THE MONETARY POLICY OF EGYPT

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PREFACE

This thesis contains a study and analysis of the monetary policy of Egypt. It highlights Egypt's monetary and banking experience since the middle of the nineteenth century up to the present time. Its main purpose, however, is to examine in the light of this experience, the working of the forces of monetary policy on the economic development of Egypt.

I have divided the study into two major sections, one descriptive and historical, the other analytical. The first section includes the first four chapters. It begins with an over-all appraisal of the Egyptian economy, its basic characteristics and inherent difficulties, and proceeds to review the monetary and exchange systems since 1850 up to the present time. Interest here centers chiefly upon the consequences of Egypt's lack of an independent monetary system until 1947 when it started to develop its own monetary and banking system.

The second half of the thesis includes the remaining last three chapters and is largely analytical. It discusses the impacts of monetary policy on the economic development of Egypt, manifested mainly in its impacts on industrialization and the diversification of agricultural production. The forces governing the inflationary tendencies and pressures, and their effects on the economy are also discussed in Chapter VI. The last chapter includes a summary and conclusion for the entire study.

The study was begun in October 1956 and virtually completed in June 1958. I am lastingly indebted to Dr. Paul J. Klat for his valuable advice and guidance over a period of two years, and without his assistance and recommendations this research study would not have been possible. I wish also to express my deep gratitude to Mr. Assad Y. Nasr, for providing me with his continuous incentives as well as the opportunity to proceed with my research while holding a position at Middle East Airlines' Planning & Economics Department. Finally, I should like to express my thanks to Miss Samia Geadah and Miss Nadida Saadeh who participated in the typing of this thesis, and also to Miss Myra Khoury for drawing the graphs included in this study.

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G.S.M.

ABSTRACT

The economy of Egypt is basically agrarian, depending almost entirely on a single export product, cotton. This specialized cotton economy has proved highly vulnerable to world market fluctuations. At times it has dragged the country through grave depressions, and at other times, stimulated by abnormal demand, it has virtually exploded in inflationary booms. For these reasons, it has been widely felt in Egypt that specialization was overdone and that a more diversified and stable economy must be developed. Consequently, the present economic policy of Egypt aims at industrialization and the diversification of agricultural production as the ultimate solution to the problem of underdevelopment as well to the inherent problem of disguised unemployment.

In this respect, monetary policy can have a far reaching effect on the economic structure of almost any country. My main objective in this study is to discern the impacts of such policy that was in practice in Egypt, on the economic development of the country. There did not, however, exist in Egypt a designed and clear monetary policy. All that existed in this respect was a scattered collection of rules and legislations regulating the monetary and exchange systems and which embodied the general spirit of the policy in practice.

The conventional weapons of monetary policy had never acquired much stature in Egypt where the center of money creation is not the

banking system to which these techniques are addressed, but the balance of payments and particularly, the exports proceeds of the country's main product, cotton. Hence, an exchange control system which attacks the balance of payments directly had considerable appeal in Egypt.

Three major developments in the monetary and banking field were achieved during the past decade. First, is the widening in 1947 of the exchange control system which was set-up initially in 1939. Second, the transformation of the National Bank of Egypt into the de-jure central bank of the state in 1951. Third, the law of Egyptianization of all banks in 1957.

Inspite of all these and other developments, the money and capital markets are still rudimentary and are quite insensitive to the subtle influence of the conventional instruments of monetary policy. The discount rate remained constant at least since the last eight years, while open market operations are still uncommon in Egypt in view of the smallness of the money market. The credit situation, on the other hand, has been more and more stingent mainly due to the low level of savings which is a basic feature of poor countries. One can rightly say in this respect that the shortage of credit is both a cause as well as an effect of poverty in Egypt and other similarly underdeveloped countries.

Monetary policy has not so far played a direct effective role in promoting economic development in Egypt, although its merits are to some extent reflected on the development attained in the industrial sector as well as in the field of agriculture whereby diversification of agricultural production was fairly achieved. However, recently, in July 1957, the Government declared officially its new monetary and banking policy embodied in law number 163 of 1957. By this law, the central bank was given firm authorities to regulate the availability and cost of credit to meet the requirements of the economy, and to control banking activity and manage the gold and foreign exchange reserves. In general, the control of the banking system is now concentrated in the Central Bank which was also given power to undertake open market operations in order to regulate the volume of credit in accordance with the monetary and credit policy.

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CHAPTER I.

ECONOMIC BACKGROUND

A. General Remarks:

Egypt has a population of 23 million of which 32 percent live in urban areas. The country covers an area of 386,000 square miles of which 96.5 percent is uninhabitable desert. The habitable area consists of the Nile valley, its delta and a few scattered oases. Only about six million acres in the whole country are under cultivation, made possible by irrigation.

Three main factors make for the economic importance of Egypt. First is its geographical position as a bridge between three continents. Second, its command over the eastern mediterranean coast; and finally, its control of the main sea route from Europe to the Indies and beyond through the Suez Canal.

Egypt is an underdeveloped country whose economy is basically agrarian with one major export product, cotton. This cotton export economy has proved highly vulnerable to world market fluctuations. At times it has dragged the country into deep depression while at others, stimulated by abnormal demand, it has virtually exploded in inflationary booms. For this reason, it has been widely felt in Egypt that specialization has been overdone and that a more diversified economy must develop. Moreover, this densely populated peasant economy suffers from large-scale chronic disguised unemployment in agriculture. The expanding population adds continually to the number of people already working on overcrowded holdings. The transfer of working population from agriculture to industry and services have been going on for a long time. Statistics on the disbtribution of population by occupations are not available since 1947. The part of population engaged in agriculture declined from 31 percent in 1937 to 25 percent in 1947. According to these same estimates, there were some 6 million unemployed in 1937 compared to 8 million in 1947.[1]

The need for industrialization began to be felt in Egypt ever since the First World War when owing to the shortage of imports several minor industries developed and survived the war. However, inspite of the war, agriculture remained the dominant feature of the Egyptian economy. It should be noted at this level that the treaties made by Turkey could not enable Egypt to protect her infant industry.[2] Industrialization was stimulated again to a greater extent during the Second World War. Imports were drastically reduced, while the large-scale expenditure of Allied troops stationed in Egypt greatly increased the demand

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1. Ministry of Finance & Economy, Egypt, Statistical Pocket Year-Book 1955, (Cairo: Government Press, 1956) Arabic Edition.

2. Dr. Girgis Marzouk, Interviewed in Cairo, October 24, 1957.

for industrial products.

The basic requirements for industrialization are existing in Egypt but are not yet fully developed. It has no coal and only moderate oil resources which provide some two-thirds of the country's fuel requirements.[1] Egypt has, however, large iron ore deposits lying in the desert near Asswan which are now being exploited. It has also enormous water power potentialities which are now being utilized intensively. Besides, there is a large surplus labour force available in Egypt in the form of disguised unemployment.

B. National Income:

National income in Egypt was officially estimated in 1954 at LE 867.5 million to which agriculture contributed 36 percent. Cotton alone represented some 10 percent of total national income. Income from trade, on the other hand, fell to 8 percent compared to 15 percent in 1953, while income from manufacturing industries amounted to 10 percent, an increase of 2 percent over the previous year.[2]

The most striking aspect of Egypt's national income is that cotton alone accounts for 10 percent of total income. The Government sector contributes 15 percent of total income. Little

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1. Barclay's Bank, Egypt, An Economic Survey (London: Lea & Co., 1955), p. 12.
2. Ministry of Finance & Economy, Egypt, Statistical Pocket Year-Book 1955, (Cairo: Government Press, 1956) Arabic Edition.

is known of the distribution of national income; however, owing to the smallness of the middle class the distribution is bound to be highly unequal. In addition to the inequality among the different income brackets, there is also a considerable inequality of income between the cities, on the one side, and the country, on the other.

The per capita national income tends to be stable since 1950 at the rather low level of about LE 37 compared to LE 17 in India, LE 57 in Greece and Turkey, LE 240 in France, LE 284 in United Kingdom and LE 799 in the United States.[1]

C. The Role of Cotton in the Economy:

Cotton production in Egypt dates back to the beginning of the nineteenth century at which time Mohamed Ali was impressed by the fine qualities of the Egyptian long staple cotton and the great possibilities of its development. He took steps to encourage and enforce the growing of the new crop. The venture proved extremely successful and the importance of cotton in the economic life of Egypt grew steadily. It was finally the American civil war with all its deterring effects on American cotton growing which fixed the crop firmly as Egypt's main economic basis. Moreover, it was the intention of the United Kingdom which occupied Egypt for more than half a century, to make Egypt a cotton estate.

1."National Income of Egypt", Egyptian Economic & Political Review, Vol 1, No. 6, February 1955.

Egypt normally supplies 40 percent of long staples and over half of the extra long staples that are required by world spinners.[1] Thus Egypt came to occupy a unique place in the world of cotton. Although it accounts for only 5 percent of the world crop, it is however the second exporter after the United States of America. Egyptian long staple cotton is famous for its length, resistance, and glossiness. It enjoys a practical monopoly for certain uses, such as airplane tyres and sewing thread, yet most of the crop must compete with foreign staples and its price is determined by the world market price which is not significantly influenced by the size of the Egyptian crop.

The nature of cotton in comparison with other agricultural products is of special importance. While other crops are on the whole foodstuffs which are generally consumed locally and the demand for them is relatively inelastic in view of their being the basic necessities of life, cotton, on the other hand, is an industrial raw material which has a world market and the demand for it is directly affected by constantly changing world demand conditions.

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1. The Egyptian types of long-staples are superior to and longer than American Middling. Their length ranges from $1\frac{1}{8}$ to $1\frac{1}{2}$ inches and are referred to in Egypt as Medium staples. The extra-long-staples are $1\frac{1}{2}$ inches and above; they are referred to in Egypt as long staples. See: C. Issawi, Egypt at Mid-Century, (London: Oxford University Press, 1954) p. 112.

D. Foreign Trade and Cotton:

A description of the factors determining Egypt's foreign trade, like that of the internal structure of the economy, inevitably turns in terms of cotton.

The year 1939 has been the last year in the economic history of Egypt during which a surplus in foreign trade was achieved. The excess exports amounted in that year to LE 0.7 million and has been followed by sixteen years of consecutive deficits. During the war years, the heaviest deficit occurred in 1942 when, owing to shipping restrictions, cotton exports dropped to a mere trickle and remained at a level below LE 50 million until 1945 (see table I). During the seven years of war the total value of imports amounted to LE 305 million while export proceeds totaled LE 207 million, an amount almost equal to one year export in 1951. While imports comprised mainly foodstuffs and fertilizers, exports, on the other hand, consisted almost entirely of cotton.

TABLE I.

FOREIGN TRADE (1939 - 1945)

(in LE million)

Year	Imports	Exports	Difference
1939	34.1	34.8	+ 0.7
1940	31.4	28.3	- 3.1
1941	33.1	22.6	- 10.5
1942	55.5	19.3	- 36.2
1943	39.2	26.6	- 12.6
1944	51.0	30.0	- 21.0
1945	60.5	45.2	- 15.3
Total 1939/45	304.8	206.8	- 98.0

Source: vide - "Post-War Trade Development", in The Egyptian Economic and Political Review, Vol. 2, No. 7, (Cairo: March 1956).

During the last decade following the war, a remarkable change took place in the pattern and terms of trade. Egypt had emerged after World War II as a creditor country mainly due to large allied military expenditures. The assets of the country consisted of Sterling balances estimated at LE 400 million, large Government reserve funds built up of budgetary surpluses, and an industrial expansion stimulated by war time conditions. The liability of the country, on the other hand, consisted of the need of replacement of equipment, renewals of railroads and roads, and the demand for imports of consumer goods and fertilizers.[1] Besides, there was a rapid increase in population not accompanied by increase in production.

The rise in export proceeds from LE 135 million in 1949 to LE 173 million in 1950 and to LE 201 million in 1951 was due to the rise in cotton prices during the Korean boom, while the sharp decline in these proceeds in 1952 was the outcome of the reversal of this trend. As a result, the level of imports increased from LE 158 million in 1949 to LE 222 million in 1950 and LE 242 million in 1951. The fall in imports in 1952 was smaller than the fall in exports partly because the prices of imports had not attained their pre-boom level. The rise in imports in 1952 was mainly due to large imports of wheat and import of non-monetary gold. The reduction in the adverse trade balance to LE 40 million in 1953 was due to import restrictions, smaller imports of wheat and the fall in prices of many imported goods. The year 1954 witnessed a recovery of exports and a fall in imports in view of rising local production and increased import duties on a number of articles. The rising deficit during the last two years may be accounted for by increased imports of capital goods with the acceleration of expenditure on development projects, increased imports of security equipment and wheat accompanied by a lower level of cotton exports.[2]

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1. The land rotation system was disturbed during the war which led to an increase in demand for fertilizers after the war.

2. Henry Tadros, "Recent Developments of Egypt's Balance of Payments", <u>Middle East Economic Papers 1957</u>, (Beirut: Economic Research Institute, 1957).

The following table shows foreign trade figures from 1947 to 1956 compared to the pre-war figures of 1939:-

TABLE II.

FOREIGN TRADE (1939-1956)

(in LE million)

Year	Imports	Exports			Re-Exports	Total Exports & Re-Exports	Balance
		Cotton	Other	Total			
1939	34.1	24.3	9.8	34.1	0.7	34.8	+ 0.7
....	....	....	...	....	...	....	......
1947	102.4	69.3	16.6	85.9	3.8	89.7	- 12.7
1948	172.9	113.3	27.4	140.7	2.4	143.1	- 29.8
1949	178.2	106.1	29.8	135.9	2.1	138.0	- 40.2
1950	215.7	149.8	23.2	173.0	2.5	175.5	- 40.2
1951	242.3	164.1	36.5	200.6	2.4	203.0	- 39.3
1952	223.5	126.4	16.4	142.8	2.3	145.1	- 78.4
1953	177.8	116.3	19.5	135.8	1.5	137.3	- 40.5
1954	161.4	113.1	23.6	136.7	1.6	138.3	- 23.1
1955	183.2	107.4	29.6	137.0	1.4	138.4	- 44.8
1956	185.0	98.9	42.0	140.9	1.4	142.3	- 43.7

Source: NBE, Economic Bulletin, Arabic Edition, Vol. IX, No. 4, 1956, p. 422. & Vol. X, No. 1, 1957, p.76, (English Edition).

Cotton accounts for 80 to 85 percent of total exports. Britain remained for a long period the best customer for Egyptian cotton. Its share of total exports amounted to 32 percent in 1939 and to 30 percent in 1949. This ratio, however, dropped to 17 percent in 1950 and since then it continued to drop until it reached a negligible amount during the last cotton season. During 1955/56 season, cotton exports amounted to 6.5 million kantars of a total value of LE 113.7 million which represents 85 percent of total value of exports and 60 percent of that of imports during 1955.[1]

The chief cotton importing countries during the 1955/56 were the following:-[2]

Csechoslovakia...	17.6%
India............	11.5%
France...........	10.5%
Japan............	8.0%
Italy............	7.0%

Domestic consumption during the season, which ended on August 31, 1956, was 1.9 million kantars and the remaining stock at the end of the season amounted to approximately two million kantars.[3]

During the 1956/57 season cotton exports did not move satisfactorily partly due to the loss of some 20 days in Novem-

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1. International Financial New Survey. Vol. IX, No. 17, (October 26, 1956) p. 136.
2. N.B.E., Economic Bulletin, op.cit p. 423.
3. Ibid, p. 379.

ber 1956 but the main reason was the increase in cotton exports by the U.S.A. to India, Japan and a number of European countries under credit conditions and at highly competitive prices. As a result, India became in the tenth position in the list of Egyptian customers for cotton. While all other countries show similar reductions during the last season, USSR on the other hand, increased its purchases and ranks now first on the list of Egyptian cotton importers.

It should be noted that Russia has been working hard to establish a pre-eminent position for the Eastern bloc in Egyptian trade. Whereas Britain and France have now completely dropped out of the Egyptian market,[1] the Eastern block are stepping in. British trade which consisted over a quarter of Egypt's foreign dealings has steadily declined to a point of secondary importance. The "Iron Curtain" trade on the other hand, including that of China, now constitutes about 38 percent of Egypt's foreign dealings.[2]

E. Balance of Payments:

During the First World War the balance of payments estimates showed a yearly surplus which amounted to a maximum of

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1. This was due to political tension which led to the severing of economic connections between Egypt on one side and Britain and France on the other, following upon the Suez Canal crisis in 1956.

2. "Soviet Show in Cairo", The Economist, Vol. CLXXXII, February 2, 1957, p. 371.

LE 4.3 million in 1918.[1] The period 1920-38 showed a very small import surplus which was partly financed by net export of specie.

During the Second World War, a large import surplus was accumulated which aggregated LE 98 million between 1940 and 1945 inclusive.[2] This, however, was more than compensated for by Allied military expenditure amounting to a net surplus of LE 400 million during the same period.

The post-war decade was marked by a persistent deficit in the balance of payments of Egypt. This deficit has been chiefly met by reductions in Egypt's sterling balances.[3] For the first time since years the persistent deficit turned into a small surplus in 1954 (see table III). This was due to the higher value of cotton exports owing to a rise in its world prices during that year, and also due to a relative fall in imports. In the following two years, the traditional deficit occurred again, being mainly caused by a relatively higher level of imports of capital goods and military equipment accompanied by smaller cotton exports.

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1. M. Ali Rifaat, Monetary System of Egypt, (London: Allen & Union, 1935), p. 57.

2. Charles Issawi, Egypt at Mid Century, (London: Oxford University Press, 1954), p. 204.

3. These balances amounted to approximately LE 400 million by the end of the war - Ibid, p. 204.

A common feature of post-war balance of payments estimates has been the emergence of large adverse trade balance partly offset by surpluses resulting from invisible current transactions. The overall result depended on the magnitude of these two factors. Another basic characteristic of these estimates is the tendency of export proceeds to become rigid and for import disbursements to rise.

Receipts from invisibles accounted for 41 percent of total receipts in 1956 compared to 31 percent in 1950. Disbursements on similar items represented 25 percent of total payments incurred in 1956 compared to 22 percent in 1950 (see table III).

TABLE III.

EGYPT'S BALANCE OF PAYMENTS

(in LE million)

CURRENT TRANSACTIONS	1950	1951	1952	1953	1954	1955	1956
Receipts							
Proceeds from Exports	184.8	201.9	145.6	135.3	139.8	133.1	129.9
Invisibles	83.5	90.3	73.1	79.8	82.4	94.2	88.9
Total	268.3	292.2	218.7	215.1	222.2	227.3	218.8
Disbursements							
Payments for Imports	221.7	241.9	210.5	165.2	150.7	190.3	192.3
Invisibles	57.2	65.5	61.6	57.8	68.4	71.0	59.5
Total	278.9	307.4	272.1	223.0	219.1	261.3	251.8
Balance of Current Transactions	-10.4	-15.2	-53.4	- 7.9	+ 3.1	-34.0	-33.0
Net Capital Outflow	- 3.6	- 4.6	- 2.0	- 0.4	+ 0.2	+ 2.2	+ 0.3
Donation...........	...	...	...	...	...	...	+ 1.7
Overall Deficit or Surplus	-14.0	-19.8	-55.4	- 8.3	+ 3.3	-31.8	-31.0
Compensatory Finance							
Foreign Exchange Holdings[1]	-29.0	-44.5	-57.8	- 4.1	+ 6.9	-32.3	-38.3
Monetary Gold	+23.0	+26.6	–	–	–	–	+ 5.0
Non-Resident A/C	- 8.0	- 1.9	+ 1.8	- 4.5	- 3.8	+ 0.9	+ 1.6
IMF Resource Funds	–	–	–	–	–	–	- 5.2
Suez Canal Dues, Late Settlement	–	–	–	–	–	–	+ 5.4
Errors and Omissions	–	–	+ 0.6	+ 0.3	+ 0.2	- 0.4	+ 0.5
Total	-14.0	-19.8	-55.4	- 8.3	+ 3.3	-31.8	-31.0

Source: NBE. Economic Bulletins 1951-1956 and Vol. X, No. 2, 1957

1. Includes Sterling Balances.

The balance of invisible items has been marking by yearly surplus and which amounted to LE 23.2 million in 1955, and to LE 29.4 million during 1956 (see table IV).

The most important item under invisible receipts is the Suez Canal dues which amount to an average of 35 percent of total annual invisible receipts. Invisibles under the heading "Other Receipts" consist of local unclassified expenditures of branches and subsidiaries of foreign companies and consulates. They are individual amounts not exceeding one thousand pounds each.

Government expenditures include spendings made by Egyptian diplomatic corps and other state expenses abroad apart from government imports. Finally, the item of 'interest, dividends, and other revenue' on the debit side covers income from direct investment in Egypt and other revenues accruing to non-residents.[1] Such payments decreased by one million pounds in 1955. The rise in the receipts of such items on the credit side may be attributed to the higher yield of Egyptian foreign investments as a result of the rise in interest rates in 1955.

Cotton marketing and the diversification of exports are the focal point in the balance of payments policy in Egypt. Import restrictions were resorted to as well as restrictions on

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1. It includes Suez Canal Company dividends, profits of oil companies, and profits of branches and subsidiaries of foreign establishments.

travel. A tax of 10% was also imposed on certain transfers abroad. All these measures and others were taken in attempt to lessen the strain on the balance of payments and to adopt the cotton market to changing world conditions. Moreover, a system of exchange control was established in 1947 for the purpose and has undergone various developments which are referred to in chapter four.

TABLE IV.

EGYPT'S BALANCE OF PAYMENTS

INVISIBLE ITEMS

(in LE million)

CURRENT TRANSACTIONS	1950	1951	1952	1953	1954	1955	1956
Invisible Receipts							
Transit Trade	-	2.6	3.2	2.5	4.4	6.0	2.6
Insurance - Not on Export and Imports	-	0.4	1.0	0.7	0.5	0.4	0.4
Shipping	7.5	7.5	6.8	7.1	7.1	9.1	8.7
Suez Canal Dues	26.2	26.4	26.6	29.1	30.6	31.8	29.3
Interest, Dividends & Others ...	-	4.9	4.8	6.3	5.0	7.3	5.6
British Army Expenditure	13.0	14.7	5.8	9.0	5.6	4.8	-
Other Receipts	36.8	33.8	24.9	25.1	29.2	34.8	42.3
Total ...	83.5	90.3	73.1	79.8	82.4	94.2	88.9
Invisible Disbursements							
Transit Trade	-	1.5	2.4	1.5	5.2	3.6	3.7
Insurance - Not Imports and Exports	-	1.5	0.9	1.1	1.0	1.0	0.6
Other Commercial Payments	-	2.5	2.2	2.2	2.4	2.8	2.9
Shipping	7.0	6.1	6.9	6.3	6.8	9.3	8.8
Interest, Dividends and Other Revenue	15.8	17.4	16.9	17.4	18.1	17.1	10.7
Travel and Maintenance	10.3	15.3	11.6	9.6	13.0	10.2	8.0
Egyptian Government Expenditure.	-	6.3	5.7	6.6	9.4	11.0	12.9
Other Disbursements	24.1	14.9	15.0	13.1	12.5	16.0	11.9
Total ...	57.2	65.5	61.6	57.8	68.4	71.0	59.5
Balance of Invisible Items	26.3	24.8	11.5	22.0	14.0	23.2	29.4

Source: NBE, Economic Bulletins, 1951 - 1956. & Vol. X, No. 2, 1956, p. 141.

F. The Purchasing Power of the Egyptian Pound:

Money is usually referred to as serving both as a means of exchange and as a store of value. In all its uses, however, money is held not for its own sake but for its purchasing power, i.e., for what it buys. The phrase 'Purchasing Power' does not suggest a list of things that some specified unit of currency does buy but a number of alternative sets of things that it can buy. In fact, there is no such thing as the purchasing power of a pound or a dollar or any other currency. There is a purchasing power for "the representative pound in the money income of any one specified person or group of persons",[1] such as a group of wage earners, members of professional class, etc., or finally, a whole community combined together. As defined by Keynes, the purchasing power is the power of money to buy the goods and services on the purchase of which, for purposes of consumption, a given community of individuals expend their money income.[2] Hence, the purchasing power of money is measured by these goods and services, weighted according to their importance as objects of consumption, which a unit of money will buy.

In general, when reference is made to the purchasing power of a currency during any period, without further specification as to what group of people it applies, it is supposedly in-

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1. A.C. Pigou, The Veil of Money, (London: Macmillan, 1956) p. 57.

2. J.M. Keynes, A Treatise on Money, (London: Macmillan, 1953), Vol. 1, p. 54.

tended to be for that unit of currency that is representative of the whole community.

Purchasing power is measured more or less accurately, by means of index numbers of prices of a composite commodity representative of consumption.

In most countries, the nearest thing to the Consumption Index Number is the Cost of Living Index for wage earners. However even such an Index is not available for Egypt but instead, the general cost of Living Index and the Wholesale Prices Index can both serve our purpose at least in showing the general trend of price changes and, consequently, of the changes in the Purchasing Power of the Egyptian pound.

The large sterling balances that were accumulated by Egypt during the last world war led to a considerable increase in the quantity of circulating money unaccompanied by an increase in production. As a result, an inflationary situation emerged which was manifested by a general rise in the level of prices and a corresponding decline in the purchasing power of the pound. A review of the Wholesale Prices and Cost of Living Indices would help in estimating the rate at which purchasing power of the pound declined since 1939. Table V shows the index numbers for wholesale prices and cost of living in Egypt during the period 1949 - 55 inclusive.

TABLE V.

COST OF LIVING AND WHOLESALE PRICE INDICES
AND THE PURCHASING POWER OF
THE EGYPTIAN POUND

(June - August 1939 = 100)

End Of	Wholesale Prices	Cost of Living	Purchasing Power of LE
1939	132	108	92.6
1945	333	290	34.5
1946	316	289	34.6
1947	311	280	35.7
1948	324	282	35.5
1949	322	282	35.5
1950	376	306	32.7
1951	386	328	30.5
1952	343	296	33.8
1953	354	294	34.0
1954	342	283	35.3
1955	351	283	35.3
1956	415	297	33.7
1957	417	298	33.8

Source: National Bank of Egypt, Economic Bulletins, Vol. IX, No. 2, (1956), Vol. X, Nos. 1 & 3 (1957).
Also M.Z. Shafii, Mukadama Fil Noukoud Wal Bunuk, (Cairo: Rennaissance Librairy, 1956) p. 67.

The purchasing power of the Egyptian pound declined in 1948 to about 35 percent its pre-war level and in June 1957 that figure dropped to 34 (see table V). The cost of living index has been almost steady since 1952. It dropped in 1954 by about 4 percent and in 1956 it rose again to the 1952 level. In terms of wholesale price index, the purchasing power declined to 30 percent in 1948 and 34 percent in 1957 compared to the pre-war level.

The rise in cost of living index and of wholesale price index during the last decade was more than matched by 42 percent increase in note issue and 47 percent increase in net notes in circulation.[1] The note issue increased tremendously during the second world war as a result of large expenditures of British troops in Egypt against which British treasury bills were issued in London. This act led to a large injection of money in circulation resulting in an increase in the level of prices not matched by an increase in production.

Until July 1947, when Egypt left the sterling area, the Egyptian pound enjoyed the advantages and vicissitudes which a link with sterling meant. With the severance of this link and the blocking of Egypt's sterling balances in England, the Egyptian pound was then placed in an intricate position of an 'open currency' whose exchange value would normally be determined

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1. See table IV, Chapter I.

by the difference between the relative levels of local and foreign prices. In other words, if left free, the Egyptian pound would have marked a large decline in value viz-a-viz some other foreign currencies simply due to the wide gap that existed between the price level at home and that of abroad.[1] In view of this fact, the government resorted to various restrictive measures to maintain the value of the pound at a relatively high level.

Exchange control, which was originally set in 1939, was widened in 1947 to cover transaction with scheduled territories. Other measures of trade restrictions and control over the use of released sterling balances, were also imposed (discussed more amply in chapter IV).

