Volume Title: Foreign Trade Regimes and Economic Development: Egypt

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Volume Publisher: NBER

Volume ISBN: 0-87014-504-5

Volume URL: http://www.nber.org/books/hans75-1

Publication Date: 1975

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Chapter URL: http://www.nber.org/chapters/c4051

Chapter pages in book: (p. 25 - 52)

Chapter 2

Foreign Exchange Regimes, 1946-1961: Oscillations between Phases I, II, and V

The years between the end of World War II and the nationalizations of 1961 form a convenient period for the start of our survey. During its entirety Egypt continued to rely mainly upon private enterprise and, until the last year or two, applied only policy measures that were consistent with it and that had been used in Europe until the trade liberalization of the mid-fifties. The period started with the country leaving the sterling area and saw the introduction and termination of a number of exchange control arrangements, as well as a strong expansion of bilateral trade.[1] After the Suez War of 1956, trade with communist countries rose sharply and a substantial effective depreciation of the currency took place, leading up to the official devaluation of 1962.

The beginning of the period under review was characterized by the postwar recovery, and until 1947 a number of wartime restrictions disappeared. Thus, it may be said that the immediate postwar years somewhat resembled the co-directors' Phase V (see p. 349), although strongly influenced by the special postwar conditions.

Despite a huge exchange reserve, the improving cotton price, and a continued economic upswing, from 1947 onward Egypt ran into serious exchange problems, closely related to the difficulties of the British economy and the pound sterling. A number of foreign exchange measures were taken, and during the years 1947 to 1950 the country clearly found itself in Phase I on the road to balance of payments and exchange controls. (See pp. 26–32 below.)

During the Korean boom, 1950–1952, the country experienced a brief spell of import liberalization—not unlike Phase V—but also an integrated portion of anti-inflationary policies. (See the discussion on pp. 32–39 below.)

With the breakdown of the Korean boom, exchange controls were tightened again, and, since various arrangements introduced during the years 1947–1950 (Phase I) were never abrogated, it makes sense to identify the period from 1953 to 1961 as Phase II. Although the nature of the controls varied quite substantially during these years, they generally tended to become ever tighter.

The changed institutional framework in the wake of the nationalization of foreign trade in 1961 makes it difficult to identify further developments in terms of the phases set up by the co-directors.

THE POSTWAR RECOVERY

Egypt came out of World War II—during which, although theoretically neutral, the country served as the main Middle East base for the Allied forces—without much direct destruction. The productive machinery was worn out, however, and agriculture suffered from soil exhaustion due to insufficient fertilizing during the war years. Stocks of imported raw materials and consumer goods, including food, were emptied. On the other hand, the country had accumulated substantial stocks of cotton and a very large foreign exchange reserve, held in pounds sterling in London. This reserve amounted to more than two-thirds of Egypt's national income, or about four years' imports at the 1945 level.

Under these circumstances, there could be only one course to follow: to use exchange reserves for replacement and modernization in industry and communications, replenishment of exhausted commodity stocks, and recovery of soil fertility. The policy was successful in terms of production, which increased rapidly in industry and agriculture. Large trade deficits did appear (although improvements in the terms of trade favored the country greatly), but foreign exchange reserves declined slowly as British military spending continued, Suez Canal toll revenues increased, and exchange controls contained the pressure on the balance of payments. The major developments are shown in Tables 2–1 and 2–2, as well as in Table 1–3.

THE DOLLAR SHORTAGE, TRIANGULAR TRANSACTIONS, AND THE EXPORT POUND: PHASE I

The exchange control regime in Egypt originated at the outbreak of World War II. At that time Britain imposed exchange controls on her foreign trans-

TABLE 2–1

Production, Income, and Foreign Trade, 1945–1949

Year	Gross National Product, at Constant 1954 Prices (mill. £E) (1)	Growth Rate (%) (2)	Gross National Income, at Constant 1954 Prices (incl. terms of trade gains) (mill. £E) (3)	Growth Rate (%) (4)	Agricultural Production (major field crops) (5)	Industrial Production (6)	Barter Terms of Trade (1945=100) (7)	Imports (% GNP) (8)	Exports (% GNP) (9)	Trade Deficit (mill. £E) (10)	Foreign Exchange Reserve (end of year, mill. £E) (11)
1945	711	—	673	—	100	100	100	10.2	7.8	n.a.	379
1946	744	6.4	704	4.6	97	101	121	14.2	12.3	35.8	n.a.
1947	776	4.3	731	3.8	102	110	122	16.1	14.5	37.6	353[a]
1948	877	13.0	908	24.2	121	124	180	21.2	18.9	29.9	323
1949	927	5.7	937	3.2	119	139	159	19.1	15.8	18.0	321

SOURCES: Cols. (1) and (2): B. Hansen and G. Marzouk, *Development and Economic Policy in the U.A.R. (Egypt)*, Amsterdam, 1965, p. 319.

Cols. (3) and (4): Ibid., p. 319.

Col. (5): M. El Imam, "A Production Function for Egyptian Agriculture," *Memo No. 259*, Institute of National Planning, Cairo, December 31, 1962, Table VIII, p. 43.

Col. (6): Hansen and Marzouk, op. cit., pp. 115–118.

Cols. (7)–(11): Ibid., pp. 186–187, 174, 176, and 190.

a. October 4, 1947.

TABLE 2–2

Trade with Sterling Area and Nonsterling Countries, 1946–1950

(mill. £E)

Year	Merchandise Exports		Merchandise Imports		Balance on Current Account	
	Sterling Area	Non-sterling	Sterling Area	Non-sterling	Sterling Area	Non-sterling
1946	24.4	27.5	39.0	49.6	+8.4	−27.8
1947	31.4	35.8	37.1	63.3	+12.2	−43.9
1948	67.0	65.6	68.9	93.6	+29.5	−41.7
1949	64.7	74.0	57.8	100.5	+33.2	−38.9
1950	73.0	111.9	84.7	132.0	+8.1	−22.5

SOURCE: *Economic Bulletin,* National Bank of Egypt, various issues.

actions, a move which was followed by similar measures in Egypt and other countries belonging to the sterling area. While trade and capital movements within the sterling area were unrestricted, transactions in currencies other than sterling were tightly controlled. Egypt, as a member, desposited all of her foreign exchange earnings in the London pool, where they were credited to her in sterling, while, in turn, Britain would annually release foreign currencies to Egypt according to a quota system instituted for her trading partners. Even then, the composition and origin of Egyptian imports were controlled from the Allied Center for the Supply of the Middle East.

It was only in December 1944 that Egypt regained her freedom to import and the administration of exchange control was shifted from London to the Foreign Exchange Control Committee at Cairo, an Egyptian government authority. In practice, however, Egypt was limited by the inconvertibility of her sterling balances, the restrictions (through the quotas mentioned above) imposed on her access to hard currencies, and the commodity shortages in the sterling area.

