

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

For Immediate Attention

EBS/62/103

CONFIDENTIAL

August 23, 1962

To: Members of the Executive Board

From: The Acting Secretary

Subject: United Arab Republic - Request for Amendment of Stand-By Arrangement

Attached for consideration by the Executive Directors is a request from the United Arab Republic for certain modifications in the stand-by arrangement with the Fund and for approval of certain exchange practices, together with an analysis and recommendation by the staff.

It is not proposed to bring this matter to the agenda for discussion unless an Executive Director so requests by the close of business on Wednesday, August 29, 1962. In the absence of such request, the decision proposed by the staff will be deemed approved by the Executive Board and will be recorded in the minutes of the next meeting thereafter.

Att: (1)

Confidential

INTERNATIONAL MONETARY FUND

United Arab Republic - Request for Amendment of Stand-by Arrangement

Prepared by the Middle Eastern Department
and the Exchange Restrictions Department

(In consultation with the Legal Department and the Office of the Treasurer)

Approved by John W. Gunter and Roger V. Anderson

August 22, 1962

In the attached letter of August 14, 1962, signed by the Minister of Economy, the Government of the United Arab Republic requests that the stand-by arrangement, which is valid until May 6, 1963, be amended and that certain exchange practices be approved. The Fund extended a stand-by arrangement to the United Arab Republic in an amount equivalent to \$42.5 million to begin on May 7, 1962 for a period of one year, and the United Arab Republic Government adopted a stabilization program which was described in a letter to the Managing Director dated April 26, 1962. Some of the provisions specified in this letter of intent annexed to the stand-by arrangement could not be fully implemented, and the United Arab Republic was required to consult with the Fund to agree on new terms and conditions before further drawings could be made. Discussions took place in Cairo in the latter part of May 1962 and again in mid-July. It is now proposed to modify the stand-by arrangement by annexing thereto and making a part thereof the letter of August 14, 1962.

The United Arab Republic has made one drawing under the stand-by arrangement in an amount equivalent to \$20 million, and the Fund's holdings of Egyptian pounds now amount to almost 175 per cent of the quota of \$90 million. Under the terms of the stand-by arrangement effective May 7, 1962, the amount so far purchased by the United Arab Republic is the maximum that could be purchased in the first three months of the period covered by the stand-by arrangement. If the United Arab Republic makes full use of the remaining facilities under the stand-by arrangement, now amounting to \$22.5 million, the Fund's holdings of Egyptian pounds would increase to almost 200 per cent of the quota. An increase in the U.A.R.'s quota to \$120 million has been approved by the Board of Governors but the U.A.R. has not yet consented to this increase.

(In millions of Egyptian pounds)

1962 (end of month)	March ^{1/}	June	July	Ceiling
Net claims on the Government	279.6	288.2	289.0	289.6
Cotton financing	39.4	17.1	12.2	27.0
Other claims on nongovernment sector	340.8	368.8	373.7	345.8
Of which: commodity stocks held by Agricultural Bank	32.2	49.3	49.2	--

^{1/} Revised data.

Net claims on the Government have risen since the beginning of the program, but remained within the ceiling. The seasonal contraction of cotton financing has been greater than expected, so that the ceiling on this financing causes no problems at the present time. The increase of other claims on the nongovernment sector to a greater extent than contemplated in the program, thus involving the piercing of the ceiling, was due to reasons explained in the attached letter of August 14, 1962 and discussed below. The credit control measures described in paragraph 5 of the letter of April 26, including the increases in the discount rate of the Central Bank from 3 to 5 per cent and in reserve requirements for commercial banks by 5 percentage points, have been taken.

With regard to the exchange system, the new rate of \$2.30 per Egyptian pound is now applied to most transactions, but, as explained in the attached letter, it will take some months before the rate can be applied to all transactions and the system of premiums entirely abolished as specified in the letter of April 26, 1962. There are thus several exchange practices which require the approval of the Fund. No progress has so far been made on eliminating bilateral payments agreements.

