FOR AGENDA

EBS/62/24

CONFIDENTIAL

March 2, 1962

To: Members of the Executive Board

From: The Secretary

Subject: United Arab Republic - Use of the Fund's Resources

Attached for consideration by the Executive Directors is a request from the United Arab Republic for a drawing, together with the staff's analysis and recommendation.

This subject has been placed on the agenda for Meeting 62/10, Wednesday, March 7, 1962.

Att:(1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

United Arab Republic - Use of the Fund's Resources

Prepared by Middle Eastern Department in collaboration with
Legal Department, Exchange Restrictions Department, and
Office of the Treasurer

Approved by John W. Gunter

March 2. 1962

I. Introduction

The United Arab Republic has submitted a request for a purchase of the equivalent of US$7.5 million, one half in U.S. dollars and one half in Deutsche Mark. A waiver is required under Article V, Section 4.

The proposed drawing would increase the Fund's holdings of Egyptian pounds to 155 per cent of quota. There have been a number of transactions with the U.A.R. The most recent drawing, which raised the Fund's holdings of Egyptian pounds to 155 per cent of quota, was a purchase of the equivalent of $22.4 million in sterling in January 1962 against gold collateral and with repurchase term of one year. On February 28, 1962 the U.A.R. repurchased the equivalent of US$7.5 million of the Fund's holdings of Egyptian pounds in accordance with a repurchase schedule agreed with the Fund (EBM/59/41). This repurchase reduced the Fund's holdings of Egyptian pounds to the present level which equals 147 per cent of the U.A.R. quota of US$90 million. The U.A.R. will have to make a repurchase of the equivalent of US$2.5 million during April 1962, in accordance with Section III of the Report on Enlargement of Fund Resources Through Increases in Quotas.

The U.A.R. has proposed that the new drawing of $7.5 million would, as in the case of the drawing in January 1962, be against gold collateral and with repurchase term of one year.

II. Discussion

A Fund mission visited Cairo between January 16 and February 5, 1962 for the purpose of holding Article XIV consultations discussions with the U.A.R. authorities, and to assist them in working out the details of a stabilization program. The papers relating to these discussions will be submitted to the Executive Board in the near future. The major questions discussed were the adequacy of the exchange system and the permissible level of domestic credit expansion, but no agreed conclusions were reached. The U.A.R. authorities are studying the views expressed during these discussions by the Fund mission.

As was pointed out in connection with the drawing in January 1962 (EBS/62/1), the U.A.R. has experienced balance of payments difficulties for a number of years. While variations in the marketing situation for cotton have had substantial effect on the payments situation from year to year, the principal source of the payments problem has been the inflationary impact of credit expansion. Large contractual payments have added to the problem. Moreover, the situation was aggravated in 1961 as a consequence of a sharp fall in agricultural production, affecting in particular cotton exports. Efforts to deal with the payments problem by continuing resort to bilateralism and multiple currency arrangements were not successful, and foreign assets have been declining for a number of years. During 1961 foreign assets again showed a considerable decline, and as of February 8, 1962 the gross assets of the Central Bank of Egypt amounted to LE 105.1 million, composed of LE 60.6 million in gold, LE 7.3 million in convertible assets, and LE 37.2 million under payments agreements and clearing accounts. As of the same date, Central Bank liabilities, other than IMF accounts and long-term liabilities, amounted to LE 86.3 million, representing largely liabilities under payments agreements. The U.A.R. authorities do not consider the gold holdings as readily available to meet external payments. Commercial banks' foreign exchange holdings amounted to about LE 30 million as of December 31, 1961, most of which are understood to be required against outstanding current liabilities.

The principal expansionary force in the economy has been the heavy reliance of the public sector on the banking system, particularly to finance development expenditures. Such financing, including changes in counterpart funds arising from P.L. 480 operations, amounted to over LE 94 million in 1961, that is, approximately 25 per cent of the money supply. The rate of expansion, however, declined in the last quarter of the year, as foreign exchange difficulties slowed down the rate of development expenditures.

Bank credit to the nongovernment sector[1] was not an important factor in 1961, rising by about LE 2 million during the year. A large part of such credit is for cotton financing; this financing is subject to a seasonal pattern, with the expansion beginning in September and rising to a peak in December, after which it declines, reaching its lowest level in August. In December 1961 outstanding credit for cotton was considerably lower than in the previous year, as the cotton crop was much smaller than normal. Bank credit to the nongovernment sector for purposes other than cotton financing increased rather sharply in the first half of the year, but declined in the second half. The expansion in the first half was for the purpose of financing the cultivation and trade of crops other than cotton, while the decline in the second half was partly seasonal and partly a consequence of nationalization and other changes that tended to dampen the level of activity in the nongovernment sector.