The sterling balances stemmed mainly from the expenditures by the Allied forces in Egypt and the inability of the Allies to meet Egypt's import requirements. The reserves, on a steady uptrend during the war, reached their peak immediately afterwards at £E425 million. The Egyptian government found it both natural and desirable that in this situation it should be able to utilize its sterling balances to finance a dollar trade deficit for a number of years. Hence, an Egyptian delegation was sent to London in June 1947 to negotiate along these lines on the disposal of the sterling balances. The agreement that emerged, however, was to fall significantly short of Egyptian plans and hopes. The British position on all such sterling balances accumulated during the war years was that (1) a part of the balances would be released and made freely convertible immediately; (2) another part would be gradually released over a period of years; and (3) the remainder would be "readjusted" or "scaled down."[2] It meant, simply, that her colonies and dependencies were expected to pay part of the costs of World War II. In Egypt's case, the part released as "No. 1 sterling account" was £8 million, with an additional £12 million put on standby to meet any deficit; the remainder was blocked as "No. 2 sterling account."

Faced with these terms, Egypt decided to leave the sterling area, although the British threats of "scaling down" the balances never materialized. An additional consideration in this decision was that Britain was still unable at that time to deliver the raw materials and capital equipment that Egypt badly needed. Wheat, in particular, which Egypt needed to import on a large scale, was not available for export in the sterling area. Thus, sterling as such was not very useful. Egypt's imports form nonsterling countries exceeded those from the sterling area, resulting in a substantial current hard currency deficit. At the same time, on top of her accumulated sterling balances, her current sterling account was also in surplus (mostly because of continued British military expenditures in Egypt and increasing Suez Canal revenues).

It should be recalled that Britain was committed to the United States (as a condition for loans obtained in 1946) to introduce full convertibility of the pound sterling. Egypt thus had good reason to expect that whatever was released from her blocked balances would be fully convertible into hard currency. As of July 15, 1947, the British actually did introduce full convertibility, and the Egyptian exchange position then looked fairly satisfactory. This situation did not last long, however, and the problem of her deficit vis-à-vis non-sterling area countries was again accentuated when Britain, on August 20, 1947, reneged on its commitment to full convertibility.[3] Egypt found herself placed outside the sterling area, with all her reserves in sterling and partly blocked, and with no right to convertibility of released balances and of current sterling earnings. The subsequent transfer of £21 million from No. 2 to No. 1 account under a 1948 agreement had no effect in alleviating the shortage of nonsterling currencies, nor any relevance to her sterling trade, where Egypt was running a surplus in any case. At the same time, Egypt's efforts to increase her exports to dollar countries were frustrated as the United States imposed import restrictions on cotton.[4]

This situation resulted in two Egyptian policy moves: (1) relaxation and subsequent removal in March 1948 of trade regulations against sterling area countries and any other country accepting sterling; and (2) adoption of auxiliary trade methods to alleviate the dollar shortage.

Triangular Trade.

One such auxiliary method was to engage in triangular trade relations with other sterling area countries which, instead of selling their dollar earnings to the London pool, would manage to buy dollar goods and resell them against sterling at prices higher than those corresponding to the official parity. Through these arrangements Egypt was able to convert part of her transferable sterling into dollar goods, although at a premium. The premium was in the range of 20 to 25 percent, as quotations for most third countries' transferable sterling accounts were in the range of U.S. $2.95–3.10 per Egyptian pound, compared with a par rate of U.S. $4.027 per Egyptian pound.

Conversely, Egyptian cotton bought with sterling was offered against hard currencies "at a considerable discount," thus making direct purchases from Egypt by hard currency countries unprofitable. Hence the government resorted to direct cotton sales against hard currencies from its surplus stocks (accumulated during the war) at low prices. It also reserved certain export goods, such as rice and cottonseed cake, for hard currency purchasers.[5] These transactions clearly represented a partial depreciation of the Egyptian pound vis-à-vis the U.S. dollar and other hard currencies.

Barter Trade and Bilateral Agreements.

Other auxiliary trade methods adopted at the same time were barter and bilateral agreements with countries facing similar problems. The first such barter agreement was concluded with the Soviet Union in 1948, shortly followed by a bilateral agreement with France. Bilateral trade was increasingly resorted to throughout the 1950s in coping with balance of payments difficulties (see p. 43 below).

Licensing.

A licensing system for exports to and imports from countries outside the sterling area was also introduced in 1948. Export products were divided into four schedules which differed as to means of payment and restrictions on the volume exported. For instance, shoes and hides could only be exported against hard currency, while yarn and textiles could only be exported after domestic demand was fulfilled. Most imports were licensed as to country of origin; licenses were given freely to imports from countries with which Egypt had bilateral agreements, while tight restrictions were imposed on imports from the dollar area. With imports thus restricted, the government moved to limit excess profits through price control, specifying maximum profit margins according to the type of goods involved (for example, woolens, 30 percent, agricultural machinery, 22 percent, tea and coffee, 18 percent).[6] There is no evidence that significant shortages developed in these commodities. By and large, it seems that quantities sufficient to clear the market at the controlled prices were imported; this, of course, indicates that prices and profit margins must have been set at generous levels.

The Export Pound.

In March 1949 a new agreement was reached with Britain, converting £E5 million into dollars and shifting £E12 million from the No. 2 to the No. 1 (released sterling) account. As the Egyptian No. 1 sterling balances at that time stood at £E7.4 million, the new releases were of little immediate consequence. Indeed, the problem continued to be Britain's inability to deliver commodities at competitive prices. Moreover, a critical restrictive amendment was attached to the agreement: Britain insisted that the right to use sterling be restricted to direct current transactions on goods originating in the country to which the payment was made.[7] By thus barring triangular transactions, it deprived Egypt of an important access to hard currency goods. In response, Egypt created a transferable Egyptian pound on "export account" to finance trade with soft currency countries.

As a background to a discussion of the export pound arrangement, a few words are in order on the international devaluations that took place in September 1949. Britain devalued against the U.S. dollar by over 30 percent, and Egypt, which sent roughly half of her exports to sterling area countries, followed suit immediately. Since Egypt's trade with the United States was very small at that time, the average depreciation involved was very small as well. The result was some rise in cotton prices in Egypt and a reorientation of cotton exports toward hard currency countries, while expectations of price increases in Britain as a consequence of the sterling devaluation induced a temporary increase of imports from the sterling area. Egyptian sterling balances fell steadily as exports to the United Kingdom were reduced. The development of a deficit in sterling and the subsequent reduction of free Egyptian sterling balances prompted the government from 1952 on to follow a path of increasing general intervention in foreign trade (see pp. 41–45).

We mentioned that Egypt created so-called "export accounts" so that Egyptian pounds could be used in trade with soft currency countries in lieu of the abolished triangular transactions in pounds sterling. Under this arrangement Egyptian importers of specified hard currency goods from specified soft currency countries could make their Egyptian pound payment to nonresidents' "export accounts." Egyptian pounds from these accounts were freely transferable to other nonresidents and could be used to pay for Egyptian exports to a long list of soft currency countries. The "export pounds," being freely transferable, were traded and quoted at a discount in third-country exchange markets. In this way Egypt could acquire hard currency goods indirectly through third countries, while exports from Egypt to such countries were promoted.

The whole arrangement amounted, of course, to a partial, floating exchange rate for Egyptian pounds and involved a depreciation of the currency. While the official rate set in September 1949 was U.S. $2.87 per Egyptian pound, the price in Tangiers of Egyptian pounds on export account ranged between U.S. $2.24 and $2.48 during 1951, with a tendency to increase over the next several years (Table 2–3, col. 2). Thus, the depreciation of the export pound averaged about 17 percent in 1950, but only about 9 percent from 1953 to 1955. The rates depended mostly on the quantities of wheat Egypt was buying abroad with export pounds.