As long as the natural rate remains at a lower level than the official fixed rate, the tendency of imports will continue to increase while export of Egyptian products will be hampered due to the high prices, viewed as such in foreign markets.

G. The Difficulties of Living on Exporting:

The most obvious feature of an export economy like that of Egypt is that exports and imports respectively, assume the

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1. M. Ali Rifaat, Mashakel Misr Al-Iktisadiah, (Cairo: Anglo-Egyptian Library, 1951) p.42.

roles that are played by investment and saving in an investment economy like that of the United States. Exports rather than investment are the main source of national income; and imports rather than savings represent the main leakage from the income stream.[1] As a result, the Egyptian economy tends to play a passive role in world-wide fluctuations whereby it reacts to them but does little to originate them. Moreover, fluctuations in the Egyptian economy are likely to be intensified by the perverse changes they occasion in liquidity. A favorable balance of payments, other things remaining the same, increases money supply at the same time as it raises national income. Instead of a contraction of money and credit during such periods, Egypt experiences rising internal liquidity which intensifies the booms. During the downswing, on the other hand, when the balance of payments is unfavourable, the supply of money contracts sharply which tends to aggregate the depression.

The quantity of money, therefore, is an important element in the economy of Egypt where exports and imports play a major role, because an active or passive balance of payments automatically changes the money supply. Although normally the inflow of foreign exchange creates a basis for large-scale additional bank credit expansion, yet this factor has been relative-

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1. Equally important in Egypt is fiscal policy where budgetary revenue and expenditure play a major role in affecting the level of consumption and hence national income.

ly of little importance in Egypt where banks, mostly foreign until recently, have shown themselves quite insensitive to the pressure of large reserves, with the result that excessive bank credit has not been a major cause of inflation although it remains as a potential threat.

Thus exports acquire an importance as a strategic factor in the Egyptian economy far beyond their quantitative predominance. The relative importance of exports to Egypt is considerably greater than that of investment to any capitalized investment economy. This fact indicates how heavily is Egypt dependent for its normal well-being upon two factors outside its control - first, the purchasing power of foreign countries, second, cotton prices. Foreign depressions have thus great impacts on Egypt as well as on other country producing raw materials. The structure of the economy does not readily permit a shift of productive factors away from depressed export production for the home market. Furthermore, Egypt's export economy does not, at first, lend itself easily to governmental stimulation except by the awkward method of purchasing unexportable surpluses, which has frequently been the case. Such purchases, however, add nothing of permanent value to the economy as do public works or any other sort of productive government activity. Instead, the piled up stocks are likely to depress the market and become a source of embarrassment.

Lately, however, the Government has been adopting more useful measures to stimulate cotton exports among which was the entitlement system introducing a partially free market for certain foreign currencies.[1] This system was later abolished in 1955 and a more or less similar system was set up in 1957 whereby exporters were allowed to offer discounts on cotton sales against hard currencies up to 20 percent below market price, to be covered by the premium obtained on such currencies in the internal market.[2]

Moreover, in so far as monetary and fiscal policy succeeds in raising national income, imports will rise sharply and a passive balance will develop. A successful policy of domestic stimulation may lead to an exhaustion of exchange reserves and hence confront the country with a choice between depreciation and exchange control in order to equilibrate the balance of payments. Egypt, incidentally, chose exchange control not as a result of domestic stimulation but mainly because its Sterling assets in London were blocked.

An economy that depends on exports and imports can drop much lower than one dominated chiefly by investments and savings. Although exports are less likely to go to zero than investment,

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1. See Chapter IV.
2. H. Tadros, "Recent Developments of Egypt's Balance of Payments", in the Middle East Economic Papers 1957. (Beirut: Economic Research Institute, 1957).

nevertheless, they are capable of enormous fluctuations. In this respect, an export economy like Egypt is much more unstable than an investment economy.[1]

The need for diversified economic development is therefore clearly manifested in Egypt. It has the resources to develop a variety of agricultural lines as well as numerous light industries and a few heavier industries. The missing link, however, for such a development to occur is the general low level of savings which is a normal result of the low national income and the high marginal propensity to consume. The incentives to invest are low in Egypt especially due to the fear from foreign competition. The government in this respect, can play a primary role through its monetary weapons and mechanisms, to create the necessary favorable atmosphere for investment. Monetary policy can have a far reaching effect on the economic structure of any country and the purpose of this dissertation is to analyse and isolate these effects in relation to the specific case of the Egyptian economy.

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1. Egypt's case is similar to the sugar export economy of Cuba. See Wallich, Monetary Problems of an Export Economy, (Cambridge, Massachusets: Harvard University Press, 1950) p. 211.

CHAPTER II.

THE DEVELOPMENT OF THE MONETARY SYSTEM

A. Origin of Credit Institutions:

To give a clear picture of the trend of events in the evolution of the monetary policy of Egypt, it is necessary to begin with a historical description of the main monetary institutions which constitute the basis of the present monetary policy.

The history of monetary and banking operations in Egypt dates back to the beginning of the second half of the nineteenth century, despite the fact that Egypt has been in close connections with western civilization and western ideas ever since the French Expedition. Some writers attempt to explain this peculiar situation as being a consequence of the Islamic Code which forbade lending at interest. The real explanation, however, must be sought in the relevant factors affecting the Egyptian economy at that time. The existence of government monopolies, the low financial standing of the people, and the nature of economic activity, which was based on complete dependence on agriculture, all these factors did not call for the services of deposit and commercial banks. Agricultural credit, on the other hand, was hindred by the village money lenders and by the fact that small holdings rendered such credit risky and troublesome.

With the passing of Mohamed Ali, freedom of economic and commercial enterprise became again the rule. The state monopolies, which he had established disintegrated and were replaced by concessionary companies. As a result the need for the services of banks emerged.

The early banks were mainly branches of foreign financial institutions whose primary activities were based on providing loans to the Khedive.

During a period of fifteen years (1862-1876), a huge foreign debt amounting to some £91 million was entailed by the Khedives of Egypt and accumulated in a heavy public burden.[1] Much was wasted on ostentatious or exorbitant schemes, but the bulk was spent on productive public works.

Most of this debt which was obtained at a high rate of interest, was incurred by Khedive Ismail. His interest was not merely confined to agriculture and cotton but also to industry and public works. He encouraged the plantation of sugar cane while new sugar factories were constructed in upper and lower Egypt. Moreover, a network of railways extending some 1100 miles

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1. M.A. Al-Arabi, Mabad'i Ilm Al-Maliah Al-A'mah, (Cairo: Misr Press) p. 132.

was built connecting agricultural areas with the main urban centers. With his effort too, the post office was established in Egypt and a network of telephone and electric wires was erected.[1]

The year 1875 marked the peak of monetary crisis in Egypt. Treasury bills were sold at a discount of 75 percent, and the Egyptian shares in the Suez Canal company were sold to the British Government for four million pounds sterling.

In the following year, Egypt was declared bankrupt, and henceforth started the foreign monetary and fiscal domination in Egypt. A Public Debt Fund was established and was controlled by an international committee. Its function was to assess revenue for the repayment of Egypt's debts. Moreover, the Government was not allowed to incur new debts without the prior approval of the Committee. Egyptian Debt Bills were issued, 85 percent of which were in the hands of British and French financiers.[2]

After the monetary crisis of 1876, banks diverted their activities to finance external trade and cotton, both of which constituted, as they still do to some extent today, the basis of foreign commercial dealings.

Commercial banks preceded all other types of credit institutions and by the end of the past century there were seven of

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1. Al-Ahram, Supplement, "The Industrial and Agricultural Fair 1949".
2. Al-Arabi, op.cit., p. 147.

them operating in Egypt. Three were British, two French, one Japanese; and finally the National Bank of Egypt was established in 1898 as an Egyptian Company.

The sizeable group of large and small banks that existed in Egypt before 1939 did not form a cohesive banking system and operated practically without any sort of legal control. Commercial banks had practically no other business than the financing of cotton and external trade. Their main business was concentrated during the few months of the cotton season and for the rest of the year the banks' funds were repatriated. Another characteristic of the early banks is that they were completely dependent on foreign sources of funds instead of on local sources which were lacking. These banks were dependent on borrowings from abroad and in particular for the London Money Market.

The weakness of the commercial banking system of Egypt was clearly realized as a result of World War I during which the foreign banks, being directly affected by the economic conditions in their respective home countries, stopped their loan advances during the cotton seasons.

The lack of unified effort to remedy this situation was immediately felt in Egypt and led to a widespread feeling of the necessity of establishing Egyptian banking institutions with Egyptian capital and under Egyptian control. As a result "Bank

Misr" was created in 1920 with a total paid-up capital of LE 80,000 which was eventually increased to one million Egyptian pounds in 1927. This national institution is the first of its kind to have appeared on the financial scene of Egypt. It soon became a dominant factor cutting deep into the business activity of foreign banks and took initiative in creating and financing local industrial enterprises.

The number of banks increased during the inter-war period. Besides Bank Misr, four other commercial banks were established in the 1920's. These banks were incorporated in Egypt but were financed and controlled from abroad.

In 1925, the Anglo-Egyptian bank was absorbed by Barclay's Bank, and the Egyptian branches of Lloyds Bank were absorbed by the National Bank of Egypt. By the end of 1928, clearing houses were started in Cairo, and a few months later in Alexandria, through the initiative of the National Bank of Egypt. "The business passing through these institutions tended to increase, but the tendency has been veiled, though not altogether reversed, by the effects of the depression".[1] The habit of using the cheque as a means of payment gradually developed as a post-war phenomenon.

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1. Vide, "Banking in Egypt", <u>Economist</u>, (October 14, 1933), p. 19.

The banks affiliated to the clearing house comprised six Egyptian banks, i.e. banks incorporated under Egyptian Law, two British, two French, one German, two Greek, one Japanese, and one Turkish.[1]

The relative importance of banks has changed considerably since 1939. This is mainly due to the growth of indigenous banking and the impact of certain political events which resulted in the disappearance of some foreign banks such as the Yokohama Specie and the Dredsner Banks, and the reduced scope of activity of Italian banks which were long under sequestration.

Two new commercial banks were established in Egypt under the new revolutionary regine since 1952. The first of these banks is the Goumhouria Bank which started operating by the end of 1956 with a paid up capital of half a million pounds, 25 percent of which was contributed by the Government.[2] The second new bank is the Bank of Alexandria which was recently established by the Economic Organization for the purpose of taking over the activities of the Barclays Bank as a result of the Egyptianization law.

At the time of Egyptianization there were a total of 32 banks operating in Egypt of which 19 were branches or

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1. "Banking in Egypt", op.cit., p. 20.

2. National Bank of Egypt, Economic Bulletin, Vol. VIII, No. 3, (1955), p. 290.

affiliates of foreign banks. Of the remaining thirteen Egyptian banks six are small concerns of almost no significance. Clearing banks, besides the National Bank, were eleven and no other banks were allowed to become members thereof before they fulfill certain conditions regarding period of existence, capital and turnover. Among the clearing banks, only two, namely Misr Bank and the Import and Export Bank are purely Egyptian besides the National Bank.

Early in 1957, all banks operating in Egypt were Egyptianized whereby they were required by law to take the form of Egyptian Joint Stock companies with nominative shares to be held by Egyptian subjects. British and French banks were immediately put under sequestration while all other banks were given a maximum delay period of five years to comply with the regulations of the new legislation.[1]

B. <u>The Historical Development of the National Bank of Egypt</u>:

In June 1898, a Khedival decree was promulgated by which a Britisher and two local residents were authorized to establish an Egyptian company by the name of the National Bank of Egypt, (hereafter referred to as NBE) and were given, a concessionary right for a period of fifty years expiring in June 1948. The original capital of this company was one million Egyptian pounds

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1. See the section of the Egyptianization of banks in chapter III.

half of which was subscribed by the Britisher and the remaining half was equally subscribed by his two associates.

Although the head office of NBE was in Cairo, final control was exercised in London where a Committee was set up to approve all the important decisions of the Cairo Board.

The NBE was given the sole power to issue banknotes, make advances to cultivators and the central Government, make advances on securities, discount bills, accept deposits, and in general to conduct all commercial, financial, and industrial banking business in Egypt and the Sudan.

Thus, since its establishment, NBE was the central bank of Egypt "de facto". It was granted the monopoly of note issue and at the same time it was allowed to engage in all banking operations except in real estate. However, these two distinct practices were separated into two independent departments within the Bank.

Although NBE served the country's interests in one way or another, yet it had always the benefit of its shareholders as its guiding principle.

At the time when Britain abandoned the Gold Standard in 1931 and the world was just recovering from the Great Depression, the Government of Egypt realized that it was time to have a central bank which would entirely be guided by the country's interests. As a result, the Government started negotiations with NBE which lasted for several years until finally an agreement was reached in 1939 by which the note issue right to NBE was extended for another forty years and the basic law of the Bank was amended to provide for an Egyptian majority in its Board of Directors. Moreover, the shares of the Bank were to be transformed after June 1948 (date of expiration of the concessionary right) into nominal ones. The Bank undertook to limit its commercial activities to big operations only, but continued acting as the Government bank by advancing short term loans to the Government at a reduced rate of interest; however, such loans could not exceed the limit of LE 2 million. Finally, new legislation was to be issued to enable NBE to undertake additional central banking activities; such as supervising the activities of other credit institutions and obliging them to place part of their assets with NBE.

Egypt remained without a de jure central bank until the year 1951 when NBE was 'centralized' by decree number 57. By that decree the bank was to extend its scope of control over other banks, regulate money supply, and in general to act as the official instrument for carrying out Monetary Policy.

The relations between clearing banks and NBE, with respect to internal business, were more or less those between competitors. It was hardly realized that in view of its banknote privilege NBE represented the ultimate cash reserve for other banks. By the end of 1938, the total banks' deposits with NBE amounted to LE 608,000; they rose to over 45 million by the end of 1956.[1] NBE provided practically no advance or discount facilities to banks. Their usual means to obtain the necessary cash in Egyptian pounds was to place at the disposal of NBE sterling balances in London against which Egyptian banknotes were automatically issued in Cairo.

A new situation developed as Egypt left the Sterling Area in 1947. Free transfers of funds outside Egypt ceased and foreign exchange transactions became subject to control. As a result, the existing de facto link between the Egyptian pound and sterling came to an end while the automatic flow of money between Cairo and London ceased. Consequently, NBE had to provide for the seasonal financing of external trade needs thus assuming another central banking function.

The evolution of the National Bank of Egypt during a period of fifty years finally culminated in its transformation into the State's Central Bank. The Bank's scope of activity in its two departments, namely, the Issue and the Banking Depart-

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1. National Bank of Egypt, Economic Bulletin, Vol. IX, No. 4, 1956.

ments, has marked a worthy increase ever since its centralization. However, the desired end has not yet been achieved. The basic demerit of NBE still lies in its Banking Department which maintains direct relations with the private sector. As a result, commercial banks continue to view NBE as a competitor rather than as their lender of last resort. The NBE balance sheet for September 1957 shows that total assets or liabilities pertaining to individual clients amounted to some LE 50 million which constitutes approximately 25 percent of the total liabilities of the bank.[1]

C. The Development of the Currency System:

Early in the nineteenth century the circulating currency consisted of gold and silver coins. In 1836 Mohamed Ali minted new silver coins based on the Egyptian piaster. Smaller divisions of the new currency were also minted to facilitate retail trade and maintain stability in the home trade situation. During Ismail, the currency was in its worst condition mainly due to the shortage of coins required for circulation and also due to their bad minting. As a result, foreign currencies spread in Egypt and the British pound was the most popular currency used because of its firm international position and of the high value of its gold content. The large foreign debt incurred by Ismail had its great repercussions on the Egyptian economy as a whole

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1. The Egyptian Economic and Political Review, Vol. 4, No. 3, February 1958, p. 46.

and on the currency system in particular. The debt installments had to be paid in good and sound currencies, thus leaving in the country the bad currencies.

In 1881, a Special Currency Committee was appointed to study the existing currency system of Egypt and give its recommendations as to the possible means of reforming it. In 1885 a Supreme Order put into effect the recommendations of the Committee which consisted of three main issues. First, the Egyptian pound was fixed as the unit of account; second, the gold content of the pound was fixed at 8.5 grams; third, power was delegated to the Minister of Finance to appoint any currency for use in circulation during the transitional period until a sufficient quantity of the Egyptian gold pounds was minted.

The currency reform of 1885, therefore, may be considered as the starting point from which the currency system emerged and developed to its present stage. The reform established a metallic gold standard which replaced the bimetallic system in operation since 1834.

In 1887, the Minister of Finance restricted circulation to the British gold pound, the twenty - French - Franc piece,[1] and the Majidi gold pound. Moreover, the Minister fixed the official rate of exchange between these currencies and the

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1. Napoleon's face.

Egyptian pound at a lower level than that of their real metallic value. Consequently, the Egyptian pound was viewed as the worst, in terms of real metallic value, viz-a-viz other foreign currencies. As a result, it was expected that the Egyptian pound would drive all other foreign currencies out of circulation as soon as a sufficient quantity of it was put in circulation.[1]

For some reason, the required quantity of Egyptian gold pounds was not issued. Moreover, the difference between the nominal and the real metallic value of the sterling pound was the least in relation to that of other currencies. As a result, the sterling pound was valued as the worst currency among those actually existing in circulation (at least it seemed to be the worst relative to other currencies). Thus, the sterling pound took over the role which the Egyptian pound was supposed to take, of driving the other foreign currencies out of circulation, and thereby becoming the most circulating coin in Egypt by the end of last century.[2]

Paper money was practically unknown in Egypt prior to the establishment of NBE which was granted exclusive privilege of issuing banknotes. This incident marked the beginning of the usage of paper money in Egypt. However, paper money was not popular before the First World War. Up till 1914 the total notes

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1. According to Grasham's Law which says that bad money drives good money out of circulation.
2. Jad Labib, Bina Al-Iktisad Al-Masri, (Cairo: Anglo-Egyptian Library 1954), p. 15.

that circulated in Egypt and Sudan amounted to only LE 2.7 million. A great deal of local business was still carried by means of gold which was periodically imported from abroad to finance the crop season. Most of the imported gold was usually repatriated at the end of the season in the financing of imports.

The right of NBE to issue banknotes was limited by requiring it to keep half the cover in gold and the other half in approved securities. The notes were not yet legal tender; they were redeemable in gold on demand, and were acceptable by the Treasury in unlimited amounts.

By and by, people became accustomed to the use of paper money. At the outbreak of the First World War, an obvious consequence was that banks, which were branches of foreign credit institutions, were directly and instantaneously affected by home conditions. Short-term funds were repatriated and gold imports became unreliable in view of the war situation in Europe. On the other hand, creditors pressed on their loans and depositors rushed on banks to draw their balances. Consequently, the Government declared a temporary moratorium and on the 2nd of August, 1914, NBE notes were declared legal tender thus relieving the Bank from the obligation to redeem its notes in gold. The 50 percent gold-cover was maintained and the Government provided Treasury bonds to cover the fiduciary issue.

The Government had authorized NBE to deposit the gold at the Bank of England. In 1916, the latter informed NBE that its Egyptian gold balance was transformed into British Teasury bonds and bills to be used as a backing for the Egyptian banknote instead of gold. In other words, Sterling came to be used as a substitute for gold. There was no obligation to convert Egyptian notes into sterling but a gentlemen's unsigned agreement between NBE and other banks provided for the transfer to and from London of sums exceeding LE 50,000. Banks wishing to transfer money to Egypt paid in sterling to the NBE agent in London who exchanged them for British Treasury Bills which in turn were deposited as cover against the new issue. The Issue Department of NBE could then expand the note issue by an amount equivalent to that paid in sterling to its agent in London. Conversely, a transfer from Egypt to London involved a contraction of the note issue.

As a result, Egypt came to be virtually on a Sterling Exchange Standard with no obstacles whatsoever on the movement of funds between Egypt and London. The Egyptian pound lost its independence and became tied up with sterling until 1947. A rise in the value of sterling automatically led to a rise in the value of the Egyptian pound and, conversely, a fall in the value of sterling led to a fall in the value of the Egyptian pound.

Hence, British monetary policy had its immediate repercussions on Egypt's economic and, particularly, financial conditions. "As prices in Britain rose or fell, so did the Egyptian prices, not necessarily in exact proportion, but in such a manner as to keep the price structure of the two countries in equilibrium."[1] See tables VI & VII.

TABLE VI.

Wholesale Price Index in Britain	
1867 - 1876	= 100
1914	- 82.4
1915	= 113.1
1916	= 154.3
1917	= 185.1
1918	= 196.0

Source: Mohamed Ali Rifaat, Monetary System of Egypt. (London: Allen and Unwin, 1935), p. 65.

TABLE VII.

Wholesale Price Index in Egypt

Year	Index
1913 - 1914	100
1915	115
1916	152
1917	199
1918	212

Source: National Bank of Egypt. 1898 - 1948 (Cairo: NBE Press, 1948).

1. Rifaat, op.cit., p. 69.

The note issue increased tremendously during the First World War. By the end of 1919, the total notes in circulation amounted to LE 63 million and constituted about 93 percent of total note issue (see table below). After 1919, the notes in circulation declined relatively and averaged 35 million during the twenties.[1]

TABLE VIII.

NOTE ISSUE, NOTE CIRCULATION AND GOLD RESERVES

1913 - 1919

(in 000's)

Year	Note Issue	Circulation	Gold
1913	2,700	2,236	1,350
1914	8,250	7,466	4,330
1915	11,550	10,583	7,130
1916	21,200	19,374	5,930
1917	30,800	29,552	3,860
1918	46,000	44,490	3,310
1919	67,300	62,820	3,330

Source: National Bank of Egypt, Golden Jubilee book 1898 - 1948 (Cairo: NBE Press, 1948), p. 130; also: M.Z. Shafii, Mukadama Fil Nukud Wal Bunuk, (Cairo: Renaissance Library, 1956) ed. 3, p. 130.

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1. See: NBE Golden Jubilee Book 1898-1948, (Cairo: NBE press, 1948) p. 130.

When Britain returned to the Gold Standard in 1925, from which it had parted at the outbreak of the war, Egypt by the same measure returned to gold. In 1931, Britain parted again from the Gold standard while Egypt continued its link with Sterling for otherwise, NBE would have incurred great losses in its Sterling reserves due to the depreciation of Sterling pound in relation to gold. Besides, the independence of the Egyptian pound at that time would have endangered cotton exports to Britain whereby cotton prices would have appeared high to the British importers. As a result, Egypt had no alternative but to join the Sterling Area which was established in 1931.

The currency inflated further during the second war, caused by the huge expenditures of allied troops in Egypt. Large Sterling balances were accumulated by Egypt in London against which Egyptian banknotes were issued. After the war, the note circulation continued to increase reflecting an increased business activity during the last decade. By the end of 1956 the note issue amounted to 233 million pounds compared to 164 million in 1948. Net circulation amounted during the same period in 1956 to 215 million compared to 146 million by the end of 1948. (see table IX)

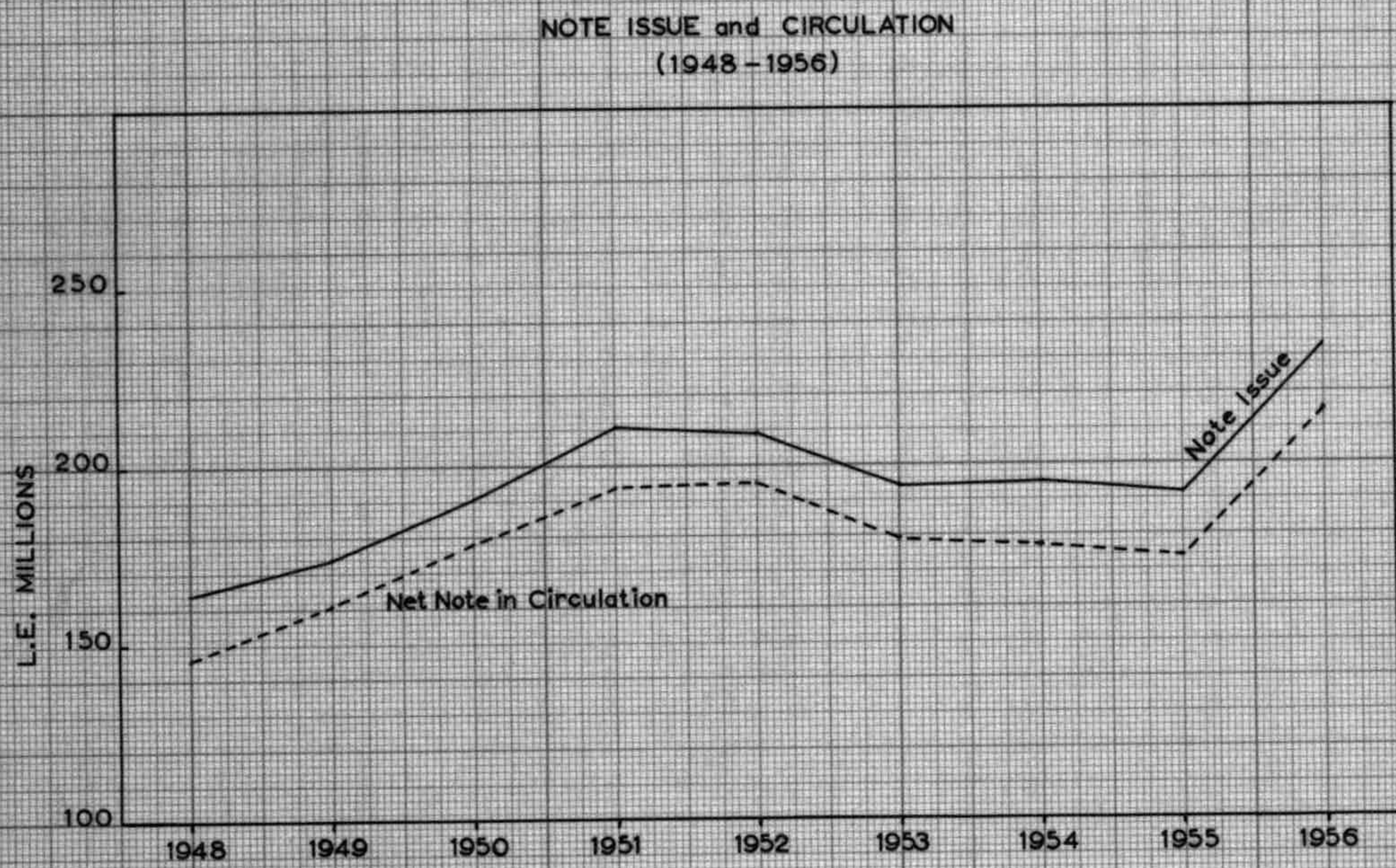
TABLE IX.

