapter Five). Most imports were to be charged at 30-40 per cent of their value.⁷⁰

In implementing the above economic measures, Mubarak's regime adopted a policy of little publicity. All of the economic reforms leading to the 1991 agreement with the IMF were enacted with little press attention and fanfare, and the parliamentary debate in the spring of 1991 over Law 203 of June 1991,⁷¹ which governed public sector reform and privatisation programme, was brief.⁷² Law 203 was passed but not without resistance from trade unions whose members in parliament opposed the bill. To show that privatisation would not harm workers' rights, the amendments were made to the initial draft following the demand of the General Trade Union Federation for the addition of provisions in favour of workers. They included the retention of profit shares distributed to workers, and the validity of existing public sector labour legislation until overwritten by a new labour law.⁷³ Furthermore, repressive and restrictive measures were pursued (for further discussions, see Section A). Electoral laws became restrictive following the electoral 'reform' carried out only two months before the 1990 parliamentary elections, which led to the boycott by most opposition parties in the elections.⁷⁴ In the spring of 1991, Mubarak extended the emergency laws for another three years and shortly thereafter he rejected appeals from the opposition for constitutional reform.⁷⁵

⁷⁰ EIU, *Egypt: Country Report*, no. 2, 1991, pp. 11-12.

⁷¹ Law 203 reorganised the public enterprise sector into 17 financially-autonomous holding companies with 314 affiliated companies so as to prepare for their privatisation. The holding companies were in charge of the financial and technical restructuring of the affiliated companies before bringing them to the point of sale.

⁷² Posusney, *op. cit.*, p. 214.

⁷³ *Ibid.*; and Weiss and Wurzel, *op. cit.*, p. 120.

⁷⁴ Under the new system, a two-round majority vote for individual candidates replaced the vote for party lists, and new constituencies were set up. This presented disadvantages for non-National Democratic Party (NDP) candidates who had limited supporting resources and would thus be harder to win seats allocated by majority vote in many individual constituencies than seats allocated to lists on the basis of proportional representation. See Kienle, *op. cit.*, 2001, pp. 52-56.

⁷⁵ Posusney, *op. cit.*, p. 214.

Besides policy measures and targets set as prior actions, Egypt managed to meet some of the agreed criteria, including the unification of exchange rates on 8 October 1991, which was unexpectedly well ahead of the deadline, i.e. by February 1992. However, there were some policy targets which Egypt failed to meet. They included the budget deficit which stayed above its target of 9.5 per cent of GDP in 1991/92. Despite such a slippage, Egypt, however, passed the first review of performance in December 1991 when the IMF, after some amendments to the original targets, approved the disbursement of the second tranche of the stand-by credit, worth SDR 88 million, in two stages.⁷⁶ Superficially, the IMF was understood to allow some degree of flexibility in assessing Egypt's economic efforts since it was convinced that the Egyptian government was serious in its intentions to pursue and maintain the economic reform programme as a whole, and particularly to make up the fiscal shortfall in the course of the fiscal year 1991/92 (i.e. by the end of June 1992).⁷⁷ However, there seemed to be political support from 'big' countries during the implementation period, when the agreement was breached.⁷⁸ Egypt was said to be strongly supported by the US, which held its interest in Egypt's political stability, on the IMF's Executive Board.⁷⁹ Therefore, the IMF's apparent belief in Egypt's seriousness towards economic reform, compared with the second half of the 1980s, was seemingly underpinned by the political interference of powerful member countries.

In the period following the first review of the stand-by programme, the failure to meet some policy targets and the slowed pace of Egypt's structural adjustment reform, the process of which had lacked behind the monetary and fiscal reforms, were apparent. This caused the IMF's and also the World Bank's dissatisfaction. The IMF admitted that considerable progress had been made in Egypt's economic reform programme, including a stable exchange rate, a decline in inflation, and a surplus in the current account. However, the IMF was still concerned about the expansion of money supply, the need for further taxation reforms, deregulation of private investment and trade liberalisation, the slow pace of privatisation, and the budget deficit. Concerning the latter, there was reportedly a technical disagreement over the scale of the cut in the

⁷⁶ The first half was released immediately and the other equal half was subject to confirmation that the Egyptian government had adhered to its performance criteria set for the end of December 1991. *MEED*, 17 Jan. 1992, p. 11.

⁷⁷ See, for example, EIU, *Egypt: Country Report*, no. 1, 1992, p. 10.

⁷⁸ Interviewee 10 (a former official of the Central Bank of Egypt), personal interview, Cairo, 15 Feb. 2001.

⁷⁹ *Égypt/Monde Arabe*, 11, 1992. Cited in Weiss and Wurzel, *op. cit.*, p. 54.

budget deficit. According to Prime Minister Atef Sidqi, the IMF insisted that since Egypt's interest payments on foreign debt had been lessened substantially by the concessional terms of the Paris Club agreement, Egypt's budget deficit should be reduced to 4 per cent of GDP.⁸⁰ Consequently, the second review of Egypt's stand-by programme and the disbursement of the remaining stand-by credit (SDR 130 million), originally due in June 1992, had to be postponed.

Meanwhile, additional pressure was put upon Egypt by the World Bank. The disbursement of the second and final tranche (worth US\$ 150 million) of the US\$ 300 million SAL agreed with the World Bank was scheduled to be disbursed around June 1992. However, it was put off due to Egypt's reluctance to move forwards with the Structural Adjustment Programme, in particular with privatisation of public sector enterprises and trade liberalisation. The World Bank, as well as the IMF, complained that the valuation of the companies to be sold was proceeding slowly and, because of the transfer of assets to the private sector had hardly begun, public sector firms were placing extensive demands on the credit system, crowding out the private sector. They were also dissatisfied by delays in the liberalisation of trade regulations which protected the public sector from foreign competition.⁸¹ In mid-July 1992, Spiros Voyadzis, the head of the World Bank's Middle East division, warned Egypt that in September 1992 the 15 former Soviet republics would join the World Bank, and 'If Egypt does not move fast, it is only one cake that is provided and that cake may be given to other countries.'⁸²

However, what Egypt in fact ultimately longed for was not their credits, rather the seals of approval from the two institutions, which would enable Egypt to claim the second phase (15 per cent) of the Paris Club debt relief, worth around US\$ 3 billion. As a result, Egypt had to push further the economic reform programme. This included the abolition of credit ceilings to the private sector in early October 1992, for which the IMF had reportedly urged since June 1992.⁸³ The government, in an effort to comply with the 1991 SAL agreement with the World Bank, further eased its trade restrictions by removing the special low tariff status of 60 categories of goods.⁸⁴ In August 1992,

⁸⁰ Sidqi, Atef, interview, *Al-Ahram*, 1 November 1992, in EIU, *Egypt: Country Report*, no. 4, 1992, p. 14.

⁸¹ Posusney, *op. cit.*, p. 216.

⁸² EIU, *Egypt: Country Report*, no. 3, 1992, p. 14.

⁸³ The ceilings were introduced in 1991 as part of the counter-inflationary programme agreed with the IMF. *MEED*, 23 Oct. 1992, p. 18.

⁸⁴ EIU, *Egypt: Country Report*, no. 1, 1993, p. 13.

the number of prohibited imports was reduced from 105 to 78 in line with IMF conditionality, which meant that the importation of previously prohibited products such as tractors, tobacco, soft drinks, meat, fruits, perfumes, radios, refrigerators and cement was allowed.⁸⁵ Furthermore, the Egyptian government, in February 1993, announced a programme of privatisation, including the granting of authorisation on 5 February 1993 to eight public and mixed banks to sell the state's participation in 16 enterprises and Prime Minister Atef Sidqi's announcement on 26 February 1993 to privatise 85 public or joint venture enterprises by June 1997.⁸⁶

The IMF finally approved the second review of Egypt's economic performance on 18 March 1993. The IMF appeared to look for the World Bank's seal of approval before granting its own since its approval came only a few days after the World Bank's Board of Directors agreed on 12 March 1993 to release the remaining US\$ 150 million of the SAL. Despite receiving the approvals from both IFIs, Egypt refrained from drawing on the remaining credits of both IMF and World Bank. When the 1991 SBA programme with the IMF ended in May 1993, the total amount of IMF and World Bank credits disbursed was only SDR 147.2 million (see Table II.1 on p. 120) and US\$ 150 million,⁸⁷ respectively. There would be less need for Egypt to draw their credits, in particular when its resource position improved, notably a high level of its foreign exchange reserves in 1992-1993 (see Table 6.1).

It was the first time since the mid-1960s that Egypt had succeeded in remaining bound to its agreement with the IMF. The agreements signed with the IMF in earlier periods (i.e. those of 1977, 1978 and 1987) had all been abandoned by the Egyptian government. The successful completion of the May 1991 agreement partly reflected Egypt's desire to continue its agreement with the IMF, evident through its requests for the extensions of the agreement. This can be understood in the light of the second phase of the Paris Club debt relief agreement originally due in December 1992, which came after the original expiration date of the May 1991 SBA (November 1992). In addition, the completion of the agreement and economic reform programme by Egypt

⁸⁵ Weiss and Wurzel, *op. cit.*, p. 55.

⁸⁶ *Ibid.*, p. 59.

⁸⁷ International Monetary Fund, 'Egypt – Relations with the World Bank,' in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Acting Secretary, *Arab Republic of Egypt – Staff Report for the 1996 Article IV Consultation and Request for Stand-By Arrangement*, EBS/96/149, confidential, 17 Sept. 1996, p. 42. See also World Bank, *Egypt: Country Assistance Evaluation*, Report no. 20513, 26 June 2000, p. 5.

was also facilitated by the IMF's flexibility on the timetable of economic reform. A number of deadline extensions were allowed. Following Egypt's requests, the initial deadline of 30 November 1992 was extended for three months until the end of February 1993; for three weeks until 21 March 1993; and then again for over two months until 31 May 1993, while disputes between the two parties over the slow pace of privatisation and the size of the budget deficit were dragging on. The IMF granted the first extension of agreement period after the Cairo earthquake of October 1992.⁸⁸ Without further information, however, it is difficult to know why the IMF was repeatedly flexible over the issue of timetable.

It was reported that at the meeting of the IMF's Executive Board to consider the approval of the final review, criticisms were raised by member states over the Egyptian government's commitment to economic reform and its slow pace. The major points of disagreement with Egypt's reform performance were the budget deficit, obstacles to private investment, liberalisation of housing rents, fiscal reform (including its failure to introduce a unified tax law), and delays in implementing the Social Fund.⁸⁹ Nonetheless, Egypt gained strong support from Saudi Arabia,⁹⁰ which might feel obliged owing largely to Egypt's stance in the US-led coalition against Iraq. Therefore, Egypt's success in keeping its terms with the IMF was thanks to not only coordination among creditors and the IMF's flexibility but also their apparent political support for Egypt within the IMF.

6.2 The September 1993 Extended Fund Facility

6.2.1 Negotiations Leading to the September 1993 Extended Fund Facility

Despite its improved economic situation, especially its accumulating foreign exchange reserves, Egypt strove for a successive agreement with the IMF. There remained an incentive for doing so since only one of the three tranches of the debt reduction had become effective and Egypt needed to secure another US\$ 3 billion of the Paris Club debt write-off, the second stage of debt rescheduling.

⁸⁸ Weiss and Wurzel, *op. cit.*, p. 59.

⁸⁹ *Ibid.*; and EIU, *Egypt: Country Report*, no. 2, 1993, p. 14.

⁹⁰ EIU, *Egypt: Country Report*, no. 2, 1993, p. 14.

To pave the way for a new agreement with the IMF, President Mubarak pursued the old tactic of seeking assistance from 'friends.' He told the press that in his meeting with President Clinton in Washington, D. C. in early April 1993, he would request the maintenance of present levels of US aid for three years, and also US support in Egypt's dealings with the IMF, including his meeting with Michel Camdessus on the following day.⁹¹

Shortly after the completion of the May 1991 agreement, a new round of what donors described as 'exploratory' talks began between an IMF staff team and the Egyptian officials in Cairo in early April 1993.⁹² While its negotiations with the IMF were taking place, Egypt (whose previous SAL accord of May 1991 with the World Bank ended in March 1993) was simultaneously trying to reach a successive agreement with the World Bank, which was co-ordinating with the IMF. The World Bank's task was to monitor a large part of the structural adjustment reforms envisaged under the new agreement, in addition to the provision of extended technical assistance for the reforms. Negotiations were in fact held between a joint IMF-WB team, on the one hand, and the Egyptian team, on the other hand. This is because the focus of the economic reform programme under a new agreement shifted to structural adjustment, the process of which fell behind monetary and fiscal reforms under the previous agreement. This in effect meant that the IMF would only sign an agreement with Egypt once the World Bank agreed. Thus, the co-ordination between the two institutions seemed to lend the IMF some certain degree of bargaining strength vis-à-vis Egypt.

Egypt's intensive talks with a joint negotiating team of the IMF and the World Bank officials held in Cairo in late May and early June 1993 brought about little progress. Both sides reportedly agreed on some areas, including general fiscal and monetary policies. However, disagreement remained over the pace of implementation and the extent of the new economic reforms in several areas. Among them was the sluggish pace of privatisation. At a seminar held in Cairo on 7 June 1993 Atef Obeid, Minister of Cabinet Affairs and Administration Development, admitted that privatisation was progressing slowly. However, while Obeid confirmed the presence of Egypt's political commitment towards privatisation, he argued that Egypt lacked sufficient technological

⁹¹ Weiss and Wurzel, *op. cit.*, pp. 59 and 63.

⁹² EIU, *Egypt: Country Report*, no. 2, 1993, p. 14; and *MEED*, 16 Apr. 1993, p. 10.

skills for this complex process. He insisted on Egypt's preferred pace of economic reform: 'We think we are doing it the right way – at a slow speed but slowly and surely . . . we cannot afford to fail.'⁹³ He criticised the approach of the World Bank (and the IMF) that 'the advisor will not be driving the car but he might be visiting us in hospital if we crash it.' On the other hand, the Egyptian government's sluggish pace was criticised by Caio Koch-Weser, the World Bank's vice president for the Middle East and North Africa. He conceded that the Egyptian government faced bureaucratic resistance to privatisation and public sector reform and was correct to be concerned about the prospect of increased unemployment as a result of the reform. He, nonetheless, implicitly argued for the faster pace: 'Having said that, I believed that the pace issue is so important because of the momentum that is needed . . . to make this economy grow again, to make sure private investors don't sit on the fence.'⁹⁴

In addition to the pace of privatisation, the other areas of disagreement were the solvency of the four public sector banks, trade liberalisation, taxation, and budget deficit targets. The IMF was reported to be urging for rapid reductions in the maximum rate of import tariffs (from 80 per cent to 50 per cent in July 1993, 40 per cent in July 1994 and 30 per cent in July 1995), for an extension of the sales tax to include a full range of goods and services, and for a reduction in the number of tax exemptions. However, the Egyptian government argued for a slower timetable for changes in the tariff system to allow more time for local industries to adjust, and for more time for taxation reform.⁹⁵

By July 1993, Egypt came close to agreement with the IMF. An optimistic hope was expressed in statements by Egyptian officials. Following Youssef Boutros Ghali's (Minister of State) statement on 6 July 1993 in Washington that a Letter of Intent with the IMF would be signed shortly, President Mubarak announced on 14 July 1993 that agreement with the IMF 'in a final form' had been reached.⁹⁶ Although some areas, including the development of the sales tax into a full value-added tax, remained unresolved, substantial progress was made during talks with IMF and World Bank

⁹³ EIU, *Egypt: Country Report*, no. 3, 1993, p. 20.

⁹⁴ *MEED*, 18 June 1993, p. 11.

⁹⁵ *Ibid.*

⁹⁶ EIU, *Egypt: Country Report*, no. 3, 1993, pp. 18-19.

officials in Washington, specifically over the budget deficit target, the reduction in maximum import tariff, and a detailed timetable for privatisation.⁹⁷

After several months of tough and intensive negotiations, agreement between the Egyptian government and the IMF staff team resulted in a Letter of Intent in late July 1993. On 20 September 1993, the IMF's Executive Board approved a three-year credit of SDR 400 million (about US\$ 569 million) for Egypt under the EFF. The IMF's approval was granted only after Egypt concluded a three-year Structural Adjustment Monitoring Programme (SAMP) with the World Bank on 10 September 1993. However, with its strong balance of payments position as well as a high level of foreign reserves (US\$ 1.7 billion in September 1993⁹⁸). Egypt withdrew its right to draw on IMF and World Bank credits available under the EFF and the SAMP, respectively.

The overall objective of the September 1993 EFF was to create 'a decentralized, outward-oriented market economy' and to encourage a greater involvement of the private sector through 'a stable and competitive environment.' In order to establish and maintain increasing market confidence in the economy and to accelerate investment, growth and employment, the emphasis was shifted from fiscal and monetary policies, which dominated in the previous SBA, towards structural reform policies. The latter included public sector restructuring, privatisation (including banking and insurance companies), deregulation of prices and investment, regulatory reforms (including the implementation of a 'Unified Law' for all companies by the end of December 1994), tax reforms (including the introduction of a full retail value-added tax (VAT) by the end of July 1995 and of a personal income tax by the end of December 1993), exchange and trade liberalisation, financial sector reforms, and a social safety net to alleviate the adverse consequences of the structural adjustment reform on the vulnerable groups of the population.⁹⁹

The September 1993 accord entailed a long, comprehensive list of policies and targets including continued efforts to keep its budget deficit under control and to further bring down inflation. A compromise seemed to be made over the budget deficit target for 1993/94, after Egypt failed to meet its 1992/93 target of 3.5 per cent, which reached 4.7

⁹⁷ EIU, *Egypt: Country Report*, no. 3, 1993, p. 19.

⁹⁸ EIU, *Egypt: Country Report*, no. 4, 1993, pp. 13-14.

⁹⁹ For more details on IMF conditionality under the 1993 EFF, see Appendix G.

per cent of GDP. Under the 1993 EFF, the budget deficit target was raised to 2.6 per cent from the IMF's original target of 2 per cent.¹⁰⁰ Inflation was set to decline to 9.5 per cent on an annual average basis in 1993/94 from an estimated average of more than 11 per cent in 1992/93. Furthermore, the IMF (and the World Bank which had a supervisory role in the large area of structural adjustment reforms under the 1993 EFF) seemed to accept the slower pace and lesser extent of economic reform adhered to by Egypt. This was apparent in the issue of tariff reduction. The maximum tariff of 80 per cent was to be reduced to only 70 per cent by the end of 1993, to 60 per cent by the end of 1994, and to 50 per cent by the end of 1995, as compared with their original figures (see p. 250).

Following the signing of the September 1993 EFF with the IMF, the second stage of its US\$ 10 billion debt relief agreed with the Paris Club creditors in May 1991, worth about US\$ 3 billion and representing a further 15 per cent reduction, automatically came into effect. Meanwhile, the third and final 20 per cent tranche (worth about US\$ 4 billion and accounting for a 20 per cent reduction) was due to go into effect in July 1994, subject to the targets laid out in the EFF programme being met.

6.2.2 Implementation of IMF Conditionality: Two Major Disagreements

After the two parties had reached agreement in principle in July 1993, efforts were immediately made in implementing prior actions so as to ensure the approval of the IMF's Executive Board for the agreement. These included the extension of the coverage of the sales tax that had been introduced in May 1991 and trade liberalisation. An amendment was introduced in July 1993 by presidential decree to establish taxes of 20-30 per cent on luxury items, of 25 per cent on electrical appliances, and of 10 per cent on a number of services (such as express couriers, cleaning, personal security, and car hiring).¹⁰¹ By the end of July 1993, the foreign trade regime was further liberalised by degrees. The measures included a reduction of import tariffs on 44 raw materials and intermediate products to encourage local manufacturers; the elimination of customs duties on 53 locally manufactured products (such as lorries, buses, tractors, motorcycles and bicycles); and the lifting of import ban on 52 articles, including that on automobiles. Trade protection was maintained on textiles made from synthetic fibres.

¹⁰⁰ EIU, *Egypt: Country Report*, no. 4, 1993, p. 14.

¹⁰¹ Weiss and Wurzel, *op. cit.*, p. 60.

Only 4.8 per cent of Egypt's agricultural and industrial production remained subject to import prohibition, compared to 36 per cent the year before. The variation of tariffs was reduced to a range of 10-80 per cent (with high tariffs on high-powered automobiles, cigarettes and alcohol), compared to 5-80 per cent before. Other measures were the abolition of preferential tariffs for public enterprises and of the need for prior approval of exports and allowing private companies to deal in public sector imports.¹⁰²

Nonetheless, the relationship between the IMF and Egypt reached an impasse not long after the signing of the September 1993 EFF. In early December 1993, the first review of the September 1993 EFF was undertaken by an IMF team in Cairo. This encompassed all areas of the economic reform programme with an emphasis on trade liberalisation, privatisation, taxation reform, banking sector reform, and price and investment decontrol.¹⁰³ There were at least two major disagreements between the two sides during the implementation of the September 1993 agreement: one was concerned with the pace of economic reform; and the other was over the exchange rate policy.

6.2.2.1 Disagreement over the Pace of Economic Reform

The IMF seemed to be satisfied with Egypt's progress on macroeconomic reforms. Following Egypt's talks in Washington in mid-April 1994 with the IMF and the World Bank concerning the reviews of the economic reform progress, Abdel-Shakour Shaalan (the IMF's Executive Director representing Egypt and a group of other Arab countries) told Reuters that Egypt's principal macroeconomic indicators fell within the range that the IMF was seeking. According to Shaalan, the budget deficit was only 0.8 per cent GDP for the first half of the fiscal year 1993/94 while the annual target (ending in June 1994) was 2.6 per cent. Also inflation at that time showed a rate of about 7.3 per cent, compared with the target of 9.5 per cent for the same fiscal year.¹⁰⁴

However, the IMF and its co-ordinator, the World Bank, were less happy with Egypt's progress on the structural adjustment reform, in particular the sluggish pace of privatisation and trade liberalisation. The IMF's frustration with Egypt's slow approach

¹⁰² Information on trade liberalisation in this paragraph was taken from Weiss and Wurzel, *op. cit.*, p. 62.