The depreciation was partial since it affected only a small part of total trade: at its peak in 1953 the export pound covered only 14 percent of exports and 12 percent of imports. Therefore, the average depreciation accomplished by this means was small, ranging from 1.17 to 0.18 percent over the period 1950–1955 (Table 2–4). Since export pounds were also bought to pay for exports to dollar areas—resulting in reduced dollar receipts—the government found it appropriate to replace the export pound gradually by an import entitlement system, and to expand bilateral trade.

THE KOREAN BOOM AND IMPORT LIBERALIZATION IN EGYPT: PHASE V

The Korean War, responsible for a strong increase in cotton prices (by about 130 percent from 1949 to 1951, calculated on annual averages) and, hence, an improvement in the barter terms of trade (by about 75 percent, as shown in Table 2–5), helped to create a kind of "stag-flation" in the Egyptian economy. The boom was accompanied by some domestic price increases (see Table 2–6); the cost of living rose by about 7 percent annually from 1949 to 1951.

Production was rather stagnant during this period. Agricultural output fell by 8 percent, while industrial production rose by only 4 percent. Real GNP increased by less than 5 percent from 1949 to 1951 (Table 2–7). But the strong improvement of the terms of trade brought a rise in real national income (GNI) of 8 percent in 1950 and another 7 percent in 1951. Although the accompanying uptrend in demand certainly influenced domestic prices, it found a partial outlet in increased imports, which, despite a rise of about 50 percent in export value, caused both the balance of trade and the balance of current payments to deteriorate during the boom.

TABLE 2–3

Exchange Rates for the Egyptian Pound

Year	Par Rate (U.S. $/ £E) (1)	Export Pound Quotations Tangiers (U.S. $/ £E) (2)	Import Entitlement Premiums Quotations from Alexandria (buying, percent, end of year) £ (3)	DM (4)	U.S. $ (5)	Quotations Abroad (buying rates for £E on "B accounts," end of year) Amsterdam (florin/ £E) (6)	Zurich (Sw. fr./ £E) (7)	Brussels (Belg. fr./ £E) (8)
1950	2.87	2.24–2.48	—	—	—	n.a.	n.a.	—
1951	2.87	2.34–2.63	—	—	—	n.a.	n.a.	—
1952	2.87	2.31–2.72	5	n.a.	11	9.6	12.10	—
1953	2.87	2.57–2.62	$5\frac{3}{16}$	$11\frac{5}{8}$	8	10.07	11.65	128.82
1954	2.87	2.55–2.75	$7\frac{1}{8}$	$8\frac{3}{16}$	10	10.06	11.18	135.37
1955	2.87	2.50–2.73	$10\frac{1}{32}$	$12\frac{1}{32}$	14	10.30[a]	11.90[a]	129.25[a]
1956	2.87	—	—	—	—	9.25[a]	10.50[a]	126.00[a]
1957	2.87	—	—	—	—	8.60[a]	9.50[a]	109.25[a]
1958	2.87	—	—	—	—	9.00	9.80	109.00
1959	2.87	—	—	—	—	8.70	9.90	110.50
1960	2.87	—	—	—	—	—	11.50	—
1961	2.87	—	—	—	—	—	10.40	—
Cross rates at official U.S. $. par rates, 1950–1961						10.40	12.40	142.05

SOURCES: *Economic Bulletin*, National Bank of Egypt, various issues; IMF, *International Financial Statistics*, various issues.

a. November figures.

TABLE 2–4

Depreciation through the Export Pound

(percent)

Year	Export Pound, Depreciation in Relation to Par Rate (1)	Proportion of Total Trade Effectuated via Export Account: Exports (2)	Proportion of Total Trade Effectuated via Export Account: Imports (3)	Average Depreciation for Total Trade through Export Pound: Exports (4)	Average Depreciation for Total Trade through Export Pound: Imports (5)
1950	17	5	2	0.85	0.34
1951	13	10	9	1.30	1.17
1952	12	7	5	0.84	0.60
1953	9	14	12	1.26	1.08
1954	7	6	5	0.42	0.35
1955	9	3	1	0.27	0.09

SOURCES: Col. (1): Averages of Table 2–3, col. (2).

Cols. (2) and (3): Calculated on basis of figures for payments on export account from *Economic Bulletin*, National Bank of Egypt, 1953 and 1959, and for total export and import from Hansen and Marzouk, op. cit., pp. 186–187.

TABLE 2–5

Cotton Prices, Terms of Trade, and Foreign Trade, 1949–1953

Year	Cotton Price for Crop of Previous Year, £E/Kantar (1)	Barter Terms of Trade (1938–39 = 100) (2)	% of GNP: Exports (3)	% of GNP: Imports (4)	Value (mill. £E): Balance of Trade (5)	Value (mill. £E): Balance on Current Account (6)
1949	11.05	137	15.8	19.1	−18	−4
1950	14.93	176	18.2	20.8	−32	−14
1951	25.14	243	19.4	22.1	−39	−15
1952	18.24	155	15.5	23.0	−64	−53
1953	12.28	118	15.3	19.2	−29	−8

SOURCES: Col. (1): *Annuaire Statistique*, Cairo, 1960–1961. The prices are averages for cotton season (Sept. 1–Aug. 31) for all varieties.

Col. (2): Hansen and Marzouk, op. cit., p. 176.

Cols. (3)–(6): Ibid., p. 174 and Table 1. III.

TABLE 2–6

Prices and Wages

Year	Wholesale Prices (1953 = 100) (1)	Cost of Living (1953 = 100) (2)	Industrial Wages: Weekly Earnings (£E) (3)
1949	88	94	1.46
1950	97	99	1.69
1951	108	108	1.94
1952	105	107	1.90
1953	100	100	2.03

SOURCE: D. Mead, *Growth and Structural Change in the Egyptian Economy*, Homewood, Ill., 1967, Tables VI–F–1 and II–B–7.

TABLE 2–7

National Income and Production, 1949–1953

Year	Real GNP, at 1954 Prices (mill. £E) (1)	Growth Rate of Real GNP (%) (2)	Real Gross National Income[a] at 1954 Prices (mill. £E) (3)	Growth Rate of Real GNI (%) (4)	Agricultural Production (1949 = 100) (5)	Industrial Production (1949 = 100) (6)
1949	927	5.7	937	3.2	100	100
1950	945	1.9	1,013	8.1	95	105
1951	971	2.8	1,084	7.0	92	104
1952	992	2.2	1,001	−7.7	102	107
1953	981	−1.1	956	−4.5	94	108

SOURCES: Cols. (1) to (4): Hansen and Marzouk, op. cit., p. 319.
Col. (5): See Table 2–1, col. (1).
Col. (6): See Table 2–1, col. (2).
a. Includes terms of trade gains.