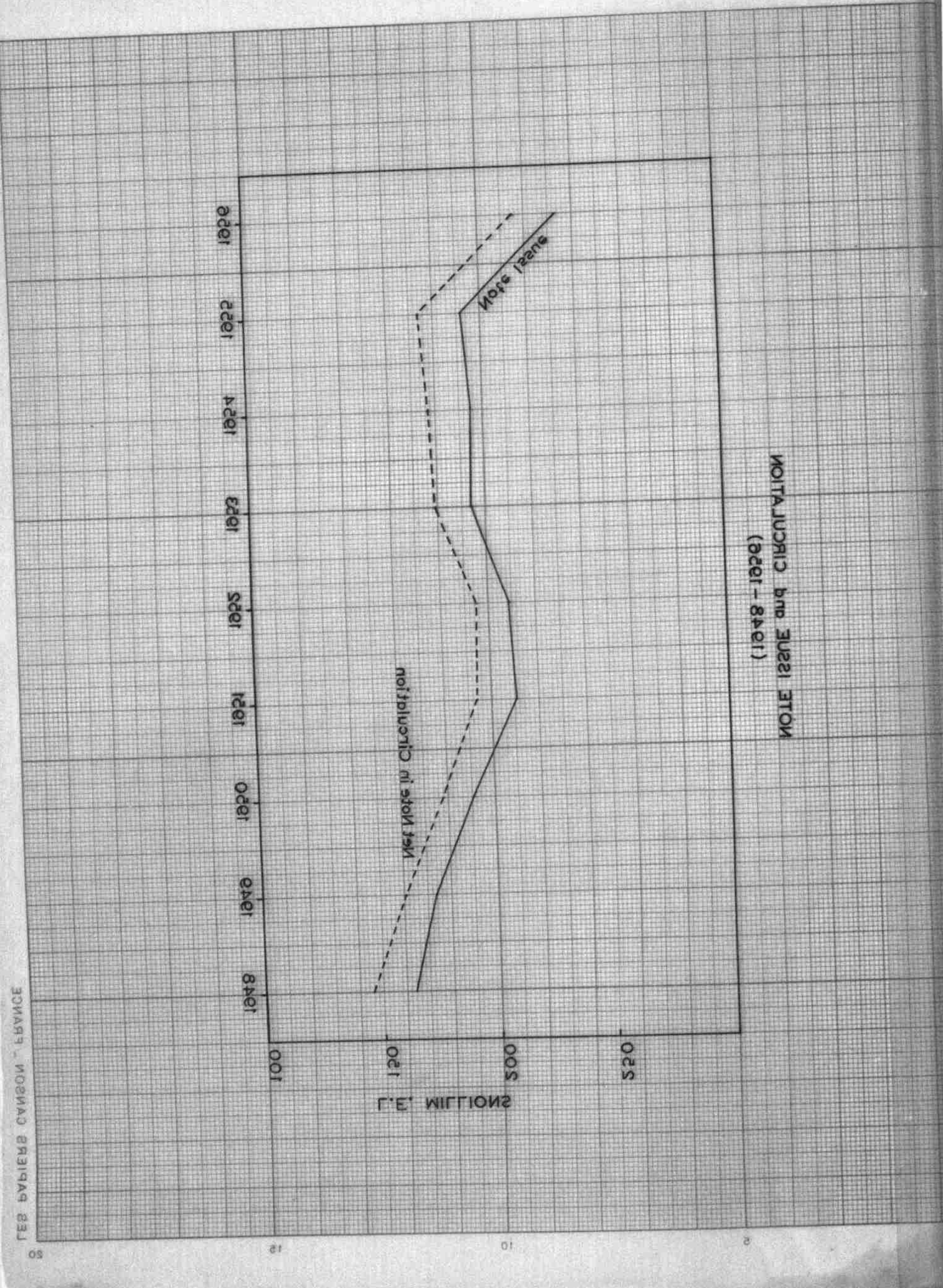
Note Issue and Circulation (1948-1956) in LE Mill.

End of:	Note Issue	Net Circulation
1948	164	146
1949	174	161
1950	191	178
1951	211	194
1952	209	195
1953	194	179
1954	195	177
1955	192	174
1956	233	215

Source: National Bank of Egypt, Economic Bulletins, Vol. VI - X. Also, A.N. Cumberbatch, Egypt, (London: HM's Stationary Office, 1952) p. 25.

British Treasury Bills continued to be used as cover for the Egyptian currency instead of gold until 1948, when law No. 119 was issue providing that all new increases in the note issue must be covered by Egyptian Treasury bills in respect of the portion of the issue which must be covered by gold, and by Egyptian Government securities, or by Egyptian securities guaranteed by the Government, or by bills of the Egyptian Treasury, in respect of the portion of the issue which must be covered by securities. Moreover, the Government was authorised to issue LE 50 million in Treasury bills. This amount proved inadequate to meet the rise in demand for money to finance cotton at the very high prices then


NOTE ISSUE and CIRCULATION
(1948 - 1956)
L.E. MILLIONS
250
200
150
100
1948
1949
1950
1951
1952
1953
1954
1955
1956
Note Issue
Net Note in Circulation



NOTE ISSUE and CIRCULATION
(1948 - 1956)
L.E. MILLIONS
100
150
200
250
1948
1949
1950
1951
1952
1953
1954
1955
1956
Note Issue
Net Note in Circulation
LES PAPIERS CANSON - FRANCE

prevailing, and as a result, the figure was raised to LE 100 million in November 1950.[1]

In February 1957, the law governing the maintenance of cover for the Egyptian note issue was revised to include Egyptian securities guaranteed by Government and commercial bills acceptable for discount.[2]

By November 1956, the gold cover amounted to 67 million pounds, constituting about 37 percent of the total note issue and 33 percent of net circulation.[3]

D. Credit Polity and the Financing of Cotton:

There was a time, not long ago, when no other business was available for a banker than the financing of foreign trade in which interested countries were represented by branch offices of their banks. Banks have always been eager to lend against cotton, Egypt's most important of all crops, especially that it can easily be graded and does not deteriorate. Exporting firms, also, have always been ready to advance to farmers the necessary funds for cultivation in return for a lien on the future crop.

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1. See law number 176 of 1950.

2. Egyptian Economic and Political Review, March 1957. Also, IMF, International Financial News Survey, Vol. X, No. 3, July 19, 1957.

3. Al-Ahram, Cairo, Arabic daily, 23 October, 1956.

These firms in turn often borrowed from banks so that the rate of interest charged to farmers was relatively high. The bulk of farm credit requirements, however, was supplied by the village usurers who charged very high rates reaching 30 or even 40 percent p.a.[1]

The main business of banks, therefore, was concentrated during the few months of the cotton season. In view of the nature and structure of the banking system, commercial banks used to finance their business through imports of gold pounds mainly from London and on periodical basis. Most of that gold was repatriated during summer in settlement of payments for imports.

The National Bank was also involved in that kind of commercial business and in addition it was acting as a conveyor of gold and, later, of funds into and out of Egypt. NBE did not, therefore, take active part in directing the monetary policy of the country. In fact, the relations between other banks and NBE were more or less those between competitors. It was hardly realised that NBE represented the ultimate cash reserve for other banks.

Besides this active cotton and trade financing business of banks, there was a rather lucrative deposit business available

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1. C. Issawi, Egypt at Mid-Century, (London: Oxford University Press, 1954) p. 221.

to foreign banks. The deposit rates were very low and in many cases were zero.

The seasonal gold movement into and out of Egypt was impeded by the first world war when foreign banks were much affected by conditions in their home countries. As a result, all banks ceased to finance cotton operations. That critical situation was to some extent cured by NBE which was then given power to extend government guaranteed loans to small farmers, aside from loans usually given to big cultivators.

Immediately after the war, the value of cotton exports increased tremendously due to the rise in world demand for cotton.[1] The period of boom resulting from the rising cotton prices, ended in 1921, and was followed by a depression in Egypt as well as in many other countries. As a result, cotton prices fell by about 60 percent.[2] During the same year, the Government asked NBE to extend advances to cotton growers against Government guarantee up to the amount of one million pounds. Meanwhile, the Government started buying stocks of cotton in order to lift up its price. In 1926, prices fell again and Government resorted back to its loan policy whereby funds were advanced to enable them to hold on their cotton stocks, thus at least arti-

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1. Total value of cotton exports in 1919/20 amounted to LE 105m. compared to LE 38m. in 1918/19.
2. The fall in price of cotton was form 87 Rials to 34 Rials per Kantar.

ficially restricting supply. The Government also granted financial assistance to cooperatives for the same purpose.

The cotton financing policy of the Government since 1943 consists of obtaining the required funds through a public debt whereby treasury bonds and bills are offered in the market at a fixed rate of 4.5 percent. The belief was that such borrowings would absorb idle funds in the country and fill in the gap that existed in the Egyptian money market. Public borrowing was preferred to excess note-issue because the latter was limited by a fifty percent cover of British Treasury bills and besides, it might lead to inflation.

E. Monetary Policy and British Domination:

The main feature of Egypt's Monetary System that prevailed during a period of seventy years is its innate dependence on British monetary policy. Various economic, political, and even historic factors have led to this situation. The Egyptian economy, which was entirely based on cotton exports to Britain, was structurally subjugated to British economic conditions. Similarly, the monetary system of Egypt was dominated by British monetary policy.

Egypt's great indebtedness to Britain during the second half of the nineteenth century marked the beginning of British monetary domination. Moreover, Britain occupied a unique place among Egypt's customers for cotton exports. As a result, Britain's demand for Egyptian cotton had direct effects on Egypt's Balance of Payments conditions, its national income, note issue and finally its internal prices.

The early banking institutions were of foreign nationalities, mainly British and French. When they first started operating in Egypt, their ultimate job consisted of providing loans to the Khedives. Later on, banks shifted their activities towards the financing of cotton and foreign trade. These banks were dependent on foreign sources of funds for financing cotton. At the end of the cotton season these funds were repatriated in payment for Egyptian imports. There was a shortage of local funds manifested by the low level of private savings. As a result, Egypt's monetary system was directly dependent on foreign sources of funds, particularly from the London money market. With the establishment of Bank Misr in 1921, a new era began in the historical development of Egypt's monetary system. During the last two or three decades, new national credit institutions were established with Egyptian capital and under Egyptian control. Private deposits in banks increased and the banks' activities were directed to assist the basic needs of the economy.

Although Egypt became a member of the Sterling area in 1931, yet it had acquired all the requirements for membership long before that date. Since 1916, when Egypt abandoned the gold standard and replaced it by a sterling exchange system, the rate of exchange between the Egyptian pound and sterling had been fixed. This arrangement repelled Egypt from the possible advantages of a stable rate of exchange viz-a-viz other foreign currencies. The exchange rates of the Egyptian pound were subject to the fluctuations of the sterling.

A further characteristic of the early monetary system is manifested in the lack of a Central Bank. Egypt remained without such a bank until the year 1951. The various banks that operated in Egypt did not form a cohesive banking system and operated practically without any legal control. Although NBE assumed several central banking functions ever since its establishment, however, it was above all like all other foreign banks, guided by the interests of its shareholders. In fact, NBE lacked as it still lacks to-day, the most important central banking weapon which consists of regulating money supply and stabilizing the value of the Egyptian pound. With respect to the latter weapon, NBE had no control whatsoever; the Egyptian pound fluctuated in the same direction as the Sterling.

Since 1947, the date of Egypt's departure from the Scheduled Territories, the monetary system of Egypt has undergone a tremendous change. Government efforts have been more and more directed towards the development of an independent national monetary system which is guided by the basic needs for economic development. An analysis of this system follows.

CHAPTER III.

MONETARY & BANKING SYSTEMS

A. Banking Legislation in Egypt:

Until recently, there was no specific law regulating banking operations in Egypt. Banks that were in the form of a company were subject to the Company Law; those that were in the form of the individual type of business were subject to the Commercial Code. The only specific banking statute, prior to the Egyptianization decrees of 1957 and Law No. 163 of 1957, is Law No. 57 of 1951 promulgated in connection with the creation of the Central Bank. This law which outlines the functions of the Central Bank includes three articles that directly concern commercial banks. Article 19 of this law requires from all commercial banks operating in Egypt to maintain with the Central Bank a creditor account bearing no interest and representing a certain proportion of their deposits; that proportion was to be fixed by the Supreme Committee for Money and Credit. Article 20 of the same law stipulates that banks must maintain permanently liquid funds of specified nature and of fixed proportion to total deposits. Finally article 21 requires every bank to submit to the Central Bank any information requested by it provided that such an act does not comport the revealing of specific clients' accounts.[1] A commercial bank in this connection is defined as any person, physical or juristic, whose main activity is the acceptance from the public of deposits payable on demand or on a fixed date.[2]

The proportion of banks' deposits with the National Bank to total deposits was initially fixed at 15 percent. It was reduced to 12.5 percent before the beginning of the cotton season of 1954/55 in an attempt to alleviate the tight position in which banks found themselves at that time. This ratio was maintained until November 1957 when it was reduced further to 7½ percent.

The reserve ratio requirement in Egypt differs from similar legislation in other countries. The Central Bank Law No. 57 of 1951 provided for a reserve ratio requirement rather than a cash ratio, where only non-interest bearing balances with NBE are to form a certain percentage of deposits. These balances include cheques and drafts, correspondents and all kinds of deposits. This same requirement is provided in the new legislation No. 163 of 1957.[3] Moreover, this reserve ratio is uniform

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1. Article 22 provides for a maximum fine of £.1000 on any infraction of the propositions of the above three articles. See: "Banks & Banking in Egypt", Egyptian Economic & Political Review, Vol. 1, No. 7, March 1955.
2. Law 57/1951, article 19.
3. See law No. 57 of 1951 and law No. 163 of 1957 in the Egyptian official gazette.

for all kinds of deposits without any differentiation between time and sight deposits.[1] Deposits in foreign currencies are in practice not included in the calculation of the reserve ratio since these deposits are fully covered by corresponding foreign exchange assets.

The most recent banking and monetary legislation is Law No. 163 of July 13, 1957, which embodies in its 65 articles the trends of the new monetary and banking policy as officially adopted by the State. The new law is divided into two major parts, the first deals with the Central Bank, commercial banks and other banks, and the second covers credit control. The National Bank is to pursue a banking and credit policy in accordance with the general plans of the Government with a view to reinforcing the national economy and stabilizing the currency (article 1). NBE, which remains the Central Bank of the State, shall continue also to act as the Government Banker and shall render such services free of charge, and may with the approval of its Board, undertake similar banking operations for public entities.[2] Moreover, NBE shall manage the public debt on behalf of the Government and shall tender its advice to the latter before the floatation of local or foreign loans (article 14). In general, the new law authorizes NBE to regulate the availability and

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1. Usually in some countries, the reserve requirements against time deposits are 1/3 of the ratio for demand deposits.

2. NBE, Economic Bulletin, Vol. X, No. 3, 1957, p. 249. See also: Article 13 of Law 163/1957.

cost of credit in such a way that real requirements of commercial, industrial and agricultural sectors are met; to lessen economic and financial disturbances; to control banking institutions and manage the gold and foreign exchange reserves.

The main objectives of the new law are to organize the banking business and provide general regulations for the supervision and control of banks and finally, to control credit in the country. All banks, by this law, must be registered with the Central Bank; registration may be abrogated in certain cases such as the non-conformity with this law or the adoption of a policy which is detrimental to the public interest.

A bank is required to keep in Egypt assets equal at least to its liabilities in respect of its creditors in Egypt as well as an amount equal to the paid-up-capital. The accounts of a bank must be examined by two auditors who must certify that the operations of the bank do not run counter to the provisions of this law or of its executive regulations.

The Central Bank is to lay down the general regulations for the control and supervision of banks and a special department for Bank Control was established for the purpose. Banks are required to supply the Central Bank with any information deemed necessary, and the books and registers of a bank may be inspected by the Central Bank, when necessary, with the approval of the Minister of Finance and Economy. Commercial banks must abstain from issuing notes payable on demand and from accepting their own shares as collateral for advances. A commercial bank cannot own shares representing more than 25 percent of the paid-up-capital of any joint stock company provided that the sum of the nominal value of these shares does not exceed the paid-up-capital and the reserves of the bank.[1]

The second part of the law which consists of eight articles (48-55) deals with credit control. The Central Bank is allowed to give advances to banks at rates which shall be fixed by the Board of Directors of NBE. In case of a financial disturbance or of an emergency, the Central Bank may grant exceptional loans to banks against the collateral of any of their assets and in accordance with the conditions laid down by the Board. The Central Bank's commercial operations are to be determined by the Minister of Finance and Economy in joint agreement with the Bank. Finally, the Central Bank may undertake open market operations in order to regulate the volume of credit in accordance with the monetary and credit policy.

A Central Department for the Collection of Credit Statistics was created by article 53 of Law 163, whereby banks and other institutions specified by the Minister of Finance and

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1. See Law 163 of 1957, article 39d.

Economy have to supply information on the position of every client enjoying credit facilities exceeding the limit established by the Central Bank.

Thus it will be observed that the above new legislation has widened the controlling power of the Ministry of Finance over the Central Bank while, at the same time, the control of banks has now been concentrated in the Central Bank. The new powers granted to the Central Bank for obtaining information concerning the operations of all banks, are an important feature of the new law whereby the Central Bank will at any time have a complete picture of the credit situation. The law maintains for banks the principle of complete Egyptianization and in general, provides the necessary legal basis for an efficiently controlled national banking system.

B. <u>Banking Activity and Credit Policy</u>:

The banking system of Egypt can be divided into four groups: The Central Bank, Clearing Banks, non-clearing banks and finally all other credit institutions whose main activity is not the 'acceptance of deposits from the public'.[1]

There are at present twenty-eight commercial banks in

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1. Article 38 of Law 163/1957 defines a commercial bank as an institution accepting demand deposits or time deposits payable within one year.

Egypt twelve of which are members of the Clearing House. Prior to Egyptianization there were thirty two commercial banks of which only thirteen were Egyptian and the remaining nineteen were branches or offsprings of foreign institutions.

Banking activity in Egypt has marked an increase during the last decade as compared to the pre-war situation. Total assets of commercial banks in Egypt have risen from approximately LE 195 million in 1952 to about LE 277 million by the end of 1956, marking an increase of 42 percent over a period of five years (see table X). More than 90 percent of commercial banking activity in Egypt is undertaken by the clearing banks. Total deposits in all commercial banks in Egypt amounted to approximately LE 195 million at the end of 1956 compared to LE 145 million at the end of 1948 and to approximately LE 40 million at the end of 1938.[1] Loans and advances on the other hand, increased from about LE 15 million in 1938 to LE 69 million in 1948 and to LE 143 million at the end of 1956.

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1. NBE, Economic Bulletin, Vol. VII No. 1 (1954) Arabic Edition; Vol. X No. 1 (1957) English Edition.

TABLE X.

AGGREGATE BALANCE SHEET OF COMMERCIAL BANKS

IN EGYPT

in LE 000's

End of	1952	1953	1954	1955	1956
ASSETS					
1) Cash	7,161	5,877	5,924	6,242	6,818
2) Balance with N.B.E.	35,032	36,754	31,999	43,601	39,953
3) Other items of cash nature	521	685	1,338	1,067	1,337
4) Bills discounted	10,880	12,733	17,681	20,729	22,779
5) Investments & securities	17,086	16,893	19,017	19,872	28,766
6) Correspondents	16,283	18,580	21,793	16,944	20,941
7) Loans and advances	102,741	101,872	126,707	126,829	142,946
8) Other assets	5,538	5,764	5,643	10,281	13,162
LIABILITIES					
9) Paid-up-capital	8,347	8,425	8,606	10,031	11,051
10) Reserve funds & undivided profits	9,367	9,012	10,669	10,580	11,389
11) Cheques, drafts, outstanding	1,368	1,368	1,594	1,395	2,311
12) Correspondents	7,034	8,149	12,150	11,428	19,803
13) Current deposits	115,985	109,891	121,386	127,533	139,730
14) Time, saving, other deposits	38,391	46,657	52,870	55,291	55,444
15) Borrowings	4,667	4,317	13,040	12,000	18,530
16) Other liabilities	10,082	11,337	9,786	16,767	18,444
TOTAL ASSETS OR LIABILITIES	195,241	199,157	230,102	245,565	276,701
CONTINGENT LIABILITIES	46,181	47,220	60,719	82,254	100,092
RESERVE RATIO % $\frac{(2) \times 100}{(11)\times(12)\times(13)\times(14)}$	21.5	22.1	17.0	22.2	18.4

Source: National Bank of Egypt, Economic Bulletins, Vol. VI, 1953; Vol. VII, 1954, p. 216; Vol. IX, No. 2, 1956; Vol. X, No. 1, p. 57.

The total amount of bills discounted by commercial banks more than doubled during the last five years. Moreover, the amount of investments and securities held by commercial banks increased by about 70 percent during the same period.

Cash holdings of commercial banks show pronounced seasonal variations and the ratio of cash to deposits falls steeply during the early stages of the cotton season (see table XI). From December - January and onward the ratio of cash to deposits rises steadily reaching the seasonal maximum in July/August. The drain on cash holdings during the cotton season is mainly due to the preference of small farmers and dealers for banknotes and their reluctance to accept cheques or other banking instruments. In order to replenish their cash reserves some banks borrow from NBE against Government security bills or against cotton. Thus, the volume of Bank's advances rises in the autumn of every year and remains high until the month of January. With the repatriation of exports proceeds, loan repayments to banks exceed new loans with the result that Banks' advances decline steadily reaching the lowest level in the middle of summer.

TABLE XI.

SEASONALITY OF CASH - DEPOSITS[x] RATIO OF COMMERCIAL BANKS IN EGYPT (1955 - 1956)

(in £1,000's)

	End of 1955			End of 1956		
	Cash	Deposits	Ratio	Cash	Deposits	Ratio
January	32781	168,653	19.4%	46879	184,638	25.4%
February	31934	166.165	19.2%	43252	181,025	23.8%
March	32366	163,617	19.8%	47228	186,139	20.5%
April	34233	163,435	20.9%	39737	182,110	21,8%
May	37148	161,226	23.0%	43452	183,057	23.7%
June	40001	160,803	24,9%	44294	186,733	23.7%
July	45680	164,620	27.7%	45746	188,450	24.3%
August	49941	167,526	29.8%	53247	183,942	28.9%
September	45154	166,748	27.1%	42505	185,019	22.9%
October	40767	171,372	23.8%	40451	191,116	21.2%
November	38559	177,162	21,8%	42248	183,141	23.1%
December	49843	182,824	27.3%	46771	195,174	23.9%

Source: N.B.E. Economic Bulletin: Vol. X, No. 1, (1957), p. 70; Vol. IX, No. 2 (1956), p. 195.

[x] Remark: Deposits include current deposits plus time, savings and other deposits. Cash includes balances of Commercial Banks with the National Bank of Egypt.

The increased liquidity of banks is one of the most noteworthy developments of the banking structure in Egypt. This increase in liquidity is mainly a direct result of exchange control and the cessation of seasonal movement of funds into and out of the country since 1947 when Egypt left the Sterling Area and established exchange control. Prior to that date, funds were moving regularly out of Egypt during the first seven months of each year and were flowing in again from August till the last month of the year for the financing of the cotton crop. As a result, there was no need for banks to maintain large liquid reserves. Now, as the full movement of funds has been stopped and has been accompanied by a considerable increase in banks deposits during the last decade, these banks are maintaining high liquid reserves during almost two-thirds of the year while during the remaining part of the year their liquidity relatively decreases when reserves are used to finance the cotton harvesting and export.

Large reserves above the legal minimum are not usual except during the slack months of April to July. Even then only few banks can boast large reserves. During the months of November to February banks maintain their legal minimum reserve requirements only by obtaining facility from the Central Bank.

The spot assets of all banks amounted to a total of LE 210 million in 1956 compared to LE 272 million in 1952 and to

LE 364 million in 1948. The sum of banks' assets has been falling during the last decade caused mainly by the decrease in the "number two Egyptian accounts" which consititute the blocked Egyptian balances in England and which are the subject of the Anglo-Egyptian accord.[1] These balances have fallen by LE 163 million since 1948. The Number one Free transferable accounts also marked a persistent decline since 1948 caused by a basic change in the pattern of trade with Britain during the last decade. This change is clearly manifested by the tremendous fall in Britain's share of Egyptian cotton export to 4 percent during 1955/56 and to nil in 1956/57 compared to 30 percent during 1949.

Egyptian banks' balances of United States dollars increased by about fourfold during the last decade; the value of gold holdings also increased by about fivefold, partly due to devaluation of the Egyptian pound, during the same period (see table XII).

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1. Discussed in Chapter IV.

TABLE XII.

SPOT ASSETS OF ALL BANKS IN EGYPT

(in LE million)

End of	£ No.1	£ No.2	US $	Other Currencies	Gold	Total
1948	71	264	6	10	13	364
1949	62	247	21	8	19	357
1950	52	224	26	18	34	354
1951	24	196	37	12	61	330
1952	6	174	20	11	61	272
1953	19	164	12	10	61	266
1954	35	146	13	15	61	270
1955	21	125	21	10	61	238
1956	7	100	21	16	66	210

Source: The National Bank of Egypt, Economic Bulletin, Vol. X, No. 2, 1957, p. 206.

All these developments reveal some important facts with regard to the achievement of one of the basic objectives of monetary policy during the last ten years. Government policy with regard to monetary problems has aimed since 1947 at running annual deficit in the Sterling transactions while trying to achieve a surplus or at least a balance with regards to other currencies especially the US dollar. To that extent, it can be realized that exchange control has been successful in implementing the purpose for which it was established.

Another important feature of banking development in Egypt is reflected in the marked increase in the volume of bank clearings during the past few years. The total value of cheques cleared at the clearing houses of Egypt during 1956 amounted to LE 804 million, compared to LE 606 million in 1952 and LE 474 million in 1949.[1]

C. The National Bank of Egypt:

The monetary developments that occured during the last few years are reflected in the balance sheet of the National Bank.

Credit expansion is reflected in the advances of NBE to banks and other credit institutions. In 1952 and 1953 credit contracted and then started to expand again in 1954 and thereafter. Total advances and discounts amounted to LE 42 million by the end of 1956 compared to 7 million in 1948 and to 22 million in 1952. Advances to banks alone amounted to LE 17 million by the end of 1956 compared to about one million during the same period in 1952 (see table XIII).

Foreign assets consisting of foreign treasury bills, foreign investments and short-term foreign exchange holdings, have fallen since 1948 by 58 percent due to the persistent deficits in

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1. NBE, Economic Bulletin, Vol. IX, No. 3 (1956), p. 286.

the balance of payments. These assets are the major source of Egypt's compensatory financing. By the end of 1956 foreign assets at NBE amounted to LE 135 million. During 1954, foreign assets remained almost constant owing to the slight surplus achieved in the balance of payments during that year.

TABLE XIII.

NATIONAL BANK OF EGYPT ACTIVITY

1948 - 1956

End of Year	Egyptian Treasury Bills	Foreign Assets	Discounts & Advances To Banks	Discounts & Advances Others	Deposits Egypt' Govt.	Deposits Banks	Deposits Other Current	Deposits Time & Notice
1948	41	320	1.4	6.0	44	43	78	5.8
1949	48	317	6.8	9.6	70	24	67	4.5
1950	67	297	13.0	18.0	56	31	64	2.4
1951	95	264	16.6	12.4	31	52	54	8.3
1952	102	202	4.4	18.0	-	38	52	3.2
1953	90	194	4.1	13.0	6	39	59	2.9
1954	81	194	12.9	12.6	7	34	64	2.8
1955	70	165	13.2	18.4	2	44	74	2.0
1956	138	135	17.4	24.8	8	48	81	2.3

Source: National Bank of Egypt, Economic Bulletin, Vol. X, No. 2, 1957, p. 204.

The increase in the portfolio of Treasury Bills including bills issued as note cover in conformity with law 57/1951 is a direct result of the deficit in the annual budget.

The most noteworthy feature that occured during 1956 was the increase of about LE 41 million in note circulation over the previous year. Following is the note circulation trend since 1953:

End of	LE Million
1953	184
1954	182
1955	180
1956	221
1957 (July)	196[1]
1956 (July)	175

The increase occured in 1956 despite the large deficit in the balance of payments owing to the increase of holdings of Egyptian treasury bills and to the increase in total advances. In July 1957, the note circulation marked a decrease of LE 25 million, compared to December 1956, which is mainly due to the withdrawal of Egyptian banknotes circulating in the Sudan in accordance with the financial agreement recently concluded between the two countries. To this was added the deflationary factor of the balance of payments deficit. However, the note circulation at the end of the cotton season of 1956/57 stood at

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1. Excluding Egyptian banknotes circulating in Sudan.

a much higher level compared with the previous year due to the large rise in Treasury Bills and Government securities.

The National Bank's advances and discounts show seasonal variations; they rise during the early months of the cotton season and reach their maximum in December/January after which they fall again until they reach their minimum level in July/August. Following are the seasonal trends of NBE advances and discounts to banks:

TABLE XIV.