¹⁰³ Arab Republic of Egypt, 'Memorandum of Understanding,' 18 Aug. 1993, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Acting Secretary, *Arab Republic of Egypt – Request for Extended Arrangement - Letter of Intent*, EBS/93/139, confidential, 20 Aug. 1993, p. 40.

¹⁰⁴ *MEED*, 29 Apr. 1994, p. 24.

is reflected in an IMF official's remarks prior to the December 1993 review: 'They [the Egyptian government] keep pointing to Eastern Europe to try to prove for their case that the gradual approach is better – we beg to differ.'¹⁰⁵ Similarly, the World Bank reportedly left Cairo expressing disappointment with Egypt's performance, following the first review of Egypt's SAMP in mid-March 1994. Disputes between Egypt and the World Bank remained over the slow pace of privatisation, trade liberalisation and energy pricing.¹⁰⁶

On the other hand, the Egyptian government often said that they recognised the importance of economic reform and were still firmly committed to it. However, the Egyptian government insisted that this had to be done at their own preferred pace, 'slowly but surely.' Youssef Boutros Ghali, Minister of State for International Co-operation, stressed that it had to be 'an indigenous process, driven by local considerations and not processed by the outside world.'¹⁰⁷ In an interview with the *Financial Times* in the first half of May 1995, President Mubarak complained by analogy:

Those sitting in Europe and the US cannot understand the reality we face. If you want a paved road from here to Hurghada [on the Red Sea], in the flat areas I can do it very quickly, but when I get to the hills I have to change pace. If I mess that up, the whole road is useless.¹⁰⁸

Indeed, while under pressure on the international front to comply with IMF conditionality, the Egyptian government also faced difficulties on the domestic front in executing the politically sensitive economic reforms. There was internal pressure upon the Egyptian government from various local interest groups, depending on what was at stake as a result of particular reform areas. For instance, in addition to the lack of technical skills as the government often pointed out, the delay in the privatisation progress was partly due to resistance from vested interests of the establishment, namely the management of the holding companies, in selling state-owned enterprises to the private sector. Under Law no. 203 of 1991, state-owned enterprises (the so-called affiliated companies) were grouped under a newly-created 17 holding companies, which held the responsibility for financial restructuring of the affiliated companies and bring

¹⁰⁵ EIU, *Egypt: Country Report*, no. 2, 1994, p. 13; and *MEED*, 26 Nov. 1993, p. 25.

¹⁰⁶ *Financial Times*, 22 Apr. 1994.

¹⁰⁷ *Financial Times*, 3 Nov. 1995.

¹⁰⁸ *Financial Times*, 15 May 1995.

them to the point of sale. However, in practice, there were limited incentives for the holding companies to bring affiliated companies to the point of sale (such as making up for losses of other affiliated companies and financing new investments) since this would involve a loss of their eventual profits for the holding companies. Furthermore, a rapid sale of affiliated companies, if approved by the Ministry of Public Sector, would weaken the holding companies' management and would eventually lead to its own liquidation.¹⁰⁹ Thus, the majority of the holding companies had developed an interest in building a strong and mutually supportive conglomerate of affiliated companies rather than dismantling it by privatisation, and tried to postpone the sale of affiliated companies as long as possible.¹¹⁰ In addition, the Minister of Public Sector apparently supported the reluctance of these holding companies by repeatedly withholding his approval of sales, which had already been negotiated between a private investor and the holding company board, or simply by not reacting to a privatisation proposal. The Egyptian government sometimes objected to the low valuation of affiliated companies to be sold and complained that if privatisation proceeded too rapidly, this would further depreciate the value of the assets.¹¹¹ Such actions by the government could be seen as an attempt to further prolong the privatisation process which would benefit both domestically in dealing with domestic resistance against privatisation and internationally in its negotiations with the two IFIs.

In order not to antagonise the workers who were likely to be the major loser of privatisation (for example, as a result of reductions in their supplementary pay or layoffs), the government insisted that its privatisation programme was geared towards protecting workers' jobs and rights. In the sales of the two bottling companies (the El-Nasr Bottling Company and the Egyptian Bottling Company), the purchasers agreed in writing not to reduce the existing workforce of the firms. However, these were rather exceptional cases. Being under pressure to make their firms more profitable, numerous public sector managers resorted to lay off temporary workers while some declared that large numbers of their full-time, permanent workers were made redundant.¹¹²

¹⁰⁹ Weiss and Wurzel, *op. cit.*, p. 116.

¹¹⁰ As a result, in August 1995, a Consultative Committee for the capital market and privatisation operations was created to speed up procedures for the divestiture of state assets, to 'support' the holding companies and to prevent them from setting 'inaccurate prices.' *Ibid.*, p. 124.

¹¹¹ *Ibid.*, p. 116; and Posusney, *op. cit.*, p. 218.

¹¹² Posusney, *op. cit.*, p. 217.

Furthermore, in seeking to remain in power, the 'slowly but surely' approach advocated by Mubarak's regime would help. The Egyptian government appeared to delay the process of the structural reform programme, fearing that the acceleration of the reform risked possible social disruption prompted by economic hardship and an increase in the unemployment level (which was already high and estimated to be around 17.5 per cent of the workforce or 2.8 million people¹¹³) as a result of privatisation. This fear was further exacerbated by the attacks launched by the militant Islamist movement. The attacks carried out by such militant Islamist groups as the Jama'a al-Islamiyya and the Islamic Jihad against security forces, senior government officials, banks and tourists since late 1992, including an Islamist assassination attempt on Mubarak himself in Ethiopia in June 1995, did not help eradicate the fear either.

The strategy used by the Egyptian government to launch, formulate and adopt the public sector reform further contributed to the delay in privatisation (as well as other structural adjustment reforms). To gain the widest possible approval and thereby guarding their political status quo, the Egyptian government allowed various actors to voice their opinion (which could, sometimes, be contradictory) on whether and how the reform should be carried out and what the reform should include. Due to the controversial nature of the reform, the government had to cautiously move forward and sometimes make compromises as a consequence of interest group lobbying.¹¹⁴ Simultaneously, such an inclusive strategy augmented Egypt's bargaining power with the IMF. By pursuing such a strategy, the Egyptian government in effect gained more time as a result of the delay and more room to manoeuvre in negotiating with the IMF.

Trade liberalisation was another sensitive issue, particularly when a powerful private-sector business lobby opposed to opening the Egyptian market to competition via tariff reductions. Egyptian businessmen had expressed particular concern about the target of decreasing the maximum tariff to 50 per cent and the increased exposure to international competition. Other demands of the business community included minimum prices for all imported articles, with customs duties levied accordingly, and import quotas for each product group.¹¹⁵ As a result of adjustments following pressure

¹¹³ EIU, *Egypt: Country Report*, no. 1, 1995, p. 6.

¹¹⁴ Belev, B., 'Privatization in Egypt and Tunisia: Liberal Outcomes and/or Liberal Policies?', *Mediterranean Politics*, vol. 6, no. 2, summer 2001, pp. 74-81.

¹¹⁵ Weiss and Wurzel, *op. cit.*, p. 65.

by Egyptian businessmen, the new Egyptian customs tariff, which should have been effective since 1 January 1994, was finally ratified on 13 February 1994. The maximum tariff was reduced from 80 to 70 per cent (except for high-powered cars, cigarettes and alcohol) and tariff rates for a wide range of goods (such as several raw materials; food items including raw and refined sugar, cheese, butter, oil and cocoa; paper products; fertilisers; and leather) were also decreased.¹¹⁶

The division within the Egyptian cabinet between the reformists and the gradualists also contributed to the delay in implementing the structural reform programme. The reformists within the Egyptian cabinet did not constitute an overriding majority, and their number was in decline following the departure of Fouad Sultan (former Minister for Tourism and Civil Aviation) in the October 1993 cabinet reshuffle. Fouad Sultan, who was regarded as 'the government's most ardent champion of the private sector,'¹¹⁷ was believed to be punished from having gone too far in pushing the large-scale privatisation of hotel facilities.¹¹⁸ This seemed to suggest that President Mubarak had used the cabinet reshuffle as a way to maintain control over the pace of economic reforms, which would not jeopardise his regime's political survival. This at the same time enhanced Egypt's negotiating power vis-à-vis the IMF through the extra time derived from the delay in implementing structural adjustment reforms. In addition to the above reasons, Mubarak's re-nomination for the presidency in the fall of 1993 added to further delay.¹¹⁹

As a consequence, IMF conditionality was implemented in a piece-meal fashion. Some conditions were fulfilled on time. They included:

- i) the passing of a new unified personal taxation law through the People's Assembly on 31 December 1993, which had received substantial opposition from deputies, even from within the ruling National Democratic Party, which were said to argue for lower-income groups and that higher taxation would jeopardise investment;
- ii) the abolition of almost all controls on foreign exchange dealings, including the previous requirement on exporters, travel agents, and

¹¹⁶ Weiss and Wurzel, *op. cit.*, pp. 66-67; EIU, *Egypt: Country Report*, no. 2, 1994, p. 15; and *MEED*, 25 Feb. 1994, p. 28

¹¹⁷ *Financial Times*, 22 Apr. 1994.

¹¹⁸ Weiss and Wurzel, *op. cit.*, p. 114.

¹¹⁹ *Ibid.*, p. 122; and Posusney, *op. cit.*, pp. 216-217.

- public enterprises to repatriate their foreign exchange receipts, following the passing of a new foreign currency law by the People's Assembly on 27 April 1994; and
- iii) the passing of the law liberalising the cotton trade on 7 May 1994, which freed cotton prices from 1 September 1994.¹²⁰

On the other hand, the Egyptian government failed to meet targets (either on time or at all) in most areas, notably trade liberalisation, privatisation, and price liberalisation. As has previously discussed, due to intense lobbying by Egyptian businessmen who feared international competition, the reduction of the maximum tariff from 80 per cent to 70 per cent was implemented one and a half months behind the deadline (by December 1993). Similarly, the second phase of reducing the maximum tariff from 70 per cent to 60 per cent was not put into effect by the December 1994 deadline and was left unimplemented under the 1993 EFF. Concerning privatisation, at the time of the first review by the World Bank of Egypt's SAMP in March 1994, only three sales had been agreed (the El-Nasr Bottling Company, the Egyptian Bottling Company and El-Nasr Boilers and Pressure Vessels Company) but none of the deals had been completed.¹²¹ Under the 1993 EFF, a draft amendment of the new rent law to decontrol rents on new and vacant units and buildings was due to be present to the People's Assembly by the end of 1993, and should have been passed by the People's Assembly and put into practice by the end of June 1994 (see Appendix G). However, the draft amendment of the rent law was subject to recall following a public outcry over its terms, and the passing of the amendment did not come until 30 January 1996.¹²² By early 1996, another highly sensitive issue, the civil service reform, remained stalled, even though it was, according to the 1993 EFF, due to begin in 1994.¹²³

6.2.2.2 Disagreement over Devaluation of the Egyptian Pounds

Besides the issue of the pace of Egypt's economic reform, another major contentious area between the Egyptian government and the IMF which became public in mid-June 1994 was over the exchange rate policy, in particular the devaluation of the Egyptian pound.

¹²⁰ EIU, *Egypt: Country Report*, no. 1, 1994, p. 14, no. 3, 1994, pp. 20-21.

¹²¹ EIU, *Egypt: Country Report*, no. 2, 1994, p. 13.

¹²² EIU, *Egypt: Country Report*, no. 3, 1994, p. 22, and no. 1, 1996, pp. 20-21.

¹²³ EIU, *Egypt: Country Report*, no. 1, 1996, p. 7.

In fact the 1993 EFF contained no explicit provision for the devaluation of the Egyptian pound. Therefore, the issue of devaluation was subject to various interpretations, even among IMF officials. For some IMF officials, devaluation did not form part of IMF conditionality under the 1993 agreement,¹²⁴ while for others, it did.¹²⁵ However, IMF conditionality under the 1993 agreement implied a flexible exchange rate policy.¹²⁶ The 1993 EFF agreement was concerned with the exchange rate to the extent that:

[A] competitive exchange rate is a key to promoting investment, growth, and efficient diversification of the economy through the growth of the tradable goods sector. Consequently, exchange rate and financial policy will be geared toward gradually improving international competitiveness. The primary instrument will be tighter fiscal policy supported by prudent monetary policy, but *exchange rate market interventions may also be required* [emphasis added]. An improvement in international competitiveness during the course of 1993/94 is targeted. The [Egyptian] Government will closely monitor indicators of non-oil exports, tourist activity, and nominal and real effective exchange rate movements, which will be a key in determining the pace of improvement in international competitiveness.¹²⁷

Yet, Egypt did not in practice adopt the flexible exchange rate policy. The CBE in fact intervened to protect the Egypt pound by pressuring banks to sell limited quantities of dollars except for export purposes.¹²⁸

A) The IMF's View

With regard to the IMF's view over the exchange rate policy, it claimed that due to the lack of progress on Egypt's economic reform during the second half of 1994, economic growth was on a decline while unemployment remained high.¹²⁹ The IMF, applying the concept of real effective exchange rate,¹³⁰ argued that the value of the Egyptian currency (which had remained stable at around US\$ 1 = LE 3.3 since the unification of exchange rates in October 1991), should be adjusted downward since inflation was higher than that in its major trading partners in the West. The IMF estimated that the

¹²⁴ Interviewee 27 (a former IMF official), personal interview, Washington, D. C., 3 Oct. 2001; and Interviewee 30 (a present IMF official), personal interview, Washington, D. C., 16 Oct. 2001. It should be noticed that under the 1991 SBA, devaluation was part of IMF conditionality and Egypt did devalue its currency.

¹²⁵ Interviewee 29 (a present IMF official), personal interview, Washington, D. C., 11 Oct. 2001.

¹²⁶ Interviewee 27, *op. cit.*, 3 Oct. 2001.

¹²⁷ Arab Republic of Egypt, 'Memorandum on Economic Policy of the Egyptian Government,' 18 Aug. 1993, in International Monetary Fund, *op. cit.*, 20 Aug. 1993, p. 20.

¹²⁸ As a consequence, a black market began to develop whereby dollars bought from public-sector banks were resold to private exchange dealers at a small profit. EIU, *Egypt: Country Report*, no. 1, 1995, p. 18.

¹²⁹ *Ibid.*, p. 15.

¹³⁰ The exchange rate that takes into account the effects of inflation differentials.

inflation differential since 1991 was between 35-40 per cent, while over the same period the exchange rate had depreciated a mere 6.25 per cent.¹³¹ Thus, on this basis, the Egyptian pound was overvalued, which in turn adversely affected Egypt's export competitiveness and hindered its economic growth. IMF officials emphasised that they did not necessarily look for a significant devaluation of the Egyptian pound for its own sake.¹³² They had indicated that they were in favour of a reduction in interest rates (claiming that high rates also restricted growth) as a policy instrument to bring about depreciation of the domestic currency.¹³³ IMF officials explained that the latter would, in turn, stimulate the demand for Egyptian exports and would also prevent an influx of imports following the reduction in tariff rates. They added that a cut in interest rates would also boost investment and lessen the burden of interest rates on the government budget.¹³⁴ However, this received resistance from both the Egyptian government, and the private sector businesses and bankers.

B) Egypt's View

The Egyptian government asserted that devaluation was not part of Egypt's letter of intent approved under the September 1993 EFF and was thereby opposed to the idea of the government's intervention to devalue the Egyptian pound, as reflected in a number of Egyptian officials' pronouncements.¹³⁵ Although he admitted that the Egyptian pound had appreciated, but only by a 'modest' amount, Atef Obeid (Minister for Public Enterprise and Administrative Affairs) said in mid-June 1994 that the devaluation of the Egyptian pound would never happen. He cited export-oriented Asian economies as examples of countries that achieved rapid growth assisted by stable exchange rates.¹³⁶

¹³¹ EIU, *Egypt: Country Report*, no. 3, 1994, p. 15.

¹³² EIU, *Egypt: Country Report*, no. 1, 1995, p. 15.

¹³³ It should be noticed that this was different from the IMF demand over changes in interest rates in the 1980s. In 1987, the IMF asked for an increase in interest rates but now it wanted a reduction in interest rates instead. In both occasions, the interest rates were used as an instrument but to deal with different economic problems. In 1987, the IMF wanted to use the interest rates as an instrument to deal with the high level of inflation, so it asked for an increase in interest rates (so people would save more and spend less) as a way to bring down the inflation. In 1994, the IMF aimed to use the lowering of interest rates to bring down the overvalued Egyptian pound (the demand for the Egyptian pound in the currency market would be less and so its value). Therefore, the difference in movement of interest rates demanded by the IMF was due to the different aims in using interest rates.

¹³⁴ *MEED*, 22 July 1994, p. 20.

¹³⁵ While the devaluation dispute remained unsettled, speculation about a possible devaluation and a report in the opposition daily *Al-Wafd* prompted heavy selling of the Egyptian pound in late July 1994. The CBE intervened to buy pounds with dollars, worth estimated US\$ 200 million. The Egyptian pound, thus, stabilised at around US\$ 1 = LE 3.39 at the end of July following Egyptian officials firmly denied the government's intention to devalue. *Al-Ahram Weekly*, 4-10 Aug. 1994, and 28 July-3 Aug. 1994; EIU, *Egypt: Country Report*, no. 3, 1994, p. 15; and *Financial Times*, 29 July 1994, p. 4.

¹³⁶ EIU, *Egypt: Country Report*, no. 3, 1994, p. 15.

The Egyptian government's decision to resist the IMF's suggestions was fully supported by President Mubarak, who had the final say. At a meeting with National Democratic Party officials in Alexandria on 6 August 1994, President Mubarak stated: 'There will be no devaluation of the pound and no increase in the price of dollar. This will be left to supply and demand.'¹³⁷

With a lesson learnt from the Mexican peso crisis of late 1994 and early 1995 that a sudden devaluation could be damaging, the Egyptian Government continued to resist reducing the value of the pound to stimulate exports on grounds that the stability of the exchange rate was a crucial factor for rebuilding investors' confidence and that a rise in import bills and inflation as a result of devaluation would outweigh its advantages. As Ahmed el-Darsh, First Under-secretary for International Finance at the Ministry for International Co-operation, put it:

[D]evaluating the currency is not the right way of handling this situation . . . , but if we take this general medicine it will have other negative effects. The confidence that has been built from the stability of the Egyptian pound over a long period of time is priceless; something we should not part with.¹³⁸

The Egyptian government rejected the claim that a strong Egyptian pound hindered exports and devaluation made domestic products more competitive than imports. The government asserted that there were other policy measures available which could be utilised to encourage exports, and that the key to promote domestic products and exports was through the improvement of marketing efforts and of packaging, delivering on time, and ensuring quality control, rather than through financial competitiveness.¹³⁹ As Youssef Boutros Ghali, Minister for International Co-operation, summarised, 'Our entire economic policy is geared towards the tradable sector. But I deeply believe the issue of competitiveness lies in the technical competence of our exporters – this is what we need to worry about.'¹⁴⁰

¹³⁷ *MEED*, 19 Aug. 1994, p. 11.

¹³⁸ *Al-Ahram Weekly*, 30 June-6 July 1994.

¹³⁹ Such arguments were expressed by a number of senior Egyptian ministers such as Prime Minister Atef Sidqi and Mahmoud Mohammed Mahmoud, Minister of Economy and Foreign Trade. For their statements, see EIU, *Egypt: Country Report*, no. 1, 1995, p. 18; and *Financial Times*, 15 May 1995, and 3 Nov. 1995.

¹⁴⁰ *Financial Times*, 21 June 1994, p. 6.

The IMF's insistence on reducing the value of the pound also provoked unanticipated opposition from Egyptian business circles, which had been supporting the IMF-inspired reform policies since the beginning of the reform programme. Letters were sent to the IMF by business organisations and the Chambers of Commerce to express their opposition to the IMF-proposed devaluation. During a visit to the IMF by a government official team during the mid-July 1994, a letter written by the Egyptian Businessmen's Association was passed on to the IMF, arguing against devaluation of the Egyptian pound. The Egyptian Businessmen claimed that the devaluation would not enhance the competitiveness of their exports.¹⁴¹ According to Ramzi Rushdi, a member of the Board of Governors of the American Chamber of Commerce in Egypt, the American Chamber of Commerce in Egypt sent a letter to the IMF arguing that the business community was against government intervention in the "free" foreign exchange market. In its letter, the American Chamber of Commerce, which shared a similar argument to the government's, pointed out that devaluation would increase the prices of imports and so build inflationary pressure which would in turn have serious social repercussions. The letter also argued that devaluation would also erode the current confidence in the Egyptian pound through speculation and thus, discourage potential local and foreign investors who would not be able to forecast their profits.¹⁴²

Likewise, little support for devaluation was found among Egyptian bankers. Mohammed Abdel-Aziz, Chairman of the Egyptian Banks Federation, expressed his rejection of the devaluation by primarily arguing that devaluation would not benefit exports, especially since Egypt imports most of the materials needed for production, and would instead result in a rise in production costs and a failure to compete in local and international markets.¹⁴³ One local banker asserted: 'Devaluation is only useful if it results in more exports and tourism income.' He suggested that the exchange rate had only marginal significance in this respect in Egypt now. He said: 'Tourism has been affected by special factors unrelated to price, and the poor performance of exports reflects other factors than price, such as freight costs, reliability and proper cover of markets.'¹⁴⁴ Those against the idea of devaluation of the Egyptian pound also pointed

¹⁴¹ *MEED*, 29 July 1994, p. 8. For views expressed by individual members of the Egyptian Businessmen's Association such as Gamal al-Nazir, deputy chairman of the Egyptian Businessmen's Association (EBA), and Na'ilah Allubah, chairwoman of the export committee at the EBA, see *SWB: Weekly Economic Report*, MEW/0345, 9 Aug. 1994, p. WME/2.