A more detailed analysis of events is, unfortunately, handicapped by the existence of two different series of government budget figures: the official series (see Table 2–8, A) and a revised series compiled by the Institute of National Planning, Cairo (Table 2–8, B). The latter is based on United Nations definitions and classification and is known to be a thorough and compe-

TABLE 2–8
Egypt's Budget
(mill. £E)

A. Government Budget: Official Presentation

Budget Year July 1 to June 30	Surplus (1)	Expenditure: Total (2)	Expenditure: "Economic Administration" (3)	Revenue: Total (4)	Revenue: Customs Duties (5)
1948–49	−15	158	34	143	53
1949–50	−15	164	36	159	62
1950–51	2	190	38	185	75
1951–52	−39	233	n.a.	194	77
1952–53	−10	208	n.a.	198	74

B. Government Ordinary Budget: Special Study

Budget Year July 1 to June 30	Surplus (1)	Expenditure: Total (2)	Expenditure: "Economic Services" (3)	Revenue: Total (4)	Revenue: Duties on Imports (5)	Revenue: Duties on Exports (6)	Revenue: Duties on Total (7)
1948–49	−2	145	34	143	46	10	56
1949–50	−28	187	75	159	50	11	61
1950–51	46	204	72	250	80	24	104
1951–52	−25	219	54	194	60	14	74
1952–53	−4	202	43	198	57	14	71

SOURCES: A: *Annuaire Statistique*, 1949–1950, 1950–1951, Cairo, 1953; 1951–1952, 1952–1953, and 1953–1954, Cairo, 1956.

B: Mead, op. cit., Tables VI–E–3 and VI–E–4. These figures are based on an unpublished study by Rasheed Khalid of the IMF at the Institute of National Planning, Cairo. Khalid's reclassification and presentation follows the principles laid down in *A Manual for the Economic and Functional Classification of Government Transactions*, United Nations, 1958.

tent piece of work. It also makes more sense than the official budget series insofar as it shows strong uptrends in government spending for 1949–50, when the government embarked upon a development program, and in customs revenues for 1950–51, when foreign trade reached its peak—two phenomena neither one of which shows up in the official series. On the other hand, it is difficult to reconcile the revised series' large surplus figure for 1950–51 with data on changes in the banking system's net claims on the government (see Table 3–5). Considering the known government loan transactions outside the banking system, in particular the large Palestinian War Loan of £E30 million in 1948–49, the official surplus figures tally reasonably well with the changes in the banking system's net claims on the government. The revised surplus figures do too, except for 1950–51. We suspect that—being based on U.N. definitions—the revised revenue figures reflect tax liabilities rather than actual tax collections; it stands to reason that large tax arrears were built up during the boom years (a very normal phenomenon in Egypt) which, after the collapse of the boom in 1952 and the land reforms and other events that followed, were never paid. These considerations have led us to use the revised figures for all years except 1950–51, for which we have preferred to use the official revenue figures. But we call the reader's attention to the fact that the analysis of 1950–51 depends critically upon which budget revenue figures are used; since both sets of figures may be correct (in terms of their own definition) our problem is, in effect, whether budget analysis should be based on actual tax receipts or on tax liabilities. Our choice is to work on a cash basis.

Inflationary tendencies were already beginning to build up in the economy before the outbreak of the Korean War in June 1950. The development program implied an increase of government expenditure in 1949–50 by about £E40 million, corresponding to 4 percent of the national income, and a budget deficit of close to £E30 million (Table 2–8, B). At first, the main impact of the expansionary forces was on imports rather than on prices and domestic production. Imports started to increase as a result of a reduction in tariff rates accompanying the removal of trade regulations with the sterling area (see below), the increasing export capacity of the member countries of the area, and some shift from grain crops to cotton in Egypt.

From the second half of 1950, exports took the lead in the expansionary process. The major driving force was certainly the rising world demand for raw materials of strategic importance. Both export and import values soared, exports through price increases, imports mainly through volume increases. The expansion of the value of imports in 1950 was stronger than the value of exports, which by itself suggests that domestic forces added to the export boom. The money supply began to increase—by 4.2 percent in 1950 and 6.5 percent in 1951, as compared with a slight fall in 1949 (see Table 3–5). Even so, money supply was hardly a decisive factor in the process.[8] More importantly, government expenditures expanded further during 1950–51 and 1951–52. On the other hand, production tended to stagnate during 1950 and 1951, partly because crops were small (due to low floods and plant disease), but also because industrial expansion slowed down. Government revenue in 1950–51 (even according to the official figures) rose so much that the deficits of the earlier years were replaced by a small surplus, serving to dampen domestic demand somewhat. The revenue increase was, however, mainly an automatic response to the expansionary forces emanating from both exports and government expenditure; in 1951–52 the growth in expenditure actually exceeded that in revenue, and a substantial deficit developed once again.

The peculiar stagnation in industrial production was, of course, partly related to the bad crops, but increased liberalization and stronger competition from imported goods most probably played a role as well. Deliberate liberalization measures were taken during these years, partly to stimulate growth, partly to induce imports as an anti-inflationary measure. Licenses were issued more generously. In early 1950 the ad valorem duty was reduced from 7 to 3 percent; duties on machinery for new industrial undertakings were reduced from the 6–10 percent range to 4 percent; and wheat, barley, beans, and lentils were exempted from all duties. Later in 1951 tariffs on a number of foodstuffs were abolished altogether, and the ad valorem duty on imports of machinery and certain foodstuffs was reduced to 1 percent.[9] Revenue duties on tobacco and alcoholic beverages were, on the other hand, increased sharply, together with duties on automobiles.

The combination of an inflationary boom and stagnation in industry thus seems to be explained by two circumstances. *First,* when a country experiences a strong improvement in its terms of trade through a rise in export prices, national income and expenditure are bound to expand more strongly than national product in real terms. The difference consists, of course, in the terms of trade gain. Business indicators related to expenditures are therefore also bound to show stronger expansion than indicators related to production. And there is nothing to prevent real expenditure from increasing even with falling production. *Second,* high cotton prices and the expenditure boom did not lead to a production boom but, rather, the opposite because, on the one hand, full capacity in cotton acreage was already reached before the Korean boom and, on the other, economic policy as expressed in trade liberalization served to divert domestic demand toward imported goods. But, of course, as we have pointed out, there were also exogenous factors that affected manufacturing adversely through the poor agricultural crops.

The international cotton market collapsed at the end of 1951, and, after a vain attempt by the Egyptian government to keep international prices for extra long staple cotton at a high level (among other things, by taking over all futures contracts at the Alexandria Bourse and buying in the spot market for stockpiling), Egyptian cotton prices fell drastically during 1952.[10] Export revenues shrank, and the trade deficit soared to a peak of £E65 million that year. The rapid drop in the exchange reserves generated a fall in money supply (Table 3–5), and for 1952–53 the government cut expenditure by about 10 percent. The general situation thus shifted very rapidly from an expenditure boom to a recession.

With the end of prosperity, Egypt's liberalization policy vanished, too. It had helped to stabilize prices, but had probably also contributed to the stagnation in domestic production. It was too short-lived to have had any importance for long-term growth. (For a discussion of this policy in a more general setting, see Chapter 3, p. 75.)