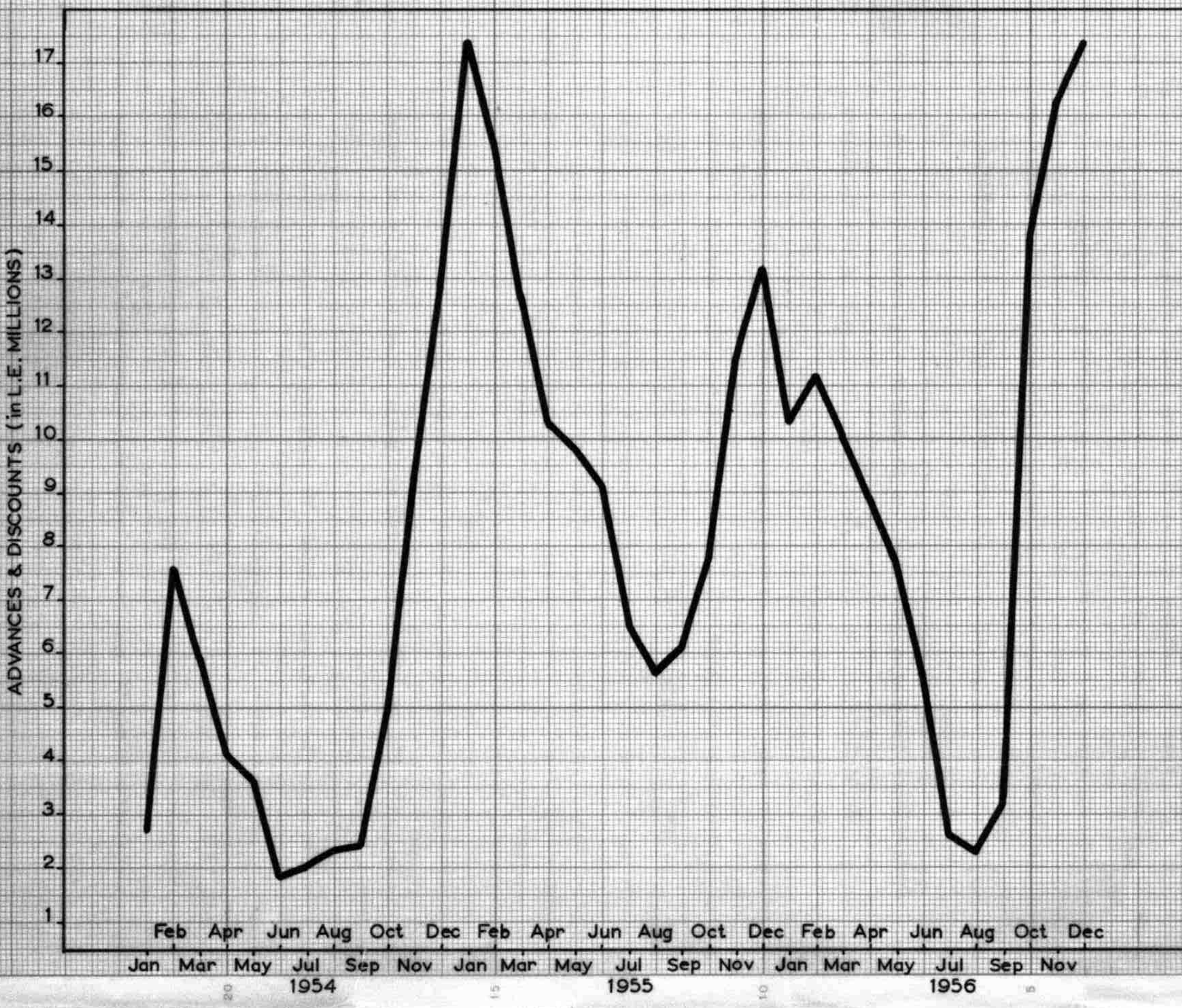
SEASONAL MOVEMENT OF ADVANCES & DISCOUNTS

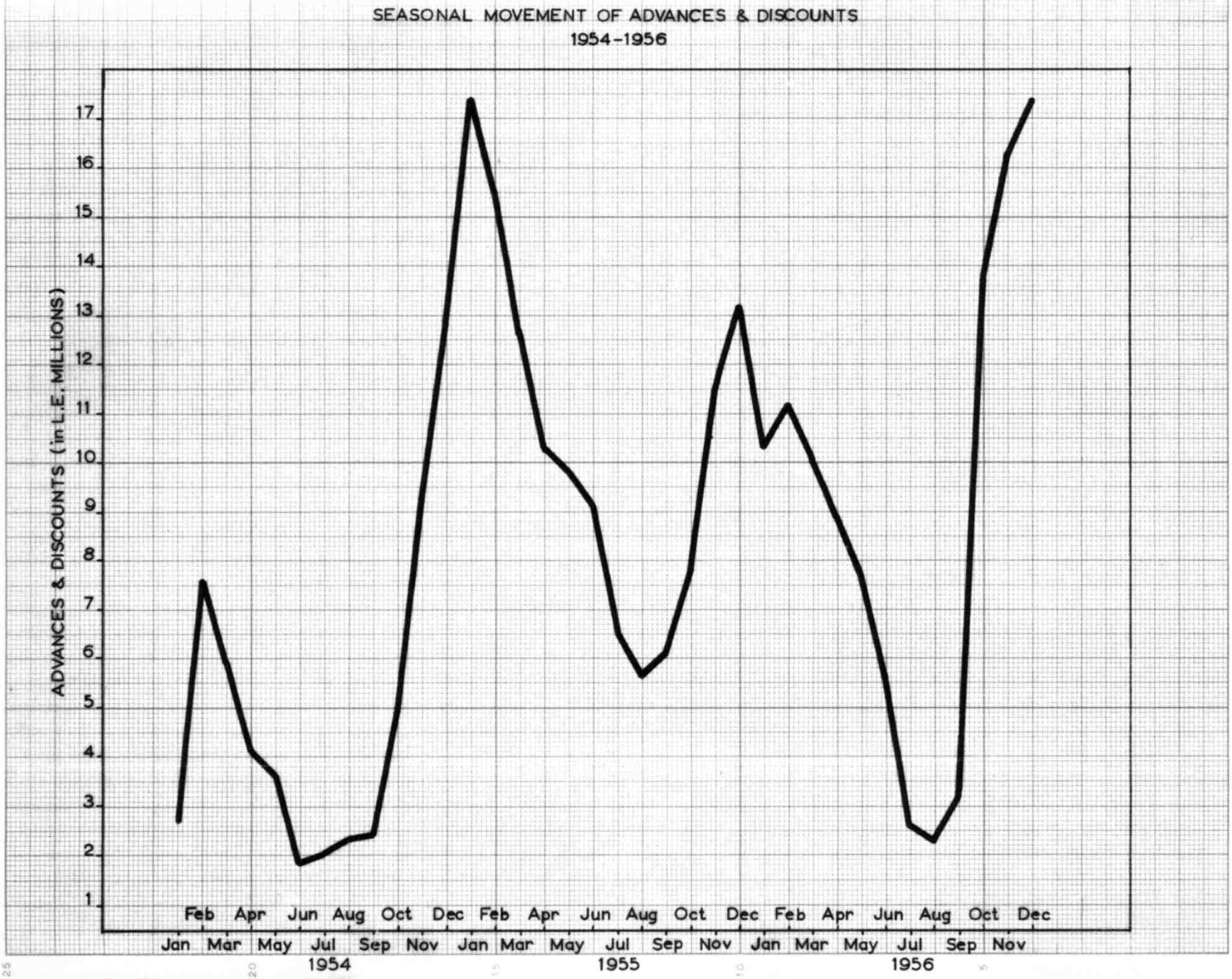
(in LE million)

End of Month	1954	1955	1956
January	2.7	17.4	10.3
February	7.6	15.5	11.2
March	5.9	12.6	10.0
April	4.1	10.3	8.9
May	3.6	9.8	7.7
June	1.8	9.1	5.6
July	2.0	6.5	2.3
August	2.3	5.6	2.3
September	2.4	6.1	3.2
October	5.1	7.8	13.8
November	9.3	11.5	16.3
December	12.9	13.2	17.4

Source: National Bank of Egypt, Economic Bulletin, Vol. IX, No. 2, p. 194 & Vol. X, No. 2, p. 204.

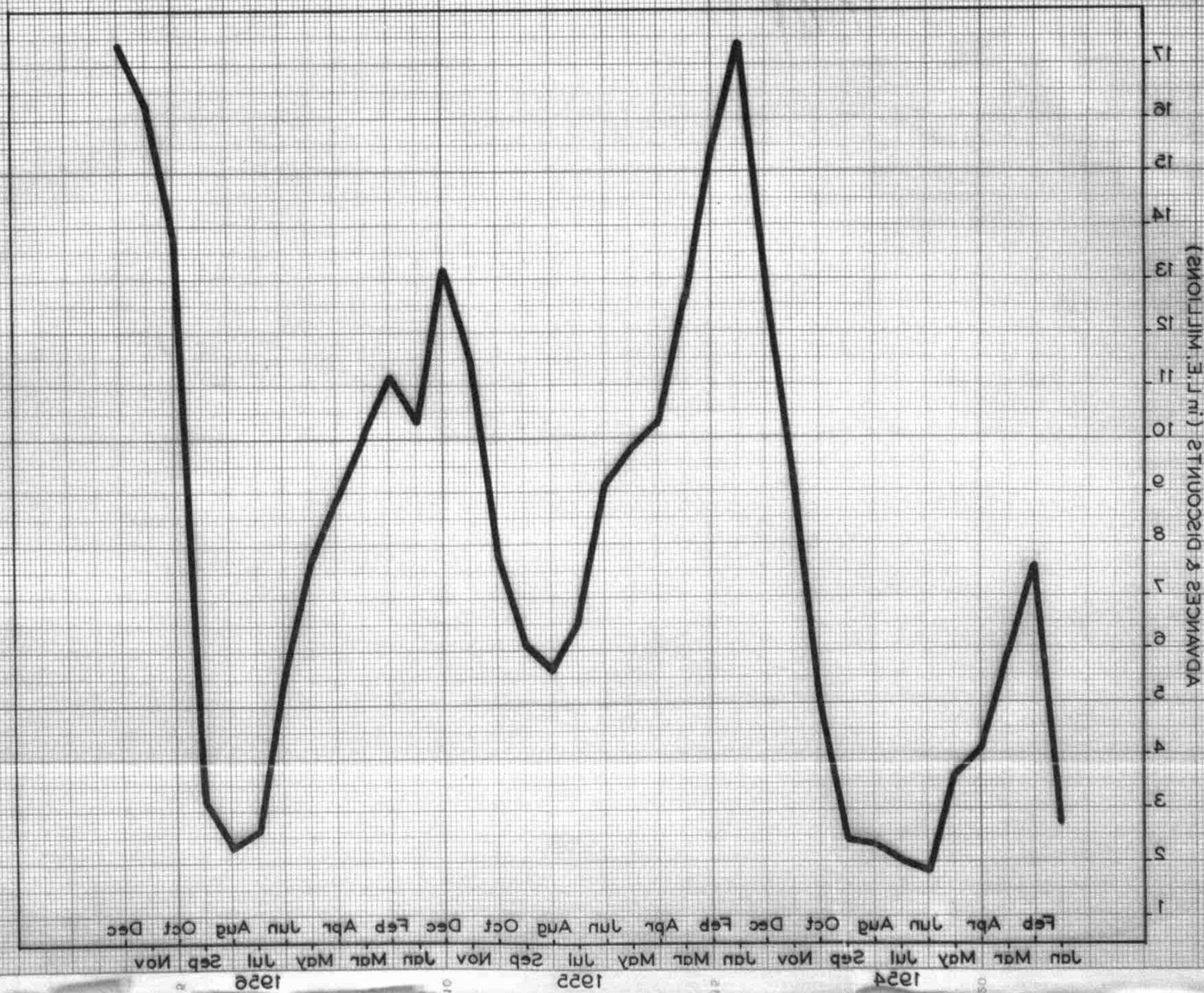
SEASONAL MOVEMENT OF ADVANCES & DISCOUNTS
1954-1956



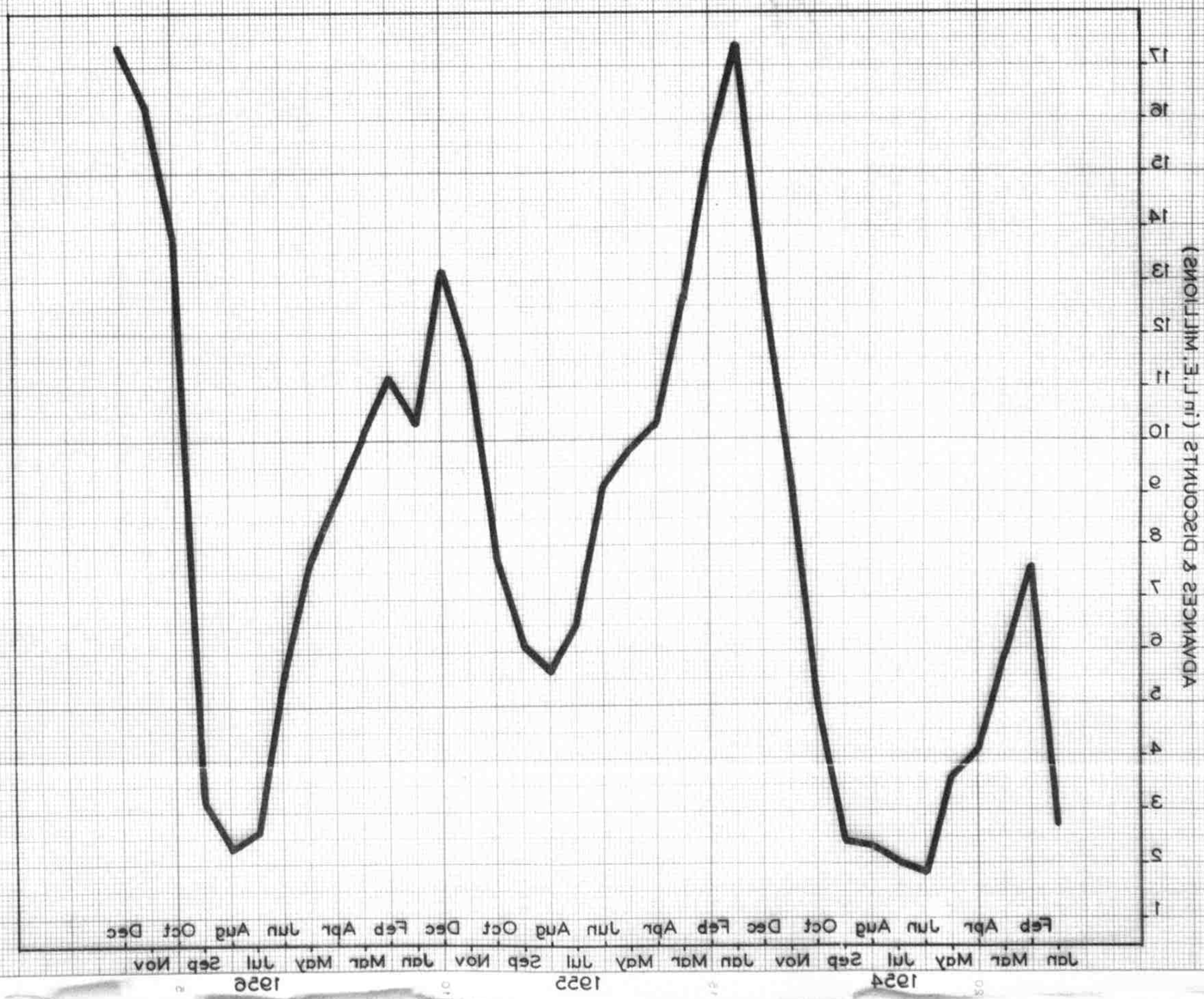


SEASONAL MOVEMENT OF ADVANCES & DISCOUNTS
1954-1956
ADVANCES & DISCOUNTS (in L.E. MILLIONS)
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
1954
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
1955
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
1956

SEASONAL MOVEMENT OF ADVANCES & DISCOUNTS
1954-1956



SEASONAL MOVEMENT OF ADVANCES & DISCOUNTS
1954-1956



D. Money Supply and Money Market:

Money Supply has been increasing during the last few years at an average yearly rate of 5.5 percent. During the same period, currency in circulation increased by 8.9 percent or at an average yearly rate of 2.2 percent. Most of the increase was in Government and other deposits.

The year 1956 witnessed an important expansion in money supply reaching the level of LE 511.3 million compared to LE 458.4 million during the same period in 1955. Contrary to 1955, however, when the increase was entirely in deposits, most of the increase during 1956 was in banknotes. The monetary expansion of 1956 resulted from increased Government borrowings in conjunction with a rise in loans and discounts which more than counteracted the deflationary effect of the deficit in the balance of payments (see table XV).

In April 1957, money supply rose to LE 517.8 million compared to LE 457.2 million during the same period of the previous year. Currency incirculation accounted for 42 percent of total money supply and the remaining 58 percent consisted of private and Government deposits. On the counterpart of money supply, foreign assets and gold amounted to LE 182.2 in April 1957 marking a decrease of about 9 percent for the previous year. Treasury bills and investments increased by 45 and 50 percent respectively while loans and discounts increased by about 9 percent during the same period.[1]

1. Ibid., Vol. X, No. 2, 1957, p. 171.

TABLE XV.

SEASONAL DEVELOPMENTS IN MONEY SUPPLY

1953 - 1956

	1953	1954		1955		1956	
	December	August	December	August	December	August	December
MONEY SUPPLY							
Currency in circulation	189.0	166.4	186.9	165.5	185.4	174.9	226.5
Government Deposits	19.8	15.1	24.2	35.9	23.9	33.8	25.4
Other Deposits	210.0	219.2	231.7	238.7	249.1	235.0	259.4
TOTAL	418.8	400.7	442.5	440.1	458.4	443.7	511.3
COUNTERPART OF MONEY SUPPLY							
x Foreign Assets & Gold	248.3	249.5	246.5	236.5	212.4	172.3	173.3
Egyptian Treasury Bills	37.3	30.1	27.2	65.5	71.0	120.2	144.2
Loans and Discounts	122.6	114.6	156.2	127.7	167.1	132.3	186.9
Investments	35.6	36.0	39.9	37.1	38.0	45.4	47.1
Residual	- 25.0	- 29.5	- 27.3	- 26.7	- 30.1	- 26.5	- 40.2
TOTAL	418.8	400.7	442.5	440.1	458.4	443.7	511.3

x Net of foreign liabilities; foreign investments are included at book value.

Source: National Bank of Egypt, Economic Bulletin, Vol. IX, No. 2, 1956, p. 117; Vol. X, No. 2, 1957, p. 126.

The movement of short-term loanable funds in the money market of Egypt are characterized by a seasonal cycle that accompanies the marketing of the cotton crop. The volume of credit reaches its maximum in December and then starts to fall until it reaches its minimum in July/August every year. This cycle follows almost the same pattern as that of the National Bank's advances and discounts already discussed above.[1] Cotton merchants resort to commercial banks for financing their crop purchases. They obtain loans and advances against the collateral of cotton produce. Cotton is then exported and paid for by means of foreign bills that are again discounted by the commercial banks until the date of their final settlement by foreign importers which is effected during the early months of each year. During these months, foreign exchange flows into Egypt and is used in settlement of the short-term credit acquired by the cotton merchants. The surplus money thus accumulated by commercial banks is partly invested in Egyptian Government Treasury Bills while the rest is usually deposited at the National Bank.

The above seasonal fluctuations are shown clearly in banknote circulation and rarely in deposits. This is due to the fact that cotton financing is still being done through banknotes rather than through transfer of bank deposits.

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1. See Table XIV and Graph "A" on pages 57 and 57a.

The rediscount rate of treasury bills was at the end of 1956, 2¼% while the rate for eligible commercial bills and loans was 3%. As a result of the seasonal demand for credit, a manipulation of bank rates can be effective only during the cotton season. In fact, during the cotton season of 1953, NBE raised the rediscount rate to 3½% and lowered it again to 3% after few months.

Beside the Central Bank, the commercial banks constitute the main group of lenders in the Egyptian money market. Commercial banks are mainly concerned with short-term financing of trade and their busiest season is, evidently, the cotton season when the short-term rate varies between 4 and 6 percent depending upon the solvency of the borrower and the value of the collateral.

E. Industrial Credit:

The development of Industrial Credit in Egypt has undergone two main stages, namely before and after the establishment of the Industrial Bank. The first practical attempt to achieve modern industrialization was made during the first half of the nineteenth century, and was inspired by the European Industrial Revolution. It was a movement in which the state played a leading role; however, this attempt was not destined to last for, soon afterwards, Egypt turned to another field of specialization namely agriculture. Moreover, the then prevailing free trade policy and the high excise duty made it almost impossible for Egypt to develop an industrial structure of its own.

With the outbreak of the First World War, the country actually experienced the dangers of its almost complete dependence on foreign industry. A few local industries developed during the war but the end of the war brought with it an influx of foreign goods at comparatively low prices causing the decline of a number of Egyptian industries.

During the period immediately following the first war, Bank Misr was established and took initiative in the establishment of a number of industrial companies. The year 1922 witnessed the beginning of the industrial credit system in Egypt. During that year, the Government deposited with Bank Misr the sum of LE 50,000 for the purpose of extending loans at special terms, to small industries which were still in their early stage of growth.[1] Individual loans were limited to one thousand pounds and could not run for more than five years. Total loans granted in 1923 amounted to LE 14,500.

The major difficulty with regard to the application of

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1. The rate charged by the Bank was 6 percent while the Bank paid an interest of 2 percent on the amount deposited by Government.

this system was the lack of the required collateral.[1] It was subsequently decided to extend loans to larger industries and to remove the limit of one thousand pounds for individual loans.

By the end of 1936, total funds allocated for industrial loans at Bank Misr exceeded one million pounds. It was then realized that the majority of small industrialists did not employ the loans they obtained in their industries, whereas larger industries more or less benefited from the loans granted to them. On the other hand, the additional amounts allocated by the Government for industrial credit were still inadequate to meet the requirement of industrial progress.

With the outbreak of the Second World War, Egypt passed to a more clearly outlined stage of industrial credit whereby the Government played an active role in the development of industry. The Government then participated with various organization and individuals in the formation of the Industrial Bank. Industrialization was looked at as the means to economic development not only because it provides the country's requirements of industrial products, but also because it reduces unemployment which is ultimately the main problem of Egypt.

In 1947, Law No. 131 was promulgated authorizing the

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1. Machinery could not be accepted as collateral being regarded as movable property.

Government to participate in the establishment of the Industrial Bank. The Bank was actually established in 1948 as an Egyptian joint stock company with a total paid-up capital of LE 1.5 million of which the Government share is 51 percent. A minimum dividend of 3.5 percent is guaranteed by the Government. Moreover, the Bank was authorized to contract loans from the Government up to two million pounds,[1] and to issue Government guaranteed bonds for a maximum value equivalent to the Bank's capital.

The basic objective and the main function of the Industrial Bank were outlined as consisting in the promotion of Egyptian industry and the handling of all sorts of banking transactions related thereto. The Bank participates in the establishment and promotion of Egyptian industrial enterprises and it provides the Egyptian industry with its requirement of raw materials, machinery and other technical assistance. The Bank grants industrial credit for any length of time, against a collateral of personal security. As well, the Bank extends assistance to graduates of technical institutes to start new industrial enterprises. In all cases, the type of industry seeking credit must have all the requirements and potentialities of success and must be actually in need of the required funds. Furthermore, the Bank must be ascertained that the loans will be spent on the purposes for which they were granted.

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1. This figure was raised to LE 5 million in 1955; See Law No. 140 of 1955.

TABLE XVI.

LOANS AND CREDITS GRANTED BY THE INDUSTRIAL BANK

1950 - 1956

LE 000's

Year	Long & Medium term loans	Short-term loans	Credits	Total
1950	364	108	134	606
1951	308	57	235	600
1952	173	9	107	289
1953	91	235	-	326
1954	623	320	97	1040
1955	638	364	843	1845
1956	346	108	266	720
1950/56	2543	1201	1682	5426
Percent	47%	22%	31%	100%

Source: The Industrial Bank, The Development of Industrial Credit In Egypt, (Cairo: Mondiale Press, 1956), p. 18, 1956 figures: The Industrial Bank, Quarterly Bulletin, Vol. I, No. 2, 1957, p. 34.

Until October 1953, the Industrial Bank was much hesitant in extending credit especially to small and medium industries. Nevertheless, during the period October 1949 - October 1953, the Bank granted loans to 133 establishments of a total capital of eight million pounds. Total loans and credits granted to these establishments during the period under consideration amounted to some LE 1.8 million which accounts for 22.5 percent of the capital of the recipient establishments.[1] Medium and short term loans amounted to 49 percent each while long term loans did not exceed 2 percent. Moreover, during the same period, loans exceeding 5,000 pounds consisted of 8.5 percent of the total.[2]

Towards the end of 1953 the industrial credit policy was reconsidered to implement the new industrialization policy set up by the new regime that came to power in July 1952. The Bank's efforts were met with full support from the Government financial resources within the limits prescribed by its statutes. It borrowed one million pounds from NBE, and LE 100,000 from the Department of Insurance and Savings.[3] Moreover, the Government guaranteed two loans totalling LE 2.5 million from NBE.

There are two marked features characterizing the Industrial Bank's work at present. First, its giving priority to loans for constructive and developmental purposes. Second, its direct participation in the establishment of industries which have the necessary economic and technical requirements of success.

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1. Industrial Bank, The Industrial Bank & the companies it helped to establish, (Cairo: Mondiale Press, 1957) p. 9.

2. Industrial Bank, The Development of Industrial Credit in Egypt, (Cairo: Mondiale Press, 1956) p. 19.

3. Both borrowings were guaranteed by the Government. See Ibid p. 23.

The bank's activities have remarkably increased during the two years following 1953. Total industrial loans and credits granted during 1955 amounted to approximately LE 1.8 million compared to LE 1.0 million in 1954, LE 0.3 million in 1953 and LE 0.6 million in 1950.[1] During 1956, the volume of credit relatively declined in view of the political disturbances that Egypt experienced during the second half of 1956. The total investments of the Industrial Bank amounted to about LE 2.4 million in 1956 compared to 0.4 million in 1954 and 50,000 in 1953.[2] Moreover, the total liabilities of the Bank increased by about fivefold from 1950 to 1956. During the same period, a total of about 5.5 million pounds were granted by the Industrial Bank in various forms of loans and credits. Out of this total, 47% consisted of long and medium term loans, 22% short-term loan and 31% credits.

F. Agricultural Credit:

The early stage in the development of agricultural credit in Egypt dates back to the year 1923 when the cooperative system was first instituted for the purpose of supplying the farmers with loans. At that stage, a Government credit of LE 100,000 was deposited with Bank Misr upon which cooperative societies could draw at a rate of interest of 5 percent per annum.

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1. See table XVI.

2. See Industrial Bank's Balance Sheets for the year 1950-55. Op.cit p. 26. Also: The Industrial Bank Quarterly Bulletin, (Cairo: Akhbar El-Yum Press) Vol. 1, No. 2, 1957, p. 36.

In 1930 that amount was increased to LE 350,000. This system, however, proved inadequate in view of the excessive financial needs of the farming class. In 1931 the financial crisis tightened the credit situation in the country and the Government was faced with the problem of organizing agricultural credit as a means of alleviating the crisis. During that year, the Agricultural Credit Bank was established by the joint effort of the Government, some banks and other commercial organizations. The initial capital of the Bank was one million pounds of which 50 percent was contributed by Government. Moreover, the Government stood ready to grant loans to the Bank up to six million pounds at a rate varying between 2-3.5 percent p.a. The Bank on the other hand, provided loans to individuals at a rate of 7% and to cooperatives at a rate of 5%. Later these rates were reduced to 5 and 3 percent respectively. Up till 1939, the total value of loans and credits granted by the Agricultural Credit Bank amounted to six million pounds. During the war years this figure was reduced to reach a minimum of about four million pounds in 1942.[1] In 1949 the name of the Bank was changed to "The Agricultural and Cooperative Bank". At present, the Bank provides three types of loans: short, medium and long term loans.[2] Total loans and credits

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1. Hamad N. Mohamed, "Agricultural Credit in Egypt" Banking Studies Institute, (Cairo: Mondiale Press) January 1955, p. 10, (Arabic).