¹⁴² *Al-Ahram Weekly*, 20 June-6 July 1994.

¹⁴³ *SWB: Weekly Economic Report*, MEW/0345, 9 Aug. 1994, p. WME/2.

¹⁴⁴ *MEED*, 1 July 1994, p. 16.

out that oil and cotton exports (representing some 50 per cent of total exports), as well as Suez Canal tolls, were valued in dollars. Furthermore, non-oil exports were increasing by more than 10 per cent annually despite the exchange rate factor.¹⁴⁵

While the two contentious issues of devaluation and the pace of reform ran parallel, the Egyptian government was able to exploit the devaluation dispute with the IMF for its own political interest in avoiding implementing unpopular reform measures which might trigger public outcry in the run-up of the November 1995 parliamentary elections. Its over-emphasis on the devaluation dispute in public appeared to be used as a tactic to delay the implementation of the EFF economic reform in the light of its deteriorating relationship with the IMF. Prime Minister Atef Sidqi said in October 1994 that while there were many important disagreements on the economic reform programme, the Egyptian government refused to privatise banks and insurance companies as agreed upon under the September 1993 EFF. In December 1994 he added: 'We will have recourse to privatisation as the last means to improve living conditions.'¹⁴⁶

As a result of the disagreements over the exchange rate issue and the pace of economic reform, the EFF signed in September 1993 became stalled and the first review of the September 1993 EFF was not approved. Without passing the first review, the implementation of Egypt's third and final stage of its US\$ 10 billion Paris Club debt-relief agreement, which was originally scheduled for the end of June 1994, was held up. IMF inflexibility on the exchange rate issue seems to be largely rooted in its concern that, once Egypt passed its first review and consequently obtained the final tranche of the Paris Club debt write-off, the IMF, the World Bank, and other donors would have little leverage on the Egyptian government concerning economic reform for the future period. On the other hand, Egypt appeared to take a cost-benefit analysis, viewing that the total cost of devaluation outweighed the financial gain of the debt relief (additional interest payments of approximately US\$ 360 million per annum). In particular, Egypt's negotiating position with the IMF was strong not only because of the domestic support from Egyptian business circles but also due largely to the timing when its economic situation had substantially improved. Owing to a current account surplus (contributed to by high remittances and increasing tourism revenues), despite the growing trade

¹⁴⁵ *MEED*, 1 July 1994, p. 16.

¹⁴⁶ Weiss and Wurzel, *op. cit.*, p. 69.

deficit, foreign exchange reserves excluding gold had been on an upward trend since the early 1990s, which made it less urgent to reduce foreign debt. They rose from US\$ 6.8 billion at the end of June 1991 to US\$ 18.2 billion at the end of June 1995, which represented an 18-month import cover.¹⁴⁷ Other macroeconomic indicators had also improved substantially since 1991. Inflation had dropped from about 20 per cent in 1991 to 9 per cent in 1994, and the budget deficit declined from 20 per cent of GDP in 1990-1991 to 2.6 per cent of GDP in 1993-1994.¹⁴⁸ Prime Minister Atef Sidqi remarked on 17 December 1994 that 'the government would not allow the adoption of measures moving in the direction of devaluation such as a decrease of interest on pound deposits. The delay of the annulment of the debt is no problem for us and will have no consequences on the Egyptian economy.'¹⁴⁹ Thus, despite its desire to secure the final stage of debt relief, the macroeconomic improvement, particularly the high amount of foreign exchange reserves, seemed to allow Egypt some room to manoeuvre by buying time to resist the IMF's demand and thereby lessened the IMF's leverage over the Egyptian government.

To show its sincerity in arguing against devaluation but also its willingness to continue its economic reform programme in general, measures were announced by the Egyptian government to promote exports through means other than devaluation. On 21 September 1994, the higher committee for exports, under the chairmanship of Kamal el-Ganzouri, Deputy Prime Minister, announced a series of recommended measures with the aim of helping exporters. The measures included a reduction of the interest on loans to exporters by 1-2 per cent; a cut in bank fees on export financing by 25-50 per cent; the lowering of freight, port services and storage charges; and the provision of incentives for aircraft passing through Egypt to carry Egyptian goods for export.¹⁵⁰ While the devaluation disagreement continued, another series of non-devaluation measures aiming at promoting exports was announced in mid-November 1994. Such measures included a reduction of land prices for industrial projects in new cities plus further tax exemptions to industrialists, and government financial assistance to cover part of the costs incurred by textile exporters who improved their product quality.¹⁵¹

¹⁴⁷ *Financial Times*, 3 Nov. 1995.

¹⁴⁸ Weiss and Wurzel, *op. cit.*, pp. 60 and 68.

¹⁴⁹ *Ibid.*, 1998, p. 70.

¹⁵⁰ EIU, *Egypt: Country Report*, no. 4, 1994, p. 15; and *MEED*, 7 Oct. 1994, p. 19.

¹⁵¹ EIU, *Egypt: Country Report*, no. 1, 1995, p. 19.

In an attempt to break the deadlock over the devaluation of the Egyptian pound and also Egypt's slow progress on structural reform, a series of talks between the Egyptian government and the IMF had been held in the second half of 1994 but resulted in little progress. One of the former IMF officials described how: 'The relation [between Egypt and the IMF] was at a low ebb and broke down after the failure of the EFF. The Fund staff did not visit Egypt for 18 months from October 1994 until March 1996. There was a hiatus.'¹⁵² The relationship between the two sides deteriorated to the degree that the devaluation dispute apparently became personalised at the top level between President Mubarak and Michel Camdessus, the IMF's Managing Director, who adhered to opposite views.¹⁵³

At the IMF Executive Board meeting held on 22 September 1995 for a review of Egypt's economic performance in the context of the annual Article IV consultations,¹⁵⁴ it was reported that the debate over Egypt's exchange rate policy rumbled on although a consensus was reached on the government's need to improve export competitiveness. This was partly due to the lobbying of developing country members of the IMF by Abdel-Shakour Shaalan to ensure support for Egypt vis-à-vis the G7 country members.¹⁵⁵ The IMF staff report prepared for the meeting called for devaluation of 25-40 per cent, including an immediate 15 per cent devaluation.¹⁵⁶

However, the devaluation stalemate did not come to an end until the following month when the case was discussed at a meeting of the IMF's Executive Board. At the meeting, Abdel-Shakour Shaalan argued against the strong recommendation for devaluation put forward by the IMF's Management and staff, and the Executive Board finally agreed with the former.¹⁵⁷ Consequently, the Executive Board decided that the devaluation was unnecessary at the time of the robust performance of Egyptian exports over the past year. According to Stanley Fisher, IMF Deputy Managing Director, such a shift in the IMF's position on the exchange rate issue stemmed in particular from a sharp rise in non-oil exports by 70 per cent during the first nine months of the fiscal

¹⁵² Interviewee 27, *op. cit.*, 3 Oct. 2001.

¹⁵³ EIU, *Egypt: Country Report*, no. 4, 1995, p. 16.

¹⁵⁴ The consultations were not directly related to the stalled EFF signed in September 1993. They were consultations carried out annually by the IMF with member countries in accordance with Article 4 of the IMF's Articles of Agreement.

¹⁵⁵ EIU, *Egypt: Country Report*, no. 4, 1995, p. 15.

¹⁵⁶ *Ibid.*

¹⁵⁷ Interviewee 27, *op. cit.*, 3 Oct. 2001; and Interviewee 29, *op. cit.*, 11 Oct. 2001.

year 1994/95.¹⁵⁸ On 25 October 1995, in response to the question over the devaluation of the Egyptian pound, Fisher remarked that:

There is agreement that the primary areas in which progress has to be made in Egypt are with structural reforms. That's agreed by the IMF and agreed with the Egyptian government and I don't think there is much ambiguity about that. There is nothing in the Egyptian economy now that indicates the need for a change in the exchange rate or the exchange system that we see.¹⁵⁹

As a result of the two main contentious issues, the 1993 economic programme came to a halt and was subsequently aborted by the Egyptian government without passing any of the IMF's review. The IMF staff in its report summarised how the Egyptian government performed in the implementation of the 1993 programme:

The pace of reform has been sporadic and generally slower than envisaged under the extended arrangement (which expires September 19, 1996), with the result that none of the reviews was completed. However, important progress has been made toward fiscal adjustment and toward creating a more decentralized, market-oriented and open economy.¹⁶⁰

6.3 The October 1996 Stand-By Arrangement

Prior to the beginning of negotiations for an agreement with the IMF, Egypt's economic position remained relatively strong. There were a number of macroeconomic indicators suggesting such strength. Real GDP growth increased to more than 4 per cent in 1995/96 from stagnation in 1991/92, while inflation on an annual basis declined to slightly over 7 per cent from more than 21 per cent in the early 1990s. The overall fiscal deficit was brought down to 1.3 per cent of GDP in 1995/96 from double digits in the early 1990s. In particular, the overall balance of payments remained in surplus, leading to a substantial accumulation of net international reserves. The latter stood at nearly US\$ 19 billion in 1995/96, representing about 15 months of imports. The ratio of external debt to GDP reduced to about 47 per cent in mid-1996 from about 75 per cent in 1991/92, and the debt-service ratio fell to about 11 of current account receipts (including all transfers) from 14 per cent in 1991/92.¹⁶¹

¹⁵⁸ EIU, *Egypt: Country Report*, no. 1, 1996, p. 18; and *MEED*, 17 Nov. 1995, p. 19.

¹⁵⁹ EIU, *Egypt: Country Report*, no. 1, 1996, p. 18; and *MEED*, 17 Nov. 1995, p. 19. See also *Al-Ahram Weekly*, 29 Feb.-6 Mar. 1996.

¹⁶⁰ International Monetary Fund, *op. cit.*, 17 Sept. 1996, p. iii.

¹⁶¹ International Monetary Fund, *Annual Report*, 1997, p. 74; and International Monetary Fund, *IMF Survey*, 28 Oct. 1996, p. 354.

Therefore, Egypt's interest in reaching another agreement with the IMF again seemed to go beyond the provision of the IMF's credit. With such a high level of foreign exchange reserves, there would be no need for Egypt to request extra credits. Indeed, the Egyptian government subsequently forewent its drawing right on the stand-by credit owing to its strong international reserve position. It was in fact the cancellation of the third and final tranche (worth about US\$ 4 billion) of the US\$ 10 billion Paris Club debt, which was conditional on the IMF's approval, that largely induced Egypt to conclude another agreement with the IMF.

6.3.1 Negotiations Leading to the October 1996 Stand-By Arrangement

Talks between the IMF and the Egyptian government resumed immediately following the end of the devaluation dispute. On 26 November 1995, Kamal el-Ganzouri, Planning Minister, held talks in Paris with Paul Chabrier, the IMF's Director of the Middle East Department. These talks were a preliminary step for a new round of formal discussions between the two sides.¹⁶² Due to changes in the general economic situation since the signing of the 1993 EFF accord, negotiations between the two sides aimed at concluding a new stand-by agreement,¹⁶³ rather than reviewing the old EFF.

On the domestic front, after the elections of November 1995, there seemed to be indications that the official commitment to the economic reform was renewed. In January 1996, the Egyptian cabinet was altered. In his statements on 2 January 1996, President Mubarak used the slow progress of Egypt's economic reform in explaining his thinking behind the change of government. He remarked: 'I want to give a new push to national work in various domains. I change [personnel] in order to stimulate the development process.' He said that if the government's economic reform policy had slowed down, 'it is important to step up the pace' since 'maintaining the economic reform process is imperative.' He added: '[W]e would change an incompetent minister or one who was exhausted so that the process might continue.'¹⁶⁴ The reshuffle of the Egyptian cabinet in January 1996 was therefore seen as an attempt by President Mubarak to speed up Egypt's economic reform, in particular the privatisation process, which had slowed down largely as a result of the substantial improvement of the

¹⁶² EIU, *Egypt: Country Report*, no. 1, 1996, p. 18; and *MEED*, 8 Dec. 1995, p. 18.

¹⁶³ According to IMF officials, it was the Egyptian government's choice to decide whether the new agreement would be in the form of a review of the Extended Fund Facility signed in 1993, or a new Stand-By Arrangement. *MEED*, 10 May 1996, p. 16.

¹⁶⁴ *SWB*, ME/2500, 4 Jan. 1996, p. MED/2.

economy and of Egypt's relative bargaining strength, in combination with domestic resistance and fear of its negative effect on the result of the November 1995 elections.

A new government was formed under the premiership of Kamal el-Ganzouri in place of Atef Sidqi. The IFIs and the US Embassy in Cairo identified the former as someone with whom business could clearly be done.¹⁶⁵ At first, it seemed to be a contradiction to have Kamal el-Ganzouri appointed as a prime minister with a main agenda to accelerate the pace of economic reforms. Kamal el-Ganzouri, who had served as planning minister and subsequently deputy prime minister for planning during Mubarak's 14-year presidency since January 1982, would, on the basis of his long-term career in planning, be seen as pro-central planning and pro-public sector, rather than pro-free market and pro-private sector. However, Kamal el-Ganzouri, who was described as a 'born again reformist,'¹⁶⁶ admitted a recent change in his view towards economic reforms, particularly over public and private sector reforms, and their benefits. He remarked in an interview with the *Financial Times*:

Frankly 3 years ago, I thought, why not keep the public sector . . . and the private sector can come and invest in any activity. Right now I find it very hard to invite the private sector to work while we have this big pyramid of public enterprises.¹⁶⁷

However, one important question needs to be addressed: why did Egypt or, to be more specifically, President Mubarak make a U-turn policy by adopting a faster pace of the economic reform? Perhaps the renewed official commitment lay in a number of political factors (both international and domestic). At the international level, there seemed to be a better understanding in view of the end of the Cold War, in particular from President Mubarak himself, that Egypt could no longer rely on the rivalry of the two superpowers to gain economic and financial benefits, and therefore it needed to act faster in order to move its economy forward to catch up with the rest of the world. It was reported that ministers and diplomats attested that President Mubarak gave instructions to accelerate the privatisation after learning that, by South-East Asian standards, the amount of foreign investment in Egypt was minute.¹⁶⁸ Kamal el-Ganzouri complained: 'It was very hard to be in my position and to know that last year

¹⁶⁵ Bush, *op. cit.*, p. 31.

¹⁶⁶ *Financial Times*, 3 Jan. 1996.

¹⁶⁷ El-Ganzouri, Kamal, interview, *Financial Times*, 20 May 1996.

¹⁶⁸ *Financial Times*, 20 May 1996.

[1995] we got foreign investment of US\$ 400 million while in Indonesia – I don't think they have more potential than Egypt – they got US\$ 40 billion.'¹⁶⁹

Besides the conclusion of the Cold War, Egypt faced a possible loss of another underlying source of bargaining strength vis-à-vis the IMF, the Arab-Israeli conflict. By the mid-1990s, there was a growing concern that once Arab states established relations with Israel (Jordan had already signed a peace treaty with Israel in October 1994), Egypt's leading regional role and thus its crucial source of bargaining power vis-à-vis the IMF might be threatened. Furthermore, Egyptian-US relations were strained by Egypt's refusal to sign the Non-Proliferation Treaty (NPT) and over Mubarak's links with Colonel Qaddafi of Libya. Thus, a number of US newspapers and journals had raised the question as to whether Egypt should continue to receive substantial US economic aid, and the view that Egypt no longer deserved substantial US aid had also been expressed by some members of the new Republican majority in the US Congress.¹⁷⁰ Therefore, it may be possible that being aware of such potential threats, the Egyptian government then decided to speed up the economic reforms.

Domestically, the end of the parliamentary elections of November 1995 and a landslide 94 per cent victory of the ruling NDP meant that the Egyptian government could now afford to divert its attention to the economic reforms. In addition, while the economic reform had stalled, Mubarak's regime had continued to pursue its repressive policy towards real or potential challenges for its political survival. In September before the 1995 parliamentary elections took place, more than 80 prominent members of the officially banned Muslim Brotherhood, who had probably intended to stand for election as independent candidates, were arrested, and some were given three to five year imprisonment sentences by a military court for unspecified illegal political activities.¹⁷¹ The government was accused by opposition newspapers of wide spread electoral abuses, vote rigging, intimidation and harassment. Also by this time, the Egyptian government successfully expelled most of the Islamist militants from the main Egyptian cities and tourist sites.¹⁷² Nearly all the violence was confined to gun battles between the Egyptian authorities and the militants in central and Upper Egypt, and the security

¹⁶⁹ El-Ganzouri, Kamal, *op. cit.*, 20 May 1996.

¹⁷⁰ *Middle East and North Africa 2000*, 46th ed. (London: Europa, 1999), pp. 426-427.

¹⁷¹ See Kienle, *op. cit.*, 2001, pp. 56-62.

¹⁷² Weiss and Wurzel, *op. cit.*, p. 75.

appeared to be stabilising, particularly in Cairo.¹⁷³ By the end of 1994, Mubarak's regime became more repressive towards informal and more spontaneous labour protests, although some concessions were made. The latter emerged in response to sudden reductions in their supplementary pay or the threat of layoff as the holding companies started reviewing affiliated companies' finances and operations.¹⁷⁴

Moreover, there was another domestic political reason for President Mubarak to accelerate the pace of economic reforms. It was reported that early in 1996 Egyptian businessmen, close to the President, had informed him why influential members of the business community were concerned about the slow pace of economic reforms.¹⁷⁵ The problems such as a brain drain of highly qualified young labour and transfer of private investments to foreign countries were likely to remain as long as the economic reforms were carried out at a sluggish pace. If President Mubarak wanted to retain the support of the leading business circles, the momentum of reform would have to be increased. Thus, it seems that in order to satisfy influential supporters of Mubarak's regime in the Egyptian business community, the Egyptian cabinet was instructed to push further economic reforms.

As a consequence, the Egyptian government began to increase the pace of the economic reform. In January 1996, customs duties were reduced by 10 per cent on a number of imported items,¹⁷⁶ which was far behind schedule as indicated in IMF conditionality under the 1993 EFF (see Appendix G). By February 1996, out of 314 unidentified state entities initially released for sale, only three had been sold outright, 10 had been liquidated, and 16 had been partly divested through the issue of 10 per cent blocks of shares to the public.¹⁷⁷ However, following the cabinet reshuffle, the privatisation process started to move forward. On 15 February 1996, Egypt took a step towards privatising its state-dominated industry by releasing a list of more than 80 companies it hoped to sell in 1996, including hotels, Nile cruisers and some of the state's most profitable industrial companies in cement, metallurgy textiles and food.¹⁷⁸ After May 1996, the acceleration of the privatisation programme became apparent. On 6 May

¹⁷³ Gerges, F. A., 'The End of the Islamist Insurgency in Egypt?: Costs and Prospects,' *Middle East Journal*, vol. 54, no. 4, fall 2000, p. 608.

¹⁷⁴ Posusney, *op. cit.*, pp. 219 and 233-237.

¹⁷⁵ Weiss and Wurzel, *op. cit.*, p. 114.

¹⁷⁶ *Ibid.*, p. 79.

¹⁷⁷ *Financial Times*, 16 Feb. 1996.

¹⁷⁸ *Ibid.*

1996, the Egyptian government announced its decision to sell 75 per cent of a public sector real estate company, Nasr City Housing and Construction, representing the first majority sale to private investors through the Cairo stock exchange.¹⁷⁹ Since then, a series of sales of public enterprises followed, including fertilisers, electrical products, pharmaceutical and chemical firms in May and June 1996.¹⁸⁰

On the other front, the negotiations between the IMF and Egypt continued in 1996 following an interruption caused by Egyptian parliamentary elections at the end of 1995 and January 1996. There were also World Bank staff who participated in the talks between the IMF and Egypt. The World Bank had a limited role in the economic reform programme in the case of Egypt. It merely collaborated with IMF staff on the issues such as civil service reform, trade and privatisation, without being involved in negotiations for a programme.¹⁸¹ According to IMF officials, talks convened in Washington at the end of April 1996 were constructive and cordial. One of the IMF officials stated: 'We were impressed with the new seriousness of the Egyptian authorities, and their determination to place the economy on a high growth trajectory . . . The fund finds their programme far-reaching and believes it will be effective.'¹⁸²

Since devaluation was no longer the issue for discussion, the focus of the talks was on speeding up structural reform and in particular privatisation and trade liberalisation in order to attract more investment and increase exports.¹⁸³ With some progress having been made, privatisation proved less controversial between the Egyptian government and the IMF. On the other hand, the issues of trade liberalisation and energy pricing remained contentious. The IMF reportedly demanded immediate and substantial tariff reductions.¹⁸⁴ However, the Egyptian government's concern was over the effect of a sharp reduction in import tariffs on the government budget and a perceived need to protect specific local industries such as car assembly. Also, Kamal el-Ganzouri wanted to keep his promise not to raise energy prices during the 1996/97 fiscal year.¹⁸⁵ By early 1996, electricity and domestic petroleum prices equalled to approximately 80 per

¹⁷⁹ EIU, *Egypt: Country Report*, no. 3, 1996, p. 19; and *Financial Times*, 7 May 1996.