The attached letter is designed to amend the ceiling on credit to the nongovernment sector for purposes other than cotton, introduce some flexibility in reserve requirements, revise the time-table for completing the unification of the exchange rate structure and eliminating the premium system, and correct a typographical error in the letter of April 26.

Ceiling on Bank Claims (excluding cotton financing) for the Nongovernment Sector

The U.A.R. is proposing two changes in the ceiling applying to bank claims on the nongovernment sector for purposes other than cotton financing:

1. The ceiling as it now stands treats the stocks held by the Agricultural and Cooperative Bank as an accommodation of the banking system to the nongovernment sector, and it is proposed to eliminate these stocks from the ceiling.

2. It is proposed also to adjust the ceiling to allow for a seasonal movement in agricultural credit.

The elimination of commodity stocks held by the Agricultural Bank from the ceiling may be regarded as a technical adjustment with little or no implication with respect to credit policy. Some of the stocks held by the Agricultural Bank relate to the loan operations of the Bank; many of its loans are in kind rather than cash, taking the form of seeds, fertilizers, insecticides, etc. The Agricultural Bank also acts as agent for the Government for the importation of some foodstuffs, in particular cereals. In carrying out these operations, the Agricultural Bank operates on a commercial basis, or if the Government's policy is to subsidize the commodity in question, the Bank is financed from the budget. The reason for proposing the omission of these stocks from the credit ceiling is that the stocks fluctuate considerably from time to time, thus making the administration of the ceiling somewhat difficult. Stocks had a rising trend recently until May 1962, declined slightly in June and July, and are expected to decline substantially over the next several months.

The present ceiling on claims on the nongovernment sector (excluding cotton) is based on a rate of increase of LE 10 million per year and provides for no seasonal fluctuation. There is, however, a considerable seasonal movement in credit extended by the Agricultural Bank. This movement is of much smaller amplitude than the one for financing the cotton trade (covered by a separate ceiling); it tends to decline when cotton financing is increasing and vice versa. Agricultural credit for purposes other than cotton trade financing^{1/} shows some rising tendency beginning in November, but the main increase occurs in the March-August period, followed by a rather sharp decline thereafter.

The proposed revision in the ceiling on claims on the nongovernment sector would permit the normal rather sharp upswing in agricultural credit during the summer months, but would then require a contraction in the next three months, levelling off thereafter until the end of March 1963. Under the proposed new ceiling, the net increase for the year ending March 31, 1963 would be the same as in the ceiling set forth in the letter of April 26, 1962. The new ceiling would permit the seasonal upswing to begin again after March 31, 1963.

The elimination of commodity stocks of the Agricultural Bank from the ceiling requires a modification in the wording of paragraph 11 of the letter of April 26, and the modification proposed is appropriate.

^{1/} The financing of the cotton trade is mainly by the commercial banks.

Reserve Requirements for Commercial Banks

As indicated earlier, the main seasonal movement in bank credit in the U.A.R. relates to cotton financing. Such financing begins to rise in September, reaches its peak usually in December, and declines thereafter; total credit shows the same general movement. The financing of the cotton trade is provided by the commercial banks, and during the period of rapid expansion the commercial banks find it necessary to seek some accommodation from the Central Bank. It has been the practice of the Central Bank for a number of years to assist the commercial banks in this financing by reducing reserve requirements by from two and one-half to five percentage points, beginning in October and continuing through March. In paragraph 5 of the letter of April 26, 1962, a uniform reserve requirement of 17.5 per cent is made applicable throughout the year, but at the time of the consideration by the Executive Board of the stand-by arrangement it was stated that a reduction of this ratio to 14.5 per cent during the cotton financing period would be necessary. The proposal now is to permit the reserve requirement to be reduced temporarily to 12.5 per cent.