2. Short term not exceeding 14 months, Medium term up to five years, and long term up to ten years.

effected by the Agricultural and Coöperative Bank amounted during 1956 to 19.5 million pounds compared to 16 million in 1952 and to 9 million in 1949.[1] Of the total loans granted by the Bank, an average of 98 percent are short term loans not exceeding 14 months. Two thirds of the cultivable land in Egypt is cultivated by small tenants who, under the above credit system, were still cut off the source of funds especially because of the required collateral security. Moreover, cooperative spirit and consciousness were weak in Egypt. The then existing cooperative societies lacked good management and their activities were mainly confined to obtaining loans for their members at a cheaper rate from the Bank while they left the members to dispose of their affairs according to their own discretion.[2] The Agrarian Reform Law was introduced in 1952 with the aims of redistribution of land ownership, the reduction of rent, and the raising of agricultural wages. The higher Committee of Land Reform Organization took it as its responsibility to supply the tenants with the necessary funds for the exploitation of the confiscated and redistributed lands. An additional credit of one million was allocated for the purpose and the aggregate loans for the same purpose amounted to LE 1.4 million in 1954.

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1. Ministry of Finance & Economy, Statistical Pocket Book 1955, (Cairo: Al-Amirieh Press 1956) p. 130.

2. Marei, Sayed, "Agricultural & Cooperative Credit in Egypt" Banking Studies Institute, Cairo, February 1956.

G. Features of the Banking System:

The lack of development banks is a notable feature of the banking system in Egypt. The central objective of public policy and national endeavours since the Revolution of 1952 has been the promotion of rapid and balanced economic development. Consequently, the problem of financing development has been constantly facing the Egyptian Authorities.

Egypt, like all under-developed countries, cannot depend on internal means to finance its development projects simply due to the low level of national savings and the difficulty of channeling the available low savings into useful investments. Public savings, on the other hand, constitute another basic weakness whereby the State has limited resources, by way of surpluses, and it has therefore to depend upon whatever transfer of private savings which it can bring about through its borrowing programmes or through deficit financing.

The size of the public debt in Egypt is small compared to that in many other countries, and cannot be expected to witness a great expansion, at least in the near future, simply because these loans are subscribed for by private savings which, as already noted, are small.

Foreign capital, on the other hand, has not been invested in industry especially due to the small size of the Egyptian market in the sense that people's command over purchasing power is meagre. As a result, foreign capital was mainly invested in land. Real estate banks financed with foreign capital were established in Egypt. Among these banks were the Credit Foncier Egyptien and the Credit Hypothecaire Egyptien. When income from the agricultural sector relatively increased real estate loans, mainly short and medium, relatively contracted. Despite the resulting decline in the activities of real estate banks, the shifting in activity was towards the construction of buildings rather than industrial investment. The annual report of the Board of Directors of the Credit Foncier for 1956 indicates that 93 percent of its operations during 1956 consisted of loans for building construction. Early in 1957 the Government restricted new investments in this industry through limitation of licenses.

Prior to the Egyptianization law, the majority of commercial banks were in the hands of foreigners. The provision of adequate private sources of funds for agricultural and industrial credit met great obstacles. Foreign banks were handicaped in this respect by their traditional commercial credit principles, the remote control to which they were subject, and the implications of their mother countrys' policies. Moreover, commercial banks adopted a general policy of credit constraction reflected by the high liquidity ratio which amounts to about 25 percent of their total deposits.

The above main features of the banking system in Egypt are among the main causes that led to the Egyptianization of all banks in Egypt in January 1957.

H. <u>The Egyptianization of Banks</u>:

On January 16, 1957, Legislative Decree No. 22 was issued concerning the organization of banks functioning in Egypt. According to this law all banking institutions working in Egypt must take the form of Egyptian Joint Stock Companies whose shares are to be nominative and the property of Egyptian subjects. The paid-up capital of these banks should not be less than 500,000 pounds and the directors and responsible officials should be Egyptian subjects.

French and British banks were immediately put under sequestration while the rest of foreign banks were given a delay period of five years within which to comply with the provisions of the legislation.

Prior to this law the banking structure was more or less dominated by foreign capital and administration. Foreign banks competed with each other for the ultimate purpose of serving the interests of their mother countries.[1] The Government under the

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1. Choucair, Labib, Assistant professor of economics, University of Cairo, Personal interview on October 27, 1957.

revolutionary regime provided special attention to improve the banking system and direct it to help in raising the level of economy in the country.

Banks are the central pillars of the economic structure of any country. They gather in individual savings and are the source of funds for the development of trade, industry and agriculture.

After the nationalization of the Suez Canal the French and British banks are said to have refused to finance the cotton crop with the object of creating an atmosphere of economic instability thus causing a fall in cotton prices. Moreover, after the blocking of Egyptian monetary reserves by Britain, France and USA, these banks resorted to encouraging individuals to open more and more accounts abroad in order to draw off what little free monetary reserves remained thus causing a deterioration in the value of the Egyptian pound abroad.[1]

The Egyptian point of view maintains that the majority of foreign banks usually abstained from providing credit facilities to Egyptian firms. They made loans to clients in Egypt only in accordance with direct instructions from abroad. As a result, the Egyptian economy was generally guided by the dictates of foreign policy while at the same time this power of foreign banks

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1. The drop in value of the Egyptian pound abroad was also aggravated by large movement of smuggled banknotes out of Egypt.

was derived from funds accumulated from the deposits and savings entrusted to them by Egyptian subjects. The total capital of foreign banks amounted to LE 5.2 million and that of sequestrated banks alone did not exceed LE 2 million.[1] At the end of December 1956, foreign banks were controlling about LE 100 million of deposits out of a total of LE 195 million. Their discounts and advances on the other hand amounted to about LE 76 million compared to a total of 158 million for all commercial banks. The ratio of advances to deposits amounted to 76 percent for foreign banks and 86 percent for Egyptian banks.

Of a total of 32 banks operating in Egypt at the time of Egyptianization, 19 were foreign and the remaining 13 Egyptian banks consisted of the National Bank of Egypt (the Central Bank), Misr Bank, Bank of Cairo, Commercial Banks of Egypt, Import and Export Bank and Bank Al-Goumhouria. The remaining six banks are small concerns of no great significance. The Bank of Alexandria was recently established by the Economic Organization to take over the Barclays Bank.

The Egyptianization procedure consists of issuing new shares with regard of branches of foreign institutions, or the transfer of ownership of the existing shares to Egyptian subjects.

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1. National Bank of Egypt, Economic Bulletin, Vol. X, No. 2, 1957, also: The Egyptian Economic & Political, Vol. 3, No. 6, February 1957.

All shares should be floated in the capital market and the Economic Organization will buy that part of the remaining stock which would not be coped with in the market. Foreign banks will be allowed to transfer their capital out of Egypt in accordance with exchange control regulations.

By April 1957, the Egyptianization of all firms under sequestration, including banks, had been completed. With regard to banks, the Ottoman Bank and the Ionian Bank were both taken over by Al-Goumhouria while the Credit Lyonnais and the Comptoir National d'Escompte de Paris were taken over by the Bank of Cairo. Finally, Barclays bank was taken over by the Bank of Alexandria which was created for this purpose. The Credit d'Orient which was already an Egyptian joint stock company but an off-shot of the French B.N.C.I. was taken over by a newly founded bank, the Banque de l'Union Commerciale with a capital of LE 500,000.[1]

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1. The Egyptian Economic & Political Review, Vol. 3, No. 8, April 1957, page 33. Also: IMF, "International Financial News Survey", Vol. X, No. 4, October 4, 1957.

CHAPTER IV

EXCHANGE SYSTEM OF EGYPT

The term "foreign exchange" covers the means and methods by which rights to wealth expressed in terms of money are converted from one country to another. More simply, it is the method by which the currency of one country is exchanged for that of another. The expression is also used to denote a foreign currency, while the term "exchanges" or "foreign exchanges" is particularly used by the press to denote the rates at which currencies exchange for one another.

In a world of free exchange systems, the rate of exchange, or the price of one currency in terms of another, cannot be fixed but varies continually with variations in world demand and supply conditions of that particular currency.

The most usual starting point for calculating the relative rates of exchange between various currencies is a comparison of the quantity of precious metal, usually gold, contained in each of the currency units. The metallic content should be fixed by law, even though such a measure may be purely theoretical.

The use by different countries of different units of currency creates a difficulty in settling international payments. However, such payments have been eased to a great extent by means of the foreign exchange markets in which for many years, expert dealers all over the world are being prepared to buy and sell, at a price, any recognized national currency. As long as a currency has a certain internal purchasing power, it will always command a proportionate rate of exchange against other currencies.

A comparatively recent phenomenon of foreign exchange practice is Exchange Control which first appeared on a wide scale in Europe after the First World War. Today, with few exceptions, it has spread all over the world. The primary objective of any foreign exchange control system has been to secure the power to purchase those foreign goods and services most essential to the internal national economy. In this respect, any attempt at a comprehensive exchange control should first be preceded by a mobilization of the country's liquid resources abroad. Residents are usually asked, by force of law, to declare and place at the disposal of the state all their holdings of and claims for foreign currencies and all securities which are capable of being redeemed abroad. Steps to punish hoarding are also often taken but cannot be regarded as successful especially in large and semi-illiterate peasant populations such as India and Egypt.

The Exchange System of Egypt can rightly be described as a complicated one consisting essentialy of exchange control. In this respect, it is essential to define the term "Exchange Control" which is frequently used in different senses on various occasions. "Exchange Control" is often used as a synonym to exchange restrictions, while in fact, exchange restrictions constitute only one exchange control. The foreign exchange dealers understand by exchange control a system whereby exchange operations are undertaken by or on behalf of the monetary authorities. Government intervention in the exchange market is another category of exchange control.

Exchange control covers every form of intervention on the part of the monetary authorities, or on their behalf, aiming at interfering in the tendencies affecting exchange rates.

There are in all countries of the world normal measures of exchange control undertaken by monetary authorities; however, these are not points of interest. Instead, we are interested in the extraordinary, direct and indirect, measures undertaken by the Government. While direct measures aim, as they connote, at affecting foreign exchange directly, the indirect measures, on the other hand, aim at affecting foreign exchange situation through the intermediary of some other aspects of economic activity.

Among the direct measures are: (1) Intervention, whereby the monetary authorities resort to foreign exchange open market operations in attempting to influence the exchange rates. (2)

Restrictions, which consist of official measures aiming at the limitation or suppression of the freedom of foreign exchange transactions. Restrictions may be imposed on capital movements, external debt payments, holdings of foreign currencies, or even on speculation in the exchange market. (3) Finally, gold policy can be applied under exchange control by departing from the rules of the Gold Standard and controlling the exchange by changing the official price of gold.

The indirect measures, on the other hand, may be classified into four groups: (1) Import restrictions, provided that their primary aim is to safeguard the foreign exchange situation rather than to protect home trade and "infant industry". Usually, however, governments have both ends in mind. (2) Encouragement of exports. In general, export bounties are given in order to stimulate foreign trade; however, governments have also in mind the support of foreign exchange. (3) Barter arrangements are also twofold, they first relieve pressure on exchange, and secondly, create new markets for home products. (4) Embargoes on foreign loans have usually the object of retaining national savings exclusively for inland requirements.

It should be noted at this level that the above classification of the various categories of exchange control are not considered to be absolute or complete, for, every now and then new regulations regarding exchange control are introduced in some part of the world.

A. Egypt and the Sterling Area:

Until the middle of 1947, Egypt was still a member of the Sterling Area under which it was required to hand over all its dollar and other than sterling earnings to the "London Pool" and to receive Sterling in exchange.

The term "Sterling Area" refers to a group of countries whose currencies are officially linked to the sterling pound, but which, for the purposes of British Exchange Control Act of 1947, this group of countries is actually entitled "the Scheduled Territories". The term was originally used to describe the group of countries which attached their currencies to sterling following the widespread suspension of gold payments in 1931. The group comprised the British Dominions and colonies,[1] the Scandinavian countries, Portugal, and Argentina. They voluntarily linked their currencies to sterling at declared parities. This sort of association broke up eventually as the international payments system returned to normal conditions.

With the outbreak of the War in 1939 and the introduction of an exchange control system in the United Kingdom and applied

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1. Canada remained outside the Area in view of its proximity to and close trade and financial relationship with the United States.

only outside the sterling area during the same year, the whole of the British Common Wealth of Nations, the colonies, dependencies, and mandated territories, assumed exchange and trade controls on lines similar to those adopted by Britain.

The need for cooperation during the war led to the creation of a system whereby Britain became in a sense the banker for a large group of countries on whose behalf she was responsible for the collection and allocation of foreign exchange. Canada and Newfoundland remained outside this monetary area in view of their close economic and financial ties with the United States. Owing to its "open market" position, Hong Kong also remained, for a time, outside the "Area", however, she was subsequently brought into the system which was also voluntarily joined by Eire and Egypt. Today, the scheduled territories include some fifty countries in various parts of the world.[1]

Thus in 1939, all the Sterling Area countries, among them Egypt, were asked to introduce exchange controls. Adhering to the "Area" regulations, a system of exchange control was initially introduced into Egypt on the 25th of September 1939, Law 109. All foreign exchange operations, other than in sterling, were forbidden unless justified by normal needs of trade and industry.

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1. For a complete list of them, see H.E. Evitt, <u>A Manual of Foreign Exchange</u>, (London: Pitman and Sons Ltd., 1955), ed. IV, p. 78.

It is interesting to note in this respect, that the law did not provide for the obligatory repatriation of export proceeds. In fact, it was not even noticed that exports involved foreign exchange transactions.[1]

The defects of this one-sided control were soon realized and on June 15, 1940, Law No. 53 was promulgated to include the repatriation of export proceeds. Thus up to the middle of 1947, the Egyptian exchange control system was a simple adaptation of the control regulations published in London. The National Bank of Egypt kept its foreign exchange reserves in the form of sterling balances in London. All applications for foreign exchange had to be submitted to the National Bank to be checked and approved.

Imports were normally payable, through London, in the currency of the country of origin. Capital remittances were not permissible except in the case of legacies to the United States which were freely treated on the basis of reciprocity. Other non-residents' revenue remittances were freely permitted only upon a presentation of a satisfactory proof of the revenue earned.

In general and in the point of view of exchange control technique, the system worked smoothly and Egypt had an apparent

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1. N. Koestner, "Exchange Control in Egypt", Banking Studies Institute, (Cairo: Mondiale Press, 1956), p. 17.

autonomy in foreign exchange transactions. By selling its daily surpluses to London, the control could cover its foreign exchange requirements almost automatically from the same source. However, there were strong outside controls that limited the Egyptian requirements of foreign exchange. One of these controls was the "Navicet", i.e., a certificate for shipping space, without which no import or export license could be granted during the war years.

In provision of a growing demand for foreign exchange, as the end of the war came into sight, a British delegation visited Cairo in December 1944 to discuss matters concerning the Egyptian foreign exchange requirements for 1945. In view of the shortage of certain so-called "hard" currencies, among which the most important were the United States and Canadian dollars, Swiss francs, and Swedish Kronors, Egypt, as well as all the other members of the Sterling Area were asked to cut down their imports paid for in these currencies. Consequently, a "target" was set, up to which Egypt could buy the above mentioned "hard" currencies against Egyptian pounds or Sterling. This arrangement extended until July 14, 1947, the date of Egypt's leaving the Sterling Area.

The target system assigned to Egypt an amount of hard currencies equivalent to about LE 1 million per month, without taking any account of the sums surrendered by Egypt to London. Besides, this arrangement did not deal with the accumulated Sterling balances in London. Thus Egypt was expected to surrender her hard currency earnings, while, on the other hand, she was offered a very limited facility in utilizing the London Dollar Pool. Moreover, Egypt was given only a limited amount of free Sterling while the rest of her balances were blocked. She had therefore, to introduce an exchange control vis-a-vis the United Kingdom.

The only solution seemed for Egypt to depart from the Sterling Area which it actually did in July 1947. Since then, she had to find and obtain foreign exchange from her own resources and reserves. Thus, Egyptian cotton and rice were sold by auction in dollars, which policy, together with the post-war boom condition, permitted the accumulation of large dollar balances which were partly utilized for the purchase of gold from the United States.

B. Egypt and the I.M.F.:

In 1946, Egypt joined the International Monetary Fund which was organized as a result of the Bretton Woods Agreement in attempting to solve post-war problems in international financing. Each member country had to declare a par value for her national currency based on its gold content. This par value had to be decided upon by each of the member countries which had to undertake to maintain that value from fluctuating more than 1% either way. Egypt declared on December 18, 1946, a par value of 3.67288 grams of gold which, after the devaluation in September 1949, was reduced to 2.55187. The latter rate gives a conversion of LE 1 = US $ 2.87 which is the present par value of the Egyptian pound. This declared rate was such that the cross rate between Sterling and the Egyptian pound remained unchanged at 97½ Egyptian piasters per Sterling pound.

One of the basic rules of the I.M.F. was that member countries may not resort to exchange control in attempting to solve their exchange problems. All obstacles put in the way of international trade are contrary to the Fund's articles. The only cases, however, in which the Fund authorized exchange control was during the so-called transitory period from 1947-52, and there was a provision that this period could be expanded after the consultation of the Fund. Egypt, taking advantage of this provision, has expanded the transitory period until the present date.

When the I.M.F. began operation, its Articles of Agreement prescribed the quota of each original member. The quota was to be subscribed 25 percent in gold and the remainder in national currency. Both the gold and currency deposits comprise an international pool available for sale to members in case of need. Purchases from the Fund during any single year may not exceed 25 percent of the member's quota and total purchases may not exceed 125 percent of its quota.

Egypt's quota subscription amounts to sixty million dollars of which 25 percent are paid in US dollars and the remainder consists of Egyptian pounds. In 1949 Egypt purchased US $ 3 million from the Fund against Egyptian pounds. The repurchase was made in 1950 at which time the Fund's holdings of Egyptian pounds were reduced to 75 percent of Egypt's quota.[1] In September 1956, Egypt purchased Canadian dollars equivalent to US $ 15 million from the Fund and paid for them in Egyptian pounds. This was the second purchase made by Egypt from the Fund and amounted to 25 percent of Egypt's Quota. In February 1957 Egypt made a third purchase from the Fund also with Canadian dollars equivalent to US $ 15 million. With this purchase, the Fund's holdings of Egyptian currency amounted to the maximum limit which is 125 percent of Egypt's quota. This final purchase was made after the incidence of the Suez Canal which resulted in the blockade of Egypt's balances in Britain, France and the United States. The country was threatened with a shortage of wheat and Egypt was in need of hard currency to buy the wheat from Canada. On the other hand, the Fund agreed to this purchase on the basis that Egypt would repurchase the amount from the Fund as soon as Egypt's blocked dollar balances in the US are released. Thus, the outstanding net drawings of Egypt from the Fund amount at present to 30 million US dollars.[2]

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1. Vide - International Financial News Survey, Vol. IX, No. 16, (October 1956), p. 128

2. IMF , International Financial Statistics, Vol. X, No. 12, December 1957, p. 4.

C. Exchange Control System:

In 1947, the Law No. 80 was promulgated which stipulated the rules and regulations related to the application of exchange control in Egypt.

The Law, which was amended in 1951, 1952, and 1953, prohibited all sorts of money transfers and foreign exchange transactions except by special permission of the Ministry of Finance and provided that they be effected through authorized banks in Egypt. All imports and exports of Egyptian and/or foreign currencies of all sorts are prohibited except under the provisions of the Ministry of Finance which also regulated the imports and negotiations of tourist cheques.[1]

Article three of the Law specifies that all physical and moral persons are obliged to submit to the Ministry of Finance and at the official rate of exchange, all their bank balances in foreign exchange, and as well all foreign revenues accruing to them, and all sorts of foreign currency possessed by such persons residing in Egypt. Exports proceeds are to be repatriated within a period of six months unless exempted from their obligation by special authorization from the Ministry of Finance. Moreover, all non-transferable debts of residents in Egypt in favor of non-residents abroad were to be considered as "blocked accounts" which

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1. Law 80, 1947, Article II.

would be disposed of under special conditions as viewed convenient by the Minister of Finance.

All banks which are authorized to affect foreign exchange operations are required by law to transmit to the Ministry of Finance an account of their purchases and sales of foreign currencies as well as the transfers effected by them in conformity with the present law. Finally, the Minister of Finance was authorized to appoint a central committee, by a special decree, charged to supervise the proper enforcement of this law. This committee is itself the Central Exchange Control Office.

1. Exchange Accounts:

The "Egyptian Accounts" are those balances acquired by firms and individuals residing in Egypt, possessed through the sale of liquid assets in the United Kingdom and are calculated in Sterling.

The "Number-one-Transferable Accounts" are free balances in the United Kingdom possessed by Egyptian banks.

"Transferable Accounts" are free Sterling balances possessed by Egypt in the United Kingdom. They include since the 22nd of March, 1954, the ancient number-one transferable accounts of banks and the ancient Egyptian accounts of particular firms and individuals. These accounts are credited through payments effected by residents of "Scheduled Territories" in conformity with the British exchange regulations.

The "Number-Two-Egyptian Accounts" constitute the blocked Egyptian balances in Great Britain. These accounts are the subject of the Anglo-Egyptian accord.

An influx of capital in Egypt during the Second World War was represented by an increase in Egypt's Sterling balances in London which amounted to some LE 400 million by the end of the war. At the same time London blocked up all its foreign obligations in order to preserve the value of sterling. As Egypt first demanded from Britain to pay their war debts the latter refused, trying to persuade Egypt to consider these debts as Egypt's share in the expense of war. Temporary agreements were finally reached in 1947, 1948, and 1949, which stipulated the way in which Egypt would get its balances back. However, in 1951, a long-term accord was signed which provided for freeing £ 150 million out of the frozen assets over a period ranging between ten and thirteen years. The accord also provided for negotiations to liquidate the remaining balances which amounted to £ 80 million before the expiration of the agreement. In August 1956, just before the nationalization of the Canal, the Government decided to allocate most of its receipts from these accounts for development purposes. Early 1955, an agreement was signed whereby Egypt was permitted to transfer from its number-two blocked accounts an amount of £ 20 million per year between the years 1955-60 and of £ 10 million per year in 1961 and 1962, while the small remaining balance was to be settled in 1963.[1] As a result of the nationalization of Suez Canal all the sterling balances were completely blocked by Britain and as well, the United States and France took similar steps in connection with dollar and franc balances respectively

2. Monetary Zones:

From the point of view of exchange control in Egypt, a clearcut difference divides bank accounts into two separate categories. The distinction is made according to the place of residence of the beneficiary. Hence these accounts are indicated as "Resident" or "non-Resident". All physical and moral persons of whatever nationality who are residing in Egypt are considered as "Residents". The "non-Residents" on the other hand, are all physical and moral persons of any nationality residing outside Egyptian territory. It is important to note in this respect that the Egyptians who reside or wish to reside abroad even if on permanent basis, cannot acquire a non-resident status and their accounts continue to be considered as "Resident", and consequently their revenues and accounts are transferable abroad only by special authorization and within

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1. Vide - The Economist, London, September 3, 1955.

determined limits.[1]

The non-resident accounts are in turn divided into four categories: the non-resident free accounts, the blocked, provisionally blocked, and the export accounts. The "non-resident free" are unblocked accounts held in Egypt and in Egyptian pounds, possessed by physical and moral persons residing abroad. Such balances can be used for payments in Egypt and are in principle transferable to the titular countries. These accounts can be credited by payments of profits, interest, and income earned in Egypt by non-residents. They can also be credited by transfers received from the monetary zone of the non-resident in Sterling pounds credited to the "transferable accounts" or in the currency of that monetary zone if acceptable by the Egyptian control or through payments in any other acceptable foreign currency.

Non-resident accounts can be debited, on the other hand, by payments in favor of residents in Egypt or for all purchases in destination of the monetary zones of that particular account, or, such accounts can be debited to the profit of another "non-Resident Account" pertaining to the same monetary area.

The second category of non-resident accounts are the "non-resident blocked accounts" which as their name denotes,

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1. The limit is usually LE 1200 per year.

are blocked balances held in Egyptian pounds by individuals, firms and banks residing outside Egypt. Such balances are not transferable but can be used internally in Egypt within determined limits. These accounts, previously known as "capital accounts", are credited by funds from the following sources: (1) Sales of movable and immovable capital assets; (2) inheritance, legacy, and donations; (3) "dead" capital disbursement. They are usable to the amount of LE 1,000 per year in Egypt for daily expense purposes. Moreover, they are also investible in stage funds not payable before ten years, and could be transferred only by permission of the central exchange control.

The "non-resident provisionally blocked accounts" are special balances held in Egyptian pounds in favor of the United States, Canada, and the dollar area. They are maintained by profits earned in Egypt by non-residents from the above mentioned monetary area. Such balances are not transferable due to the scarcity of the dollar but are usable in Egypt within certain limits too.

Finally, the non-resident export accounts are held in Egyptian pounds and fed by legal import proceeds. These balances are non-transferable and are used in Egypt to cover Egyptian exports to all countries other than those with whom Egypt signed bilateral agreements or countries which are part of the British and American monetary zones.

The relative scarcity of foreign exchange in Egypt, specially during the last decade, has deprived the country from the possibility of importing certain indispensable commodities. Consequently, the "Non-Resident Export Account" was established as a sort of remedy for this queer situation. Thus by the new arrangement, licenses for essential imports, paid for in Egyptian pounds, were issued in favor of non-resident suppliers in the country of origin.

Imports in this form continued to be paid in Egyptian pounds which are non-transferable and are credited in favor of selling countries. Such accounts, called "Export Accounts" bear indications of the monetary zone of the beneficiary. Thus the account of Finland is called the "Finnish non-resident export account", etc. By this arrangement Egypt could obtain all the goods it needed without being required to pay for them in any foreign exchange. Moreover, Egypt favored its exports and permitted indirect settlement to non-resident sellers such as in the following example: A merchant in Egypt wishing to import American cars by any means, contacts a financial intermediary residing in Sweden who arranges to pay the United States exporter in dollars by his own proper means; at the same time, he (the Swedish dealer) will be credited in Egypt under the Swedish non-resident account which can only be used in Egypt in settlement of certain exports. The intermediary may himself use these Egyptian non-transferable export accounts or he may submit them to certain other beneficiant country which can use them in payment for their imports from Egypt.

The "exports accounts" arrangement has been abolished since January 1955, but the remaining balances which authorize imports based on approved licenses were not affected.

3. Other Foreign Accounts:

The "Collector Account" is a common term for "clearing" or "compensation" accounts created with countries which have concluded payments agreements with Egypt. Balances under this category are held in the conventional respective currencies specified in the agreement.

Finally, the "Import Entitlement Account", which has also been liquidated, was an order account held in U.S. dollars, Sterling, or Deutsch Mark, representing a right to be refused in a quota system corresponding to the repatriated sums of these currencies in payment for Egyptian exports. These balances are refused in payment for imports, in respective currencies, based on licenses which provide payments by previous deductions from this right.

The "rights" embodied in these accounts acquired a sort of designated commercial value varying according to supply and demand conditions. The Import Entitlement arrangements were abolished in October 1955 being replaced by an additional import duty of 7 percent applied to all goods other than raw materials, capital goods, and book publications.

Thus broadly speaking, a system of unitary exchange rate operates in Egypt today, although a tax of 10 percent on certain invisible transfers, is still in operation.

4. Exchange Control and International Trade:

Merchandise trade in Egypt is subject to heavy restrictions and to foreign exchange provisions. All private imports require prior licensing.[1] The issue of such licenses depends upon the currency in which import payments are to be settled, the form of payment, and the nature of the goods to be imported. Licenses are given relatively freely for all imports which do not require dollars or any other scarce currency.

Specified essential imports from the dollar area as well as from countries other than those with whom Egypt concluded payments agreements, are also licensed more or less liberally if paid for in "Export Pounds", i.e. through the "Export Accounts" which replaced the import entitlement procedure since October 1955.