¹⁸⁰ EIU, *Egypt: Country Report*, no. 3, 1996, p. 20.

¹⁸¹ Interviewee 27, *op. cit.*, 3 Oct. 2001.

¹⁸² *MEED*, 10 May 1996, p. 19.

¹⁸³ EIU, *Egypt: Country Report*, no. 3, 1996, p. 18.

¹⁸⁴ *Ibid.*

¹⁸⁵ *Ibid.*, p. 6.

cent and 90 per cent of international prices, respectively.¹⁸⁶ Fearful that further rises in energy prices would trigger public anger, Ganzouri's government had insisted that there would be no further cut in state subsidies, including those on energy.¹⁸⁷ In addition to these issues, the IMF also wanted to include Egypt's acceptance of Article VIII (which was primarily concerned with the convertibility of the Egyptian pound) of the IMF's Articles of Agreement as one of prior actions (i.e. conditions to be implemented before the approval of the 1996 agreement). However, Egypt did not accept this condition immediately, saying that they would look at it favourable in the course of the programme.¹⁸⁸

While the negotiations with the IMF continued, besides the adoption of repressive measures against domestic resistance, the government at the same time intensified its efforts on the domestic front to reassure the public in an attempt to avoid public outcry triggered by the fear of negative impact of economic reforms. In his statement to *Mayu* on 8 September 1996, President Mubarak said that Egypt adhered to the policy of economic reform without placing any burdens on the low-income category.¹⁸⁹ There were also attempts by the government to deny any job losses arising from privatisation. The official line from the President down was that privatisation was beneficial to workers and that the government remained committed to the protection of workers' rights. President Mubarak in his Labour Day speech on 24 April 1996 emphasised that no jobs would be lost through privatisation. He remarked:

I have frequently stated that protecting the workers' rights is a major responsibility of any government that primarily seeks to safeguard the working classes' interests . . . the process of privatization in Egypt is governed by numerous controls. Foremost among these is . . . [that] the new management is required to keep the company's workers in their jobs.¹⁹⁰

Similarly, Prime Minister Kamal el-Ganzouri said to *Al-Akhbar* newspaper published on 27 February 1996 that the success of the privatisation programme would increase workers' income and provide new job opportunities for our youths without harming any worker. He stressed the government's promise that no worker would be affected

¹⁸⁶ EIU, *Egypt: Country Report*, no. 1, 1996, p. 8.

¹⁸⁷ *Ibid.*

¹⁸⁸ Interviewee 27, *op. cit.*, 3 Oct. 2001.

¹⁸⁹ SWB: *Weekly Economic Report*, MEW/0453, 17 Sept. 1996, p. WME/2.

¹⁹⁰ SWB, ME/2596, 26 Apr. 1996, p. MED/29.

adversely through the privatisation.¹⁹¹ He made a similar point on 20 September 1996 that privatisation did not mean, as some believed, getting rid of the workforce but in fact privatised companies would need more workers in addition to those currently working with them if the potential of the companies was properly exploited and the quality and cost of their products were improved.¹⁹² Also, Atef Obeid, Minister of Public Enterprises, emphasised in a statement to *Al-Ahram* published on 21 May 1996 that privatisation in Egypt was necessary and inevitable. It was good for workers and also for society as a whole, which would benefit from the investment revenue.¹⁹³

In addition to the issue of privatisation addressed to workers, the government's reassurance was manifest in other issues such as tax reform. In his speech following his first cabinet meetings in Cairo on 6 January 1996, Kamal el-Ganzouri stated that:

During the former period, it was inevitable that various fees and taxes would be imposed to remedy the budget deficit. We needed revenues. However, we have reached a point where we have no right to impose new burdens on Egyptian citizens. What we will do is to increase state revenue by increasing the number of taxpayers without raising taxes or imposing new fees. I assure the Egyptian citizens that there are no plans to impose new burdens on them.¹⁹⁴

Besides the use of public statements, the government also introduced compensatory measures along with such economic measures as tariff reductions. To alleviate concerns of local industrialists about the decrease of protective barriers as well as to stimulate local industrial production and encourage exports, tariff rates on 25 imported commodities used as industrial inputs were dropped in late January 1996 from between 30 per cent and 70 per cent to 10 per cent. The commodities included car components, air compressors, textiles machinery, construction vehicles and electric power-generating units.¹⁹⁵ A similar action in relation to tariff reductions was also taken by the government along with the implementation of IMF conditionality (see later discussions).

¹⁹¹ SWB: *Weekly Economic Report*, MEW/0425, 5 Mar. 1996, p. WME/2.

¹⁹² SWB: *Weekly Economic Report*, MEW/0454, 24 Sept. 1996, p. WME/3.

¹⁹³ SWB: *Weekly Economic Report*, MEW/0437, 28 May 1996, p. WME/4.

¹⁹⁴ SWB: *Weekly Economic Report*, MEW/0418, 16 Jan. 1996, p. WME/3.

¹⁹⁵ EIU, *Egypt: Country Report*, no. 2, 1996, p. 22.

By July 1996, Egypt and the IMF had agreed in principle on an economic reform programme after four rounds of talks under way since March in the same year.¹⁹⁶ On 11 October 1996, the IMF's Executive Board granted its approval for a SBA with a total credit of SDR 271.4 million (US\$ 391 million) over a period of two years through 30 September 1998. Again Egypt did not draw on the available credit, thanks to its strong international reserve position. The two-year economic programme under the 1996 SBA was seen as the third phase of economic liberalisation and structural adjustment programme, labelled 'Take off' by Prime Minister Kamal el-Ganzouri.¹⁹⁷ The economic programme was designed to 'foster . . . stronger output growth, generat[e] higher employment, and increas[e] the standard of living of the Egyptian population while preserving financial stability and external viability.'¹⁹⁸ Real GDP growth was targeted to increase to about 5 per cent in 1997/98 which would thereby facilitate the creation of some 400,000 new jobs per year.¹⁹⁹ To achieve the objectives, the programme focused on two keys elements:

- i) the consolidation of the gains on macroeconomic stabilisation through fiscal, monetary and external policies; and
- ii) The broadening and deepening of the structural reforms through privatisation, trade liberalisation, structural fiscal reform, energy prices, financial sector reform, and deregulation.²⁰⁰

The programme entailed numerous policy measures and targets in the above policy areas to be implemented before and during the agreement.²⁰¹

A mid-way solution seemed to be reached between the two sides on energy price liberalisation. Although the Egyptian government agreed to put an end to its energy price subsidies as the IMF insisted, this would gradually be adopted (the approach that the Egyptian government always argued for) and would not come to an end until July 1999. By setting the deadline of July 1997 for the first one-third removal of the subsidy would in effect allow Kamal el-Ganzouri to keep his promise not to remove energy subsidies and thereby raise energy prices in 1996/97.

¹⁹⁶ Weiss and Wurzel, *op. cit.*, p. 80.

¹⁹⁷ *Financial Times*, 11 Oct. 1996.

¹⁹⁸ Arab Republic of Egypt, 'Memorandum on Economic Policy of the Egyptian Government,' 12 Sept. 1996, in International Monetary Fund, *op. cit.*, 17 Sept. 1996, p. 56.

¹⁹⁹ International Monetary Fund, 'Egypt: Stand-By,' *Press Release*, no. 96/50, 11 Oct. 1996, in International Monetary Fund, *IMF Survey*, 28 Oct. 1996, pp. 354-355.

²⁰⁰ International Monetary Fund, *op. cit.*, 17 Sept. 1996, p. iii.

²⁰¹ For more details on IMF conditionality under the 1996 SBA, see Appendix H.

The agreement with the IMF in October 1996 finally paved the way to the third and final tranche of Egypt's US\$ 10 billion debt write-off and rescheduling agreement with the Paris Club later in the same month. According to the IMF, the debt relief was worth US\$ 5.4 billion undiscounted, US\$ 4 billion if discount at 6 per cent per year, or US\$ 3.4 billion if discounted at 7.5 per cent per year. Mohieddin el-Gharib, Financial Minister, stated that the debt relief would save Egypt about LE 1 billion (US\$ 290 million) annually in debt serving and would cut Egypt's external debt to about US\$ 28 billion, compared with more than US\$ 40 billion before the government embarked on the economic reform programme in 1991.²⁰²

6.3.2 Implementation of IMF Conditionality

To gain the IMF's approval of the 1996 SBA, the Egyptian government had made efforts to meet prior actions. These included adopting action plans for extending the general sales tax to the wholesale and retail levels, for enhancing prudential regulation of banking system, for eliminating energy subsidies, and for improving national income accounts. The government also took further steps towards privatisation and trade liberalisation. The former included divesting a majority interest in 12 public companies, offering a majority interest in a further eight companies, divesting up to 40 per cent of a further five companies, liquidating one holding company, and announcing details of the 1997-98 privatisation programme. As for trade liberalisation, the Egyptian government, on 30 September 1996, announced tariff reductions by 10-25 per cent. The maximum rate for goods, other than luxuries and cars, had been reduced to 55 per cent from 70 per cent. The premium rate of 160 per cent went down to 135 per cent, 60 per cent to 45 per cent, 50 per cent to 40 per cent, and 40 per cent to 30 per cent.²⁰³ It should be noticed that the reduction of import tariffs was not formally announced and was deliberately ignored by the official press, reflecting the government's concern about the reaction of local industrialists, who had lobbied hard not to lose the high degree of tariff protection.²⁰⁴ Furthermore, in an attempt to compensate local industrialists and lessen their outcry, the Egyptian government also adopted a parallel reduction of tariffs on raw materials for plastics, metals and textiles industries.²⁰⁵

²⁰² EIU, *Egypt: Country Report*, no. 4, 1996, pp. 39-40.

²⁰³ *Al-Ahram Weekly*, 17-23 Oct. 1996; EIU, *Egypt: Country Report*, no. 4, 1996, p. 21; *Financial Times*, 11 Oct. 1996; and *MEED*, 11 Oct. 1996, p. 31.

²⁰⁴ EIU, *Egypt: Country Report*, no. 4, 1996, p. 21.

²⁰⁵ *Ibid.*; and *MEED*, 11 Oct. 1996, p. 31.

Under the October 1996 SBA, the economic programme was subject to seven quarterly reviews, the first of which started in January 1997.²⁰⁶ Egypt seemed to pass all of the reviews with ease and, thus, successfully completed the 1996 SBA agreement in September 1998. Following the first quarterly review of the 1996 SBA in late January 1997, the IMF said it was satisfied with most areas of Egypt's economic performance, and 'more than satisfied' with some areas.²⁰⁷ Furthermore, the first review was approved by the IMF's Executive Board in early April 1997 without discussing the IMF mission's report on the review of the SBA's progress. According to IMF officials, this reflected the IMF's confidence in the Egyptian government's way of conducting economic reforms.²⁰⁸

In an interview with *Al-Ahram Weekly* in August 1998, Mauro Mecagni, the IMF's residential representative in Cairo, expressed his overall assessment of the October 1996 SBA:

In general, the outcome of the programme has been very positive. Almost all the performance criteria have been met: credit, fiscal, monetary, and external reserves. From the macroeconomic point of view, the progress that has been made is indicated by a continuing disinflationary trend and strength of external indicators despite the shocks.

Structurally, the pace and the extent of privatization have exceeded the targets set by the programme. There has also been a degree of success in reducing the impediments to trade.²⁰⁹

Throughout the two-year period of the 1996 SBA, most of the macroeconomic targets were fulfilled, while some did better than the targets. For instance, the 1996/97 budget deficit stood at 0.8 per cent of GDP compared with the target of 1.1 per cent. The inflation rate was below the target of 6.2 per cent for 1996/97. Furthermore, the net international reserves continued to remain high (standing at US\$ 20.3 billion by mid-July 1997).²¹⁰ At a press briefing following the sixth quarterly review of Egypt's 2-year SBA in the spring of 1998, an IMF mission concluded that the Egyptian government has made significant progress on economic reforms, withstanding problems caused by the Luxor massacre and oil price fluctuations as well as the uncertainties associated

²⁰⁶ Arab Republic of Egypt, 'Memorandum of Economic Policy of the Egyptian Government,' 12 Sept. 1996, in International Monetary Fund, *op. cit.*, 17 Sept. 1996, pp. 74-77.

²⁰⁷ *MEED*, 14 Feb. 1997, p. 15.

²⁰⁸ EIU, *Egypt: Country Report*, no. 2, 1997, p. 17; and *MEED*, 18 Apr. 1997, p. 9.

²⁰⁹ *Al-Ahram Weekly*, 20-26 Aug. 1998.

²¹⁰ EIU, *Egypt: Country Report*, no. 4, 1997, p. 17.

with the Asian stock market crisis. Howard Handy, Assistant Director of the IMF's Middle East Department, said in May 1998 that the Egyptian economy had been performing remarkably well in recent years with over five per cent growth rate, declining inflation to less than 4 per cent, the budget deficit of less than 1 per cent and 'modest and manageable levels' of foreign debt.²¹¹ A similar conclusion was reached following the final review in the summer of 1998.²¹²

The IMF was seemingly tolerant of Egypt's pace of implementing its conditionality, particularly structural adjustment reforms. Some conditions were met but not without delays which were due partly to bureaucracy. For instance, a new investment law, Law 8 of 1997, was passed in May 1997 to provide incentives for private investment,²¹³ although it was due to be passed by 1 January 1997 under the 1996 SBA. In addition, a number of conditions concerning trade liberalisation were not met by the deadline, i.e. by 1 July 1998. However, it was not until the day before the SBA expired on 30 September 1998 that they were implemented, including cutting import tariffs by 5-10 per cent, and reducing the import surcharge from 3 per cent to 2 per cent, although the agreement required a fall to 1 per cent. The standard maximum customs tariff was cut from 50 per cent to 40 per cent; the tariff rates of 45 per cent dropped to 40 per cent, of 40 per cent to 30 per cent; and of 35 per cent to 30 per cent.²¹⁴ It was in fact a backdated ministerial decree that enabled the Egyptian government to fulfil the conditions on time.²¹⁵

Such a failure was apparent even though the IMF had urged the Egyptian government to put more efforts to liberalise its trade system. Handy said in Cairo on 5 May 1997: 'Without progress on reducing tariff and non-tariff barriers, the potential for export growth is undermined.'²¹⁶ This largely reflected the dramatic decline in the IMF's leverage over Egypt following the Paris Club's release of the third and final tranche of the debt write-off agreement shortly after the Executive Board approved the 1996 SBA. On the other hand, Egypt's bargaining strength was high in the light of its robust macroeconomic position.

²¹¹ *Al-Ahram Weekly*, 7-13 May 1998.

²¹² *Al-Ahram Weekly*, 31 Dec. 1998-6 Jan. 1999.

²¹³ EIU, *Egypt: Country Report*, no. 3, 1997, p. 16.

²¹⁴ EIU, *Egypt: Country Report*, no. 4, 1998, p. 16.

²¹⁵ Interviewee 14 (a journalist), personal interview, Cairo, 22 Feb. 2001.

²¹⁶ *MEED*, 15 May 1998, p. 10.

However, the completion of the agreement partly reflected Egypt's political commitment towards IMF conditionality. Despite its strong bargaining strength and the fact that it had already secured the last stage of the Paris Club debt relief, Egypt continued to implement IMF conditionality until it completed the agreement, even though there were delays in the implementation of some conditions as discussed above. Its commitment was also highlighted by the promotion of Youssef Boutros Ghali, who was regarded as one of the major driving forces behind economic reforms, to the position of the Minister of Economy in the July 1997 cabinet reshuffle. Youssef Boutros Ghali received his PhD at the Massachusetts Institute of Technology under the supervision of Stanley Fischer, Deputy Managing Director at that time, and also worked at the IMF as a senior economist before joining the Egyptian government.²¹⁷ Moreover, the reshuffle was also seen as the way to consolidate the prime minister's power to push the economic reform. The portfolio of international co-operation was removed from the ministry of economy and placed with the prime minister who also remained minister of planning. Zafer el-Bishri, Prime Minister Ganzouri's close aide, was appointed as the Minister of State for International Co-operation and Planning. Also in the cabinet reshuffle the power of his potential rival was curbed by taking away the portfolios of administrative development and environmental affairs from Atef Obeid, who retained his position as the Minister of Public Enterprises.²¹⁸

Following a meeting between the IMF delegation and the Egyptian cabinet during a visit by the former to Cairo in mid-July 1998 for a final review of the October 1996 SBA, Atef Obeid announced that Egypt would not be signing any new agreement with the IMF when the October 1996 SBA expired in September 1998. However, the government would continue to make use of IMF advice where it deemed necessary.²¹⁹

Section C: Assessment of Relative Power and the Imposition-Ownership Nature of IMF Conditionality

At the outset of the negotiations leading to the 1991 agreement, Egypt engaged in the negotiations with the IMF with relatively less power. Egypt's initial weakness stemmed from not only the need of balance of payments support from the IMF, but also from the need to extend the period of debt rescheduling. On the other hand, the IMF gained its

²¹⁷ *Financial Times*, 9 July 1997.

²¹⁸ EIU, *Egypt: Country Report*, no. 3, 1997, p. 12.

²¹⁹ *Al-Ahram Weekly*, 23-29 July 1998.

pre-negotiation power from both the holding of credit needed by Egypt and cross-conditionality of Egypt's creditors and donors which giving the IMF a 'seal of approval.'

The power imbalance where the IMF held greater strength did not mean that both parties would remain passive throughout the period and that their relative power would be static. On the IMF side, its relative power during the pre-Gulf crisis increased as a result of the cross-conditionality of Egypt's official creditors and donors and their refusal to reschedule its debts bilaterally. Some Western country creditors, the USAID and the World Bank cooperated to put pressure on Egypt by making their financial assistance contingent on agreement with the IMF.

In order to enhance its bargaining strength, Egypt adopted similar tactics to those used in the previous periods, particularly during the pre-Gulf crisis negotiations when its resistance was strong. During the pre-Gulf crisis period, it sought both direct and indirect assistance from 'friends,' especially the US, and also attempted to reach separate bilateral debt rescheduling deals with its creditors.

Nonetheless, neither produced significant successes. The tactic of reaching bilateral rescheduling agreements completely failed to achieve its goal. The tactic of seeking friends' support did not bring to bear the level of support that Egypt needed in negotiating with the IMF. This was largely due to the change in creditors and donors' strategy in dealing with Egypt in relation to the IMF and also due to better coordination between them, compared with the previous period. In the light of the experience under the 1987 SBA where the 'soft' conditions did little to guarantee the implementation of IMF conditionality, the repetition of lenient policies during the negotiations was avoided. The 1987 SBA demonstrated to the creditors and debtors that by starting with lenient conditions, the risk of having the reform carried out only to a low extent (or even having the reform unimplemented at all) would be substantial. Therefore, the creditors and donors adopted a tougher stance towards Egypt and lent little support during the negotiations until Egypt first moved to make concessions during March-August 1989. This was in order not to send a wrong message to Egypt that it would again be able to get away with the economic reform like it had done under the 1987 SBA. Instead, the creditors' and donors' support largely came during the

implementation of IMF conditionality under the 1991 SBA in the post-Gulf war period, and thus aided Egypt to remain on course with its agreements with the IMF. Although there were financial resources available from some Western, and Arab countries as well as the Soviet Union, they did not greatly reinforce Egypt's relative negotiating power since they only amounted to a relatively small sum and were tied to particular purposes. With its weaker negotiating strength and reluctance in accepting the IMF conditions implemented during the spring and summer of 1989, the degree of imposition can be said to have risen while that of ownership fell on the imposition-ownership spectrum.

Following its reluctant concessions made in 1989, Egypt's relative power vis-à-vis the IMF began to increase. First, the augmentation of Egypt's negotiating power took place immediately after Egypt's concessional moves on economic reform. It stemmed from a combination of factors working together: Egypt's political and strategic importance in the region and social unrest elsewhere in the developing world as well as domestic constraints in terms of signs of social instability. In the view of the occurrence of real social unrest taking place elsewhere, particularly in the region, and of potential large-scale riots in Egypt, the US was keen to maintain the political status quo in Egypt and thus its ongoing peace efforts in the Middle East. This was achieved through its postponement of the deadline for the repayment of Egypt's US military debt and release of its cash aid previously withheld. As a result, additional financial resources became available, and this, together with the repayment postponement on US military debt, in effect reduced the sense of urgency for Egypt to accept IMF demands via extra time gained until the outbreak of the Gulf crisis.

During and after the Gulf crisis, Egypt's relative bargaining power was affected by a number of factors, including the international events (the Gulf crisis and the end of the Cold War) and its geopolitical significance in the region. At the international level, the dramatic changes in the international political system following the collapse of the USSR and its Eastern bloc implied a reduction in the strategic importance of Egypt for the US, which had consequently emerged as the sole superpower. This resulted in a decline in Egypt's relative bargaining strength. On the other hand, the 1990-1991 Gulf crisis provided Egypt with a chance to boost its strategic importance for the US. The improvement in the balance of payments situation arising from the financial gains from Egypt's stance in the Gulf war in terms of debt write-offs and new aid packages

substantially reinforced its relative negotiating strength vis-à-vis the IMF. Such a significant increase in its relative negotiating power seemed to outweigh the negative effect of the end of the Cold War on its relative power.

As for the negotiations leading to the 1993 and 1996 agreements, the need for balance of payments support was no longer the issue that weakened Egypt's initial relative power since Egypt's balance of payments improved substantially as a result of the debt reduction and aid inflows as well as the implementation of economic reform. On the other hand, the desire for the two remaining tranches of the Paris Club debt reduction remained the major constraining factor. On the IMF side, its relative bargaining power mainly came from the 'seal of approval' for Egypt's further debt reduction with the Paris Club.