POST-KOREAN RECESSION, LICENSING, AND THE IMPORT ENTITLEMENT SYSTEM: THE BEGINNING OF PHASE II

In its first years, the economic policy of the revolutionary government, except for the land reforms, was generally conservative. Both monetary and fiscal policy were, on balance, deflationary, and production expanded only slowly until around 1955. Between 1952 and 1955, the budget deficit averaged only about £E3 million and the money supply remained nearly constant. From virtual stagnation in 1952–53 the growth rate of GNP rose to about 3½ percent in 1955–56. A major reason for the stagnation was the lack of appreciable growth in agricultural production (slightly above 1 percent annually on the average from 1952–53 to 1956–57). This slow growth was partly a result of the depressed prices[11] and partly a result of the government's area restriction policies, which from 1953 on aimed at shifting agricultural production from cotton to wheat (see Chapter 6 and Appendix A). Cotton export taxes (temporarily abrogated in 1952) remained high for some time despite the depressed international prices. At the same time, industrial growth was also slow until 1955 (see Table 2–9).

Until 1952 Egypt had a small deficit in its balance of trade with the sterling area. However, this was more than offset by a surplus generated on the invisible accounts (stemming mostly from Britain's military expenditures in Egypt). This surplus, as well as the gradual release of old sterling balances, had financed a large deficit vis-à-vis dollar and soft currency countries, initially through triangular transactions and later through the export pound.

In 1952, following the collapse of cotton prices, sales to the United Kingdom (Egypt's largest customer) fell to about a fifth of their average in the years since the end of the war.[12] This would not deserve special mention if it had been a temporary phenomenon related to the post-Korean recession in the developed countries, but, in fact, it marked the beginning of the downward trend of cotton exports to Western countries. Long-run factors included the decline of the Lancashire textile industry, the gradual substitution of synthetic fibers for cotton, and technological innovations that permitted the use of medium and coarse counts of cotton in the production of fine cloth. Demand shifted away from extra long staple—the Egyptian speciality—to long

TABLE 2–9

Production and Foreign Trade, 1953–1956

Fiscal Year	GNI at 1953–54 Prices (mill. £E) (1)	GNI at 1953–54 Prices Growth Rate (%) (2)	Agricultural Production (1952–53 = 100) (3)	Industrial Production (1952–53 = 100) (4)	Exports as % of GNP (5)	Imports as % of GNP (6)	Balance on Current Account (mill. £E) (7)
1952–53	947	0.6	100	100	15.4	21.1	−30.5
1953–54	963	1.7	101	103	14.9	17.9	−5.7
1954–55	999	3.7	104	110	14.2	17.3	−18.8
1955–56	1,032	3.3	103	118	13.5	18.1	−33.5
1956–57	1,045	1.3	106	126	13.8	17.4	−32.1

NOTE: In cols. (3) to (7) the budget year figures are averages of calendar year figures.
SOURCES: Cols. (1) and (2): Hansen and Marzouk, op. cit., p. 320.
Col. (3): See Table 2–1, col. (5).
Col. (4): See Table 2–1, col. (6).
Cols. (5) and (6): Hansen and Marzouk, op. cit., p. 174.
Col. (7): Table 1–3.

TABLE 2–10
Trade with Sterling Area and Nonsterling Countries, 1951–1957
(mill. £E)

	Merchandise Exports		Merchandise Imports		Balance on Current Account	
Year	Sterling Area	Nonsterling	Sterling Area	Nonsterling	Sterling Area	Nonsterling
1951	74.5	127.4	77.2	164.7	27.3	−42.5
1952	27.7	117.9	52.8	157.7	−3.6	−49.8
1953	35.2	100.1	31.4	133.8	27.7	−35.6
1954	36.3	103.5	36.5	114.2	17.2	−13.6
1955	24.3	108.8	40.7	149.5	−4.7	−38.7
1956	19.9	110.0	42.9	149.4	−5.7	−38.7
1957	8.8	157.2	18.1	199.4	−5.7	−25.5

SOURCES: *Annuaire Statistique* and *Economic Bulletin*, various issues.

and medium staple, which favored Sudanese and American varieties. At the same time, Sudan emerged as a major producer of long staple cotton and substantially eroded the Egyptian share of the Western market.

Not surprisingly, therefore, Egypt experienced a deficit in her current transactions with the sterling area and other countries in 1952 (see Table 2–10). By the end of the year her free sterling reserves were down to a negligible amount (£E6.3 million). The total free reserves including gold (£E 98 million) were still roughly equivalent to five months' imports.[13] The external deficit on current account was reduced considerably in 1953, and in 1954 there was even a slight surplus, actually a sign of domestic slackness rather than of soundness in the economy. In 1955 and 1956 the deficit became significant once more as a result of a strong expansion in imports (Table 2–10) of credit-financed capital goods.

In view of the unfavorable balance of payments picture in 1952, the government felt that it had to take strong corrective measures, but it was certainly too deflationary in its general policy. Exchange regulations and controls now became so comprehensive that developments can be identified with the co-directors' Phase II, which lasted until the nationalization of 1961.

General Import Licensing.

The first step taken by the government to improve the foreign exchange position was to extend import licensing in 1952 to all countries and to limit imports from the sterling area to necessities. Further, a 10 percent surcharge was imposed on all remittances abroad, and customs duties on tobacco and luxuries were raised. On the other hand, licenses for imports from countries with which Egypt had bilateral agreements were issued without limit. In general, imports in hard currency were confined to essentials, while semi-essential imports, such as textiles, were restricted to the export pound or to barter agreements.

The Import Entitlement System.

The second step was to introduce a comprehensive import entitlement system in 1953. Under this arrangement exporters who shipped goods to the dollar or sterling areas received an import entitlement for 75 percent of the value of exports (66 percent for goods shipped to West Germany) and for 100 percent in the case of exports of cotton yarn and textiles. The entitlement was transferable. Exporters could now sell cotton at a discount, recouping any losses by the premium they obtained through selling their import entitlement to importers. Import entitlements commanded a premium ranging over the next several years from 8 to 14 percent for dollars, 5 to 10 percent for sterling, and 8 to 12 percent for German marks (Table 2–3, columns 3–5). They could be used to import the commodities on the list for the export account (essentials and semi-essentials); but they were less restrictive in that they permitted importation from the sterling and dollar areas. Moreover, in order to encourage foreign investment and as an exception to the import entitlement regulations, all products could be imported from dollar and sterling areas provided that the proceeds of the sales were invested in Egypt. The value of such imports could not exceed 65 percent of the total foreign capital to be invested in Egypt; the remainder had to be invested in dollars or sterling at par.[14]

The import entitlement system was far more comprehensive than the export accounts, and it spread the partial devaluation to a larger segment of trade. At their peak, export accounts financed only 12 percent of imports, while the import entitlement system covered 40 percent of imports in the first year of its operation.[15] The supplementation of the export pound by the import entitlement system thus represented a further depreciation of the Egyptian currency. Nevertheless, the depreciation as reflected in the import entitlement quotations throughout 1953 and 1954 remained small; by the end of 1954, the premiums were 7.13 percent for sterling and 10 percent for the U.S. dollar (Table 2–3).

Through the relative rise in import prices in terms of domestic currency and the discount on exports, the import entitlement system, together with tighter import control on nonessentials, probably contributed to the marked improvement in the balance of payments and the resulting small current account surplus in 1954. However, it applied to only three currencies, which created severe imbalances with other currencies. Imports from France, to which entitlements did not apply, were relatively cheap, while exports to France were relatively expensive. This contributed to a severe Egyptian deficit vis-à-vis France which the government tried to reduce by ad hoc measures (for example, granting cotton a discount of 6.5 percent when exported to France).[16]

BILATERAL TRADE

With the shortage of transferable sterling as well as hard currencies, bilateral agreements appeared increasingly attractive to Egypt and its trading partners in Western and Eastern Europe. Italy, Belgium, West Germany, and the Netherlands concluded payments and trade agreements with Egypt in the years 1952 and 1953. The proliferation of these agreements was such that, by the end of 1953, no less than 55 percent of Egypt's foreign turnover was governed by bilateral agreements, as shown in Table 2–11.