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1. With the exception of books and publications, goods imported from the Palestine zone under Egyptian control, living animals, all these categories of goods do not require prior licensing.

Foreign exchange is granted automatically upon the presentation of a valid import license. The imports of certain specified non-essential commodities are permitted on a semi-barter basis whereby goods equal to double the value of imports in question have to be exported and half the value of such exports have to be paid in Sterling. Similarly, goods may be imported from the dollar area against half the value of goods exported in exchange to the same area while the other half has to be repatriated in dollars.

Exports,on the other hand, are allowed without restrictions except in certain cases where the commodities are required for the national economy. Exports may then be prohibited or may be allowed only within a restricted quota system. An interesting illustration of such a case is the sesame seed exports. Since 1939 Egypt had been prohibiting the export of sesame seed mainly due to the fact that Egypt's product of this commodity does not fully satisfy the requirements for local consumption. However, towards the end of 1955, the Egyptian Government encouraged merchants to import Sudanese sesame seed product, of an inferior quality and lower price, by allowing these merchants to export an equal quantity of Egyptian product. These provisions were again abolished in 1957 when the Sudan prohibited the export of sesame seed due to crop shortage.

All export proceeds must be repatriated within six months from the date of shipment of goods, and foreign exchange proceeds must be surrendered to the Central Exchange Control Department of the National Bank of Egypt. Proceeds from exports to Payments Agreement countries must be obtained in accordance with the provisions of the relevant agreement.

5. Financial and Payments Agreements:

At the time when Egypt left the Sterling Area in July 1947, she had practically no foreign reserves other than Sterling. Consequently, she decided to build up foreign balances mainly in hard currencies by allocating such currencies for essential imports while directing exports to hard currency markets.

After she left the Sterling Area, Egypt had to look for alternative means to regulate its financial relations with countries, specially those which are outside the Scheduled Territories and the transferable account area. Such means were embodied in the various trade and payments bilateral agreements concluded with some thirty countries in the world. Generally, the agreements have three main basic objectives: first, to expand the Egyptian cotton market; second, to obtain the necessary capital goods for industrialization; and third, to establish the Egyptian pound as an accepted currency in international settlements. Some of the countries with which Egypt concluded bilateral agreements are in the Scheduled territories. The first agreement was concluded with France in June 1948 which marked the initial step in launching the Egyptian pound on the international money market. This agreement, which worked quite smoothly, was followed by several other agreements on more or less the same lines.

The majority of payments agreements run for one year subject to automatic renewal. They are accompanied by trade agreements embodying the most favored nation clause.

Most of the agreements concluded with Eastern European countries as well as agreements concluded with Spain and Lebanon, specify that all dealings are to be effected in Egyptian pounds. A "collector" account is opened with the National Bank of Egypt in favor of the Central Bank or similar agency of the country concerned, and a maximum debit balance is usually fixed beyond which credit facilities may not be extended to the foreign country except under special arrangements.[1]

Agreements concluded with Western European countries, on the other hand, specify that payments are to be effected in Egyptian pounds and/or the currency of the country concerned.

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1. Austria and Bulgaria are two exceptions as no overdrafts are permitted on their accounts.

In specific agreements a mutual ceiling is agreed upon beyond which net balances may not go.

There are agreements however, where the two currencies are used each for specific transactions. The agreement with Switzerland provides for a so-called "B" account through which certain transactions should be carried in Egyptian pounds while others in Swiss francs under the "A" accounts. The rate of the "Swiss Bankers' B Accounts" was left to be determined by the market conditions in Switzerland. This same procedure was later incorporated into the agreements with Belgium and the Netherlands.

A third category of agreements includes all agreements which do not provide for the use of the Egyptian pound. The agreements concluded with Japan and Turkey are made on the basis of U.S. dollars of account. The agreement with Japan provides for a "Japanese account" which may not show a deficit of more than five million dollars. Finally, the agreement with India provides for exports and imports to be invoiced in rupees; however, actually 60 percent of exports are settled in Sterling and the rest in rupees, while invisible imports are also paid in Sterling.[1]

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1. Egypt's Balance of Payments with India and Japan is persistently in her favor. See National Bank of Egypt, "Egypt's Financial and Payments Agreements", Economic Reviews, Vol. 7, (1954), p. 165.

D. Capital Movement:

1. Residents' Possessions Abroad:

The residents' possessions abroad consist of all credit accounts, foreign exchange, gold, rents, values of liquid and non-liquid assets, that are possessed outside Egypt by residents in Egypt. Such accounts are classified under three categories: (1) The liquid possessions including currency and credit accounts in foreign countries. Such accounts are required to be repatriated into Egypt and be submitted to the Central Exchange Control. This obligation does not apply to such possessions existing on and before July 14, 1947, the date of issuance of this law, but to all new funds acquired after that date. (2) Non-liquid possessions including values of fixed and movable property whose eventual revenue should be repatriated into Egypt. (3) Revenue; all revenue of any sort acquired in foreign countries should necessarily be repatriated. This covers interest, dividends, rents, profits, commissions, etc.

There are two kinds of exemptions from the obligations of this law: general and special. Under the general exemptions would fall all liquid possessions which existed on the 14th of July 1947 in the United Kingdom and pertaining to moral and/or physical persons residing in Egypt without considering their nationalities. These exempted balances were in the past denoted as "Egyptian accounts" and are actually called "transferable accounts". Special exemptions, on the other hand, cover all liquid and non-liquid possessions, and all revenue accruing in the countries of origin of foreigners residing in Egypt. For example, a Belgian residing in Egypt is exempted from repatriating his possessions in Belgium into Egypt. Hence a foreign resident in Egypt benefits automatically by first, being dispensed from the repatriation of his liquid possessions existing in the United Kingdom as on the 14th of July, 1947, and second, by the special exemption. However, he is required to repatriate into Egypt all liquid receipts possessed outside the United Kingdom and his nation country, and all profits and revenue acquired outside his nation country.

2. The Inflow of Capital:

There is no definite procedure for the inflow of foreign capital into Egypt, however, the inflow of such capital must be done through an authorized bank. Law No. 156 of 1953 and its amendments in 1954, provide for preferential treatment for foreign capital inflow for the purpose of investment in projects that contribute to the economic development of the country. A special committee was formed under the Ministry of Commerce and Industry to deal with applications of persons who wish to benefit from the provisions of this law. Applications must indicate the amount and nature of capital which is to be imported and as well the kind of project in which it will be invested. The inflowing capital is to be converted into Egyptian currency at the prevailing exchange rate. No fees or taxes are imposed on capital imports.

3. Outflow of Foreign Capital:

All foreign capital which is authorized by the above mentioned special committee may be repatriated after five years from date of importation, in yearly instalments not exceeding 20 percent of the imported capital. Moreover, foreign capital may be repatriated in full any time after the lapse of one year from date of importation, if practical difficulties accepted by the committee prevented its investment. Furthermore, foreign capital which is not registered by the special committee may not be repatriated except by an authorization from the Central Exchange Control. Such an authorization is rarely given, however, in case it is provided, foreign capital may be exported only in the original currency in which it was imported and at the exchange rate prevailing at the time of repatriation plus a ten percent tax.

4. Transferability of Profits:

Profits accruing from capital investment benefiting from the provisions of Law 156 of 1953 may be transferred abroad in full amount. With regards to profits from other foreign capital investments in Egypt, there is no theoretical limit to their remittability provided that sufficient foreign exchange is available at the Central Exchange Control. In practice, however, as Egypt's foreign exchange reserves are relatively small, the law is so administered as to limit profit remittability to a minimum and to delay or prevent it whenever possible or necessary. Profits may be transferred in the original currency in which the capital was imported and at the rate prevailing during the time of transfer. Profits, however, may be reinvested in Egypt and be eligible to the preferential treatment.

5. Invisibles:

Banks in Egypt are authorized to affect certain invisible transactions without prior exchange control approval. Expenses for travel, family maintenance, film royalties, and subscriptions and fees of professional organizations are usually approved within specified quotas. Until March 1948, the basic travel allowance was LE 150 per person per year. This was increased to LE 300 for adults over 16 years of age and remained LE 150 for children under 16. However, these excessive allowances and the extra allocations granted as well to certain persons resulted in a total volume of expenditure on tourism which far exceeds the possibilities of the Egyptian economy. As a result, travel allowance was reduced again in 1951 to LE 200 for adults and LE 100 for children. Such allocations were usually made in Sterling, however, with the increase of bilateral payments agreements it became possible to meet travel expenses in Egyptian pounds and/or in the currencies of the countries concerned. In April 1952, travel allowances were reduced further to become LE 100 for adults and LE 50 for children, and in 1953 the Egyptian authorities curtailed these allocations still further by limiting them to foreign residents traveling to their original country. Egyptians were allowed to travel only for health reasons. In 1954, as the balance of payments position showed a considerable improvement, the maximum allocation was raised again to LE 200 for elderly persons of 60 years and over,[1] while allocation of LE 75 was generalized to include Egyptians and foreign residents. Every traveller is allowed to carry with him LE 20 in cash, Egyptian or foreign currency. Transport expenses could be paid in Egyptian currency in Egypt.

Special arrangements were concluded with Lebanon in 1953 which permitted Egyptians to travel on an allowance of LE 100 and provided a minimum exchange rate guaranteed by the Lebanese Government.[2] Furthermore, the sums allocated for this purpose were credited to a special account which was to be utilized for expenditures of Lebanese in their travels to Egypt.

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1. For women, 55 years or over.

2. The rate was LL $8\frac{1}{2}$ for LE 1.

All travel and family maintenance remittances are subject to a tax of 10 percent. Some exemptions from this tax are allowed such as remittances for students and diplomats.

Tourists coming into Egypt are allowed to import any quantity of foreign exchange but Egyptian currency which is permitted to the extent of LE 20. Also, when leaving the country, travellers are allowed to take with them not more than the amount imported in foreign exchange and not more than LE 20 Egyptian banknotes subject to ten percent tax.

6. Capital Transfers:

Transfers abroad made by residents for the purpose of acquiring capital assets or securities outside Egypt require special permits which, normally, are not granted. Trade in securities and similar items requires special licenses too and their transfers within Egypt from one non-resident to another require the approval of the Central Exchange Control unless such residents belong to the same monetary zone.

E. Conclusion:

The exchange system of Egypt consists of a strictly regulated exchange control which was initially established in 1939 and was reestablished on a wider scale in 1947. This system of foreign exchange control is a relatively recent weapon added to the arsenal of monetary policy and made possible the divorce of internal monetary and fiscal action from its external effects. The main objectives of exchange control in Egypt are to assist foreign trade policy which focussed attention on the protection of infant industry and the diversification of agricultural production. Moreover, the control aims at accumulating foreign reserves and using them wisely in assistance of the urgent economic needs of the country.

CHAPTER V.

IMPACTS OF MONETARY POLICY

The broad objectives of any monetary policy should aim at securing an appropriate flow of money expenditure so as to maintain a relatively high level of employment and a general economic equilibrium. The immediate objective, however, is to stabilize the value of the monetary unit, i.e. the pound, usually in terms of gold and silver, in order to achieve both internal and external stability and promote international trade. The major criterion of monetary policy, therefore, that enjoys considerable support among economists is the stabilization of the price level through the application of the various weapons that are within the jurisdiction of monetary authorities. Unless an economy has some sort of monetary stability it will be constantly subject to intolerable fluctuations in employment and production. Granted a reasonably flexible price level system in a free economy, a decline in aggregate demand initiates a depression and a respective fall in prices. Depressions and the resulting unemployment can be kept to tolerable levels by monetary measures under even the most extreme conditions of high liquidity preference and low investment opportunities by injecting new money into the system and the demand for money could thus be met. If the new injected money went to savers a larger injection would be needed; it is however, hardly likely that savers would permit their cash balances to rise indefinitely without turning to investment so long as the prospective rate of return is above zero. Conversely, if the new money went to non-savers, i.e. the lowest income groups, consumption will increase markedly.[1]

There is practically no unanimous opinion as to the best means of implementing monetary policy through the variations in the quantity of money in circulation. The theory that prevailed during the nineteenth century and the first third of the twentieth century maintains that changes in the rate of interest, particularly the rate charged by the member banks, induced by changes in the central bank discount rate and open market operations would achieve the desired end. At a lower rate private borrowings from banks are liable to increase, and thus the quantity of money, in the form of bank deposits will be increased. This central banking policy did not prove highly effective during the panic of 1929 not because of any defects in the theory but mainly due to the fact that central banks, particularly in the USA did not take sufficiently vigorous action to implement that policy. Moreover, it takes time for a central bank to make its rate policy effective in the market, and in the short run, the demand for funds, particularly short term funds, is inelastic. Consequently, the cumulative forces of depression are likely to operate so much faster than a reduction of bank rate.

Open market operations by a central bank may have similar effects as the bank rate. In fact, their effects are of dual nature.

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1. Lloyd W. Mints, "Monetary Policy", Readings in Fiscal Policy, (London: Allen & Urwin, 1955) p. 346.

They induce changes in the rate of discount and directly affect the size of cash balances of the public. Nevertheless, open market operations tend to have immediate repercussions on cash balances of only a small proportion of individuals and corporations with the result that during severe disturbances they are likely to be sufficiently effective.

In view of all these facts, the doctrine of central bank control lost much of its reputation during the thirties and was more or less replaced by the belief that fiscal policy is the only means for adequate control of the quantity of money. This view of the conventional central banking weapons seems too pessimistic especially with regards to more developed economies. It is however, justifiable in the case of less advanced countries like Egypt where the rudimentary money and capital markets are quite insensitive to the subtle influence of central banking techniques. Besides, the level of private savings is relatively low in underdeveloped countries. In Egypt, it amounts to approximately six percent of national income.[1] Moreover, the center of money creation in Egypt is not the banking system as such, but the balance of payments and to a large extent, government expenditures.

Foreign exchange control is a relatively recent weapon added

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1. National Income during 1954 was estimated at LE 867 million. Total time and savings deposits at the end of the same year amounted to LE 53 million.

to the arsenal of monetary policy, which made possible the divorce of internal monetary and fiscal action from its external effects. There are generally two stages of control; that of capital movement and that of current account transactions. Putting it in broader terms, Exchange Control is a defensive measure set up to shield the economy against deflation from abroad. "From the view point of anticyclical policy as well as in the light of the requirements imposed by the monetary structure, the case of exchange control is stronger in an export economy".[1]

The purpose of the above theoretical expose is to summarize the main objective of monetary policy and the various means of its implementation. It is also to show, more generally, that monetary stability in free markets is not so much a remedy for unemployment as it is an essential condition for the functioning of an economy of private enterprise. Our following task shall be to discern those practical developments of monetary measures in Egypt, and to analyze their repercussions on the two major pillars of the present Egyptian economy: The movement of cotton and industrialization.

A. Monetary Policy of Egypt:

Although Egypt has achieved a remarkable step in monetary and banking developments during the past few decades, yet there

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1. Wallich, Henry C., Monetary Problems of an Export Economy, (Cambridge, Massachusets: Harvard University Press, 1950) p. 260.

has not been a coordinated and well defined monetary policy that serves as a guide to the monetary system. All that exists in this respect is a scattered collection of various monetary and fiscal legislations from which policy trends can be deduced. The National Bank policy prior and after its centralization was mainly passive. It did not exercise much control over commercial banks. Besides, its ultimate tools were the liquidity ratio and reserve requirements which were substantially high in commercial banks. As far as industrialization was concerned, NBE did not participate or encourage this sector of the economy. The general trend since 1952 has been more towards rationalization whereby greater emphasis has been put on the building up of existing and new industries in the country through the application of various exchange and trade restrictions.

An attempt, therefore, to study the monetary policy of Egypt leads to a consideration of three major monetary developments. The first consists of the exchange control system which was widened in 1947 following Egypt's departure from the Sterling Area. The second of these developments is the centralization of NBE in 1951 and the third is the Egyptianization of banks in 1957.

1. Exchange Control:

The ultimate aim of monetary policy before and during the last war consisted mainly of stabilizing the value of the Egyptian pound in relation to the Sterling pound. Until 1947, that objective was automatically achieved by virtue of the existing link between the two currencies since 1916. That link was the focal point of Egypt's monetary policy. In 1939, Egypt was required to set up exchange control with countries outside the Sterling Area if it wished to maintain its membership in that Area. Egypt had no alternative but to adhere to that request in order to protect the value of the pound from deteriorating by fixing that value to the soundest international currency at that time. As a result, the problem of stabilizing the value of the pound to the Sterling did not apply during the war and immediate post war years. With the departure of Egypt from the Sterling Area in 1947, the authorities in Egypt were faced for the first time with the real problem of how to stabilize the exchange value of the pound. That value depended to a great extent on the balance of payments position. As a result, the solution to that problem was more or less visualized in a widened scope of Exchange Control which included all countries of the Sterling Area. Moreover, the Government policy aimed at incurring annual deficit in Sterling transactions while trying to achieve a surplus or balance in the payments with hard currency zones. More and more Exchange Control was applied to serve the implementation of foreign trade policy which focussed attention on the protection of infant industry and the diversification of agricultural production. To that extent, the system can be described as succesful not only due to its own merits but also due to the post war revival of the world economic situation.

As a result of the exchange control system, the blocked and free sterling balances of Egypt decreased from LE 335 by the end of 1948 to approximately LE 100 million at the end of 1956. The dollar reserves on the other hand, increased during the same period from LE 6 million to LE 21 million. Gold also increased from LE 13 million to LE 66 million during the same period.[1] The dollar and gold reserves were accumulated mainly as a result of foreign trade policy whereby imports of luxuries and non-essential goods were restricted while imports of essential commodities and capital goods were granted priority licenses if effected from soft currency areas. Moreover, the increasing gold stock did not constitute a hindrance to the economy since that gold was purchased with the excess dollar reserves. From the purely monetary point of view it is probably more advisable to maintain reserves in gold rather than in foreign exchange.[2]

The Control Department of the Central Bank is in no position to protect the value of the pound since that value is determined by the forces of supply and demand which in turn are affected to a great extent by the demand for Egyptian

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1. See Chapter III, Section C

2. While foreign exchange rates tend to fluctuate the value of gold is fixed and is unlikely to be changed in the forseeable future, except probably upwards.

cotton. Internally, a decline in cotton exports would result in a decrease in the income earned by the farmers and by all those who depend directly or indirectly on cotton for their living. Thus the purchasing power that is in command of the cotton population will decline resulting in a decrease in consumption levels and in the demand for goods and services in general, leading to a fall in the general price level. The Banking Department of the Central Bank on the other hand, cannot use open market operations effectively to maintain the value of the pound at a stable level mainly due to the limitations of the money market.

The second major objective of Exchange Control was to check capital outflow. Although until 1947 the free movement of funds between Egypt and the rest of the sterling area countries did not result in any flight of capital outside Egypt, (actually an inflow of capital took place in the form of sterling balance created in London,)yet, the monetary authorities in Egypt failed to obtain a guarantee from the British Government against any loss that Egypt would have incurred in case of sterling depreciation as did actually happen in 1949.[1]

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1. Iran, in this respect, obtained a guarantee from Britain by which the value of Iran's Sterling balances was fixed to the value of gold with the result that in 1949, Iran's balances in London increased to the same ratio as that of the decline in Sterling value.

Although capital flights have been more or less checked since 1947, yet such movements have often occured by means of over-valuating imports rather than under-valuating exports since prices of cotton are well known and could not be played with.

Finally, the third objective of exchange control was to isolate the national economy from foreign impacts. The system failed to achieve this purpose prior to 1947 since it had failed to check capital movements. Although complete isolation cannot be achieved, an efficient control would minimize and limit the effects of foreign economic disturbances on the local economy.

Thus the basic objectives of Exchange Control have been more emphasized since 1947. Beside the ultimate aim of stabilizing the value of the Egyptian pound, the system that was set up in 1947 adopted a policy of building up foreign reserves other than Sterling, while achieving annual deficits with regard to international transactions concluded with the Sterling Area. Moreover, Exchange Control has been used as a mechanism for implementing foreign trade restrictions in order to promote industrialization and to encourage the diversification of agricultural production.

2. <u>The Centralization of NBE:</u>

The National Bank of Egypt assumed officially the role of the Central Bank of the country in 1951 and was given power to stabilize the value of the Egyptian pound and control credit. These powers were reinforced further in the recent banking and credit law No. 163 of 1957. However, so far NBE has not been successful in enforcing those powers mainly because of the limitations of the money market. As a Central Bank, NBE has the power of note issue and as such can control money supply and adapt it to the needs of the economy. It is allowed to inject new money during periods of economic instability, against any type of its assets. Moreover, the Bank is given power to undertake open market operations of buying and selling Government bills, bills guaranteed by the Government and other reliable commercial bills for the purpose of affecting the reserves of commercial banks in alignment with the general savings and monetary policy.

The reserve and liquidity ratios are important weapons of credit control in Egypt where other weapons are of limited value owing to the narrowness of the money and capital markets. By reserve ratio is meant the ratio of bank's balances with the Central Bank and its deposits or some other specified types of its liabilities. The cash ratio is similar to the reserve ratio except for adding the cash in the bank's premises to the numerator, namely the bank's balances with the

Central Bank.[1] Moreover, liquidity ratio covers a wider range of liquid assets including cash at vaults, balances with the Central Bank, Treasury Bills, Other Short-term bills and Other Self-Liquidating assets. Liquidity ratio is the percentage of liquid assets to total deposits. That ratio gives the clue to the structure of assets and liabilities in the country. Some difficulty arises in the selection of those assets which can be considered as liquid and some difficulty arises in determining the items of the numerator. In fact there is no international standard for the calculation of the liquidity ratios.

The Central Bank Law No. 57 of 1951 provided for a reserve ratio requirement rather than a cash ratio. According to that law, only non-interest-bearing balances of banks with NBE are to form a certain percentage of deposits.[2] This same provision is found in the new legislation 163 of 1957. Although the reserve ratio never reached the minimum requirement of 15 percent which was fixed by the Supreme Committee, yet the measures taken in 1954 whereby the ratio was reduced to 12.5 percent, did affect in general the total advances of commercial banks in a very positive way. The aggregate advances of these banks increased by 25 percent by the end of 1954 and 1955, and increased by approximately 40 percent by the end

1. Marzouk, Girgis, "Reserve; Cash and Liquidity ratios for Commercial Bank", Banking Studies Institute, lecture delivered in Cairo on 26/3/57.

2. The items included in the calculation of the reserve ratio are: cheques, drafts, correspondents, current deposits, time and saving deposits and other deposits.

of 1956 compared to 1953 figures.[1] Recently, in early November, 1957 the minimum reserve ratio was lowered further to 7.5 percent in attempting to alleviate the still prevailing credit stingency in the country. This measure is expected to create a sort of psychological warranty to banks which now feel more secure in the further expansion of their credit facilities. On the other hand, the recently fixed low reserve ratio indicates that the monetary authorities in Egypt have now greater faith in the banking system especially after the Egyptianization of banks which are now operating along a coordinated credit policy.

3. The Egyptianization of Banks:

The third, in chronology, of the major monetary developments achieved during the last decade is the Egyptianization of banks in 1957 which rendered banking activity a business for Egyptian nationals only. The Egyptianization law is probably the most important step ever undertaken in the field of monetary policy in Egypt since the last half century or so. That law together with the similar legislations with regards to insurance and commercial representations, brought to an end all foreign influence and interference in the domestic economic and monetary life of Egypt. Foreign banks mainly

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1. See Table X, Chapter III,

French and British, were established in Egypt in the second half of the nineteenth century and found a most lucrative business in the acceptance of deposits and in cotton financing. These banks continued to operate in Egypt in accordance with the instructions which they received from their headquarters abroad regardless of whether those instructions and designed policies assisted the economic needs of the country. Foreign banks adopted a sort of reactionary credit policy whereby they abstained in general from dealing with Egyptian firms, while their credit policy was set for them from abroad.

A view at the activity of foreign banks would tempt someone to believe that businesswise these banks were within the realm of normality. With regard to the distribution of deposits, for instance, foreign banks which outweighed local banks in number and size, were normally expected to control more than 51 percent of total banks' deposits.[1] On the other hand, the discounts and advances of foreign banks accounted for about 50 percent of the total for all commercial banks. Moreover, the ratio of advances to deposits was 76 percent for foreign banks compared to 86 percent for Egyptian banks at the end of 1956. Thus any arguement supporting the Egyptianization act on the above stated grounds would seem to be misplaced; however, an analysis of the nature of the advances

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1. See Chapter III.

of foreign banks would reveal that these advances and all other credit facilities of foreign banks were limited to a great extent to foreign commercial houses. Besides, the defects of the situation of foreign banks whereby they received order from abroad, were painfully felt in Egypt during the 1956/57 cotton season when, as a result of Egypt's nationalization act of the Canal in July 1956, foreign banks refused to finance the cotton harvest and export. Government interference at that time helped in solving the problem by asking the Central Bank to extend more Government guaranteed credit to some of the big Egyptian Banks.

One basic weakness inherent in the banking system of Egypt was the general stingency of credit which could hardly be cured as long as the pillars of the banking system received their instructions from abroad. Moreover, banks in general did not have any interest in helping Egyptian industry which is at present the corner stone of the economic development. Banking specialization does not apply to Egypt nor to any underdeveloped economy where the total level of savings is low and therefore every portion of that saving should be used in the process of capital formation. Commercial banks must fill a gap in this respect by using their idle funds during the slack season in short-term credit assistance to industry. Now that the minimum reserve ratio requirement has been set at 7.5 percent, banks are thus given a greater incentive to a more liberal credit expansion policy which is morally backed by Government through the Central Bank.

B. Financing Cotton Movement:

The commercial banks in Egypt play an essential role in the financing of cotton movement during its various stages. The economy of Egypt still depends, and to a great extent, for its survival on cotton exports. Cotton accounted for an annual average of 80 percent of total exports during the past five years and of 50 percent of total balance of payments receipts during the same period.[1] As a result, cotton continues to be the backbone of Egypt's economy and the financing of cotton exports remains to be one of the basic objectives of Egypt's monetary and banking policy. This sort of financing starts at the level of the traders who buy the cotton from the farmers some time before the harvest of the crop. Later, when the crop is delivered, it undergoes various stages of milling, pressing, and packing which all require some sort of financing that cannot be entirely met by the exporters. In the early stages of cotton movement, advances are usually granted against the collateral of the coming crop while in subsequent stages advances are usually granted against the collateral of commercial bills and papers. Finally, the last stage of cotton financing is directly connected with the export of the crop whereby it is paid for usually by foreign short-term

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1. See Chapter I.

bills, varying between two and four months, which are discounted by commercial banks in Egypt.

During the twenties, the commercial banks in Egypt, which were mainly branches and offsprings of foreign credit institutions, obtained the necessary funds for cotton financing during the season by drawing on their principal offices abroad funds which were easily transferable to Egypt. On the other hand, the Government of Egypt guaranteed all advances made by NBE up to 80 percent.

In 1939, the political and war effects had great repercussions on the movement of cotton. Trade movement in the Mediterranean sea was interrupted during the war years and the Government had to fill the gap with regards to cotton financing by issuing a loan of LE 15 million in 1941 at a rate of $4\frac{1}{2}$ percent for a period of five years. Also during the same year, treasury bills were issued for three months to the amount of half a million pounds. In 1942, the Government took over entirely upon itself the financing of the crop.

Following the second world war, the transfer of Egyptian balances in London were blocked and could not be used to finance the cotton export. Provisions were then made for the issuance of Treasury Bills up to LE 50 million to cover the required note issue for the financing of cotton during its season. The period of the last decade witnessed a remarkable increase in the aggregate deposits of commercial banks, amounting to LE 195 million by the end of 1956, which made it possible for the banking system to finance that cotton movement from purely internal sources without resorting to any foreign financial assistance. This situation was also alleviated by the increased advances of NBE to banks and others which amounted to a total of LE 42 million at the end of 1956 compared to LE 7 million during the same period in 1948.[1] Moreover, NBE in its capacity as the State Central Bank enjoys greater flexibility in its power to affect the volume of credit in the country to meet the increased demand for money during the process of cotton movement. The banknote cover was widened in February 1957 to include Egyptian securities guaranteed by Government, and also to include commercial bills acceptable for discounts.