Meanwhile, Egypt's commitment towards economic reform seemed to increase, compared with the late 1980s. This was perhaps reflected by relatively shorter periods of the post-Gulf crisis negotiations of the 1991 SBA and negotiations leading to the 1993 and 1996 agreements (all of which lasted less than a year) than that of the pre-Gulf crisis negotiations of the 1991 SBA (lasting more than two years), in spite of numerous conditions reached. Furthermore, as its economic situation improved, an opportunity was open for the Egyptian government to walk out of negotiations with the IMF. Despite the substantial gain in its relative power through aid flows and debt cancellation, Egypt opted to continue its negotiations with the IMF due largely to its desire to gain the extension of the debt rescheduling period. Also the appointment of reform proponents by President Mubarak (such as Kamal el-Ganzouri as Prime Minister in January 1996 and Youssef Boutros Ghali as Minister of Economy in July 1997) is domestically reflective of the Egyptian government's greater willingness to push forward economic reform.

As they mirrored the greater commitment towards reform, at the same time such reformers represented technocratic alliances between the IMF and the Egyptian government. Although they acted as the enhancing factor for the IMF's relative bargaining strength, given that Egypt's political will towards economic reform had also become stronger than before, it would not be correct to say that the level of imposition of IMF conditionality had also risen. That is, an increase in negotiating power

possessed by the IMF does not always necessarily mean the rise in the level of imposition since one should also need to take into account the change in the degree of the Egyptian government's willingness in accepting IMF conditionality.

The significance of factors at the level of individual negotiators such as personality and skills of negotiators was highlighted during the time of disagreement over devaluation. One of the IMF staff during the devaluation dispute was characterised as being tough, less inclined to make compromises in the negotiations, adopting a 'take-it-or leave-it' approach, and using language implying threats. His successor was, on the other hand, said to be more flexible and diplomatic in negotiations.²²⁰ After the end of the devaluation dispute, a new IMF negotiating team was set up in order to facilitate the 1996 SBA negotiations. The lack of flexibility and compromise on the part of the IMF negotiator could thus help stall the negotiations process and led to no change in the outcome of the negotiations. That is, it worked to reduce the IMF's negotiating strength.

It can be said that in the late 1980s, when the Egyptian economy was deteriorating and the creditors began to alter their strategy in dealing with Egypt, Egypt had an overall weaker leverage over the IMF. There was also a great deal of unwillingness on the Egyptian side as reflected by Egypt's long-standing resistance to IMF demands and the protracted period of negotiations. This seemed to suggest that the conditions Egypt was asked to fulfil prior to the Gulf crisis involved a larger degree of imposition than that of ownership, representing a point closer to the end of imposition than that of ownership on the imposition-ownership spectrum. The parallel international events (the Gulf crisis and the end of the Cold War) provided a turning point in the power relationship between Egypt and the IMF and the nature of IMF conditionality. The rise in the relative power of Egypt as well as the greater degree of willingness following the two events tended to indicate that there was more of ownership than imposition involved in IMF conditionality in the post-Gulf war. Therefore, during the period since the Gulf crisis, the rise in Egypt's relative negotiating power, together with its increasing reform commitment pushed IMF conditionality towards the end of ownership on the spectrum where the degree of ownership is greater than that of imposition.

²²⁰ Interviewee 15 (a present Egyptian official), personal interview, Cairo, 25 Feb. 2001; and Interviewee 14, *op. cit.*, 22 Feb. 2001.

Conclusions

The objective of this study was to examine the nature of IMF conditionality. In particular, it dealt with the issue of imposition-ownership. Unlike the two opposing schools which saw the nature of IMF conditionality as a matter of either imposition or ownership, the study argued that IMF conditionality could involve both elements. In capturing such a perspective regarding the nature of IMF conditionality, the study introduced the notion of the linear spectrum, at the opposing ends of which the elements of imposition and ownership were located. Their relative degrees could be assessed through the negotiation process with the aid of the concept of power, the degree of which varied according to the resources of the parties and their tactics. The relative power of the party could, in turn, help determine the imposition-ownership nature of IMF conditionality. The study further suggested that relative degrees of power, and the consequent location on the imposition-ownership spectrum, were not static but may vary during the course of negotiations, or indeed between negotiations.

The study began in Chapter One by providing an account of how the IMF's role in international economic relations between the developed and the developing countries had evolved. Then, in Chapter Two, the study moved to look at the development of the concept of IMF conditionality and its critiques. It argued that IMF conditionality should be considered along a linear imposition-ownership spectrum. An analytical framework was also developed for the purpose of examining the nature of IMF conditionality. Using the analytical framework developed in Chapter Two, the study then examined the nature of IMF conditionality in Egypt during the period from the 1960s to 1998 in the four subsequent chapters. Each chapter assessed the alterations in the relative power through the availability of resources and the use of tactics by the two parties, and also assessed their implications for movement along the imposition-ownership spectrum.

Here, the study will be concluded under three major sections: first, the relationship between the IMF and Egypt and the nature of their relative bargaining power; second, the issue of imposition-ownership; and third, lessons to be drawn from the case of Egypt.

The Egypt-IMF Relationship and the Nature of Their Negotiating Power

During the four decades of the 1960s-1990s, the relationship between the IMF and Egypt was, by and large, uneasy. On the one hand, the IMF as an international creditor required IMF conditionality so as to ensure repayment of its lending. On the other hand, Egypt as a borrowing country tried to avoid or minimise IMF conditionality with all its socio-economic and political costs. The relationship between the IMF and Egypt often became problematic due not only to a great deal of Egyptian resistance to IMF demands but also, at times, to internal disputes within the IMF itself regarding the issues related to the upper-credit tranche lending to Egypt.

The degree of Egypt's resistance to IMF demands was indicated in the length of the period of negotiations leading to the conclusion of a lending arrangement. The latter varied throughout the period of the study, but its trend can be detected. Prior to the outbreak of the 1990-1991 Gulf crisis, their negotiations leading to the approval of an agreement tended to last for a relatively long period (at least a year) in comparison with the negotiations after the Gulf crisis (less than a year). Of the negotiations leading to an agreement before the Gulf crisis, the period of negotiations during the 1960s were shorter than those during the rest of the period, despite the adoption of the socialist path of economic development by Nasser's regime. This was due largely to the limited scope and number of conditions developed during the 1960s which in turn reduced the likelihood of controversy, disagreement and resistance. As for the period following the outbreak of the Gulf crisis, the period of negotiations leading to an agreement was relatively shorter than in the pre-Gulf crisis, despite the substantial expansion of the number of terms subject to IMF conditionality as well as their scope. This was due partly to an apparently increasing degree of willingness on the part of the Egyptian government to accept conditions demanded by the IMF, which was brought about by major changes in the international environment and inducements from Egypt's official creditors in terms of debt cancellation and new aid. The study has suggested that these variations in the length of time required to reach agreements are indicative of degrees of resistance to imposition of conditionality, which are in turn conditioned by ability – or power – to resist!

The Nature of Power in the Conditionality Relationship

Throughout the negotiations during the period of the study, the balance of negotiating power between Egypt and the IMF was subject to constant changes. Often at the start of the negotiation process, the IMF was a stronger party than the Egyptian government due to Egypt's need for the IMF's balance of payments support and/or its 'seal of approval.' As IMF conditionality under the 1987 SBA illustrated, the initially weaker strength of Egypt did not guarantee that IMF demands would necessarily prevail over Egypt's preferences and would finally be reflected in the outcomes of negotiations. As a number of factors and/or the tactics pursued took effect, the initial power of both parties altered. There were a number of relevant factors affecting the power of the IMF and Egypt and thus the balance of power between them. These included: 1) the international context; 2) economic circumstances; 3) internal pressures; 4) third parties (their cross-conditionality and non-conditional financial assistance); 5) technocratic alliances; 6) individual negotiators; and 7) major tactics. The remainder of this section will look at how effective each of these seven factors were in affecting the power of the two parties.

1) International Context

The case of Egypt illustrated that the international environment at times proved to have an impact upon the relative power of the two parties through its effects upon economic circumstances, either on its own or working in combination with other factors. Changes in the international environment alone *could* lead to an alteration in the economic circumstances of the borrowing country, such as the increase in the price of cotton in the international market during 1963-1964 which served to add relative negotiating power to Egypt.

Yet, equally, often international events on their own did not have sufficient impact on Egypt's economic circumstances to alter the relative power of the two parties. The outbreak of the June 1967 war with Israel provided a chance for Egypt not to reach a formal agreement with the IMF and enabled it to prolong the negotiations which eventually did not result in any agreement at all due to the improvement in its financial situation. Such an improvement was thanks to not only the 1967 war itself but also Egypt's geopolitical importance to Arab states and the improvement of its relations with the West. Without Egypt's geopolitical importance to the third parties (such as the US

and the oil-rich Arab Gulf states) and also its tactics of complaining and seeking their financial support, the October 1973 war with Israel would have been meaningless and insufficient in providing Egypt additional relative bargaining strength. Another example was the Gulf crisis of 1990-1991, which provided Egypt with a golden opportunity to enhance its geopolitical importance in the region. The Gulf crisis alone would not have ensured the substantial financial gains to Egypt and improvement in its financial position. It needed to work in combination with Egypt's tactic of joining the US-led coalition forces.

The effectiveness of the international context could not, however, be guaranteed as shown by the effect of the Cold War and its conclusion in the early 1990s. During the 1960s, the Cold War environment did not lend much support to Egypt in resisting IMF demands. Egypt's ability to play the two superpowers off against each other was restricted by, for example, its foreign policy over the Arab-Israeli conflict. In the 1990s, the end of the Cold War, which was in theory supposed to reduce the relative bargaining strength of Egypt, did not in fact lead to such an outcome. Its negative effect on Egypt's relative power was by and large dominated by the positive effect of the parallel incidence, the Gulf crisis.

In sum, international events can alter economic circumstances and relative bargaining power, but at times they are insufficient on their own and much will depend on concurrent alterations in other aspects of the IMF-borrowing country relationship or on the tactics deployed by the borrowing country to take advantage of potentially fortuitous events.

2) Economic Circumstances

In addition to the international context, Egypt's relative power was also affected by its economic circumstances. Its initial economic and financial problems created weakness in Egypt's negotiating position. However, a slight/moderate improvement in economic circumstances during the negotiations (such as the increase in the price of cotton during 1963-64) provided Egypt with more room to manoeuvre. During the post-Gulf crisis, the increasing amount of foreign exchange reserves strengthened Egypt's relative bargaining power. On the other hand, the worsening of Egypt's economic situation during late 1966 and 1967, which was marked by its inability to repay its arrears to the

IMF and the reduction in cotton production, as well as the US refusal to grant a new PL 480 agreement, weakened Egypt's relative power.

The Egyptian case demonstrates that the general economic weakness which drives a borrowing country to seek IMF assistance can be ameliorated by temporary improvements in certain aspects of a national economy in determining the balance of power between the two parties.

3) Internal Pressures

On the Egyptian side, internal pressures stemmed from domestic reactions towards economic reforms, namely cabinet divisions and domestic protests/unrest against particular reforms. The cabinet divisions were at times effective in allowing Egypt to take a tougher stand towards IMF conditions and offering more time for resisting or even attempting to change them, as showed by the experiences of the 1960s and the negotiations leading to the 1977 SBA. Nevertheless, they could be ineffective as the experience of the negotiations leading to the 1978 EFF had showed. At that time the cabinet division did not lead to change in the IMF demands.

Domestic protests and unrest could act on their own or together with other factors in affecting the relative power of the negotiating parties. The January 1977 riots produced a direct effect upon Egypt's relative power and IMF demands; the IMF was obliged to give more concessions to Egypt. The support from Egyptian business circles in campaigning against the IMF's demand for currency devaluation during the devaluation dispute of the mid-1990s provided the Egyptian government with support in resisting the devaluation. Indirectly, domestic unrest in conjunction with Egypt's geopolitical importance to the third parties, particularly the US, enhanced Egypt's relative bargaining power through the increase in US financial aid, a US refinancing package and the release of its withheld cash aid during 1985-1986. However, domestic constraints did not always successfully lead to an increase in Egypt's relative negotiating power. For instance, during the negotiations leading to the 1978 EFF, the argument concerning domestic constraints put forward by Abdel-Moneim Kaissouni did not yield concessions from the IMF.

The IMF, at times, gained its additional bargaining power from its own internal constraints. For instance, the lack of support by the IMF's Executive Board for Egypt's proposals for the exchange rate policy during the 1966 negotiations lent IMF negotiators further relative bargaining power. However, the IMF was often faced with internal constraints placed by its major creditors, which were also Egypt's major creditors/donors, upon its relative power. The period during the 1970s and 1980s illustrated how the IMF's major creditors, given that they had an interest in maintaining the existing regime in Egypt, played their supporting role to Egypt within the IMF, which often resulted in favourable outcomes for Egypt in terms of lenient IMF conditions. Thus, the study highlighted the politicised nature of IMF conditionality and, to some extent, the politicised decision-making of the IMF in the case of Egypt. However, the study did not argue that IMF conditionality was always a product of political decision. In the case of Egypt, there existed a mixture of both economically- and politically-driven motives.

Internal pressures, within both the IMF and the borrowing country, can therefore serve to strengthen or weaken the relative powers of the parties. They can act either to limit their manoeuvrability (weakening them) or be utilised as a tactic (strengthening them) when one party wishes to make clear that it is conducting negotiations within the confines of internal constraints.

4) Third Parties

The study showed that third parties played a critical role in the relationship between the IMF and Egypt. The IMF-Egypt relationship formed part of a larger and more complex triangular relationship among the IMF, Egypt and third parties, namely the official creditors/donors and the World Bank. It was closely intertwined with both relationships between the IMF and the third parties, on the one hand, and between Egypt and the third parties, on the other.

Through the examination of the IMF-Egypt relationship in a broader context of such a triangular relationship, the third parties' role was linked to a number of factors which helped the IMF and Egypt reinforce their leverage vis-à-vis one another. These factors were either the types of the third parties' support to the IMF (such as cooperation among Egypt's major creditors/donors in the form of their cross-conditionality) and

Egypt (such as political influence within the IMF of Egypt's official creditors/donors (see Section Internal Pressures), and the availability of non-conditional financial resources), or its underlying causes (such as Egypt's geopolitical significance, internal reactions in Egypt, and international developments). The IMF mainly relied on cross-conditionality of the World Bank and the official creditors/donors, in particular the US, the member countries of the GODE and of the Paris Club. Since the involvement of the official creditors in IMF conditionality negotiations in the case of Egypt was driven by strategic interests (due to Egypt's holding of geopolitical significance in the region) as well as by financial interests (due to Egypt's status as their debtor), their role could be both supporting and constraining for the IMF's and Egypt's relative power. Thus, cross-conditionality of the third parties proved effective in increasing the IMF's relative bargaining power, particularly when Egypt's influential creditors/donors cooperated with regard to their cross-conditionality, as happened in the late 1980s and early 1990s. However, the lack of co-ordination among the creditors/donors themselves, which was evident at times, served to weaken the IMF's relative power rather than enhancing it. Despite their initial insistence upon cross-conditionality, financial assistance from some major creditors/donors could become available following domestic incidents that threatened the Egyptian regime's survival (such as the riots by the CSF conscripts in 1986), or international incidents that boosted Egypt's geopolitical importance (such as the October 1973 war and the Gulf war of 1991), or because of the US's overriding goals in the Middle East peace process. The availability of financial assistance brought about by these factors in turn reinforced Egypt's negotiating power vis-à-vis the IMF and enabled it to resist IMF demands.

The study has showed that the relationship between the IMF and a borrowing country should therefore be examined within the context of third parties with a strategic and/or financial interest in either or both parties.

5) Technocratic Alliances

In the Egyptian case, the effectiveness of technocratic alliances between the Egyptian negotiators and the IMF in enhancing the IMF's relative negotiating power proved to be inconsistent. During the 1960s-1980s, the technocratic alliances failed to bring about change in the outcomes of the negotiations in the IMF's favour, particularly when they faced opposition from their powerful cabinet colleagues as well as the presidents

themselves. The technocratic alliances only became effective in the second half of the 1990s. Thus, they were often ineffective in increasing the IMF's relative power. Their effectiveness was greatly hindered by the power of the Egyptian presidents in appointing and dismissing the members of the Egyptian cabinet, some of whom normally held negotiations with the IMF regarding the upper-credit-tranche loans. Although the presidents did not control every issue included in IMF conditionality, it could not be said that the Egyptian officials/negotiators enjoyed full autonomy in the domain of their responsibilities. All three Presidents, particularly Sadat and Mubarak, appeared to utilise cabinet reshuffles to control the scope, extent and pace of economic reform demanded by the IMF. Thus, such an action can be seen as a tactical move in countering the positive impact of technocratic alliances upon the IMF's relative bargaining power.

The study has shown that technocratic alliances, and the role of technocratic groups within the national polity of the borrowing country, can have a positive impact upon the relative power of the IMF. However, the extent of this impact was not wholly clear from the case-study and this did not seem to be as decisive a factor as the others discussed here.

6) Individual Negotiators

In this study, the analysis at the level of individual negotiators was limited by the amount of data available, particularly in the period of the 1960s. However, from the data gathered, the findings on the impact of factors at the level of individual negotiators upon the outcomes of negotiations were mixed. On the one hand, the experiences of the 1970s and 1980s suggested that good negotiating skills of IMF negotiators such as their diplomatic language and flexibility had little effect on the relative power of the IMF in altering the outcomes of negotiations. This contradicted the initial suggestion of the framework in Chapter Two that: 'Good negotiating skills can be a source of power in negotiations.' On the other hand, during the devaluation dispute in the mid-1990s, the lack of negotiating skills of an IMF negotiator was shown to have had a negative impact on the IMF's relative power and thus brought about its inability to alter the outcomes and the stalled process of negotiations. The IMF was the party who eventually had to withdraw its demand regarding the exchange rate, whereas throughout the dispute Egypt stood firm on its rejection of the devaluation of the Egyptian pound. It seemed that the

influential Egyptian Executive Director (Abdel-Shakour Shaalan), who rallied support from other developing country members, earned Egypt additional bargaining power vis-à-vis the IMF, which resulted in Egypt's exact preference of no further devaluation. Similarly, the role of the Executive Director was highlighted during the 1970s negotiations when Muhammad Al-Atrash (Executive Director representing Egypt) was able to secure lenient conditions in terms of less number of prior conditions than IMF staff had suggested. Therefore, having an influential Executive Director seemed to contribute to the increase in Egypt's relative negotiating power.

Again, this study has suggested that the role of individual negotiators *should* be considered in assessing the balance of power between the two parties, but that it is not a consistently identifiable or reliable factor.

7) Major Tactics Used by the Two Parties

Being aware of their own initial positions, both the Egyptian government and the IMF were on a continuous search to enhance their own relative power. The most common tactic utilised by both parties to enhance their relative bargaining power was seeking support from third parties. The IMF sought cross-conditionality from the World Bank, which helped strengthen its relative power vis-à-vis Egypt. This was clearly evident during the mid-1970s when the IMF secured the World Bank's cooperation from the beginning of the negotiation process.

On the Egyptian side, in their efforts to restrict, alter, or, if possible, avoid IMF conditionality, the successive regimes under Presidents Nasser, Sadat and Mubarak pursued several tactical moves to improve their negotiation position, including seeking third parties' support. As has been pointed out, the three presidents also resorted to cabinet reshuffles to control several aspects of economic reform, including its scope, extent and pace. Nonetheless, the tactics adopted by Nasser's regime were slightly different from and more limited than those of the regimes of Sadat and Mubarak. This was due largely to the different circumstances, especially regarding Egypt's foreign relations. Under Nasser's regime after the mid-1960s, the options to strengthen its relative power vis-à-vis the IMF were restricted by the deterioration in Egypt's relations with Western and monarchical oil-rich Arab Gulf states, which were in a position to influence the IMF as a result of their holding of the majority of the votes within the IMF

and/or to increase Egypt's bargaining power through their financial assistance, if non-conditional. In addition to cabinet reshuffles, another tactic used by Nasser's regime to prolong the negotiations was to gain IMF credits without committing itself to IMF conditionality through the offers of gold collateral, as took place during the negotiations leading to the 1962 SBA.

The range of tactics was widened under Sadat's and Mubarak's regimes when Egypt's relations with the West, especially the US, and oil-rich Arab Gulf states (prior to the signing of the Egyptian-Israeli peace treaty and during the Gulf crisis) improved. The tactics which were often employed by both Sadat's and Mubarak's regimes were the requests for rescheduling its debts on a bilateral basis and for third parties' support. The majority of Egypt's debt was owed to other governments and multilateral aid agencies whereas its debt to international commercial banks was relatively small. To reduce cooperation among their official creditors, the two regimes attempted to reach bilateral debt rescheduling deals with each individual creditor. However, this proved unsuccessful as the official creditors wanted to ensure that Egypt would have to undertake IMF conditionality to a certain extent. It was likely that Egypt would have avoided reaching an agreement with the IMF and adopting economic reform entailed in IMF conditionality, unless Egypt's creditors/donors had insisted on a multilateral debt rescheduling agreement.