1/ The nongovernment sector includes all activities not financed through government budgets.

Taking financing of the public and nongovernment sectors (other than for cotton financing) together, expansion in the second half of the year was considerably smaller than in the first half; in fact, in the last quarter of the year there was little net expansion.

The payments position is expected to continue to be difficult in 1962, even though there may be a reduction in inflationary pressures, thus curtailing the demand for imports. In view of the recent nationalization measures, it is not expected that credit to the nongovernment sector will have a significant expansionary effect. As to the public sector, the Government has indicated its intentions of reducing its reliance on the banking system, but the extent of the reduction is not yet clear. In addition, payments difficulties in 1962 will arise from the crop failures in 1961. The cotton crop now being marketed has declined by about 30 per cent as compared to 1960, due to pests and, moreover, it is of poor quality. On the basis of current prices, exports of cotton in the 1961/62 season are expected to be lower than in the previous season by over $100 million. Other crops have also been affected and, in addition, the rice crop was subnormal due to inadequate water supply. Some of the crop deficiencies may be offset by increased foreign assistance, particularly from the United States, but the remaining impact on the balance of payments of the decline in agricultural production will still be substantial. The crop outlook for 1962 is satisfactory so far.

On January 1, 1962, the U.A.R. applied a uniform premium of 20 per cent on the par value to foreign receipts and payments with the exception of certain invisible transactions and receipts through certain bilateral accounts. Previously, a premium of 10 per cent applied to imports, many of which were also subject to a license fee of 9.9 per cent (now abolished), and premiums at different rates applied to other transactions in convertible currencies. The new measure has formally simplified the exchange system, but other simultaneous changes weakened the impact of the simplification. A tax of 20 per cent has been imposed on exports (other than cotton) which previously were effected at the official rate, while in the case of cotton exports the premium is received by the Egyptian Cotton Commission and not by the exporters. Further, importers of essential goods (which previously were exempted from the license fee of 9.9 per cent) now receive a refund of one-half of the 20 per cent premium. With respect to import policy, the level of restrictions continues to be high, but there has been a reduction in discrimination in favor of bilateral partners. The forthcoming report on the Article XIV consultations discussions will deal in detail with the changes in the existing systems.

It is apparent that the situation is essentially unchanged from that existing at the time of the drawing in January 1962.

III. Terms of Repurchase

The request for a purchase by the United Arab Republic of US$7.5 million has been made pursuant to Article V, Sections 3 and 4. The U.A.R. has undertaken to repurchase with gold or convertible currencies acceptable to the Fund an equivalent amount of U.A.R. currency not later than twelve months after the purchase. To secure this repurchase, the U.A.R. has offered as collateral the pledge of gold to the full amount of the purchase along the same lines as the transaction with the Fund in January 1962 (EBS/62/1).

It is understood that in the event that repurchase is not otherwise effected at the latest twelve months after the transfer, and the pledged gold is used in repurchase, the provisions of Rule G-6 would be applicable.

IV. Decision

The following decision, paragraph 2 of which is the same as the decision of January 1962, is submitted for the consideration of the Executive Board:

1. The Government of the United Arab Republic has requested the purchase of U.S. dollars 3.75 million and Deutsche Mark 15 million from the Fund pursuant to Article V, Sections 3 and 4, and has undertaken to repurchase with gold or convertible currencies acceptable to the Fund an equivalent amount of United Arab Republic currency not later than twelve months after the transfer. To secure this repurchase the United Arab Republic has offered as collateral the pledge of gold to the full amount of the purchase.

2. The Fund agrees to the request on the terms contained in paragraph 1 above, grants the necessary waiver under Article V, Section 4 of the Articles of Agreement, and the transaction shall be completed after the following provisions are complied with:

(a) The member advises the Fund that identified gold bars, which it certifies can be disposed of under its law, have been deposited in the Fund's United Arab Republic depository in a special account bearing in its title an indication of the special character of the account as containing gold pledged to the Fund.

(b) The member has instructed the depository that no disposition is to be made of the gold in the said account without the prior instruction of the Fund; that the gold is to be transferred to the ownership and into the name of the Fund on the receipt of notification from the Fund that repurchase has not otherwise been completed within twelve months after the date of the transfer of the exchange by the Fund; and that on receipt of notification from the Fund that repurchase has otherwise been completed, the gold is to be released from the special account.

(c) The Fund has been advised by its United Arab Republic depository that it has received the identified gold bars and has established the account in accordance with paragraph (a) above and has received instructions in accordance with paragraph (b) above.