It should be pointed at this level that there has been a gradual shift from fiscal to monetary measures adhered to by Government in its policy with regard to financing cotton movement. While previously the Government adopted the policy of extending loans obtained from the annual ordinary budget to finance the cotton movement, and while the Government went still further to the extreme of purchasing cotton stocks during the war and immediate post-war years, the tendency since then has been to set up a reliable and efficient banking system which in cooperation with the Central Bank can take over fully that most

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1. See Chapter III, Table XIII.

significant job. To achieve those ultimate ends, the Government realized that there were some inherent defects in the banking structure that needed an immediate curement. Those defects were more than ever realized during the cotton season of 1956/57 when following Egypt's act of nationalization of the Suez Canal in July 1956, the foreign banks in Egypt were reluctant to finance cotton and instead invested part of their excess reserves in Treasury Bills. Egyptian banks which had to fill the gap, turned to the Central Bank for accomodation as their cash reserves were strained. By the end of 1956, all justifiable demand for credit was met. This mere incident during the last cotton season, was probably the direct cause that led the Government to reconsider to banking structure of Egypt and thereby issue the Egyptianization decrees in January 1957.

As far as cotton movement and its financing are concerned, the Egyptianization of banks is not expected by any means to be of any impediment to the cotton movement since as it has already been noted, the banking system does not anymore depend on foreign sources of funds for the financing of cotton movement. Moreover, under the new system the prospects are great that the financing of cotton exports will be maintained with greater efficiency and regularity and especially that the new banking system will be guided by the general interests of the economy as dictated by the basic needs of the country rather than being guided by various conflicting policies outlined at the headquarters of the foreign banks.

C. The Impacts of Monetary Policy On Industrialization:

Economic development of backward areas is an issue of paramount importance in the world today. Whereas the ultimate objectives of undeveloped countries are undebateable, the means of achieving those objectives are subjects of controversy on which economic experts do not usually agree. Some economic thinkers believe that the agricultural population of an over populated agrarian economy, like that of Egypt, is the main consumer class, and its purchasing power is the monetary counterpart of the surplus production which is not consumed on the farms. Consequently, since this surplus is small, the purchases of industrial products by the fellah would thus be very limited, and although one can imagine a harmonious development of industry whereby the industrial population itself will represent the market for goods produced, such a scheme cannot actually be the basis for industrialization. Agriculture produces the major part of the food for the industrial population and an important part of the required raw materials for industry. Thus a healthy inter-relationship between the two sectors of the economy is essential. Other economists on the other hand, maintain that the case of Egypt, where disguised unemployment in agriculture is an inherent characteristic of the economy, development must be achieved through industrialization whereby the excess unproductive population will be engaged in new industries while agricultural production will be maintained at its same level at least in the short run. In the long run, modern equipment and new techniques will be introduced in agriculture and will increase the productivity in this sector of the economy. These are the different views of economists of the problem of development. In both cases, actually, industrialization is the ultimate end but viewed from different angles. The argument that industrialization solves the problem of disguised unemployment should be reserved, but, at the same time, agriculture should not be ignored, it must be developed, so that the market for industrial production will expand and hence make the expansion of industry possible. In this connection, the Government in Egypt started from the proper end by assigning the first major capital investment of its development schemes for the expansion of cultivable agricultural area while encouraging industry through various monetary and exchange measures practiced.[1]

The impacts of monetary policy on industrialization are of special importance and interest even though they cannot be accurately depicted and analyzed. These impacts are generally reflected in Egypt's pace in industrial development. Egypt is steadily expanding its industry and there have been some consi-

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1. The LE 11.8 million profit from the gold revaluation in 1951 and the $ 10 million from Point Four were assigned for agricultural expansion. See NBE, Economic Bulletin, Vol. VI, 1953, p. 1.

derable developments in this field during recent years. Obstacles to industrial developments, however, are still strong and it is not surprising that Egypt is making immense efforts to overcome them. As most of Egypt's industrial development has been done in conjunction with British and other European agencies, most of the capital invested in industry in Egypt, until the abolition of the capitulations at Montreux in 1936, was foreign. Although the Second World War, by its stimulation of local industry, attracted a considerable Egyptian interest in industrial undertakings, it is not until the Revolutionary Government's land reform legislation that any serious impulse was given to make the potential Egyptian investor look towards investment in industry as an alternative to agriculture.

A vast move was undertaken to encourage the Egyptian investor into placing his capital in industrial undertakings; the process involved a reorientation of the Egyptian attitude to investment. It had been common practice in British and French banking circles to discriminate against Egyptians in favor of foreign investors. Banks have been more demanding in their guarantees and their willingness to advance capital to Egyptians. The banking system of Egypt practiced during the past decades uncovers many glaring instances of such abuses.[1] In this context, the laws concerning the Egyptianization of foreign banks must

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1. Labib Choucair, Assistant Professor of Economics, University of Cairo, interviewed on October 27, 1957.

be viewed. Other legislations have been issued simultaneously with those of the Egyptianization of banks. They deal with the setting up of a State Economic Organization which will administer government investment in industry.

In the field of foreign exchange policy, the Exchange Control system was made subservant to trade restrictions which helped the protection of infant industry. This planned control in Egypt has certainly made great strides over the past decade. It is based on a dual objective of building up foreign reserves and protecting the infant industry through the introduction of the licensing system on import and export trade. As a result, imports of luxury articles and other non-essential goods decreased during the past few years while imports of industrial and capital goods increased considerably. For the sake of illustration, imports of artificial silk products and woollen fabrics fell from LE 6.5 million to LE 2.2 million in 1952 and 1956 respectively. On the other hand, imports of machines and looms for weaving more than doubled amounting to approximately LE 5 million in 1956. Imports of iron and steel wares also increased during the past few years. They amounted to about LE 16 million in 1956 compared to LE 9 million in 1952.

The industrial credit policy is reflected by the growth of activity of the Industrial Bank in which the Government owns more than half the shares. The total loans and credit granted during the period 1950-56 amounted to about LE 5.4 million of which 47 percent consisted of long and medium term loans and the remainder were short term loans and credits.[1] These sums were advanced to 400 industrial concerns in Egypt. The geographical distribution of Bank's loans and credits remained almost constant during 1955 and 1956 at an average of 75 percent for the Cairo district, 14 percent for Alexandria and the rest for other parts of Egypt.[2] Moreover, the Industrial Bank shared in the establishment of new industrial companies and in the promotion of existing ones, to the amount of LE 2.9 million up to the end of 1956. This amount was distributed among 16 industrial companies whose total capital is LE 27.6 million contributed as follows:-

Government	41%
Banks & Insurance Companies	12%
Industrial Bank	11%
Industrial Companies	4%
Individuals	32%
	100%

The Government and the Industrial Bank together contributed 53 percent of the capital of the above 16 major industrial joint stock companies. About 80 percent of the total Government

1. See Table XVI.

2. Industrial Bank, Report of the Seventh Ordinary General Meeting, (Cairo: Mondiale Press, Arabic Edition), p. 22.

capital participation in industry was allocated for the establishment of Egyptian Iron and Steel Company and the Egyptian Chemicals Company. Also, some 33 percent of the total Industrial Bank's investments in industry consisted of the Bank's share in the establishment of the Iron and Steel Company while 20 percent of its investments were allocated to the Chemicals Company.[1]

Egyptian industry, as has already been noted, is facing grave difficulties among which is the shortage of working capital. This difficulty is reflected in the great demand for such funds from the Industrial Bank, whereas liquid balances in some companies and banks are relatively high. It suffices to note in this connection that the legal reserves in the balance sheets of commercial banks rose from 17 percent on December 31, 1954 to 22.2 percent on the corresponding day in 1955 and fell to 18.4 percent during the same period in 1956.[2] It is expected that by the new legislation which has fixed the legal reserve requirement at 7½ percent, the banking system will have great impetus to expand short term credit to industry. On the other hand, the cash balances of insurance companies operating in Egypt is estimated at nearly 12.5 percent of their total balances. This percentage amounts to nearly twice what it is in similar companies in Britain. Moreover, insurance companies in Egypt keep 15 percent approxi-

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1. The Industrial Bank, (Cairo: Mondiel Press, Arabic, 1957), Table between pp. 6 & 7.

2. See Table X,

mately of their available funds in the form of company shares. This amount is less than half the percentage retained by insurance companies in Britain.[1]

Having now reviewed the various constituent factors of the monetary policy in relation to industrialization, the problem that remains is how to measure the impacts of that policy on industrial development. An accurate measurement of such impacts is almost impossible, as the level of industrial production does reflect solely upon the merits or demerits of the policy in practice.

For some years past, investigations have been made as to the possibilities of measuring even in a very approximate way, the industrial development of Egypt. About a year ago, an index of industrial production was calculated and served in filling a gap in the knowledge of Egyptian economy. On the whole, industrial production as measured by the index shows a rise of 19 points during the period covered (1951-55). During the last five years the industrial production has been growing at a rate of about 4 - 5 percent on the average and the pace of expansion has been accelerating. In 1955, the last year in the study, the increase reached 10%.

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1. The Industrial Bank, Report of the Sixth Ordinary General Meeting, (Cairo: Mondiale Press, 1955) p. 20.

TABLE XVII

GENERAL INDEX OF INDUSTRIAL PRODUCTION

(1954 = 100)

Year	Index
1951	91
1952	95
1953	97
1954	100
1955	110

Source: NBE, Economic Bulletin, "A preliminary Index of Industrial Production", Vol. X, No. 1, 1957, p. 7.

Another indication that the economic activity has been vigorously growing is provided by the analysis of the balance sheets of 100 limited companies for the years 1954 and 1955. Not only has the dividend increased in absolute value and in comparison with the shareholder's funds, but the aggregate position of these companies appears to be well founded; they own funds exceeding in value the sum of fixed assets and stocks. The aggregate balance sheet marked a growth during the year by nearly 9% which is nearly similar to the growth of industrial production by 10%.[1]

The National Income Estimates of Egypt have shown a marked development with regard to Industry from 1950 to 1954. During the latter year, the total income accrueing to the Industrial sector amounted to about 105 million pounds in 1954 compared to 71 million in 1950. Moreover, Industry accounted for 15 percent of the total income from the business sector compared to 10 percent in 1952 and 1953, and to 9 percent in 1950 and 1951. (See table)

TABLE XVIII

NATIONAL INCOME OF EGYPT

(In LE Million)

Sector	-1950		1951		1952		1953		1954	
Business Sector:	LE	%	LE	%	LE	%	LE	%	LE	%
Agriculture	353		347		269		273		310	
Industry	71	9	76	9	70	10	74	10	105	15
Construction	25		25		25		20		25	
Trade	126		149		120		129		69	
Transport	46		53		50		52		56	
Services	47		63		46		54		38	
Other Sectors	96		123		115		107		108	
Total	764		836		695		709		711	
Government Sector	95		114		124		128		141	
Household Sector	25		28		29		28		28	
Rest of the World Sector	-11		-12		-12		- 8		-13	
General Total	873		966		836		857		867	

N.B. Margin of error approximates to ± 10%
Source: Statistical Pocket Year Book, 1954, Cairo.

1. NBE, Economic Bulletin, Vol X, No.1, 1957, p. 2.

In conclusion, the fact should be emphasized again that all these developments that were achieved in the various sectors of the economy are not claimed to be the ultimate and immediate result of the existing monetary policy. There can be no proof at all that these improvements are due to monetary policy. However, the merits and demerits of monetary policy can be reflected only in such improvements.

CHAPTER VI

INFLATIONARY PRESSURES

A. Theoretical Background:

Before discussing the inflationary pressures in Egypt it would be good to define the term inflation. For decades economists have been elaborating complex definitions of inflation. The most common definition is that it is a state of affairs in which aggregate monetary demand exceeds total supply of goods and services. It is a condition whereby there is a considerable increase in money supply in relation to the volume of trade. As a result, effective demand tends to increase leading to a rise in prices and wages. The signs of an inflationary situation are that prices in general and wage costs in particular show a rising trend and are expected to rise further.

In general there are two types of inflation: Price inflation and cost inflation. A price inflation is simply a rise in prices caused by an increase in aggregate effective demand at current prices. Cost inflation on the other hand, implies that prices may be pushed up from the cost side even in the absence of excessive demand. As long as the tendency of the economy is inflationary, both price inflation and cost inflation will be present. Wage inflation which is a type of cost inflation, keeps pace with price or demand inflation and the real inflation is actually a mixed inflation.

There is clear evidence that we are living in an inflationary age. The evidence is theoretical as well as emperical. The economic philosophy of the twentieth century prizes full employment and equality and provides the knowledge necessary for their maintenance. Both full employment and equality make for more spending and are therefore inflationary. An inflation of this order is almost incompatible with the continuation of an orderly society. Small movements of prices are supportable and are even a sign of progress and development. However, a trend of prices which reduces the purchasing power of the currency in circulation by a significant amount within a relatively short period is certainly disorderly and requires to be checked.

The conventional weapon to check inflation is by credit control which is an anti-inflationary measure of purely monetary nature and is largely a matter of central bank policy. There are two kinds of credit control, the quantitative and the qualitative control. The quantitative credit control affects the money market by limiting the quantity of money available. Its aim is to affect the cost and availability of bank credit in general without regard to its distribution in any particular direction. Among the quantitative weapons of credit control are the discount rate, open market operations and higher reserve ratio requirements.

It is assumed that bank rates rise *pari passu* with higher rediscount rates. Consequently the conventional theory maintains that high rediscount rates increase the cost of borrowing for business and consumer spending with the result that borrowing is reduced and inflationary pressures lessened. It should be noted at this stage that in the final analysis the effectiveness of high rediscount rates depends on the accessibility of commercial banks to additional reserves. If commercial banks have easy access to additional reserves, then higher rediscount rates would be largely ineffectual.[1]

On the other hand, open market buying and selling of securities by member banks, i.e. banks that are members of a clearing house, always constitute an effective instrument of monetary policy since they bring about quantitative changes in the primary reserves of the commercial banking system. Similarly, changes in the reserve requirement applicable to banks represent a doubly effective instrument of monetary policy. A rise in the reserve requirements reduces the amount of demand deposits in the economic system. Moreover, higher reserves absorb some of the excess reserves in banks and prevent them from forming a basis for further credit expansion.

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1. Kenneth, Kurihara, *Monetary Theory and Public Policy*, (London: George Allen, 1951) p. 71.

The second major type of credit control is a selective one, in which the primary impact is not on the total credit that is put to use in the economy as a whole but on the amount that is put to use in any particular sector of the economy. The principal selective measure is the regulation of the margin requirements on loans for the purchase and carrying of securities listed on the national exchanges. The regulation of consumer credit is another selective or qualitative control instrument based on the observation that the monetary demand of consumer's durable goods is extremely unstable and of strategic importance to general price movements and to the levels of aggregate output and employment.[1] In a period of full employment, the regulation of consumer credit is designed to check inflationary credit expenditures on consumers' durable goods and to minimize the possible danger of undue installment credit expansion to the future stability of the economy. The mechanisms used in achieving this end involve the raising of the minimum "down payments", i.e. the amount paid in cash for purchases of specified goods on an installment basis. The extending of "selective coverage" is another mechanism of regulation whereby the scope is extended to include further consumer's durable goods. The greater the extent of coverage in this respect the more anti-inflationary will be the effect.

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1. Ibid. p. 76.

A third mechanism in this connection involves the lowering of "maximum maturities" for paying off the debts incurred in installment purchases.[1]

Having outlined the theoretical aspects of inflation and the various conventional weapons of controlling it, our task remains to analyse the inflationary and deflationary pressures that are experienced by the Egyptian economy and to study the role of monetary policy in controlling these pressures.

B. The War Inflation:

The economy of Egypt experienced serious inflations during the past two world wars caused by the increased expenditures of allied troops in Egypt, resulting in an increase in the quantity of money in circulation over and above the amount of increase in local agricultural and industrial production. The existing monetary system made such spending by England relatively easy. British treasury bills were used as cover for Egypt's currency and NBE maintained a fixed rate of exchange between the Sterling and the Egyptian pound. In this way, Egyptian notes were issued against British treasury bills and were spent by allied troops in Egypt.

During the second world war several factors combined to

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1. *Ibid.*

generate a powerful inflationary pressure. The disruption of exports owing to the shortage of shipping, led to a heavy trade deficit amounting to about LE 98 million during the period 1940-1945 inclusive. This, however, was partly offset by the British Government purchase of the 1940 Egyptian crop and half of 1941 crop. Much more important was the effect of allied military expenditures in the country which aggregated LE 319 million during 1939-45 inclusive (see table below).

TABLE XIX

ALLIED MILITARY EXPENDITURES

1939 - 1945

YEAR	LE MILLION
1939	4.9
1940	14.8
1941	46.5
1942	73.7
1943	75.6
1944	57.5
1945	46.0
1939/45	319.0

Source: Charles Issawi, Egypt at Mid-Century, (London: Oxford University Press, 1954), p. 230.

By the end of 1946, Egypt's sterling balances held in London amounted to LE 430 million distributed as follows:[1]

Creditor	£	%
NBE Note Issue	131	30
NBE Banking Dept.	210	49
Other Banks in Egypt	43	10
Individuals and Others	46	11
	430	100

The large amount of allied military expenditures resulted in a considerable increase in national income manifested by a substantial increase in consumption. These developments were sufficient to produce a sharp rise in prices during the war years. Moreover, this effect was accentuated by the bad harvests of 1941 and the shortage of imports. The index of imports (1938 = 100) fell in 1939 to 84 and in 1943 it reached a minimum figure of 34 and then rose again to 53 in 1945. Money supply increased by more than fivefold during 1939 - 45 inclusive. The index of wholesale prices on the other hand, rose to 333 at the end of 1945 (1939 = 100), while the cost of living index rose to 291 during the same period (see table XX).

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1. Shafii, M.Z., Mukadama Fil-Nukud Wal Bunuk, (Cairo: Renaissance Library, Second Edition, 1956) p. 139.

TABLE XX.

MONETARY INFLATION DURING THE SECOND WORLD WAR

	1939	1940	1941	1942	1943	1944	1945
Wholesale Price Index (Jun-Aug 1939 = 100)	122	143	183	251	293	330	333
Cost of Living Index (Jun-Aug 1939 = 100)	108	122	156	215	257	292	291
Money Supply Index (End of 1939 = 100)	100	137	183	254	337	452	565
Imports Index (1938 = 100)	84	82	41	57	34	46	53

Source: Ibid., p. 58.

The monetary authorities of Egypt failed to realize the importance of controlling incomes rather than prices in order to check inflationary pressures during the war. It was generally believed that since the prime motive force of inflation - allied spending - was external it was therefore uncontrollable. Budget surpluses, the floatation of loans and the raising of the rate of taxation sucked out some income. Rationing on the other hand was enforced but not adequately. The ration was liberal and the number of commodities affected was small. Price control was adopted and industrial production was encouraged as much as possible.

In short, the conventional central banking weapons to combat inflation could not be effectively used in Egypt in view of the lack of developed money and capital markets. As a result, inflation was widespread during the war and immediate post war years when the purchasing power of the Egyptian pound fell to one third its 1939 level.

C. Post-War Period:

Towards the end of the war import barriers were much reduced while the freedom of the seas was reestablished. As a result foreign goods began to flow into Egypt to meet the rise in demand caused by the existing revival of economic activity as the war came to an end. The balance of trade started to show persistant deficits. These deficits amounting to an average of LE 40 million a year, have been partly covered by invisible transactions under the balance of payments, and partly by using up the sterling balances which were blocked in England and were released, under bilateral agreements, in yearly instalments. Hence, these balances which were more or less regarded as saved wealth were actually transformed into goods for immediate consumption purposes.

However, the Government budgetary expenditures increased tremendously during the last two decades. It amounted to 280 million pounds in 1956/57 compared with 102 million in 1946/47 and with 48 million in 1939/40.

These developments however, were not in accordance with a deliberate anti-deflationary policy but were actually a result of the increased scope of Government activities during the last decade or so.

Thus, although the external factors injecting inflationary pressures ceased to exist after the war yet the level of prices did not witness great changes. The cost of living index fell only from 290 to 280 during the few years following the war. During the fiscal year 1948/49 inflationary pressure appeared again in Egypt as a result of the Palestine expedition.

1. <u>The Palestine War Impact</u>:

Our interest in the Palestine expedition lies not in its political or military results, but merely because that expedition has had deep effects on the development of inflation and led to higher living costs. The expenses of the expedition constituted a heavy burden on the state finances. Total Government expenditures incurred during the fiscal year 1948/49 amounted to LE 157.7 million compared to LE 94.5 million during the previous year. Most of the excess expenditures were met by the Palestine loan of 1948.[1] The loan consisted of two parts amounting to a total of LE 30 million.

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1. Labib Shoucair, <u>Ilm-Al-Maliah Al-Ameh</u>, (Cairo: Renaissance Library, 1957), p. 325.

It was fully covered by subscribers; however, these subscribers consisted mainly of large business concerns and insurance companies. In this respect, the Palestine loan can be described as being inflationary since it did not reduce the total purchasing power available in the hands of the public for consumption purposes, but, actually, it increased their power artificially by means of excess Government spending during the expedition.[1] Bank note issue was LE 127 million in August 1948 and rose consecutively to 136, 148, 152 and 154 million during the following four months. The cost of living index number rose from 279 in October to 282 in December of the same year.[2]

2. <u>Post Palestine-War Period:</u>

This period started in the summer of 1949 and was characterized by the significant increase in Government expenditures especially for consumption purposes. Budgetary provisions for expenditures during the financial year 1956/57 amounted to LE 280 million compared to actual expenditures of 190 million in 1950/51 and 48 million in 1939/40. These developments in Government expenditure, however, cannot be regarded to have had inflationary pressures since they were more than matched by revenue receipts from taxation.

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1. Part of the excess Government spendings on the Palestine expedition were done abroad mainly for the purchase of foreign arms and war equipment.

2. M.A. Rifaat, <u>Mashakel Misr Al-Iktisadiah</u>, (Cairo: Assabah Press, 1954), p. 36.

The budgetary closed accounts showed an annual surplus until 1951. However, during the financial year 1951/52 a large deficit was incurred (38.7 million) and created some inflationary pressures which were manifested in the sudden rise in the cost of living index during the same year.[1]

The major cause for the large increase in Government budgetary outlays lied in the very nature and scope of Government activity which has been significantly widened during the last decade. On the revenue side, a marked increase has been realized in indirect taxation especially from customs.

The greater part of the increase that occured during the last decade was brought about by the expansion in defence expenditure. Taxation remains to be the main source of public revenue, accounting for about 65 percent of the total. As long as the increase in Government expenditure is matched by a respective increase in tax receipts, such excess spendings will not constitute any inflationary pressure. During the financial year 1953/54, the latest year for which closed accounts figures are available, a surplus of around 7 million pounds was achieved in the Budget. This surplus had some deflationary effects manifested in the decline in cost of living index from 296 in 1953 to 281 in 1954.

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1. The cost of living reached a record figure of 320 in July 1952, see Table XXIV.

TABLE XXI

GOVERNMENT REVENUE AND EXPENDITURE

(LE Million)

Financial Year	Revenue	Expenditure	Surplus + Deficit -
1939/40	46.1	48.6	- 2.5
....	....	....	...
1945/46	103.5	95.3	+ 8.2
1946/47	112.8	102.5	+ 10.3
1947/48	101.5	94.5	+ 7.0
1948/49	170.5	157.7	+ 12.8
1949/50	173.6	163.8	+ 9.8
1950/51	191.8	190.2	+ 1.6
1951/52	194.1	232.8	- 38.7
1952/53	198.1	208.4	- 10.3
1953/54	206.4	199.7	+ 6.7
1954/55[x]	227.9	227.9	...
1955/56[x]	238.3	238.3	...
1956/57[x]	280.5	280.5	...

Source: vide - "EGYPT", in The Middle East, A Survey and Directory of the countries of the Middle East, (London: EUROPE Publications, 1957), ed. V, p. 97.

[x] Budget estimates.

TABLE XXII.

ACTUAL EXPENDITURE FOR MINISTRY

OF WAR AND MARINE

Year	LE Million
1939/40	8.1
....	...
1945/56	7.8
1950/51	30.8
1953/54	39.3
1954/55	53.6
1955/56	55.0
1956/57	75.4

Figures for year 1955/56 and 1956/57 refer only to Budgetary Provision.

Source: Ibid.

TABLE XXIII

WAGES AND COST OF LIVING INDICES

(Base 1939 = 100)

Month of July	Index of Wages	Cost of Living	Index of Real Wages
1940	100	110	91
1941	100	138	73
1942	103	180	57
1943	109	242	45
1944	139	283	49
1945	139	293	48
1946	152	285	53
1947	158	277	57
1948	182	280	65
1949	176	274	64
1950	206	292	71
1951	218	318	69
1952	212	320	66
1953	249	296	84
1954	261	281	93
1955	273	282	97

Source: NBE, Economic Bulletin, Vol. X, No. 2, 1957, p. 105.

In December 1951 the cost of living rose to a record figure of 328 compared to 290 in December 1945 and 298 in June 1957. This rise in the cost of living resulted from the Korean war impacts whereby cotton export prices pushed upward and at the same time import prices increased tremendously. These effects lasted until early 1952.[1] In July 1952, the cost of living index rose again to the level of 320 which may be attributed partly to the large deficit resulting in the Government budget of 1951/52 and partly to political disturbances resulting from the declaration of the new revolutionary regime during the same month. Beside Government expenditures, other factors have contributed to inflationary pressures in Egypt among which are the movements in the public debt and in the money supply, in cotton prices and in the balance of payments.

D. Public Debt Impact:

Until 1943, the greater part of Egypt's public debt was foreign (about 88 percent of the total). The outstanding debt of the Government during that year amounted to LE 105.5 million. At the end of that year too the budgetary reserves amounted to an accumulated figure of 42 million while Egypt's sterling balances in London amounted to some 200 million compared with 20 million in 1939.

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1. See table V.

Hence, in view of all these developments, the Government decided to transform the public debt into a completely internal one thereby removing the heavy foreign burden, and, at the same time, absorbing the excess purchasing power in the hands of the public in order to ease down inflation.

As a result, the Government floated four loans in the market: one long term, one medium term and two short term loans. The total subscription to these loans amounted to LE 86 million distributed as follows:-

Long term	67 million
Medium term	11 million
Short term	8 million
Total	86 million

Out of the total 86 million pounds of Government receipts from subscriptions, only 40 million were cash subscriptions while the rest consisted of a mere transfer from foreign securities. In this way, more than half of Egypt's foreign debt was repaid and the remaining part was then completely settled by the Government.

Until the year 1954, Egypt did not use public debt as a means of financing development projects. However, the Government policy in this respect has undergone a change during the revolutionary regime and has become now more and more dependent on public debt as a major source of financing. This policy has taken a practical form in December 1954 when the Government floated three new loans which it called "development loans" and which totalled 25 million pounds. And in early 1956, the Government invited the public to subscribe in two new bond floatations totalling 25 million pounds which were also for the purpose of financing development projects.

All those development loans were completely covered within relatively short periods after their issuance.[1]

It should be noted at this stage that the outstanding public debt at the end of December 1956 was LE 320 million compared with 143 million in 1951. Out of the total of 320 million, 136 were in the form of treasury bills. The remaining public debt, i.e. excluding treasury bills, constituted only 20 percent of national income which was estimated for 1954 to be LE 867 million. This ratio of public debt to national income is very low compared to the ratio existing in developed countries where public debt usually exceeds the amount of national income.[2]

Government borrowing may be inflationary or deflationary depending on the nature of the loan and the economic status of

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1. United Nations, <u>Economic Developments in the Middle East</u> 1954/55, (New York: 1956), p. 97.
2. Labib Choucair, <u>Ilm Al-Maliah Al-A'mah</u>, (Cairo: Renaissance Library, 1957), p. 332.

of the subscribers.