Most of the payments agreements were based on Egyptian pounds (stipulated in those concluded with Eastern European countries) or on various combinations of the two partners' currencies (stipulated in the agreements concluded with Western European countries).[17] The exchange rates of the two currencies were fixed vis-à-vis the U.S. dollar, and the agreements guaranteed adjustment of the outstanding net balance in the event of a change in the exchange rate. They specified the manner in which any outstanding balance might be settled (usually in goods) and fixed a debt ceiling. The agreements allowed for triangular settlements, as Egyptian exchange control "often

TABLE 2–11
Egypt's Balance of Payments with Bilateral Agreement Countries
(mill. £E)

Year	Merchandise Trade Account		Other Transactions		Total Deficit	Turnover as % of Total Foreign Transactions
	Receipts	Payments	Receipts	Payments		
1951	42.3	51.0	10.9	26.1	−23.8	21
1952	70.0	73.5	16.0	31.3	−18.8	39
1953	90.8	92.1	27.1	33.3	−7.5	55

NOTE: The United Kingdom is excluded. Transactions in any one year cover only those countries with which there were agreements during that year.
SOURCE: *Economic Bulletin*, National Bank of Egypt, 1954, p. 166.

approves on an administrative basis the export of cotton to an agreement country with payment being received from the account of another agreement country."[18]

Transferability of outstanding balances enhances the efficiency of bilateral trade. Nonetheless, bilateral agreements usually imply an effective depreciation of one of the two currencies involved vis-à-vis hard currencies. For, with the addition of bilateral trade, the volume of competitive commodities traded (i.e., with a c.i.f. price equal to or lower than the world market price at the official exchange rate) is likely to exceed that which would have been contracted under pure multilateralism. Moreover, its composition is also likely to include goods for which c.i.f. import prices exceed world market prices at the official par rate. This expansion in trade volume can only be achieved by paying relatively more for imports or receiving less for exports (in terms of world market prices, not domestic prices), which amounts to some degree of currency depreciation.[19] Such implicit depreciation was brought out explicitly through the special arrangement with Switzerland commonly referred to as the "B-account." In 1950, when the agreement with Switzerland was renewed, it was decided that certain transactions should be carried in Swiss francs and others (specified in the form of a list of goods) in Egyptian pounds—the B-account. Instead of having a fixed exchange rate between the Egyptian pound and the Swiss franc, the exchange rate of the Egyptian pound in Switzerland was left to be decided by market conditions. The same arrangement was later incorporated into the agreements with Belgium and the Netherlands. The quotations for the Egyptian pound in the three markets are shown in Table 2–3. At the end of 1953 these rates reflected a depreciation of the Egyptian pound of 3 percent vis-à-vis the dollar in Amsterdam, 6 percent in Zurich, and 10 percent in Brussels.

THE ABOLITION OF THE EXPORT POUND AND IMPORT ENTITLEMENTS, 1955

The multiplicity of rates existing for identical commodities gave rise to lucrative arbitrage transactions. In 1955 Britain insisted, as part of the agreement on further sterling No. 2 releases, that the entitlement on sterling be dropped and the Egyptian pound be treated at par with sterling. The agreement was implemented in September 1955; entitlements on all other currencies were terminated as well. Earlier in the year export accounts had also been abolished, having lost all practical importance. Thus Egypt resorted again to a uniform exchange rate. But instead of devaluing its currency, which would have consolidated and generalized the previous partial depreciations, she chose to maintain the par value of the currency with the imposition of an import surcharge of 7 percent and a premium on cotton exports. The 7 percent surcharge applied to all imports except industrial equipment needed for investments and raw materials, which implied the exemption of roughly 50 percent of imports from the surcharge. The premium on cotton exports took the form of a reduction in the export tax (for example, from 300 to 160 piasters per kantar on Karnak) which corresponded to an 8 percent reduction in price. But other exports (in particular, cotton textiles, agricultural products, and leather goods) no longer benefited from any kind of premiums.

However, this was not sufficient to permit relaxation of exchange control measures; in fact, in view of the reappearance of a large balance of payments deficit in 1955, import controls were tightened. A new import policy was announced in March 1956 whereby licenses were issued on a half-yearly basis, with the aggregate value of licenses issued for each half-year period corresponding to 50 percent of the preceding year's export earnings. This was the first systematic attempt to establish a foreign exchange budget with import quotas determined in relation to exports. Old importers (somewhat inconsistently) were granted licenses up to 50 percent of their average imports during the last two years, while new importers were considered on the basis of the price of their imports and the type of currency involved.[20] The degree of restriction differed according to the priority given to various commodities (automobile and other consumer durables imports were prohibited altogether), and the 7 percent import surcharge had to be paid at the time of the issuance of the license. Later in the year an attempt was made to link import authorization to export performance by granting import licenses to any firm which succeeded in expanding its exports. A firm could import its own inputs up to 50 percent of the value of exports.

In the fall of 1956 the British-French-Israeli attack on the Suez Canal upset all these arrangements and we shall never know how they would have worked.

ECONOMIC RECOVERY AFTER 1956 AND THE SHIFT TOWARD EAST BLOC TRADE

The conservative caution of the government in regard to monetary and fiscal policy continued until 1959. Money supply, which had increased substantially during the Suez War, was only slightly higher at the end of 1958 than at the end of 1956, and government net borrowing from the banking system was modest until 1960–61 (see Table 3–5). Significant external current account deficits of about £E20 to 30 million were experienced each year from 1957 to 1960, partly caused by bank-financed capital goods imports for development purposes and weapons purchases. The remainder of the blocked sterling reserves was finally released, however, and some aid was obtained from both West and East. At the end of 1959, with all sterling reserves released, Egypt still had a gross exchange reserve corresponding to seven months' imports *plus* government payments abroad (including payments for military equipment) and a net reserve corresponding to about 3 months' imports *plus* government payments abroad.

The events surrounding the Suez War of 1956 severely disrupted the flow of trade and shifted its geographic distribution toward Eastern Europe and the Soviet Union (see Table 1–6). In the immediate aftermath of the Suez War, Egypt again concluded a number of barter agreements with Western countries in which highly inflated import prices reflected substantial discounts on sales of Egyptian cotton. At the same time, large purchases of cotton by the USSR and Czechoslovakia were re-exported to the West at discounts reaching 28 percent.[21] As a result, Western markets refrained from buying Egyptian cotton directly even when equivalent discounts were granted. Subsequently, the communist countries were to readjust their cotton policies to allow for much larger consumption of Egyptian cotton.

Nevertheless, Egyptian imports continued to reflect heavy reliance on Western sources. The deficit on current transactions was mainly with Western countries, and the need for an expansion of exports to the West was strongly felt. The payments situation in 1954 and 1957 is shown in Table 2–12.