Another tactic utilised by Sadat's and Mubarak's regimes was the search for support from other official creditors/donors. Such a tactic relied upon Egypt's regional political and strategic significance and was aided by international developments (such as the October 1973 war and the Gulf war of 1991). The support from the official creditors/donors, who had interests in keeping the existing regimes, particularly the US and oil-rich Arab Gulf states, were in the forms of both direct pressure upon the IMF and indirect assistance through their financial aid and/or postponement of debt repayment. This enabled Egypt to temporarily resist pressure to accept IMF demands and at times alter and bring them closer to its own preferences. Often the financial aid might be insufficient to allow Egypt to get out of its economic and financial problems straight away and thus avoid IMF conditionality altogether. Yet, it at times enabled Egypt to prolong the negotiations until its relative leverage had been strengthened by other factors such as an improvement in its economic situation. As had been

demonstrated in Chapters Three-Six, on several occasions Egypt was able to obtain concessions from the IMF and more lenient conditionality than might otherwise have been, and even caused a division within the IMF's Executive Board, as happened prior to the approval of the 1987 SBA.

It is worth noting that the flexibility of the IMF regarding IMF conditionality did not solely stem from the political influence of Egypt's creditors/donors over the IMF's decision-making. IMF negotiators themselves sometimes proved to be flexible, although their flexibility was insufficient in the eyes of the Egyptian government, particularly the presidents themselves. When confronting the deadlock, Sadat's regime adopted another tactic of bypassing IMF staff and instead negotiating directly with the IMF Management during February-March 1978, which resulted in IMF concessions on the timing of implementing price and interest rate increases.

Egypt's tactic of seeking the official creditors/donors' support (both direct and indirect) was successful during the period prior to 1988. In contrast, its attempts during late 1988 and throughout 1989 proved to be a failure due to the change of the official creditors/donors' approach in juggling between their two goals of pushing Egypt to adopt IMF-supported economic reform and keeping the political status quo in Egypt. In the light of the abandoned 1987 SBA, the creditors/donors adopted a tougher stance towards Egypt and hence hindered the effectiveness of such a tactic.

The study has shown, then, that neither the IMF nor the borrowing country is powerless to alter their relative bargaining power during the course of negotiations. Each party has a range of possible tactics that may be available to them, depending on circumstances, and which may affect the outcome of the negotiations. This reinforces the contention that conditionality is not wholly about either imposition or ownership but is a negotiated result somewhere on a spectrum between the two.

Imposition versus Ownership or an Imposition-Ownership Linear Spectrum?

The study showed that the concept of power was important in understanding and assessing the imposition-ownership nature of IMF conditionality in the case of Egypt. It played a major role in affecting the course of the relationship between the IMF and

Egypt, the outcomes of their negotiations and the nature of IMF conditionality. The empirical study of Egypt confirmed that a strong party in terms of its superior resources did not always prevail over a weaker party in international negotiations. More specifically, the initially stronger power of the IMF did not mean that its demands would always translate into the outcomes of negotiations and that they would be imposed upon Egypt against its will. Unlike the assumption of the imposition school, the Egyptian case showed that not all borrowing developing countries lacked room to manoeuvre, even where there had been an imbalance of power unfavourable to them at the outset of the negotiations regarding IMF conditionality. Neither were all borrowing developing countries passive in dealing with the IMF regarding IMF conditionality. As had been pointed out earlier, concessions and flexibility on the part of the IMF were sometimes evident. On this basis, the notion of imposition is inappropriate in describing the nature of IMF conditionality. However, neither was IMF conditionality in the Egyptian case completely based on the idea of ownership, as the study found. The fact that concessions and flexibility on the part of the IMF did at times exist should not be taken to mean that IMF conditionality was thus owned by Egypt, or wholly subject to Egyptian willingness to accede. The degree of flexibility offered by the IMF was often far less than that desired by Egypt. Moreover, IMF conditionality was, on a majority of occasions, not fully implemented, reflecting partly the lack of political will of the Egyptian government (which was in turn linked to the second reason) and partly the domestic opposition itself towards implementing economic reform. Thus, the findings from the Egyptian case also rejected the generalised notion that IMF conditionality was based on ownership by the borrowing countries. In this respect, it could not firmly be concluded that IMF conditionality was totally forced upon or absolutely owned by Egypt.

By examining the nature of IMF conditionality with the aid of the concept of power, the Egyptian case demonstrated that the relative power of the two negotiating parties was dynamic and so was the nature of IMF conditionality. The degrees of imposition and ownership along the imposition-ownership spectrum could vary throughout their interaction, as had been discussed in Chapters Three-Six. This depended upon the changing relative power of the two parties, which was in turn determined by a number of factors as well as the tactics utilised by the parties, as had been discussed above. Overall, the element of imposition was, on a number of occasions, greater than that of

ownership due to the relative weaker negotiating power of the Egyptian government, as showed by the periods of the 1960s, 1970s and between the late 1980s and early 1990s. Thus, often IMF conditionality in the case of Egypt should be located at a point somewhere closer to the end of imposition than that of ownership on the imposition-ownership spectrum.

Also, the case of Egypt showed that when the nature of IMF conditionality was assessed, considering the relative power of the two parties alone would be insufficient. As Chapter Six had argued, the increase in the relative power of the IMF did not necessarily mean that the degree of imposition would always rise, given that the degree of willingness also increased by more than that of imposition. Thus, an additional factor has to be taken into consideration, the degree of willingness of a country to embrace economic reform rather than resist it.

How much is the Egyptian-IMF relationship shaped by the specifics of Egypt as opposed to general rules imposed on the relationship by the nature of borrowing and of the IMF itself? In other words, how much can we generalise from the Egyptian case regarding the relative power of the two parties and the nature of IMF conditionality? Egypt was a special case where there were several factors at play, some of which may be unavailable to many borrowing developing countries. Among several observers, Egypt was often regarded as the special case that held a crucial factor of geopolitical importance to the major official creditors, which could provide Egypt leverage over the IMF. However, the study showed that often the degree of imposition in the case of Egypt seemed to be higher than that of ownership. Even when there were a number of factors available to Egypt as well as tactics to enhance its relative power, sometimes the effectiveness of the factors were low. Furthermore, as had been discussed above, often one factor alone could not bring about the change in the outcomes of negotiations; it had to work in combination with other factors and at times the parties' tactics. This would suggest that in the case of other borrowing developing countries which disagreed with IMF demands and at the same time lacked significant factors (such as geopolitical importance) to enhance their relative power, the chance to increase their relative bargaining power would be relatively more limited and the degree of imposition could be even far greater.

Lessons of the Study

Before beginning, it needs to be mentioned that this section is not an attempt to generate a comprehensive list of lessons in relation to IMF conditionality. It merely aims to provide what can be learnt from the single-case study of Egypt.

The first point to be made relates to the nature of power in the specific issue of the relationship between the IMF and borrowing countries. Power in the context of the relationship between the IMF as a lender and a borrowing country in question as a borrower is not solely an expression of economic status. Rather, it can additionally be a function of political and strategic status, plus other variables such as international circumstances, internal conditions of the parties, and negotiating skills of individual negotiators as well as tactics employed by the parties. Therefore, when one considers the issue of the relationship between the IMF and borrowing countries, power of the two parties should not be reduced to merely its economic parts.

Secondly, third parties play a particularly crucial role in affecting the outcomes of the negotiations regarding IMF conditionality and the degrees of imposition and ownership. The lesson learnt from the study, in particular for borrowing countries is that to increase their relative power during the negotiations and to enhance the effectiveness of having an impact upon IMF conditionality, assistance from the powerful third parties, if available, will have to be sought. The powerful third parties in the context of the relationship between the IMF and a borrowing country are the official Western creditors/donors, particularly the US, which holds a majority of votes in the IMF. Nevertheless, the case of Egypt showed that assistance from powerful third parties might not always be available, even though the borrowing country held strategic and political importance, as Nasser's regime had experienced in the second half of the 1960s when Egypt's relationship with the West deteriorated. Thus, seeking assistance from the official Western creditors/donors is insufficient on its own. Another important condition which must also be fulfilled before the third parties' assistance will be available is the building of supportive relationships with them.

Thirdly, the experiences of Egypt shed some light on the significance of negotiating skills, particularly of IMF staff. What the findings did suggest was that the negotiating skills of the IMF staff could at times have an impact upon the bargaining power of the

IMF and thus their importance should not be ruled out. In addition, negotiating skills could also have an impact on one party's perception and the presence of good negotiating skills would help to enhance the sense of ownership of IMF conditionality. The occasionally bold remarks of IMF staff or their stern writings damaged, or could potentially have damaged, the relationship between the IMF and Egypt and their negotiation process. Therefore, the significance of negotiation skills of IMF staff in dealing with borrowing countries should be stressed and training in negotiation skills should be encouraged.

Last, but not least, the Egyptian case showed that there was some strong evidence of politically-motivated conditionality at the expense of the notion of economic neutrality in IMF decision-making. The politicised nature of IMF conditionality, even on occasions, served to undermine the principle of neutrality of the IMF's policy on the use of its financial resources and also violate the doctrine of uniform treatment of its members. Furthermore, it has been suggested that one of the measures to enhance the sense of ownership of IMF conditionality and thus the record of implementation is selectivity whereby the approval of the use of IMF resources depends particularly on the IMF's assessment that a borrowing country is sufficiently committed to successful implementation.¹ The major drawback of this approach is related to the issue of equal treatment of all member countries. In practice, the selectivity approach is, if followed, likely to further damage the principle of uniformity to which the IMF has claimed to have adhered and thus, its credibility. In the light of the records of the politicisation of IMF conditionality, it is hard to see how this notion would in practice be adhered to without bias. As long as the structure and voting power system of the IMF remain unaltered, the occasional politicisation of IMF decision-making regarding IMF lending and conditionality would be likely to persist and so would the violation of the uniform treatment doctrine.

¹ See, for instance, International Monetary Fund, *Strengthening Country Ownership of Fund-Supported Programs*, prepared by the Policy Development and Review Department in consultation with other departments, approved by Jack Boorman, 5 Dec. 2001. Available from: <http://www.imf.org/external/np/pdr/cond/2001/eng/strength/120501.pdf> [accessed 8th Oct. 2003]

Appendix A

IMF Conditionality under the May 1962 SBA¹

1) Monetary policy and credit control:

- i) ceilings on the net claims of the banking system on the Government, on the total claims of the banking system on the non-government sector (excluding cotton financing), and on the level of cotton financing by the banking system;
- ii) the CBE would impose separate ceilings on each commercial or specialised bank, one for cotton financing and one for other financing of the non-government sector;
- iii) the CBE would, not later than 15 May 1962, raise its discount rate from 3 to 5 per cent and adjust its interest rate schedule accordingly;
- iv) the CBE would, not later than 15 May 1962, increase the reserve requirements for commercial banks from 12 ½ per cent to 17 ½ per cent; and
- v) the CBE would take steps to assure that the banks as a group maintain at least the same ratio of holdings of government obligations to their total assets as existing on 31 December 1961, and that banks henceforth purchase government obligations only from the CBE or from another bank.

2) Price control – to dismantle price controls as rapidly as possible with the aim of eventual elimination.

3) Exchange rate reform:

- i) to abandon the practice of premiums; and
- ii) to announce a new realistic rate of US\$ 2.30 per Egyptian pound for all exchange transactions not later than 15 May 1962, and in any event prior to any request for a drawing under the SBA with the IMF. To deal with the

¹ United Arab Republic, 'Stand-By Arrangement - United Arab Republic' [the text of the May-1962 SBA with an attached letter of intent], confidential, 26 Apr. 1962, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Secretary, *United Arab Republic - Stand-By Arrangement*, EBS/62/49 Supplement 2, confidential, 4 May 1962.

side effect (such as windfall profits from exports) of a new rate, export taxes would be used temporarily. Also to ease the price adjustment, there would be limited use of subsidies, applying to wheat, flour, kerosene, edible oil, sugar and other similar essential foodstuffs. The amount of these subsidies would gradually be reduced.

4) Import policies:

- i) to establish an open general license not later than 1 July 1962 for a substantial proportion of permitted imports;
- ii) to increase the use of import duties, and to decrease the use of quotas and outright prohibitions on nonessential goods; and
- iii) to instruct state owned or controlled importing agencies to operate, in making import decisions, on a commercial basis, and to give them freedom to choose sources of supply.

5) Bilateral payments agreements with IMF members would be terminated at the earliest possible date and not later than present termination dates.

6) There would be no introduction or intensification of any restrictions on current payments and transfers.

7) There would be no introduction of any multiple currency practice.

Appendix B

IMF Conditionality under the May 1964 SBA²

- 1) Monetary policy and credit control – ceilings on the net claims of the banking system on the public sector (excluding cotton financing), on the total claims of the banking system on the non-government sector (excluding cotton financing), and on the level of cotton financing by the banking system.

- 2) Fiscal policy:
 - i) ceilings on the level of investment expenditures by the public sector; and
 - ii) an increase in social security taxes.

- 3) Pricing policy:
 - i) re-examining the formulae for fixing prices of domestically produced manufactures to ensure a margin of profit and the reviewed formulae would become effective by the end of December 1964; and
 - ii) reviewing the prices for electricity, transportation and other public utilities.

- 4) External sector policy:
 - i) ceilings on the level of short- and medium-term external credits;
 - ii) introducing an additional 5 per cent “statistical” tax on imports;
 - iii) introducing a 5 per cent tax on invisible transactions with the exception of transfers on government account and funds for the Pilgrimage and for students studying abroad; and
 - iv) establishing a general export policy, involving a uniform subsidy for all exports other than cotton, rice, raw onions and crude petroleum, by 1 January 1965.

² United Arab Republic, ‘Stabilisation Program of the United Arab Republic,’ 18 Apr. 1964, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Member of the Executive Board, From the Secretary, *United Arab Republic – Stand-By Arrangement*, EBS/64/69 Supplement 1, confidential, 25 May 1964, pp. 5-8.

- 5) No new bilateral payments agreements with IMF members would be introduced and steps would be taken to eliminate bilateral payments agreements with IMF within two years.
- 6) No new restrictions on payments and transfers for current international transactions would be introduced or the existing ones would be intensified.

Appendix C

IMF Conditionality under the April 1977 SBA³

1) Exchange reform and external trade policy:

- i) by 1 January 1978, the commercial banks would be required to maintain all accounts involving foreign exchange assets and liabilities at the parallel market⁴ exchange rate; and
- ii) a price adjustment fund, which would be established as an account in the CBE to offset the impact of the shift of imports of intermediate goods and raw materials to the parallel market by providing temporary subsidies for items significant in the consumption of the lower-income groups, would be credited with no more than LE 200 million during the first half of 1977 and LE 100 million for the remainder of the stand-by period; and would not have a negative balance.

2) Domestic price liberalisation:

- i) gradually instituting a system of “management by objectives and results”, and gradually shifting performance criteria from production targets to profitability considerations, beginning with the company budgets for calendar 1977;
- ii) giving companies the power to determine the levels of production and prices of many of their products;
- iii) raising prices of the major industrial products so as to cover costs and in particular to compensate for the increased costs of inputs resulting from imports being shifted to the parallel market rate, as well as the increase in interest rates and wages; and

³ Arab Republic of Egypt, *Annex to Stand-By Arrangement* [the Letter of Intent], 4 Mar. 1977, in IMF Central Files, C/Egypt/1760, Stand-by Arrangements, 1977-1985, International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Acting Secretary, *Arab Republic of Egypt – Stand-By Arrangement*, EBS/77/90 Supplement 1, confidential, 21 Apr. 1977, pp. 1-12.

⁴ The parallel market was established by the Egyptian government in September 1973 as a way to alleviate the shortage of foreign exchange in Egypt by offering an exchange rate at a more depreciated level.

- iv) bringing the agricultural producer prices more closely into line with international prices at levels which provided adequate incentives for farmers.
- 3) Fiscal policy:
- i) increasing customs and excise duties on luxury goods, and stamp duties; and
 - ii) revising income tax law.
- 4) Monetary and credit policy – quantitative limits on the level of cotton ceilings, and on the expansion of overall domestic credits and of bank credit to the Government.
- 5) External debt policy and arrears – quantitative limits on external borrowing, public debt and arrears.
- 6) There would be no introduction of any new multiple currency practices without the IMF's approval, no introduction or intensification of restrictions on payments and transfers for currency international transactions, no introduction of any new bilateral payments agreements with the IMF's members, and no introduction or intensification of restrictions on imports for balance of payments reasons.

Appendix D

IMF Conditionality under the July 1978 EFF⁵

The first-year programme of the 1978 EFF included:

- 1) Exchange reform:
 - i) by 1 January 1979, the official and parallel rates would be unified with the prevailing parallel rate; and
 - ii) the policy of exchange rate flexibility would continue to be adopted and consultations with the IMF on exchange rate policy would be included in each review of the programme.

- 2) Pricing policy – in addition to price increase measures already taken in early 1978, further price increases of at least LE 150 million would be implemented by the end of September 1979, of which at least LE 75 million would take place by the end of June 1979.

- 3) Fiscal Policy – the Egyptian government's reliance on bank financing would be reduced by at least LE 200 million in 1979 to no more than LE 850 million, and the overall deficit would be limited to no more than LE 2,250 million.

- 4) Monetary and credit policy:
 - i) limits were set on the expansion of the net domestic assets of the banking system, and on the increase in net bank credit to public sector; and
 - ii) the interest rates would be raised by 1 percentage point from mid-June 1978, making maximum deposit rates 7 per cent and lending rates 9-10 per cent. A further increase of one percentage point would be implemented by 1 January 1979.

⁵ Arab Republic of Egypt, *Extended Arrangement – Arab Republic of Egypt*, 10 June 1978, pp. 1-14, in IMF Central Files, C/Egypt/1791, Extended Fund Facility, 1976-1979, International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Secretary, *Arab Republic of Egypt – Extended Arrangement*, EBS/78/358 Supplement 1, confidential, 2 Aug. 1978.

- 5) External debt policy – limits were placed on foreign debt.
- 6) There would be no introduction of any new multiple currency practices without the IMF's approval, no introduction or intensification of restrictions on payments and transfers for current international transactions, no introduction of any new bilateral payments agreements with the IMF's members, and no introduction or intensification of restrictions on imports for balance of payments reasons.

Appendix E

IMF Conditionality under the May 1987 SBA⁶

The supply-side measures included:

- i) a step-by-step unification of the two exchange rates markets (the commercial bank pool and the free market) by June 1988 to simplify the existing multiple exchange rate system. This would involve adjustment of the commercial bank exchange rate by transferring transactions from the commercial bank pool to the free market in three stages. The first 40 per cent of transactions would be transferred by 1 May 1987 (prior action), the further 40 per cent by the end of December 1987 and the remaining 20 per cent by the end of June 1988;
- ii) positive real interest rates;
- iii) an adjustment of the structure of lending interest rates by 1 May 1987 (prior action). This involved an introduction of a new structure of lending interest rates which would be differentiated on the new basis of the length of maturity of loans, in addition to the type of sectors as the existing differential (agricultural and industry, services, and commerce);
- iv) a gradual increase of the domestic prices of energy products to the world levels by 1991/92. As the first step, electricity tariffs would be increased by an average 29 per cent by 1 May 1987 and the prices of the petroleum products (fuel oil, kerosene, gas oil, diesel oil, and natural gas) would be increased by a weighted average 66 per cent by the same date (prior actions); and
- v) liberalisation of price controls over several agricultural commodities.

On the demand management side, the measures included:

- i) a reduction of the overall budget deficit from about 20 per cent of GDP in 1985/86 to 15 per cent in 1986/87, to 13 per cent in 1987/88, and by at

⁶ Arab Republic of Egypt, 'Statement by the Government of Egypt on its Economic and Financial Policies,' 25 Feb. 1987, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Secretary, *Arab Republic of Egypt – Stand-By Arrangement*, EBS/87/93 Supplement 1, confidential, 20 May 1987, pp. 6-24.

least an additional 2 percentage points annually in subsequent years with an objective of reducing it to 4 per cent by 1991/92;

- ii) a restrictive credit policy expressed in terms of set targets on domestic credit (ceilings on net domestic assets of the banking system, on net bank claims on the non-financial public sector and on net bank claims on the Central Government, local governments, and the General Authority for Supply Commodities); and
- iii) external policies expressed in terms of targets set on the levels of external debt (ceilings) with an eliminating of all external payments arrears by the end of June 1988, on external borrowing (ceilings) and on net international reserves of the banking system (floors).

Provisions with regard to multiple currency practices, payment and trade restrictions, and bilateral payments agreements:

- i) there would be neither introduction of new multiple currency practices nor intensification of the existing ones, except for the transfer of transactions from the commercial banking pool to the free market, and the unification of the central bank pool rate with the free market rate;
- ii) there would be neither introduction of new restrictions on payments and transfers for current international transactions nor intensification of the existing ones;
- iii) there would be neither introduction of new import restrictions for balance of payments reasons nor intensification of the existing ones; and
- iv) there would be no conclusion of bilateral payments agreements that were inconsistent with Article VIII.

Appendix F

IMF Conditionality under the May 1991 SBA⁷

In the economic programme under the May-1991 SBA, policy measures and targets included:

1) Public enterprise reform:

- i) reforming legal and institutional environment, increase the autonomy of public sector managers, and create a common regulatory environment for both the public and private sectors; and
- ii) privatising public enterprises over the medium term, with the exception of strategic enterprises.

2) Price liberalisation:

- i) price liberalisation and deregulation of public industrial and agricultural production and of the transport sector; and
- ii) energy sector:
 - a) petroleum products - to raise domestic petroleum product prices to the levels that ensure 45 per cent of world prices by 10 May 1991, representing about a 53 per cent increase (prior action); to further increase domestic petroleum prices to bring them to 56 per cent of world prices by the end of December 1991; and to increase an additional 11 per cent of petroleum product prices annually by each May of 1992-1995 with an aim to bring their prices to world equivalence by June 1995; and
 - b) electricity - to increase electricity prices by 50 per cent in order to bring electricity prices to 59 per cent of long-run marginal cost (LRMC) by 10 May 1991 (prior action); and to increase an

⁷ The following conditions are drawn from Arab Republic of Egypt, 'Memorandum on Economic Policy of the Egyptian Government' and 'Memorandum of Understanding,' 19 Apr. 1991, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Secretary, *Arab Republic of Egypt – Request for Stand-By Arrangement – Letter of Intent*, EBS/91/70, confidential, 22 Apr. 1991, pp. 3-38.

additional 10 per cent of LRMC electricity prices annually to bring them to 100 per cent of LRMC by June 1995.