It does not appear that a temporary reduction in the reserve requirement to 12.5 per cent would endanger the Central Bank's control over the credit operations of the commercial banks. Even with the proposed reduction in the reserve requirement, the commercial banks will find it necessary to seek substantial accommodation from the Central Bank in meeting the seasonal upswing in cotton financing under the program; thus the Central Bank would continue to have ample opportunity to determine whether the commercial banks are complying with credit policy.

Exchange System

The U.A.R. authorities have encountered several problems in applying the rate of US\$2.30 uniformly and directly to all exchange transactions as undertaken in paragraph 7 of the letter of April 26, 1962. This rate does not apply at the present to (a) Suez Canal dues, (b) cotton exports relating to the 1961/62 crop, and (c) exchange allowances for Egyptian tourists to Lebanon. In the case of most bilateral agreement accounts maintained in Egyptian pounds, the effective rate of LE 1 = US\$2.30 continues to be achieved by the application of a premium, now amounting to about 25 per cent on the Egyptian pound equivalent at the par value rate. With regard to other bilateral accounts in Egyptian pounds (namely, accounts with Lebanon, Austria, Netherlands, Switzerland and Belgium), the effective exchange rate is determined in the free market of the partner country. The attached letter of August 14, 1962 describes the difficulties involved and establishes a program to achieve as soon as is considered feasible the stated objectives of a uniform rate and the abolition of the premium system.

At the present time, Suez Canal tolls are quoted and paid in Egyptian pounds from special shipping accounts maintained by shipping concerns for this purpose. These accounts can be augmented only with sales of specified convertible currencies at the exchange rate based on the par value. A modification in these arrangements in order to eliminate the deviation from the exchange rate of \$2.30 may involve some discussion with the shipping interests concerned because of certain international understandings. There is no intention of changing tolls in terms of foreign exchange. The U.A.R. proposes to complete the necessary arrangements to eliminate this deviation from the \$2.30 rate by the end of 1962.

The par value rate of US\$2.87 is now being applied to contracts relating to the sale of the 1961/62 cotton crop, with the premium involved being paid to the Egyptian Cotton Commission. Nearly all of the 1961/62 crop has by now been contracted for, and the U.A.R. authorities did not consider it feasible to change the procedures relating to the sale of this crop at this time. New arrangements for the 1962/63 crop have, however, been announced which are based on the new rate of LE 1 = US\$2.30. This rate is now being applied to contracts relating to the new crop and will be fully effective from September 1, 1962 for all cotton transactions.

Under a special agreement between the U.A.R. and Lebanon, Lebanon extends an exchange rate favorable to Egyptian tourists in order to encourage them to visit Lebanon. This arrangement is renewed annually and a rate for each year agreed upon. The rate for the current year is LE 1 = LL 8, compared to the free market rate in Beirut of LL 6.75 - LL 6.80 on August 10, 1962. As the special rate of Egyptian tourists arises under an agreement between the U.A.R. and Lebanon, it constitutes a discriminatory currency arrangement of the two countries. The Fund has given temporary approval to this arrangement as a multiple currency practice of Lebanon (EEM/61/39, July 14, 1961). The U.A.R. authorities wish to maintain this arrangement for another year. The staff view, as expressed to both the U.A.R. and Lebanese authorities, is that any tourist encouragement considered necessary should be provided by measures not of an exchange character and that the present arrangement should be terminated soon. There would, however, be difficulties if the Fund insisted on an immediate termination during the summer tourist season.

As indicated in the letter of August 14, 1962, it has not been possible to eliminate the premium system as it is applied in connection with some bilateral payments agreements involving accounts denominated in Egyptian pounds. This elimination can be achieved effectively only in agreement with the partner country either to terminate the agreement or to substitute for Egyptian pounds another unit of account such as U.S. dollars or pounds sterling. In the letter of August 14, 1962, the United Arab Republic states that it is undertaking negotiations as soon as possible with the partner countries involved, and where Fund members are involved the use of the premium will be eliminated not later than the termination dates of the respective bilateral agreements. There are also five payments agreements involving accounts in Egyptian pounds to which the premium arrangement is not applied and where the effective exchange rate is determined in the free market of the partner country. In four of these countries (Austria, Belgium, Netherlands and Switzerland), the objective of the U.A.R. authorities is understood to be to liquidate outstanding balances as soon as possible. This arrangement also exists with respect to Lebanon where it applies for most current transactions. Negotiations with Lebanon will be necessary to eliminate the agreement with that country, while the other can be eliminated by not permitting any new credits to the Egyptian pound accounts.