THE FOREIGN EXCHANGE BUDGET

At the beginning of 1957 Egypt adopted a number of measures intended to encourage exports to the West and to restrict further the imports of nonessentials. A foreign exchange budget was set up, and a quarterly quota was established for imports on the basis of past export performance. The exchange budget first determined the import requirements of the Ministry of Supply (wheat, tea and coffee, et cetera), and then allocated a monthly quota for the importation of pharmaceuticals. Thereafter, it allocated to raw materials imports by industrial producers a *global* quota equal to one-fourth of the quantity imported in the previous year.[22] Finally, it allowed for seasonal imports, which were deducted from subsequent quotas.

EXPORT PREMIUM SYSTEMS AND IMPORT DUTIES, 1957–1961

As part of the policy outlined above, the government also announced a system of export premiums, which varied by currency and destination and

TABLE 2–12

Distribution of Current Payments and Receipts by Country Group, 1954 and 1957

	1954		1957	
	(mill. £E)	(%)	(mill. £E)	(%)
Current receipts from:				
Eastern Europe	21.6	10	85.2	37
West	169.3	76	95.7	40
Other countries	31.3	14	56.3	23
Total	222.2	100	237.2	100
Current payments to:				
Eastern Europe	18.3	8	84.4	31
West	174.4	80	119.2	44
Other countries	25.9	12	64.8	25
Total	218.6	100	268.4	100
Balance on current account:				
Eastern Europe	3.3	—	0.8	—
West	−5.1	—	−23.5	—
Other countries	5.4	—	−8.5	—
Total	3.6	—	−31.2	—

NOTE: "Eastern Europe" includes Austria, Bulgaria, Czechoslovakia, East Germany, Greece, Hungary, Poland, Rumania, Turkey, the USSR, and Yugoslavia. "West" includes American monetary area, sterling area, and European countries not included in Eastern Europe.
SOURCE: D. Mead, op. cit., Table V–A–10.

were adjusted periodically in response to cotton prices and the general trends in the current balance of payments. From February to May 1957, the premium was applied only to cotton; it amounted to 10 percent on exports against Indian rupees and Italian liras, 15 percent on exports to Germany in DMs, 15 percent on exports against dollars to countries other than the United States and Canada, and 20 percent on exports against dollars to the United States and Canada. In May 1957, the premiums were extended to exports of onions (20 percent) against convertible currencies, and those on cotton were raised across the board by 5 percentage points.

An import fee of 10 percent was imposed in February 1957 on all imports against convertible currencies. The 7 percent surcharge that had been introduced in 1955 was extended to all nonessentials and later increased to 9 percent. In June the fees on government purchases with the currencies mentioned above were doubled to 20 percent.

The premium system was the third example of partial, de facto depreciation introduced in the postwar period. It was accompanied by a rise in wholesale prices (8 percent between August 1956 and August 1957), which was concentrated on import goods such as tea, coffee, fuel, and paper. Imports of textiles and consumer durables (automobiles, for example) fell during 1957, as did imports of intermediate products (paper, wood, jute bags).[23] For the first time in the postwar period "a general scarcity of imported goods and raw materials" was reported.[24] Part of this phenomenon was certainly due to the disruption of trade caused by the Suez War, but it also marked the beginning of a recurrent pattern of commodity shortages in the Egyptian economy. It should be mentioned that the period 1955–1957 saw the launching of several large industrial plants (such as the iron and steel plant at Helwan, and fertilizer and tire plants), entailing heavy imports of capital equipment. At this time most Western European countries returned to convertibility, thereby increasing the number of currencies sold at a premium and reducing the opportunities for bilateral agreements, which Egypt now relied upon heavily.

In 1958, the premium on exports was extended to all commodities except rice and oil products through the reintroduction of nonresident "export accounts," which were freely transferable to other nonresidents. However, while in the old system (1950–1956) the premiums had been left to the market, in the new system the premiums were fixed by the central bank. The premium developed as follows:

	(percent)
March 1 to March 10, 1958	30.0
March 10 to June 6, 1958	26.5
June 7 to September 1, 1958	25.0
September 2, 1958 to April 20, 1959	17.6

Starting with April 1959, the premium on cotton was changed frequently, sometimes from week to week. It was adjusted according to the international supply and demand situation in an attempt to assure the competitiveness of cotton abroad at relatively stable producer prices. When the cotton season of 1958–59 was near its end and unusually large supplies were still available, the premium averaged around 53 percent (between May and July of 1959). The new season (1959–60) started with premiums around 23 percent; they were frequently adjusted downward as supplies became gradually smaller toward the spring of 1960. At that time the premium averaged 6 percent and the carryover was about half that of the previous season. When the availability of two crops overlapped, a higher premium was quoted for the old crop than for the new one. It should be added that during the cotton seasons 1958–59 and 1959–60 the cotton export taxes were lowered and subsequently abolished for almost all varieties and grades; by itself the lowering of export taxes implied a depreciation.[25] Thus, the policy shifted from taxing to subsidizing cotton cultivation for a few years until 1962.

By the middle of 1959, exports of cotton received a premium fluctuating around 25 percent, onions and textiles, a premium of 29 percent, and other exports with the exception of rice and oil products, a premium of 17.5 percent. On the import side, fluctuating premiums prevailed through 1958 at rates between 30 and 17 percent, with a higher premium applied to government purchases. At the same time all imports were paying the 9 percent surcharge. Note that trade with Eastern European countries was subject to no premiums, either on imports or on exports: export prices higher than world market prices were offset by higher import prices.[26]

In September 1959 the "export account" system was abolished and replaced by a system in which premiums on the Egyptian pound were applied to receipts and payments in convertible currencies. All current transactions were grouped into categories, as follows:[27]

1. Imports of goods and invisibles were to pay a premium of 27.5 percent, except for certain capital goods and raw materials.

2. Exports of manufactured products, except textiles and cement, were to receive a premium of 17.5 percent.

3. Exports of cotton, textiles, and onions were to receive a variable premium which would be adjusted periodically according to international market prices (each week in the case of cotton). It averaged between 25 and 30 percent in December 1959.

4. Exports of rice and cement, which were sold at the official exchange rate, occasionally carried an export tax.

As the balance of payments situation improved again, the premium on most exports was reduced, first to 20 percent in January 1960 and then to 10 percent in July. At the same time, the "statistical" ad valorem tax of 1 percent on all imports was raised to 5 percent. Moreover, the 9 percent import surcharge was extended to imports from countries with which Egypt had bilateral agreements. Half the premium was, however, refunded in the case of imports of foodstuffs, raw materials, and industrial equipment; such imports exceeded two-thirds of total imports. Thus, by adding the import surcharge of 9 percent, the premium (½ of 10 percent), and the statistical tax (5 percent), we reach an effective premium (not including tariffs) of 19 percent on imports of food, raw materials, and industrial equipment, as compared with an effective premium of 10 percent on all exports.

THE NATIONALIZATION OF FOREIGN TRADE, 1961

In July 1961 the government nationalized a large number of companies. A virtual government monopoly was established for imports: the right to import was restricted to state-owned import companies, with some state-owned industrial companies authorized to import directly the commodities and equipment needed for their own use.