3) Investment policies – decontrolling investment which was to be linked to price and import liberalisation.

4) External policies:

- i) exchange reform - unifying the dual exchange rate markets⁸ by 26 February 1992;
- ii) restoration of the customs duty rates to the levels in effect in early 1989, prior to their approximately 30 per cent reduction so as to conform with the tariff reform limits agreed with the IBRD (see below) (prior action);
- iii) trade liberalisation, including
 - a) reducing the production coverage of the import bans to 23 per cent of total tradable goods output in agriculture and manufacturing by mid-June 1991, and to 10.6 per cent by mid-1992 (before the release of the second tranche of the IBRD's Structural Adjustment Loan (SAL));
 - b) narrowing the margin between the minimum (0.7 per cent) and maximum (120 per cent) tariff rates to the range of 5-100 per cent with some exceptions (basic foods and luxury goods) by mid-June 1991, and further reducing the tariff rate range to 10-80 per cent with the above exceptions by mid-1992;
 - c) reducing tariff preferences;
 - d) abolishing the annual foreign exchange allocation and budget system for public sector companies;
 - e) reducing the list of products where prior import authorisation by the Government was required from 55 to 18 before the release of the first tranche of the SAL, and to 14 before the release of the second tranche; and
 - f) removing controls on the exports of a number of products through a reduction of export bans, a reduction of the list of

⁸ The previous multiple exchange rate system was ended on 27 February 1991 and replaced temporarily by a dual exchange rate system, consisting of a primary market and a secondary (or free) market.

products subject to annual export quotas, and a reduction of the list of exports subject to prior approvals;

iv) limits on external borrowing, arrears and international reserves.

5) Monetary policies:

- i) ceilings on net domestic assets of the banking system, net credit to the total non-financial public sector, and net credit to the central government, local governments, and the General Authority for Supply Commodities; and
- ii) reform on the monetary system to encourage savings, ensure efficiency in financial resource allocation, and make monetary policy more active.

6) Fiscal policies:

- i) the reduction of the budget deficit from an estimated 21 per cent of GDP during the fiscal year 1990/91 to 9.5 per cent of GDP in 1991/92, to 6.5 per cent of GDP in 1992/93, and to 3.5 per cent of GDP by 1995/96;
- ii) the introduction of a general sales tax by the end of April 1991 (prior action);
- iii) providing the Managing Director of the IMF by the end of April 1991 with letters from donors specifying that US\$ 70 million in grants had been provided for the year 1990/91 and that the purpose of the funds was for budgetary support (prior action);
- iv) providing the Managing Director of the IMF before 10 May 1991 with letters from donors specifying that US\$ 300 million in grants would be provided to Egypt in 1991/92 and that the grants were being provided for budgetary support in 1991/92 (prior action); and
- v) providing the Managing Director of the IMF before the end of April 1991 with a letter specifying the nature and purpose of donor-financed extra-budgetary investment expenditures, and the terms of the donor financing provided (prior action).

7) Provisions regarding payment and trade restrictions, multiple currency practices, bilateral payments agreements, and import restrictions:

- i) there would be neither introduction of new restrictions on payments and transfers for current international transactions nor intensification of the existing ones;
- ii) there would be neither introduction nor modification of multiple currency practices;
- iii) there would be no conclusion of bilateral payments agreements that were inconsistent with Article VIII of the IMF's Articles of Agreement; and
- iv) there would be neither introduction of new import restrictions for balance of payments reasons nor intensification of the existing ones.

Appendix G

IMF Conditionality under the September 1993 EFF⁹

IMF conditionality under the 1993 EFF is included in the following table. Most of the conditions in the table were structural adjustment reforms. The 'financial programme' mentioned in the first row of the table involved targets set in fiscal, monetary and external policies for fiscal year 1993/1994. In fiscal policy, the fiscal deficit was to be reduced to 2.6 per cent of GDP. In monetary policy, conditions included the curtailment of inflation to 9.5 per cent on an average annual basis, from an estimated average of over 11 per cent in 1992/93, and credit ceilings. Conditions in external policies included limits set on net international reserves, external borrowing, and arrears on external debt servicing obligations.

⁹ The following conditions are drawn from Arab Republic of Egypt, 'Memorandum on Economic Policy of the Egyptian Government' and 'Memorandum of Understanding,' 18 Aug. 1993, in International Monetary Fund, Document of International Monetary Fund and Not for Public Use, To Members of the Executive Board, From the Acting Secretary, *Arab Republic of Egypt – Request for Extended Arrangement - Letter of Intent*, EBS/93/139, confidential, 20 Aug. 1993, pp. 3-43.

Table A Egypt: Matrix Policy Actions under the 1993 EFF

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
I) <u>Macroeconomic Framework</u> A. Financial Programme	Compliance with agreed financial programme.	Compliance with agreed financial programme.	Compliance with agreed financial programme.	Compliance with agreed financial programme.	Compliance with agreed financial programme.
B. Foreign Exchange System		Send to Parliament law rationalising exchange control including requirements for repatriation.	Review remaining exchange measures under Article VIII, keeping in mind the need to avoid large potential losses.		
	Eliminate limits on dealer accounts with difference banks, raise working balance limits to US\$ 225,000 per LE 1 million of capital, and permit four branches for each LE 1 million of capital.		Review with the object of further relaxing limits on working balances and additional capital requirement for branches in the light of developments.		
C. Fiscal Policy: a. Tax Policy	Agree on and announce action plan to introduce a multi-stage value-added tax (VAT).	<u>By January 1994:</u> Begin voluntary registration of wholesalers and retailers. Announce the turnover exemption threshold level.			Multi-stage VAT in place with reduced number of tax rates and broadened base in place. End special industry arrangements.
	Current general sales tax (GST) to include: simplification of rate structure, expanded coverage including additional services, reduced exemptions.	GST to include additional services			
	End renewals of corporate tax holidays. Request Fund technical assistance for rationalising investment incentives and free zones.	Agree on investment incentive structure including reorienting free zones to export processing zones, and addressing problems of free city of Port Said along with Unified Law.	Present agreed draft law to Parliament.	After parliament approval, implement new investment incentive structure and free zones programme.	
	Global personal income tax (with 1 per cent tax on turnover of non-financial companies and 5 per cent withholding tax on interest earnings) presented to the Parliament as agreed with the IMF.	Implementation of the new global personal income tax.			

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
	Periodic adjustment of specific excises/fees/charges every 12-18 months for inflation.				Review the stamp tax for consistency with other reformed taxes and implement the reformed stamp tax.
b. Expenditure Policy	Request IMF mission on budgeting, expenditure control, and financial management. Mission to study systems and procedures.	Increase resources for operation and maintenance across sectors within overall budget targets.	Agree on programme of reform on budgeting, expenditure control, and financial management. Begin implementation in areas not related to budget cycle.	Continue implementing agreed reforms on budgetary, expenditure control, and fiscal management.	Continue implementing agreed reforms on budgetary, expenditure control, and fiscal management.
c. Public Sector Investment	Ensure that public sector investment under the Five-Year Plan is consistent with the recommendations of the Bank and with the macroeconomic framework. Size and sectoral allocation of 1993/94 and 1994/95 investment broadly in line with IBRD recommendations.	Prioritise public investment toward basic education, preventive health care, research, infrastructure complementary to private investment, poverty alleviation, and prevention of environmental degradation. IBRD to monitor.	Assess implementation of the agreed programme.	Assess implementation of the agreed programme.	Assess implementation of the agreed programme.
d. Civil Service Reform ¹	Freeze non-technical personnel hiring by Government.	Agree on terms of reference and funding for a study financed through Institutional Development Fund grant.	Civil service reform study completed.	Agree on plan for reform, and begin implementation.	Broaden the scope and continue implementation of civil service reforms.
D. Social Safety Net	Subsidy reform programme initiated limiting commodity coverage to popular bread. Initiate reform of existing cash transfers and small loan programmes. Agree on terms of reference for IBRD study for targeting consumer and electricity subsidies and labour restructuring associated with reform programme, and begin study. Appoint counterpart team.	Complete IBRD labour restructuring study; agree on a plan of action for implementation. Agree on a programme to target subsidised electricity and commodities, to be financed within the established fiscal targets.	Implement the new targeted programme.	Continue implementation of labour restructuring and targeted electricity and commodity subsidies.	Continue implementation.

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
E. Data Enhancements ¹	Agreed to i) intensify efforts to improve statistical base, including industrial production index, labour market data, and price indicators; ii) improve balance of payments statistics with technical assistance from the Fund.	Begin regular publishing: already available industrial production index, employment/unemployment indicators, and wage statistics.	Continue implementing agreed programme.	Continue implementing agreed programme.	Continue implementing agreed programme.
I	Government to request technical assistance for national income accounts funded by an IDF grant.	Complete IBRD technical assistance mission; begin implementing recommendations.	Begin regular publishing of national income accounts.		
II) <u>Real Sector Reforms</u> A. Trade Policy a. Imports	Announce publicly trade liberalisation/tariff reduction programmes, to include, inter alia, tariff reduction, no introduction of new nontariff barriers, and no tariff rate increases except when necessary to remedy distortions in tariff structure and without prejudice to Egypt's rights and obligations under the GATT. Previously banned imported items will be allocated tariff rates within the agreed tariff structure.	The maximum tariff rate is reduced from 80 per cent to 70 per cent. All other tariff brackets between 70 per cent and 30 per cent reduced by 10 percentage points; e.g., 70 per cent reduced to 60 per cent, 60 per cent reduced to 50 per cent, 50 per cent to 40 per cent, and 40 per cent to 30 per cent. Rates at 30 per cent and below not affected.		The maximum tariff rate reduced from 70 per cent to 60 per cent. All other tariff brackets between 60 per cent and 30 per cent reduced by 10 percentage points, e.g., tariff rates of 60 per cent reduced to 50 per cent, 50 per cent to 40 per cent, and 40 per cent to 30 per cent. Rates of 30 per cent and below not affected.	Authorities to review policy, with objective of reducing maximum tariff to below 50 per cent by end-December 1996. <u>Tariff reform to be implemented by December 1995:</u> The maximum tariff rates reduced from 60 per cent to 50 per cent. All other tariff brackets between 50 and 30 per cent reduced by 10 percentage points. Rates at or below 30 per cent not affected.
	No tariff rates on imports to be increased, except when necessary to remedy distortions in tariff structure and without prejudice to Egypt's rights and obligations under the GATT. Previously banned imported items will be allocated tariff rates within the agreed tariff structure.	No tariff rates on imports to be increased, except when necessary to remedy distortions in tariff structure and without prejudice to Egypt's rights and obligations under the GATT. Previously banned imported items will be allocated tariff rates within the agreed tariff structure.	No tariff rates on imports to be increased, except when necessary to remedy distortions in tariff structure and without prejudice to Egypt's rights and obligations under the GATT. Previously banned imported items will be allocated tariff rates within the agreed tariff structure.	No tariff rates on imports to be increased, except when necessary to remedy distortions in tariff structure and without prejudice to Egypt's rights and obligations under the GATT. Previously banned imported items will be allocated tariff rates within the agreed tariff structure.	No tariff rates on imports to be increased, except when necessary to remedy distortions in tariff structure and without prejudice to Egypt's rights and obligations under the GATT. Previously banned imported items will be allocated tariff rates within the agreed tariff structure.

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
		-Agree on list of capital goods with IBRD during evaluation mission. -Reduce tariffs on subset of capital goods to 5 or 10 per cent. -Agree on a programme progressively reducing tariffs on the remaining capital goods to 5 or 10 per cent, with very few exceptions.		Implement programme reducing tariffs on remaining capital goods.	<u>By end-December 1995:</u> Complete programme reducing tariffs on remaining capital goods.
	Agree on programme to eliminate exceptions to maximum tariff, except for alcohol.		- Eliminate exceptions to maximum tariff for cigarettes and automobiles, of more than 1600cc and replace with domestic excise tax. - Agree on action plan to reduce tariffs on automobiles of 1300-1600cc to maximum tariff during first review mission.	Implement agreed plan.	Implement agreed plan.
	Eliminate tariff preferences, except those governed by international treaties, and except temporarily on health and tourism.		Eliminate tariff preferences for tourism, except for alcoholic beverages.		Eliminate tariff preferences for health.
	Eliminate all import bans except on textiles, garments and their by-products and poultry to 4.7 per cent of production coverage. ²		- Bans on poultry to be removed. - Bans on textiles and garments to be reviewed in the context of the multilateral fibre agreement and after multilateral trade negotiations with the GATT.		
	Eliminate all import prior approvals.				
		Agree on a plan of action for improving safeguards, anti-dumping, countervailing duties, and agree on a programme to harmonise the enhancement of quality control standards and fees, applying equally to both imported and domestically-produced goods during evaluation missions.	Implement agreed upon plans of action for safeguards, anti-dumping, countervailing duties and standard quality control mechanisms.		

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
	Agree on draft changes in laws allowing foreign trading companies to operate on equal footing with domestic companies.	Present draft law allowing foreign trading companies to operate on equal footing with domestic companies to Parliament; seek approval.			
	-Abolish checks by the General Authority for Investment (GAFI) and the General Organisation for Industrialisation (GOI) on equipment imports. -Liberalise imports restricted by Ministry of Military Production. -Abolish the jurisdiction of the Industrial Monitoring Authority over imports. -Eliminate foreign exchange budgeting and end discrimination against private sector (e.g. wheat, cotton), and remove barriers to importers' unrestricted participation in Government procurement on an equal footing with domestic producers.	-Present draft law eliminating all remaining restrictions on private sector cotton imports and exports with imports subject to sanitary certification by the Egyptian government. -Introduce Harmonised System of Classification.	Review customs procedures and streamline as appropriate.		
	Non new non-tariff barriers (NTBs) to be introduced, or expansion of existing NTBs without prejudice to Egypt's rights under the GATT.	Non new non-tariff barriers to be introduced, or expansion of existing NTBs without prejudice to Egypt's rights under the GATT.	Non new non-tariff barriers to be introduced, or expansion of existing NTBs without prejudice to Egypt's rights under the GATT.	Non new non-tariff barriers to be introduced, or expansion of existing NTBs without prejudice to Egypt's rights under the GATT.	Non new non-tariff barriers to be introduced, or expansion of existing NTBs without prejudice to Egypt's rights under the GATT.
b. Exports	Eliminate quota on tanned hides.	Present draft law removing barriers to foreigners in trading companies to Parliament and seek approval.	Eliminate ban on raw hide exports		Eliminate ban on scrap metal exports.
B. Price Liberalisation: a. Industry		Eliminate price controls on the remaining products under Group V. ³			

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
b. Energy	Petroleum products and gas: retain SAL I schedule and formula as a floor. Increases of 10 piasters in prices of kerosene, diesel oil, and gas-oil.	Review gas pricing policy based on recommendations of ongoing study.	Petroleum products and gas: retain SAL I schedule and formula as a floor.		-Petroleum products and gas: retain SAL I schedule and formula as a floor. -Develop a programme to incorporate current world market prices, distribution margins, and taxation (as needed for fiscal reasons) by June 1996.
	Electricity: retain SAL I schedule as a floor.		Electricity: retain SAL I schedule as a floor.		
c. Agriculture	Eliminate all remaining budget input subsidies for fertilisers, and pesticides. Confirm elimination of food subsidies.	Complete deregulation cotton pricing, production, marketing, maintaining crop rotation limits.		Allow operation of cotton exchanges (by September 1994).	
		Initiate study on deregulation of sugar sector.	Complete sugar study, agree on action plan, and begin implementation of agreed measures.		Complete deregulation of sugar sector.
d. Buildings		-Present draft law to Parliament decontrolling rents on new and vacant units and buildings. -Initiate study of rent control laws, regulations, and all housing subsidies, including interest subsidies.	After Parliamentary approval, implement law decontrolling rents on new and vacant units and buildings. -Complete a study on rent control laws, regulations, and housing subsidies; set a timetable for implementation.	Present law decontrolling rents for buildings including housing to Parliament. After Parliamentary approval, begin decontrol.	Continue to deregulate buildings including housing under agreed timetable as stated in law.
C. Regulatory reform: Market Entry, Operation and Exit.	Abolish the domestic content requirements.	Abolish 'energy initiative industries' from the negative investment list.			
		Prepare draft of 'Unified Law' (which will eliminate any remaining discrimination between private and public sector companies) for all companies including bankruptcy, anti-trust, merger, and arbitration provisions. Require only registration for location changes.	Present 'Unified Law' to Parliament.	Implement 'Unified Law' after Parliament approval.	Review implementation.

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
		Abolish Governorate decrees establishing investment approval procedures, prior establishment, and GOFI licensing activities.		Replace current complicated procedure for company establishment with simple registration.	
		Joint IBRD/Government study on establishment of an independent utilities regulatory framework to be initiated.	Complete IBRD/ Government study on establishment of an independent utilities regulatory framework; and begin implementation.	Establish independent utilities regulatory commission.	
D. Non-Financial Public Enterprise Reform a. Public enterprise reform	Government and holding companies to agree on profit and rate of return on equity targets for 1993/94.	Agreement on policies and procedures that would apply to the allocation of funds from the budget for public enterprises (PEs) that are candidates for privatisation or restructuring. Privatisation outlays would be limited to amounts required for solving financial and labour problems. Restructuring outlays would be only for equity capital injection in PEs that are economically and financially viable and for amounts that cannot be raised in capital market. Total outlays will be within agreed fiscal targets. Adopt agreed divided policy.	Government and holding companies to agree on profit and rate of return on equity targets for 1994/95.		Government and holding companies to agree on profit and rate of return on equity targets for 1995/96.
		Monitor progress on agreed 1993/94 restructuring/exit programmes according to criteria to be agreed during evaluation mission.	Monitor implementation of restructuring/exit programmes according to agreed criteria.	Monitor implementation of restructuring/exit programmes according to agreed criteria.	Monitor implementation of restructuring/exit programmes according to agreed criteria.
		Agree on 1994/95 restructuring/exit programmes, including targets for action based on the latest available financial statement.		Agree on 1995/96 restructuring/exit programme, based on latest available financial statement.	

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
b. Privatisation ⁴	Issue mandates or letters of invitation to hire consultants and financial 'agents' to enhance implementation capacity.	Target: complete sales of the 22 assets/ companies brought to the point of sale through March 1993, or of similar assets for an equivalent amount. Targets: bring to the point of sale 25 per cent (LE 2.3 billion) and complete sales of 10 per cent (LE 0.9 billion) of the book value of the companies included in the 1993/94 Privatisation Programme. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵	Targets: bring to point of sale remaining 75 per cent (LE 6.8 billion) and complete sale of additional 30 per cent (LE 2.7 billion) of assets/companies of 1993/94 Privatisation Programme. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵	Target: complete sale of additional 30 per cent (LE 2.7 billion) of the 1993/94 Privatisation Programme. Progress in meeting the target must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵	Target: complete sale of the remaining 30 per cent (LE 2.7 billion) of the 1993/94 Privatisation Programme. Progress in meeting the target must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵
		Agree on the 1994/95 Privatisation Programme which should include an additional 15 per cent (LE 10.95 billion) of the book value of all public enterprises.		Targets: bring to the point of sale 50 per cent (LE 5.5 billion) of the book value of the assets/companies and complete sale of 20 per cent (LE 2.2 billion) included in the 1994/95 Privatisation Programme. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵	Targets: bring to the point of sale the remaining 50 per cent (LE 5.5 billion) and complete sale of additional 40 per cent (LE 4.4 billion) of the 1994/95 Privatisation Programme. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵
				Agree on 1995/96 Privatisation Programme, containing at least an additional 20 per cent (LE 14.6 billion) of the total book value of public enterprises.	Targets: bring to the point of sale 50 per cent (LE 7.3 billion) and complete sale of 20 per cent (LE 2.9 billion) of the book value of companies/assets of the 1995/96 Privatisation Programme. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
III) <u>Financial Sector Reforms</u> A. Banking Sector Reform		Agree on a plan of action to sell Government shares in joint-venture banks during evaluation mission. Begin implementation agreed plan of action to sell shares in joint-venture banks.	Targets: bring to point of sale 40 per cent and complete sale of 20 per cent of Government shares in joint-venture banks. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵	Targets: bring to point of sale 30 per cent and complete sale of an additional 40 per cent of Government shares in joint-venture banks. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵	Targets: bring to point of sale remaining 30 per cent and complete sale of remaining 40 per cent of Government shares in joint-venture banks. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵
				Agree on selection of one major public sector bank for privatisation.	Target: Bring to the point of sale one major public sector bank, and complete sale by December 1995. Progress in meeting the target must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵
		Reduce foreign currency reserve requirement from 15 per cent to 10 per cent.	Review with Fund the feasibility of reducing or remunerating the reserve requirement taking into account the burden of sterilising new balance of payments inflows.	Monitor programme for reduction of reserve requirement.	Monitor reduction of reserve requirement.
	Introduce repurchase agreements as a means to control short-term liquidity.				
	-Remove direct controls on bank leading to public sector companies. -Publish agreed branching criteria ensuring equal market access to solvent private and public banks.	Introduce a programme to reduce the overall exposure to a single customer to 30 per cent of the bank's capital as defined by the Basle Committee. Agree schedules for compliance.		Monitor agreed programme for reduction of the overall bank exposure to a single customer.	<u>By end-December 1996:</u> All banks to comply with 30 per cent exposure limit.
	-Remove remaining ceiling on interest rate for demand deposits. -Permit all bank customers to freely choose bank without permission of current bank or setting all balances.	Liberalise banks' fees and charges by setting minimum at zero and maximum at an unconstraining level.		Present to parliament law removing maximum and minimum limits on fees and charges.	