Staff Appraisal

The revisions in the program which have been proposed are designed to deal with practical problems which have arisen and are not intended as a curtailment of the objectives of the program. In each case the revision proposed is one which the staff would have found justifiable if it had been proposed in connection with the original draft of the program. The proposal for a revised ceiling on claims on the nongovernment sector (excluding cotton financing) appears fully justified, particularly as it would provide for an established pattern of agricultural financing. The introduction of seasonal flexibility in reserve requirements for commercial banks is also in accord with an established pattern and does not seem to provide any basis for excessive credit expansion. The proposals relating to the exchange system are largely necessary because time is required to eliminate the many complexities of the U.A.R.'s restrictive arrangements. The proposals in this connection appear reasonable, but much will depend on the vigor with which the U.A.R. pushes ahead on the reduction of its bilateral trade and payments arrangements.

Recommendations

The following decisions which would amend the letter annexed to the stand-by arrangement and approve the existing exchange practices are submitted for the consideration of the Executive Board:

Stand-By Arrangement

The United Arab Republic has consulted with the Fund concerning new terms on which further drawings may be made under the stand-by arrangement of May 7, 1962 (EBS/62/49, Supp. 2), and has proposed certain modifications in the stabilization program which are set forth in the letter of August 14, 1962 (EBS/62/103, Attachment I). The Fund agrees to the proposal of the United Arab Republic. The letter of August 14, 1962 shall be annexed to the stand-by arrangement with the United Arab Republic, and the letter of April 26, 1962 annexed to the stand-by arrangement shall be read as amended by the letter of August 14, 1962.

Exchange System

The Fund notes the intention of the United Arab Republic authorities to unify the exchange rate at US\$2.30 per Egyptian pound as soon as possible and does not object on a temporary basis to the maintenance of the existing exchange practices which are subject to Fund approval.

United Arab Republic
Ministry of Economy

Office of the Minister

Cairo, August 14, 1962

Dear Mr. Jacobsson:

Considerable progress has been made in implementing the measures described in my letter of April 26, 1962 to you in connection with the stand-by arrangement between the United Arab Republic and the Fund. Some matters, however, have arisen making necessary certain modifications to my letter of April 26. These changes and the reasons for them are described below and I hope that the changes will be mutually agreeable as a basis for modifying the understandings in the stand-by arrangement with the Fund.

1. The ceiling established by paragraph 4 of the letter of April 26 with respect to the claims of the banking system on the nongovernment sector, excluding cotton financing, does not take into account or make adequate provision for the seasonal movement in agricultural credit for purposes other than cotton. Such agricultural credit rises rather sharply during the spring and summer and declines thereafter, and it is proposed that the ceiling be adjusted to allow for this seasonal movement. It is also proposed to exclude from the ceiling stocks held by the Agricultural Bank which are now treated as a claim of the banking system on the nongovernment sector. These stocks are subject to somewhat erratic movements, making administration of the ceiling difficult, but over a period of time they do not normally add to the total accommodation of the nongovernment sector. To the extent that any of these stocks are sold below cost, the subsidy is provided by direct appropriation from the budget. Accordingly, it is proposed to modify the text of paragraph 4 of the letter of April 26 as follows:

"The total claims of the banking system on the nongovernment sector (excluding cotton financing and stocks held by the Agricultural Bank) will not rise above the level of March 31, 1962 by more than LE 20 million prior to August 31, 1962. Thereafter, such claims will decline so that by November 30, 1962 they will not be more than LE 10 million above the level of March 31, 1962. This ceiling will be maintained until March 31, 1963. After March 31, 1963, such claims will not rise above the level of March 31, 1962 by more than LE 25 million prior to June 30, 1963."