The Government policy of public borrowing aims at channelling idle private savings into productive investments and spreading the financial burden of development over a long period of time. Although an accurate determination of the contribution of public debt by the various subscribers is not possible, the general contention, especially with regard to the recent development loans, is that the main subscribers to these debts have been the big commercial, industrial and financial institutions which have benefited from the tax-free bonds and at the same time, have used these bonds as bases for acquiring more credit facilities from the banking system. In this respect, these loans may be characterized as inflationary.

It should be noted at this level that the broad objectives behind the issuance of the development loans were, as declared by the Government, to finance development projects without resorting to an increase in taxation or to a central bank loan because the resort to taxes to finance long term projects constitutes a burden on the population , and central bank loans mean that new money is launched in the market bearing with it inflationary seeds.

Despite this fact, however, we should not expect a great increase in public debt for development purposes, at least in the near future, because these loans are usually covered by private savings which are low in Egypt and do not permit large consecutive loans. Moreover, the money and capital markets of Egypt are not developed to absorb continually rising public debt. Thus, public debt and open market operations cannot be used in Egypt as an effective instrument for controlling inflation simply due to the existing low level of savings which is a characteristic of underdeveloped countries, and as well due to the limitations of the money market.

E. Money Supply and Inflation:

The money supply increased during the last few years at an average annual rate of 7 percent (1953-1956). By the end of 1956 the total money supply amounted to 511 million pounds compared to 418 million during the same period in 1953. On the other hand, foreign assets in command of banks fell from 248 to 173 million during the same period. Government borrowing from the banking system increased from 37 to 144 million during the same period, marking an increase of approximately 290 percent. Private borrowing also increased but not to the same extent.

The figure for December 1956 was LE 187 million which is 53 percent higher than the figure for the same period in 1953.[1] Thus the major inflationary factor in the money supply has been the excess Government spending. Development expenditures amounted to about 200 million during the last few years,[2] whereas ordinary

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1. See Table XV,
2. Girgis Marzouk, Assistant Chief, Banking Control Dept., NBE, Cairo, personal interview on November 28, 1957.

budget expenditures amount to over 200 million per year. Simultaneously during this period, there has been an increase in agricultural and industrial production. During the last few years, industrial production has been increasing at an average annual rate of 5 percent. During 1955 the rate of increase was ten percent. The quantum index of agricultural production on the other hand, also increased during the last few years. The index was 108 in 1956 compared to 97 in 1951 and 89 in 1946.[1]

Thus, although the money supply has been increasing during the last few years at a relatively high rate, the level of prices did not manifest significant changes mainly because the increase in money supply was accompanied by a corresponding increase in local production, agricultural and industrial; and also, by a relative increase in imports. However, there have been tendencies of cost inflation whereby the index of wages has risen to 273 in 1955 compared to 212 in 1952 and 139 in 1945 (see Table XXIV).

F. Cotton Prices and Inflation:

Beside war inflation, Egypt experienced inflationary and deflationary pressures during periods of rising and falling cotton prices. The sale of Egypt's main export product at a higher price results in an increase in the purchasing power of the internal economy. As this result is not likely to affect the production of consumable goods immediately, the level of prices of these goods

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1. NBE, Economic Bulletin, Vol. X, No. 4, 1957, p. 410.

tends to push upwards.

The indices of cotton export prices, wholesale prices and cost of living show more or less similar trends (see table XXIV).

TABLE XXIV

COTTON EXPORT PRICES, COST OF LIVING AND WHOLESALE PRICE INDICES

1943 = 100

YEAR	CEP	COL	WSP
1937	22	33	30
....	...	...	...
1948	98	95	93
....	...	...	...
1950	115	99	97
1951	192	108	108
1952	139	107	105
1953	100	100	100
1954	117	96	97
1955	115	96	99
1956	125	98	110

Source: International Monetary Fund, International Financial Statistics, Vol X, No. 9, 1957, pp. 92-95.

G. The Balance of Payment and Inflation:

The major feature of Egypt's "export" economy is that exports and imports respectively assume the roles that are played by investment and saving in an "investment" economy. Exports are the main source of national income and imports are the main leakage from the income stream. A favourable balance of payments, there, fore, increases money supply at the same time as it raises national income. Instead of a contraction of credit during such periods, Egypt experiences rising internal liquidity which intensifies the booms. On the other hand when the balance is unfavourable the supply of money tends to contract sharply and the depression is aggrevated. Hence, exports acquire an importance as a strategic factor in the Egyptian economy far beyond their quantitative predominance. The balance of payments of Egypt has shown persistent deficits since 1946 with the exception of 1949 when it was in equilibrium, and in 1954 where there was a small surplus. A common feature of post-war estimates has been the emergence of a large adverse trade balance which was partly offset by surpluses resulting from invisible current transactions. The overall results, however, depended on the conditions of these two factors. The persistent deficit was compensated mainly by the large decrease in foreign exchange holdings, especially by the annually released sterling balances.

Moreover, gold reserves have also increased during the last decade, amounting to LE 67 million by the end of 1956. Thus

The coefficient of correlation between the index of the cotton export prices (CEP) and the cost of living index is + 0.57,, while between the CEP index and the wholesale prices index it is a little higher (+ 0.617). This indicates that variations in the cotton export prices are more significantly associated with the variations in the wholesale prices index rather than with variations in the cost of living index.[1]

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1. The simplified formula for the derivation of the sample correlation coefficient is the following:

$$r = \frac{\Sigma\, x\, y \; - \; \bar{n}\, \bar{x}\, \bar{y}}{\sqrt{(\Sigma\, x^2 - n\, \bar{x}^2)(\, y^2 - n\, \bar{y}^2)}}$$

the formula for the two correlations are

1. $$\frac{91516 - 7 \times 129 \times 100}{\sqrt{(121949 - 7\ (129)^2)\ (70950 - 7\ (100)^2)}}$$

2. $$\frac{92970 - 7 \times 129 \times 102.28}{\sqrt{(121949 - 7\ (129)^2)\ (73408 - 7\ (102.28)^2)}}$$

the economy of Egypt did not suffer a strain in the foreign exchange position as a result of the balance of payments deficits simply because of the existence of large sterling balances which are blocked in London and are released annually under a bilateral agreement. Consequently, the conventional features of balance of payments repercussions mentioned above were not fully manifested at least during the last decade. Instead, the potential deflationary pressures resulting from the balance of payments deficits were more or less offset during the last few years, by the large credit expansion which led to an increase in the private money supply (excluding public deposits). Private money supply marked an increase of LE 68 million during this period.[1]

In September 1949, Britain devalued sterling by 30.5%. This devaluation initiated a readjustment of the values of most of the world currencies including the Egyptian pound. Some countries devalued by less than 30.5%,[2] but Egypt maintained its parity and devalued by the same amount as sterling.

By doing so, Egypt avoided drastic losses in international reserves, for gold and dollar reserves increased in value. The results of the sterling devaluation and the readjustment of most

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1. Henry Tadros, "Recent Development of Egypt's Balance of Payments", in the <u>Middle East Economic Papers 1957</u>, (Beirut: Economic Research Institute, A.U.B., 1957).

2. Belgium 12.3%, Portugal 13%.

other currencies have been observed by several international developments such as the business revival in the U.S., the tightening of import controls in some countries and the sharp rise in prices of raw materials following the outbreak of the Korean war in 1951. In Egypt, prices in general rose after devaluation, escpecially cotton prices which also rose in the world market. As a result of the rise in cotton prices some improvements were achieved in the balance of payments whereby the proceeds from exports reached a record figure of approximately 202 million pounds which is the highest figure that was ever achieved.[1] By the end of 1951, the cost of living index also reached a record figure of 328.[2] In July of the same year the index was 318 compared to 292 during the same month in 1950 and to 298 in June 1957.

H. Conclusion:

Egypt has been occasionally exposed to serious inflationary pressures. During the two world wars such pressures were wastly manifested and were caused by the excess expenditures of allied troops in Egypt.

The existing monetary system made such spending by England relatively easy whereby British Treasury bills were used to cover Egyptian note issue. Thus, the wartime inflation was ultimately caused by the increase in note issue resulting from the excess

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1. See Table III in Chapter One.

2. See Table V in Chapter One.

military expenditures of allied troops, accompanied by only a very slight increase in local production and a drastic fall in imports. It should be mentioned at this stage that there is no attempt whatsoever on behalf of the writer to deny the role of bank credit expansion at that time and the increased spending resulting therefrom. However, in so far as the wartime inflation was concerned, the large increase in the supply of notes was the major factor responsible for the inflationary troubles. During the world war years the money supply increased by more than fivefold and the cost of living rose to 291 in 1945 compared to 100 in 1939.

During the immediate post-war years a disinflationary situation existed whereby prices and cost of living tended to fall, relatively, as a result of the ending of allied expenditures and the restoration of the freedom of the seas when imports of consumers' goods began to flow into Egypt. Later in 1948, inflationary pressures appeared again resulting from increased Government expenditures mainly for defense purposes in financing the Palestine expenditure.

In 1950/51 the Korean war had repercussions in Egypt affecting the stability of the internal price level. During that period, cotton export prices pushed upwards, resulting in a new inflationary pressure which lasted until the beginning of 1952. The index of the cost of living rose to a maximum figure of 328 in December 1951 compared to 290 during the same month in 1945 and to 298 in June 1957.[1]

Since 1952, the level of prices has remained almost constant with the exception of 1954 and 1955 when a relative decline resulted from the fall in the volume of currency in circulation. Bank credit also increased during this period. The value of bills discounted almost doubled by December 1956 while loans and advances amounted to about LE 143 million compared to LE 103 million in December 1952.

Beside war inflations, inflationary pressures were also exhibited in Egypt during periods of rising cotton prices. This effect is a distinguishing feature of an export economy like that of Egypt, which depends primarily of the export of its single crop, cotton. In an industrially developed economy there is no reason to expect prices to rise before a stage of full employment is reached. However, for a raw material economy like that of Egypt an assumption of constant prices is altogether inadmissible no matter how large the volume of idle resources, mainly because the prices of raw materials are dominated by world market conditions. Moreover, the price of cotton is controlled by outside factors, a world wide market, which are beyond Egyptian influence. It is determined by world demand and supply conditions and, Egypt's role in affecting these two variables is almost passive.

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1. See Table V.

Monetary policy could not possibly be applied effectively as a means to check inflationary pressures in view of the absence of developed money and capital markets in Egypt together with the lack of a regulated banking system and a powerful central banking control.

The quantitative credit control is a purely monetary weapon to check inflationary tendencies by affecting the quantity of money available in the market. Among the conventional weapons of quantitative credit control are the discount rate, open market operations and higher reserve ratio requirements. In the absence of a regulated banking system and a developed money market in Egypt, all these weapons of credit control were unapplicable and their effects were largely insignificant. The selective control measures on the other hand, are basically weapons of developed economies where monetary authorities have access in controlling the entire credit system in the whole economy. They are more intricate weapons and require a high degree of socio-economic development.

Recently in 1957, with the introduction of the new legislations regulating the banking system and the credit situation, more emphasis has been laid on the possibility of applying monetary policy which is directly focused upon the supply of and demand for money in the form of aggregate cash and credit regulation. A general planning commission is at present preparing an elaborate plan for economic development in all the sectors of the economy . The plan embodies the general economic policy of the country and highlights the monetary policy that will be adopted in order to sub-serve the implementation of the economic policy. These plans have not yet been published and are treated by the Planning Commission with top secrecy. However, the general contention with regard to monetary policy, is that it how aims more and more towards the regulation of the banking and credit system, and the development of the money and capital markets. The central bank is now given wider control over the activities of other banks which are now all being Egyptianized.

The important thing which makes for the effectiveness of monetary policy in controlling inflationary tendencies is the control of the credit base. It is possible to conceive of conditions in which the quantity of money spent is regulated entirely by movements of a single rate of interest, but, such models are far from the realities of money markets.

"It is much more realistic to think of the size of the credit base coming first and movements of rates of discount and the rest being consequential adjustments".[1]

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1. Lionel Robins, "The Control of Inflation", in <u>The Economist in the Twentieth Century</u>, (London: Macmillain 1954), p. 76.

CHAPTER VII

SUMMARY & CONCLUSION

The Economy:

Egypt is a densely populated underdeveloped country whose economy is basically agrarian with one major export product, cotton. Agriculture accounts for some 36 percent of total national income and cotton alone represents 10 percent of this total.

Cotton plays an important role in the economy of Egypt. It is an industrial raw material which has a world market and the demand for it is directly affected by constantly changing world demand conditions. Cotton accounts for 80 to 85 percent of total exports of Egypt and as such, its marketing constitutes the focal point in the balance of payments policy.

The need for industrialization and the diversification of agricultural production has been felt in Egypt during the last few decades. Industrialization was stimulated to a great extent during the second world war when, owing to the shortage of imports, several industries developed and survived the war. Moreover, during the new revolutionary regime, industrialization was viewed as the ultimate solution for accelerating the pace of development and for the inherent problem of disguised unemployment. The basic requirements for industrialization are existing in Egypt but are not yet fully developed. The missing links in this connection is the low level of savings which is a normal result of the low national income and the high marginal propensity to consume.

A basic feature of post-war balance of payments has been the emergence of large adverse trade balance partly offset by surpluses resulting from invisible current transactions. Another basic characteristic of the balance of payments estimates is the tendency of export proceeds to become rigid and for import disbursements to rise.

Exports acquire an importance as a strategic factor in the Egyptian economy. Egypt is heavily dependent for its normal well-being upon two factors outside its control which are first, the purchasing power of foreign countries, second, cotton prices. Foreign depressions exercise great impacts on Egypt where the structure of the economy does not permit a ready shift of productive factors away from the depressed export production to the home market. An economy that depends largely on exports and imports can fluctuate more heavily than one dominated chiefly by investments and savings.

The Monetary System:

The history of monetary and banking operations in Egypt dates back to the beginning of the second half of the nineteenth century. Prior to that date the services of deposit and commercial banks were not really required, partly because of the prevalence of Government monopolies and partly because of the general low financial standing of the people.

The early banks were mainly branches of foreign institutions whose primary activities consisted in providing loans to the Khedives of Egypt. Such loans amounted to £ 96 million in 1876. This large foreign public debt resulted in a severe monetary crisis which culminated in the sale by Egypt of its shares in the Suez Canal Company to the British Government at a very low price. Finally, the crisis led to British political and economic domination of Egypt in 1882.

After the monetary crisis of 1876, banks diverted their activities to finance external trade and cotton, both of which constituted, as they still do today, the basis of Egypt's foreign commercial dealings. In 1898 the National Bank of Egypt was established with head offices in London. It was given the sole power to issue banknotes, to act as the Government bank, and, in general, to engage in all banking operations except in real estate. The evolution of NBE during a period of fifty years finally culminated in its becoming a central bank in 1951.

In 1914, NBE notes were declared legal tender and a fifty-percent gold-cover was maintained. In 1916, in view of the war conditions and consequences, gold was replaced by sterling as backing for the note issue. Thus Egypt came to be virtually on a sterling exchange standard until the year 1947.

The banking system is composed, at present, of twenty-eight commercial banks twelve of which are members of the Clearing House. The total assets of all banks increased by 40 percent from 1952 to 1956. Banks' deposits increased by 34 percent and their loans and advances increased by more than 100 percent from 1948 to 1956. The amount of bills discounted by the commercial banks more than doubled during the last five years, and the value of investments held by these banks increased by about 70 percent.

The most noteworthy recent development of banking in Egypt is its increased liquidity. This was a direct result of exchange control which brought to an end the seasonal movement of funds into and out of Egypt in the process of financing the cotton crop. Commercial banks are now maintaining high liquid reserves during almost two-thirds of the year. A general credit expansion has been manifested in Egypt and is reflected in the increase of NBE advances to banks and other credit institutions. Such advances have doubled since 1952, and in 1956 their value amounted to sixfold that of 1948.

Money supply has also increased during the last few years at an average rate of 5.5 percent per annum. Note circulation, on the other hand, has increased at an average yearly rate of 2.2 percent. The movement of short-term loanable funds in the money market are characterized by a seasonal cycle that accompanies the marketing of cotton. This seasonal fluctuation reveals the fact that cotton financing is still being done through banknotes rather than through transfers of bank deposits.

Beside the development of commercial credit, industrial credit has also increased tremendously during the last decade. The Industrial Bank was established in 1948 with the Government participating in 51 percent of its paid-up capital. The bank has been participating in the establishment and promotion of new industrial enterprises by granting them credit facilities for any length of time, against a collateral of personal security. Total industrial credit granted by the bank in 1955 amounted to LE 1.8 million compared to 0.6 million in 1950.

Agricultural credit also marked some development. Total loans and credits affected by the Agricultural and Cooperative Bank amounted to about LE 20 million in 1956, marking an increase of 25 percent over the figure of 1952 and 120 percent over 1949. About 98 percent of total agricultural loans are granted for short-terms.

A noteable feature of the banking system of Egypt is the lack of development banks, beside the industrial and agricultural banks, which are most necessary for financing economic development. Prior to the Egyptianization decrees, the majority of commercial banks were in the hands of foreigners. These banks adopted a general policy of credit stingency reflected by the high liquidity rates which they maintained. In January 1957, all banks operating in Egypt were Egyptianized whereby they were required by law to take the form of

Egyptian Joint Stock Companies. French and British banks were put under sequestration and by April of the same year, they were completely Egyptianized. The rest of the foreign banks were given a delay of five years within which to comply with the provisions of the law. Of a total of 32 banks operating in Egypt at the time of Egyptianization, 19 were foreign and the remaining 13 were Egyptian. The total capital of foreign banks amounted to LE 5.2 million, but that of the sequestrated banks alone did not exceed LE 2 million. At the end of December 1956, foreign banks were controlling about LE 100 million of deposits out of a total of LE 195 million. Their discounts and advances on the other hand amounted to about 48 percent of total discounts and advances made by all banks.

<u>The Exchange System</u>:

A system of exchange control was initially introduced into Egypt in 1939, in compliance with the "Sterling Area" regulations, in which Egypt was a member. Up to 1947, the Egyptian Exchange Control system was a simple adaptation of the control regulations published in London. In general, the system worked smoothly and Egypt had an apparent autonomy in its foreign exchange transactions. By selling its daily surpluses to London, the control could cover its foreign exchange requirements almost automatically from the same source. By the end of the second war, Egypt manifested a growing demand for foreign exchange, especially for "hard" currencies. At the same time, in view of the shortage of these "hard" currencies, Egypt and all the members of the sterling area were asked to cut down their imports paid for in these currencies. A "target" system was set up to which Egypt could buy the above-mentioned "hard" currencies against Egyptian pounds or sterling. By this arrangement, Egypt was expected to surrender her hard currency earnings while she was offered a very limited facility in utilizing the dollar pool. Moreover, Egypt was given a limited amount of free sterling while the rest of her balances were blocked. Consequently, the only solution seemed for Egypt to depart from the Sterling Area, which it actually did in July 1947. During the same year, Exchange Control was reestablished on a wider basis. All imports and exports of Egyptian and/or foreign currencies of all sorts were prohibited except under provisions laid down by the Ministry of Finance which also regulated the import and negotiation of tourist cheques.

During the second world war there was an influx of foreign capital into Egypt, represented by an increase in Egypt's sterling balances in London which amounted to some LE 400 million by the end of the war. These balances were blocked in London and are being released in annual instalments under bilateral agreements. As a result of the nationalization of the Suez Canal in August 1956 all the remaining sterling balances were completely blocked again and the United States and France took similar steps in connection with dollar and franc balances respectively. Towards the end of April 1958, the United States released Egypt's blocked dollar balances.

Egypt joined the International Monetary Fund in 1946 and declared a par value of 3.67288 grams of gold for the Egyptian pound.

This par was reduced to 2.55187 after the devaluation of 1949. Egypt's quota subscription amounts to sixty million dollars of which 25 percent are paid in U.S. Dollars and the remainder in Egyptian Pounds. The Fund's holdings of Egyptian currency amount at present to 125 percent of Egypt's quota, i.e. the net drawings of Egypt from the Fund amount to 30 million US Dollars.

International trade is subject to heavy restrictions and foreign exchange provisions. All imports require prior licensing which are granted relatively freely for all imports which do not require dollars or any other scarce currency. Foreign exchange is granted automatically upon the presentation of a valid import license. Exports on the other hand, are allowed without restrictions except in certain cases where the commodities are required for the national economy. All exports proceeds must be repatriated within six months from the date of shipment of goods, and foreign exchange proceeds must be surrendered to the Central Exchange Control Department of NBE.

Egypt has concluded various trade and payments agreements with some thirty countries. The basic objectives of such agreements are to expand the Egyptian cotton market, to obtain the necessary capital goods for industrialization, and to establish the Egyptian pound as an accepted currency in international settlements.

The Impact of Monetary Policy:

In the course of the last few decades, the emphasis on monetary policy throughout the world has gradually shifted from external to internal stability. The balance of payments which originally had been the chief object of anxiety and trouble, became a secondary element the reactions of which were somewhat unwillingly taken into account as a limiting factor upon the freedom of internal policy. Several developments occured while this shift in economic thinking took place. First, there was a considerable increase in the volume of liquid funds practically in all countries. In Egypt, the note circulation amounted to 215 million pounds in 1956 compared with 146 million and 62 million in 1948 and 1915 respectively. Second, the experiences of the two world wars and their aftermath undermined the belief in the stability of the major currencies as a manifestation almost of natural law. Third, trade barriers and other regidities had continued to mount. As a result, foreign exchange control was the logical culmination of these conflicting trends. This relatively new and powerful weapon which is adopted today by a large number of countries made possible the divorce of internal monetary and fiscal action from its external effects. Moreover, the conventional instruments of monetary policy, i.e. the discount rate and open market operations, faded into the background of the international picture wherever foreign exchange control appeared.

In Egypt these conventional techniques had never acquired much stature. The center of money creation in Egypt is not the banking systems to which these techniques are addressed, but the balance of payments and particularly, the exports proceeds of the country's main product, cotton. Hence, an exchange control system which attacks the balance of payments directly instead of seeking to influence it via bank credit,had considerable appeal in Egypt.

A system of exchange control was initially introduced in Egypt in 1939, and in 1947 the system was reestablished on a new and wider basis. Beside the regulation of foreign exchange payments in alignment with the receipts, the system of control aimed at serving the implementation of foreign trade policy which focussed attention on the protection of infant industry and the diversification of agricultural production. As far as these objectives are concerned, the system was successful due to its own merits as well as due to the revival of the world economic situation during the post-war era. As a result of the exchange control system, the blocked and free sterling balances of Egypt decreased to about LE 100 million by the end of 1956 compared to LE 335 million in 1948. The dollar reserves, on the other hand, increased by LE 15 million during the same period while the gold stock also increased from 13 million to 66 million. These results were attained mainly as a consequence of foreign trade policy which restricted the imports of luxuries and non-essential goods while the more essential commodities and capital goods were granted priority licenses if effected from soft currency areas. Moreover, the exchange control imposed a check on capital outflow with few exceptions where imports were overvalued.

In 1951 NBE became the de-jure Central Bank of Egypt. Its policy prior and after its "centralization" was mainly passive and its control over commercial banks was loose and largely elastic. It was given power to stabilize the value of the pound and control credit, but so far, it has not been successful in enforcing those powers mainly due to the limitations of the money and capital markets. Besides, the majority of the commercial banks were until the Egyptianization law, in the hands of foreigners and consequently, the Central Bank had little control over their activities. They did not form a cohesive banking system and operated practically without any sort of legal control. Their main business was concentrated in the financing of cotton and external trade, depending mainly on foreign source of funds for their operations. The relative importance of foreign banks had gradually changed with the growth of indigeneous banking and the increased scope of activities of existing banks. Now that the Egyptianization of banks has been achieved, the banks are being directed to assist the urgent needs of the economy by creating the right atmosphere to encourage savings and to channel them into fruitful investments. Prior to Egyptianization the majority of foreign banks usually abstained from providing credit facilities to Egyptian firms at a time when these firms as well as the entire economy were in great need of funds for financing development projects.

Although individual opinions differ on the Egyptianization act, yet the general contention is that the new legislation will serve in the promotion of the national economy especially by controlling savings and investments in the country and by regulating the money and credit supply. The Central Bank was recently given more power to control other banks and as such it has acquired a new active role. The Central Bank has now the power of setting and implementing a national monetary policy that coincides with the needs of the economy and aims at maintaining economic and monetary stability in the country. Moreover, the reserve and liquidity ratios which are effective weapons of credit control in the hand of the Central Bank, can now be used more intensively and with far more tangible results. In January 1958, the first results of Egyptianization after one year of its application, were announced by the Minister of Finance. Private deposits in banks increased by 13 million pounds during 1957, and the aggregate banks' loan for cotton financing increased by LE 18 million. Other savings also increased among which the Post Office savings increased by about 16 percent.[1] These developments have had some repercussions on the capital market which featured a recovery during 1957. The market value of the total securities of Egyptian joint stock companies amounted to 217 million pounds in January 1957 compared to 212 million pounds in January 1956.

Paralell to the above monetary developments that were achieved in Egypt, a general economic revival has occured during the last decade or so. The course of development has been gradually shifting the basis of the economy from being ultimately dependent on a single export agricultural product to an economy in which industry now plays

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1. Al-Ahram, Cairo, January 15, 1958, p. 7.

an important role. The emphasis of economic policy is now on industrialization and the diversification of agriculture. This policy has been regarded as an interrupting factor in the vicious circle of poverty and the basis for accelerating the pace of economic development in Egypt.

New industries were established in Egypt while existing ones have been promoted and developed. Among the new industries some are heavy industries such as the Iron and Steel industry. Total industrial production marked a significant increase during the last few years at an average rate of 5 percent per annum. Moreover, agricultural production has also increased and is now more diversified. For example, the production of wheat increased during the last five years by about 25 percent compared to the 1946 production. Rice and sugar cane increased by 85 and 80 percent respectively during the same period.

Although these economic developments are not claimed to be the ultimate result of the existing money and banking policy, however, the effects of this policy are fairly reflected in the relative changes in the economy.

Conclusion:

The term "monetary policy" denotes a state of affairs whereby the monetary authorities of a country decide on the basic and broad objectives of policy matters related to and regulating the monetary and banking activities. Usually, such policy is plainly stated and is announced by the authorities who are also directly responsible for its application. In some cases, however, monetary policy is not declared as such, but can be deduced from the general monetary and banking set-up of the country. In Egypt, there has never been a defined and clear policy to guide the monetary system. All that existed in this respect was a scattered collection of banking and monetary legislations that embodied the general lines of the policy in practice.

In general, the objective of monetary policy is to secure an appropriate flow of money expenditures so as to maintain a continuously high level of employment and a relatively stable level of prices. It can be an effective tool in the promotion of economic development in any country, provided that the proper channels through which policy is usually applied are existing.

These channels or "tools" of monetary policy were lacking in Egypt. At one time, when Egypt was in the Sterling Area, its monetary legislation was simply dictated to it from abroad. However, during the last decade some important developments were successfully achieved in this field of economy. The most important of these developments are: First, the reestablishment of exchange control on a wider scale in 1947; second, the "centralization" of NBE in 1951; and third, the Egyptianization of all banks operating in Egypt in 19~~4~~57.

Inspite of all these development, the money and capital markets are still rudimentary and are quite insensitive to the subtle influence of the conventional instruments of monetary policy. The discount rate has remained constant since 1951 at the level of 3 percent while open market operations by the central bank are still uncommon. Moreover, the actual reserve ratio requirements of banks has always been much higher than the legal level.

In general, the credit situation has been more or less stingent partly due to the existence, prior to Egyptianization, of foreign credit institutions that were directed by the interests of their mother countries rather than by the needs of the national economy, and partly due to the low level of national savings which is a basic characteristic of poor countries.

As a result, the apparent monetary policy of Egypt as derived from the realized Government activities in the monetary and banking field, has not so far played a direct effective role but in fact, it has been subservient to fiscal policy which is more dominent in Egypt where the yearly budget estimates amount to about one third of the national income.

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