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
		Publish by end-September 1993 and implement by January 1994 foreign currency exposure limit of 10 per cent of capital as defined by the Basle Committee for single currency and 20 per cent for total gross exposure by end-September 1993.			
	Financial data on four large public sector banks and certification to be received by IBRD before the evaluation mission.	Agree on programme to establish credit risk bureau.			
B. Securities Market Reform:	-Ensure all similar existing and future stock exchanges are subject to uniform securities regulatory requirements. IBRD to review the capital market law and executive regulations.	-Agree on a programme for improving the legal environment aimed at ensuring competition (i.e. access to security trading and liberalising broker commissions), fair trading, and transparency in security transactions. -Adopt procedures and format to implement legal requirements.	Encourage private sector creation of a central securities depository. Establish an investor protection fund. Begin implementation of programme to improve the legal environment.	-Complete implementation of programme to improve the legal environment. -Enhance capacity to enforce securities regulation. -Establish company information disclosure system. -Enhance stock exchange self-regulation.	
	Eliminate interest rate ceilings on corporate bonds.	Agree on an action plan to strengthen the Capital Market Authority (CMA) and the stock exchanges.	Implement institutional reforms in CMA and stock exchanges. Study and encourage computer assisted securities trading.		
C. Insurance Sector Reform:		Submit to Parliament a new Insurance Law based on international prudential standards.	Seek Parliamentary approval for new insurance law. Upon Parliamentary approval, issue executive regulations.		
		Begin to strengthen the Egyptian Insurance Supervisory Authority's (EISA) solvency monitoring capacity.		Complete strengthening of EISA.	
		Agree to amend the insurance law to allow foreign entry, and send proposal for amending the law and for decontrolling the premiums to the Council of Ministers for decision.	Draft amendment to the law and send it to IBRD for review.	Submit to Parliament law to deregulate insurance premiums, and allow foreign policy.	

BROAD OBJECTIVES/AREA OF INTERVENTION	POLICY ACTIONS TO BE TAKEN BY END-JULY 1993	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1993	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1994	POLICY ACTIONS TO BE TAKEN BY END-DECEMBER 1994	POLICY ACTIONS TO BE TAKEN BY END-JUNE 1995
		Agree on a plan of action to privatise public companies and all joint-venture companies.		Targets: complete sale of joint-venture companies and bring to the point of sale one public company. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵	Targets: complete sale of one public company by December 1995, and bring to the point of sale a second public company by July 1995. Progress in meeting the targets must be satisfactory to the IBRD, according to agreed evaluation criteria. ⁵
D. Social Insurance and Pension Reform		Review regulations of the private complementary pension system to improve investment rules and to strengthen solvency monitoring along international prudential standards.	Implement agreed programmes for reforming social insurance and private pension systems.	Continue implementation of agreed programmes.	Continue implementation of agreed programmes.
		Agree with IBRD on a reform of the social insurance pension system, that would continue to be based on fully funded principles and would include a detailed programme of implementation.		Begin implementation of agreed programme.	Continue implementation of agreed programmes.

Source: Taken from Arab Republic of Egypt, 'Memorandum on Economic Policy of the Egyptian Government,' 18 Aug. 1993, in IMF, *op. cit.*, 20 Aug. 1993, pp. 22-32.

Notes:

¹ These elements of the programme will be supported by IBRD operations outside of the proposed Structural Adjustment Monitoring Programme.

² Exceptions are items in areas of national security, environment, health, and national patrimony.

³ Goods produced under monopoly conditions or benefiting from subsidised inputs.

⁴ Values are based on estimated book values at historical cost, as of June 30, 1991.

⁵ All references to the progress in the privatisation programme will be related solely to measures taken by the Government and other public sector entities as agreed to with the IBRD. It is understood that the Government does not guarantee actual sales of any public asset; yet it guarantees that it will implement measures as agreed with the Bank aimed at the conclusion of sales. Progress in meeting the targets in the privatisation programme will be measured according to evaluation criteria to be agreed between the Government and the Bank during the review of the Bank monitored programme.

In addition to the conditions in the above table, there are also provisions regarding payment and trade restrictions, multiple currency practices, bilateral payments agreements, and import restrictions:

- i) there would be neither introduction of new restrictions on payments and transfers for current international transactions nor intensification of the existing ones;
- ii) there would be neither introduction nor modification of multiple currency practices;
- iii) there would be no conclusion of bilateral payments agreements that were inconsistent with Article VIII of the IMF's Articles of Agreement; and
- iv) there would be neither introduction of new import restrictions for balance of payments reasons nor intensification of the existing ones.

Appendix H

IMF Conditionality under the October 1996 SBA¹⁰

Macroeconomic targets included:

- i) curtailing the overall budget deficit to 1.1 per cent of GDP (which excluded privatisation revenue and any further debt relief) in 1996/97 from 1.3 per cent in 1995/96;
- ii) reducing liquidity growth to 9 per cent in end-June 1997;
- iii) stabilising inflation at 6.2 per cent on average annual basis in 1996/97;
- iv) introducing an asymmetric intervention policy to safeguard competitiveness; and
- v) specified limits on domestic credits, external debt and arrears, and net international reserves.

On the other hand, the policy measures and targets in relation to structural reforms included:

1) Privatisation:

- i) divesting a majority interest in 12 public sector companies (prior action);
- ii) offering for sale a majority interest in a further 8 companies by end-August 1996 (prior action);
- iii) divesting up to about 40 per cent of a further 5 companies (prior action);
- iv) liquidating one public holding company by end-September 1996, reducing the total number of holding companies to 16 (prior action);
- v) announcing the details of 1997/98 privatisation programme (prior action);
- vi) identifying two public sector banks, one of which will be selected for privatisation during 1997; elaborate a quarterly timetable to achieve this objective (prior action);

¹⁰ The following conditions are drawn from Arab Republic of Egypt, 'Memorandum on Economic Policy of the Egyptian Government' and 'Technical Memorandum of Understanding,' 12 Sept. 1996, in International Monetary Fund, Document of International Monetary Fund and Not For Public Use, To Members of the Executive Board, From The Acting Secretary, *Arab Republic of Egypt – Staff Report for the 1996 Article IV Consultation and Request for Stand-By Arrangement*, EBS/96/149, confidential, 17 Sept. 1996, pp. 56-94.

- vii) divestiture of the public commercial banks' majority holdings in four joint venture banks, and reducing the public bank's minority holdings in the other joint venture banks (prior action);
- viii) divestiture of public enterprises to yield 5-6 per cent of GDP in both 1996/97 and 1997/98;
- ix) divestiture of bulk of public holdings in joint-venture banks by December 1997;
- x) privatising one of the four public commercial banks during 1997;
- xi) divesting one of the two public insurance companies during 1997; and
- xii) privatising remaining two joint-venture insurance companies by June 1997.

2) Trade liberalisation:

- i) reducing tariff rates in a three-step programmes:
 - a) reducing tariff rates above 30 per cent by 10-15 per cent, including a cut in the maximum tariff rate (except for alcoholic beverages, automobiles, and tobacco) to 55 per cent from 70 per cent by end-September 1996 (prior action);
 - b) cutting the maximum tariff rate to 50 per cent, and rates above 30 per cent by 5 per cent by July 1997;
 - c) reducing the maximum tariff rate to 40 per cent and rates above 30 per cent to 30 per cent, and limiting the number of tariff bands to 7 by July 1998;
- ii) reducing the maximum tariff on automobiles from 160 per cent to 135 per cent by end-September 1996 and increase excise taxes accordingly (prior action);
- iii) reducing the import surcharge rate in three phases: to 4 per cent from 5 per cent by end-September 1996 (prior action), to 3 per cent (from 4 per cent) by July 1997, and to a uniform 1 per cent (from 3 and 2 per cent) by July 1998;
- iv) abolishing restrictions on cotton imports and exports (prior action);
- v) eliminating the export ban on scrap metal by September 1996 (prior action);

- vi) replacing local quality control standards on about 100 spinning and weaving products by standards of the country of origin or internationally recognised standards (prior action);
- vii) eliminating all remaining non-tariff barriers on exports and imports by July 1998;
- viii) abolishing restrictive features of import quality control system during 1997; and
- ix) setting a five-year programme on reducing tariffs on automobiles by January 1997.

3) Structural fiscal reform (revenue and expenditure reforms):

- i) adopting an action plan for extending the general sales tax to the wholesale and retail levels in the 1996/97 budget (prior action);
- ii) phasing-in the input credit mechanism to all new capital goods from January 1997;
- iii) extending the general sales tax to the wholesales and retail levels on 1 July 1997;
- iv) implementing administrative reforms to enhance tax collections;
- v) reforming the income tax system, starting with the 1997/98 budget;
- vi) cutting civil service employment by 2 per cent per year, commencing 1996/97; and
- vii) reducing the ratio of civil service wages to GDP in 1996/97 and maintain it constant thereafter.

4) Energy prices:

- i) adopting a plan to eliminate the implicit subsidy on petroleum products, natural gas, and electricity over the two years from July 1997 (prior action);
- ii) raising prices of petroleum products and natural gas by reducing and eventually eliminating implicit energy subsidy in three steps: the first one-third reduction by July 1997; a further one-third reduction by July 1998; and the final reduction by July 1999;
- iii) increasing the weighted average price of electricity to its long-run marginal cost on the same schedule as above; and

- iv) introducing an automatic energy price adjustment mechanism.

5) Financial sector reform:

- i) eliminating a 49 per cent limit on foreign ownership of joint venture banks (prior action);
- ii) adopting action plans for improving prudential regulation of the banking system, implementation of monetary policy, and functioning of foreign exchange market (prior action);
- iii) implementing a schedule for reducing the overall exposure to a single customer to 30 per cent of the commercial banks' capital (prior action);
- iv) implementing action plans for improving prudential regulation of the banking system, implementation of monetary policy, and functioning of foreign exchange market;
- v) reducing the overall exposure to a single customer to 30 per cent of the commercial banks' capital; and
- vi) lengthening the maturity structure of public debt.

6) Deregulation and statistical data:

- i) agreeing with the IMF on the details of a draft unified investment law (prior action);
- ii) adopting a plan for improving national income accounts based on IMF technical assistance (prior action);
- iii) pursuing the passage of the draft unified investment law by 1 January 1997; and
- iv) implementing action plans for improving national income accounts.

7) There are also provisions regarding payment and trade restrictions, multiple currency practices, bilateral payments agreements, and import restrictions:

- i) there would be neither introduction of new restrictions on payments and transfers for current international transactions nor intensification of the existing ones;
- ii) there would be neither introduction nor modification of multiple currency practices;

- iii) there would be no conclusion of bilateral payments agreements that were inconsistent with Article VIII of the IMF's Articles of Agreement; and
- iv) there would be neither introduction of new import restrictions for balance of payments reasons nor intensification of the existing ones.

Appendix I

John Gunter's Unpublished Paper (A Section on Egypt)

A sad story from every viewpoint.

It is time to discuss Egypt. There is a lot to be said. Perhaps I should begin by acknowledging my personal attachment to Egypt, to Cairo in particular. My feelings are an outgrowth of my living in Cairo for the better part of two years during the War. This was testing time for me - my first important assignment when I was pretty much on my own. Actually, I did virtually no work on "Egyptian problems", which were not of major concern at this time. I did not get to know any Egyptian officials very well, but did have some discussions with foreign technicians at the National Bank of Egypt.

I was attached to the American Economic Mission in the Middle East, and this mission was established primarily to work with the British in controlling shipping and supplies for the ME. The most interesting problems that I worked on in Cairo were those growing out of the differing interests of the US and the UK in the area, particularly looking forward to the end of the War.

I learned much more about other Middle Eastern countries on my trips on specific Treasury assignments (Saudi Arabia, Turkey, Ethiopia and Iran, in particular).

But I spend most of my time in Cairo, and it was living in Cairo that I found so fascinating. Cairo was a much smaller city than it is today. There was no feeling of "teeming humanity" that one gets in Cairo today. There was pleasure in wandering around the city. I stayed for a while at the old Shepheard's near the Opera, and at the Mena House near the Giza pyramids. I stayed several months with an Italian family who had a large flat in the business area, and eventually rented a house in Gezira with a number of other American men without families. We took trips to Alexandria, Suez, and up the Nile to Luxor and Aswan.

With this background, I welcomed the opportunity to lead Fund missions to Egypt, which I did for more than 20 years - more than one mission a year frequently.

The first mission, some details of which I can remember, was, of course, largely exploratory. We met for the first time Kaissouni who was Minister of Economy and would be in that position or Deputy Prime Minister for economic affairs for a number of years until at least the mid-1960's. He would drop out of the Government for a number of years, partly because of poor health, but then returned as Deputy Prime Minister. The key to Fund negotiations with Egypt was the difference in Kaissouni's policy approach from one period to the next, as I will explain.

We also met Galeel El Emory, who was Governor of the National Bank of Egypt, a large British commercial bank with the principal central banking functions. The central banking functions would soon thereafter be transferred to the Central Bank. I knew that El Emory had the reputation of being a knowledgeable central banker, as well as being highly intelligent and a man of absolute integrity. I found him to be all of these and also a modest person and a careful one. I came to admire him greatly. Our discussions with him were, however, of limited usefulness because he avoided discussing fiscal policy and took a narrow view of the role of the National Bank. He did not inform us that he would leave his position soon.

It is essential to understanding the discussions with Egypt to have in mind the changes in the Egyptian situation resulting from the overthrow of the Monarchy and the establishment of Nasser as President and, in due course, as absolute ruler. Prior to Nasser's coming to power, economic policy was strongly influenced by the British and the financial situation was dominated by the National Bank. The economy was, however, experiencing very little growth in the absence of significant capital inflow.

Nasser made great changes in virtually every direction. He had ambitions to leadership in the "third" world and formed close ties with Yugoslavia and India. At least in his early years, he did not seek a stronger role in the Middle East, but rather emphasized Egypt's position in Africa. Egypt's neutrality in East-West terms led to the development of economic ties with the Soviet Union and other nations associated politically with the Soviets, while ties with Western Europe and the US weakened. Egypt engaged heavily in bilateral trade agreements. Moreover, after negotiations with Western countries and the World Bank encountered difficulties, the Soviets undertook a major role in the construction of the High Dam.

Domestic economic policy was highlighted by nationalization of industry, the banks and the Suez Canal. Trade controls were a carry-over from the War period, but they became more pervasive, being essential to making bilateral agreements effective and to coping with growing pressures on the official exchange rate. With rising inflation, the scope of subsidized consumption was expanded well beyond the traditional loaf of bread to include many essential consumer items.

With these policy trends, there was much to discuss in the consultations with the Fund. However, there was no sharp deterioration in the domestic economic situation during the 1950's because the pressures in the economy were reflected primarily in the payments deficits. In short, Egypt drew on its sterling balances accumulated during the War. But, as the Fund staff emphasized in the early consultations discussions, these balances should be regarded as providing time during which policies could be adjusted to restore equilibrium in the economy.

What bothered me most in the early years of our discussions with Egypt was that Kaisouni made little effort to defend the lack of action to correct the situation. It became increasingly clear that Kaisouni and the group around him understood the situation quite well, but were unwilling or unable to do much about it. I pressed on several occasions for discussions at the political level, and this understandably was resented by Kaisouni as a minister. In

any event, I was careful to leave a written statement about the dangers in the situation, at the conclusion of each consultation mission. (I learned years later when I accompanied Mr. Schweitzer to meet President Nasser that the President had seen my statements regularly).

What I came to understand in time was that Kassouni believed it was important for him to keep his position in the Government because, if he left, he would probably be replaced by someone who was incompetent or would have less influence than he had with Nasser. He was probably right.

Kaisouni's position needs to be contrasted with that of several other Egyptian economists who did not accept policy-related positions. I have already noted that El Emory left the National Bank and was not willing to stay on to supervise the establishment of the Central Bank. I do not doubt that he saw the situation as hopeless for a central banker. In my judgment, the most competent of the Egyptian economists at this time was Ali Gritley. He made clear that he was unwilling to take a Government position. He became head of the nationalized Bank of Alexandria, regarding this as non-policy oriented. He and I met frequently in Cairo for private luncheons, which I found very instructive, even though he offered no criticism of Kaisouni, who was a friend. Gritley in the 1970's undertook UN assignments, including Resident Representative in Jordan.

Another economist outside of the Government with whom I maintained contact was Sherif Lotfy. He was chief economist of the National Bank for several years after it no longer functioned as central bank. He was approached to become Minister of Economy on several occasions, and once in the 1980's came close to being appointed. He always indicated his willingness to become Minister subject to prior agreement on the essential elements of a "program", which was close to Fund proposals but by no means identical.

A few words about the problems of statistics: Economic data particularly related to banking and balance of payments, were incredibly bad. Data published by the National Bank did not reflect economic concepts. We pressed hard for several years to get the situation improved particularly in the case of monetary statistics and made no progress. Then, one day we discovered at the Ministry of Planning (which lived in sort of a dream world) detailed monetary data suitable for publication in IFS. The Planning Ministry had asked the Central Bank for these data as we had been doing, and the Banking Supervision Department (not the Research Department) had required the Banks to report the necessary data monthly separately from what they were already providing the Research Department. Thereafter, the Central Bank provided these data to us on a routine basis.

However, it was at least two years before the data were transmitted officially to the Fund for publication.

Incidentally, the Banking Supervision Department had a number of very good statisticians and economists, several of whom came to work for the Bureau of Statistics.

A story about having discussions with the Egyptians sometime in the early 1960's: Our meetings were typically rather long because the Egyptians had not prepared very well, so that at the beginning of each new subject the Egyptians had a long discussion in Arabic among themselves before picking up the discussion with the mission. I wanted to know what they said among themselves. One year I brought along Samir Makdisi (Lebanese), and he gave me a summary after the meetings. At the end of the visit, Hamid El Sayeh presumed on our personal friendship to suggest that I should not bring along "that Lebanese fellow" next time. I didn't, but I did something which I think in retrospect was a bad idea. I brought along an Englishman who had lived for several years in Aden and had a working knowledge of Arabic.

In the 1960's we entered a new phase of negotiations because Egypt wanted to draw on the Fund. There was no possibility that Egypt would come forward with a major reform which would support a large stand-by arrangement. Thus, we began discussions about a less demanding program which would support a first credit tranche drawing. This was a helpful approach because it was necessary to set forth a coherent program, even if there were no "triggers". This provided a framework for discussion of credit ceilings, interest rates, subsidies, bilateralism, exchange rates, etc. Over the next several years the first credit tranche was rolled over several times, and each time we made a little progress in improving policies.

On one occasion shortly before an Annual Meeting we reached an impasse over a modest step to improve the realism of the exchange rate. Kaisouni decided to take the matter to the MD (Jacobbsen) while he was in Washington for the Annual Meeting. I briefed the MD, telling him it was likely Kaisouni would offer tighter credit policy as a substitute, and that I doubted Egypt could live with lower credit ceilings in practice, given the budgetary situation, unless new fiscal measures were undertaken. The MD invited Kaisouni to his suite at the Wardman Park, and I was the only other person present. Kaisouni did, very skillfully, what I had predicted, and the MD bought it (as I also expected). In the event, I was right too about the credit ceiling, but Egypt, of course, already had its money.

Soon thereafter, Kaisouni dropped out of the picture for a number of years. We dealt with several Ministers of Economy, all of whom were bright and seeking to do a good

job. One who had no background in economics or finance asked me to meet with him privately to explain some of the concepts involved. Another was Professor Zaki Shafei of the University of Cairo, an able economist and a good friend of Shaalan. He understood the issues very well and made a substantial effort at reform. However, ultimately the "politics" were too much for him to cope with.

Then, in the mid-1970's we had Kaisouni's second coming. This time he was resolved to put in place a genuine reform program supported by substantial Fund resources. We worked very hard with him and his associates. I remember few of the details, but a good program emerged which was "do-able" with a reasonable degree of political support. It involved significant, but we all agreed, modest reductions in consumer subsidies. I think we reached agreement at the technical level in November 1976. The mission returned to Washington to await developments.

the In December the President made a speech in which he promised continuation of the consumer subsidies, but made no mention of program being submitted to the Fund. I am uncertain whether the "letter of intent" for the stand-by arrangement reached the Fund before or after the speech. We were, of course, dismayed that apparently political support for the program would not be forthcoming. The Fund, nevertheless, approved the stand-by on the basis of the letter of intent.

When the details of the program were announced in Cairo in January, the riots resulted. No effort had been made to gain public support for the program. Few know that I arrived in Cairo on a late plane the evening of the day the riots occurred. My plane's departure from Athens (I think) was delayed because of the riots. I managed to get to my hotel in spite of a curfew, in an Egyptair bus, along with 20 or so other late arrivals. Six months later I no longer worked for the IMF. I did, however, arrange a few more trips to Cairo and, for a few years, kept close tabs on the developments in Egypt.

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Sultan, Fouad (Minister of Tourism and Civil Aviation during 1985-1993), personal interview, Cairo, 11 Mar. 2001.

Badr, Mohammed Saad (Sub-Governor for the Foreign Relations Department at the CBE), personal interview, Cairo, 11 and 13 Mar. 2001.

The remainder of the thirty-three interviewees have expressed their wish to remain anonymous and are thus coded as Interviewees 1-30. A list of their names will be made available to the examiners.