To reflect properly these changes in paragraph 4 of the letter of April 26, 1962, the third reference in paragraph 11 of that letter to the limit on claims of the Banking System on the nongovernment sector (excluding cotton financing) should be amended to read:

"(iii) The total claims of the Banking System on the nongovernment sector (excluding cotton financing and commodity stocks held by the Agricultural Bank), have not been within the limits specified in paragraph 4 above or".

2. The Central Bank finds that the reserve requirement for commercial banks of 17.5 per cent, which has been imposed in accordance with paragraph 5 of the letter of April 26, will be undesirably high during the seasonal upswing in cotton financing in the fall and winter. Consequently, the Central Bank plans to reduce the reserve requirement of 17.5 per cent by an amount not exceeding 5 percentage points, beginning no earlier than October 1, 1962. This reduction is somewhat more than originally contemplated. The requirement of 17.5 per cent will, however, be fully restored not later than March 31, 1963.

3. We have encountered difficulties in implementing fully the undertakings in paragraph 7 of the letter of April 26 to apply a uniform rate for all exchange transactions and to abandon completely the practice of premiums. We propose to amend our undertaking in this respect as follows:

- (a) The elimination of the premium system as it is applied in connection with bilateral payments agreements involving accounts denominated in Egyptian pounds can be accomplished satisfactorily only with the agreement of the partner countries. Accordingly, we have found it necessary to continue temporarily the use of the premium system in this connection. We are, however, undertaking as soon as possible negotiations, in accordance with paragraph 10 of the letter of April 26, with the partner countries involved with the view either to eliminating each respective agreement or in the case of some agreements with non-Fund members replacing the unit of account. The use of premiums in each case will be eliminated as soon as possible, but where Fund members are concerned in no event later than the present termination dates of the respective bilateral payments agreements. There are also a number of payments agreements having clearing accounts in Egyptian pounds where the effective exchange rate is determined in the exchange market of the partner country. At no time has the premium system been applied to transactions under these

agreements, and this practice has not been modified with the change in the exchange system in May 1962. This also may only be done effectively in conjunction with the partner countries. As in the case of other payments agreements, these agreements will either be eliminated or appropriately modified in the relatively near future.

- (b) For technical reasons, it was not found possible to apply the rate of \$2.30 per Egyptian pound to Suez Canal tolls by May 15, 1962, as had been indicated in my letter of April 26, 1962. This problem is under serious consideration at present and the multiple currency practice involved in the present arrangement will be eliminated not later than January 1, 1963.
- (c) It has also not been feasible to apply the new rate of \$2.30 to cotton transactions relating to the 1961/1962 season which is now approaching an end. Arrangements, however, have been announced under which the new rate is applicable to all sales proceeds relating to the 1962/63 cotton season.
- (d) Under a special arrangement between the United Arab Republic and Lebanon, Lebanon extends an agreed exchange rate to Egyptian tourists which is expected to be more appreciated than the exchange rate for Egyptian pounds prevailing in the Lebanese free market, as well as result in a cross rate different from \$2.30 per Egyptian pound. The United Arab Republic wishes to continue this arrangement for another year.

The United Arab Republic requests the Fund's approval of the exchange practices mentioned in (b), (c) and (d) above, together with the exchange rate of U.S. dollars 2.30 to the Egyptian pound applicable to all other visible and invisible external transactions.

4. There are two typographical errors in the text of my letter of April 26, 1962 as it was submitted to the Executive Board in EBS/62/49. In paragraph 2 there is a reference to the date of March 31, 1961 and the proper year is, of course, 1962; this error should be corrected. The same error also occurs in the second sentence of paragraph 4, but in this case a new text has been proposed in paragraph 1 above.

Sincerely yours,

/s/

A. M. Kaissouni
Minister of Economy

Mr. Per Jacobsson
Managing Director
International Monetary Fund
Washington D.C., U.S.A.