With respect to exports, the government acquired majority participation in all export trade companies that dealt principally in cotton. The cotton futures market was abolished and the Alexandria bourse was closed. The Egyptian Cotton Commission (ECC) was given a monopoly in internal trade and became the sole supplier to the export companies.[28] Instead of the earlier policy of giving exchange premiums to private exporters, who could then sell cotton at a discount, the ECC now simply fixed export prices periodically in line with world prices. These fell below domestic buying prices, as on previous occasions. On the other hand, the ECC sold cotton to domestic mills at prices 11 percent higher than its own purchase prices from agriculture.[29] This price differential, which was reflected in a rise in textile prices, helped check domestic consumption and increased exportable supplies; it reversed the earlier policy of sales to domestic mills at prices below world market prices (at a margin equal to the export taxes abolished during the years 1958–1960). With respect to cotton textile exports, the price differential was made up by a premium until 1962 and by a subsidy later. While cotton export prices were constantly adjusted in response to the supply and demand situation abroad, domestic buying and selling prices were adjusted occasionally only in response to cost movements or to adjust the profitability of alternative crops.

Trade in rice was also monopolized by the government, but a number of small private export companies dealing in fruits and vegetables remained in business.

FOREIGN EXCHANGE CRISIS AND DEVALUATION, 1962

During 1961 and 1962 the balance of payments suffered several setbacks. In 1961 the cotton crop experienced a major failure; production was down by 40 percent despite a record sown acreage. This crop failure was reflected in the export figures for both 1961 and 1962. Moreover, a decrease in the rice crop, together with a rise in domestic rice consumption, in 1962 cut exports of that commodity to almost half of the level they had reached in previous years. Imports of food, particularly of cereals, increased drastically in 1961 and even more so in 1962; but this increase was financed by PL 480 counterpart funds and thus did not strain exchange reserves. Egypt was, however, committed to certain extraordinary capital expenditures, such as compensations to the old Suez Canal stockholders, to the Sudanese Government on account of the Aswan High Dam construction, and to the United Kingdom for "Egyptianized" property.

All these circumstances pointed toward an acute foreign exchange crisis in 1962. The unification of the premiums on imports and exports to 20 percent at the end of 1961 and the reintroduction of a simple multiple-exchange system with three rates[30] later finally led to devaluation in May 1962.

NOTES

1. These systems are explained later in this chapter.

2. *National Bank of Egypt, 1898–1948*, National Bank of Egypt, 1950, p. 97; *Economic Bulletin*, National Bank of Egypt, Vol. 1, 1948, pp. 50–51.

3. For a description of the abortive British convertibility attempt of 1947, see L. B. Yeager, *International Monetary Relations*, New York, 1966, pp. 378–380.

4. *Economic Bulletin*, N.B.E., 1948, p. 187.

5. Ibid., Vol. 1, p. 187; Vol. 2, p. 114.

6. Ibid., Vol. 2, p. 220.

7. Ibid., Vol. 2, p. 13.

8. Whereas the increase in real GDP was 1.9 and 2.8 percent in 1950 and 1951, respectively, the increase in real GNI (including terms of trade gains) was 8.1 and 7.0 percent. We are here up against an old issue in monetary policy: should money supply be proportional to commodity (and services) output or to total factor input? To put it another way: should output prices or factor prices be kept constant? The issue arises clearly in case of productivity changes. In underdeveloped countries the two most important instances of productivity change in the short term are crop fluctuations and terms of trade changes. The issue was discussed years ago by K. Wicksell and D. Davidsson, who agreed that factor prices rather than commodity prices should be stabilized in the short term. Contemporary attitudes in developed countries are, rather, that, if anything, it is commodity prices that should be kept constant. However, there seem to be good reasons for the standpoint of Davidsson and Wicksell in the context of crop and terms of trade fluctuations in underdeveloped countries.

9. *Economic Bulletin*, N.B.E., 1950, p. 186, and 1951, p. 132.

10. Critics of the old regime maintain that the policy basically aimed at bailing out bullish speculators, among them people closely related to the establishment.

11. Once the cotton acreage has reached its technical maximum, a further cotton price increase has no effect on production. But a sufficiently strong price decline may, of course, bring cotton production down below this maximum.

12. The United Kingdom's shift of cotton purchases to the Sudan was also partly politically motivated, as it coincided with Egyptian attempts to assure British withdrawal

from the Suez Canal area. See "An Unwanted Customer?," *Economic Bulletin,* N.B.E., 1952, p. 170.

13. *Economic Bulletin,* N.B.E., 1953, pp. 31–32.

14. *Economic Bulletin,* N.B.E., 1954, p. 181.

15. *Economic Bulletin,* N.B.E., 1953, p. 198.

16. The discount was to be financed by a premium of 6.5 percent on imports of tea from Ceylon. See *Economic Bulletin,* N.B.E., 1956, p. 36.

17. In the agreement with the Netherlands, payments for goods were to be effected in Egyptian pounds, and for invisibles, in florins. In the agreement with Belgium one third of the value of Egyptian imports was to be settled in Belgian francs and the rest in Egyptian pounds, while Egyptian exports were to be settled in either currency at the option of Belgium.

18. *Economic Bulletin,* N.B.E., 1954, pp. 163–164.

19. For a theoretical treatment, see Karim Nashashibi, "Bilateral Trade as a Development Instrument under Global Trade Restrictions," NBER Working Paper 54, 1974. As an example, suppose that bilateral trade between Egypt and Belgium results in an outstanding balance in favor of Belgium. If this balance is to be settled in goods, which is the aim of bilateral trade, either Egypt has to offer additional exports at lower prices, or the balance of Egyptian pounds could be auctioned off on the Brussels currency market. In either case this would imply a partial depreciation of the Egyptian pound, which would vary according to the importer's relative demand for Egyptian goods (either for local consumption or for reexport).

20. *Economic Bulletin,* N.B.E., Vol. 9, p. 46.

21. M. S. Mourad and F. Moursy, *The Foreign Exchange Budget and the Exterior Financing of Development,* Cairo, 1967, p. 246 (in Arabic).

22. *Economic Bulletin,* N.B.E., 1957, Vol. 10, p. 31.

23. Ibid., p. 43 and pp. 162–163.

24. Ibid., p. 282.

25. B. Hansen and A. Marzouk, *Development and Economic Policy in the U.A.R. (Egypt),* Amsterdam, 1965, pp. 198–204.

26. *Economic Bulletin,* N.B.E., Vol. 14, 1961, p. 384.

27. *Yearbook of Exchange Controls,* International Monetary Fund, 1960, pp. 318–319.

28. The Commission was established in 1942 to handle government stock purchases during World War II. Continuing its activities after the war, it was the instrument of the government's price support policy vis-à-vis the cultivators and exerted an influence on export prices through its stock policies.

29. In 1960 the difference between cotton prices at delivery to ginning mill and at arrival at Alexandria was slightly less than 10 percent. Since the buying price of the ECC relates to ginned cotton, it would seem that the 11 percent price differential more than covered the trade and transport margin of the old middlemen and implied a certain taxation of domestic consumption.

30. The three rates were: (1) the official rate (£E1 = US$2.87), applying to Suez Canal tolls, and rice, oil products, onions, and groundnuts; (2) a depreciated rate—by 10 percent—on imports such as raw materials, foodstuffs, and capital equipment; and (3) a depreciated rate—by 20 percent—on all other imports and exports.