The growth and development of the modern Egyptian financial sector

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This thesis focuses on the Egyptian financial sector during the period between the Egyptian Revolution of 1952 and the late 1980's. This was a period during which the country's political leaders sought to administer the economy by a variety of different means, all of which had a marked impact on the manner in which the financial sector was able to operate. An attempt is made to assess the nature of the changes to which the sector was subject, the manner in which the changes shaped financial operations and the potential of the sector to contribute to the removal, or alleviation of some of the problems faced by Egypt today.

The techniques employed in pursuit of these objectives are various, concentrating initially on an examination of the 'ideal' role of the 'ideal' financial sector, the path of sectoral development commonly charted within the developing world, and some of the problems faced typically by financial sectors in the wake of such historic developmental experience. The thesis then goes on to discuss Egypt in particular - the background of foreign commercial banking which characterised the sector before the Revolution, and the impact of Gamal Abd al-Nasser's reforms - Egyptianisation, sequestration, nationalisation and central planning. President Sadat's Open Door Economic Policy is also examined. This leads to an assessment of economic conditions today. The activities of the sector are then discussed along with the regulatory environment imposed by the Central Bank and the government.

The main findings of this study, discussed in the penultimate chapter, suggest that whilst the financial sector has undoubtedly grown and developed, the general political, social and economic environment in which it has had to operate has prevented it from realising fully its potential. Liquidity stands in excess of 130%, and this in itself points to a lack of both confidence and perceived investment opportunities. Suggested areas of reform to enhance financial performance and improve confidence are described, reflecting the opinions of a range of financiers and others working in Egypt today.

The Growth and Development of the Modern Egyptian Financial Sector

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None of the material mentioned in this thesis has previously been submitted for a degree at this or any other university.

This craft is dedicated to all those inspirational forces

who helped fuel and fire me during the lengthy course of its production.

Whether they be of Gilesgate Moor, The Graduate Society,

Edinburgh, London, the Channel Islands, Baghdad or Cairo -

- to them all I owe a great debt of gratitude,

for time well spent in their company.

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Chapter 1 Introduction and Statement of Inquiry

Egypt, like so many other 'developing' states, has in recent decades been striving to come to terms with herself. The struggle has not only been against and alongside the aspirations of her people and the different ideologies they have adopted and engendered but that of her place within the region and, indeed, the wider world itself.

The struggle is rooted in historical identity and pride, independence and hope, reality and a possibly grudging acceptance of the surrounding world. The process is ceaseless, and through it and time, the Egyptians have seen their political masters turn from the ideological forces of nationalism and Arab socialism to that of a possibly freer, yet lukewarmly accepted and applied system of capitalism. This is a process whereby the market, or the prevailing world economic order is required to be acknowledged as the determining factor in the process of allocating resources and their distribution, providing not only daily bread but also a means to an end.

1.1 The Economic Background

Economic historians of contemporary Egypt tend to recognise a variety of distinct phases through which the economy and economic planning have passed since the Revolution of 1952.

When the Revolution dawned, the economy was dominated by the private sector, the state's role being limited to investment in the infrastructure and the social services. Such a balance was initially maintained by the new regime and the private sector continued to enjoy a high degree of government protection, as had happened in the period immediately after World War II. Not having any clear or concise economic objectives, the Free Officers' agrarian reforms of 1952 and 1961 are not generally considered to have been directed towards destabilising or restricting a particular part of the economy. Rather, the reforms are seen as an attempt on the part of the Free Officers to reduce the power base of potential political opponents, and at the same time channel financial resources towards the industrial sector.

The period 1957-60 was marked by the implementation of policies which, although not necessarily designed to inhibit the role of the private sector, certainly had such an effect, in that they permitted extensive state intervention and control. The Suez Crisis, its political ramifications and the subsequent seizure of foreign assets created short-term difficulties. Nevertheless, in the longer term, the crisis served a useful purpose when the government launched a five year plan for industrial development requiring substantial financial support. This support would not otherwise have been forthcoming.

The implementation of the 'First Five Year Plan for Economic and Social Development' in 1960 marked the introduction of a period characterised by even greater state control. The policies by which Abd al-Nasser's regime and administration are perhaps best remembered, Egyptianisation and nationalisation, were implemented on a massive scale. Legislation ensured that virtually everything, bar agriculture, was controlled by the state.

For thirteen years Abd al-Nasser's vision of Arab socialism remained the foundation upon which economic policy and planning in Egypt were based. President Anwar Sadat brought this to an abrupt end in 1973 when he introduced the Open Door Economic Policy (ODEP). With the economy and national will debilitated by the costs of war, the ODEP was aimed primarily at revitalising the private sector, altering the nature and direction of trade and encouraging large scale Arab and foreign investment.

Since the mid-1970s there have been no further attempts to bring about significant change to the economic structure or policy of Egypt. President Sadat's reforms met with varying degrees of success and, today, Husni Mubarak lives with the consequences of his predecessors' policies. He is urged by economic realities, his actions nevertheless tempered by political and social reality, to come to terms with a host of problems currently burdening the country. These problems are vast and complex in nature, although in essence they revolve around the issues of debt, a rapidly growing population and land scarcity. All are of such a proportion that they serve to divert considerable funds from a host of competing causes requiring substantial capital input, in addition to determining the size, structure and direction of the economy and the pace and extent of its development.

Egypt possesses a wide range of assets which set her apart from many other countries in the region. The size of her population and standards of education have made her the greatest source of skilled and educated manpower within the Arab world. In addition to securing her an unrivalled cultural role within the region, this has been of enormous tangible and economic benefit, a vast volume of remittances having been regularly sent home by expatriate Egyptians, employed in the Gulf, Iraq and Libya. Although the remittances have amounted to one of the greatest sources of foreign exchange for Egypt, fears have nevertheless been expressed about the brain-drain resulting from a significant portion of the skilled and educated workforce being abroad.

Abd al-Nasser's programme of heavy industrialisation and the legacy of the industrial tradition that precedes it exceeds what is to be found in any other state in the region.

Intervention and protectionism have frequently been employed excessively and unrealistically to aid the sector. However, the sector's very presence has contributed to Egypt's economic diversification, and as such is something considered beneficial.

In recent decades, the dominant role of the agricultural sector has been challenged and superseded by industry. However, given the fertility of the soil, the ready supplies of water and the ever present and demanding domestic and foreign markets, the sector continues to be a major employer and source of national income. During Abd al-Nasser's era it was one of the few areas of economic activity not under direct government control or ownership, although so complex was, and is, the government's system of subsidies, price controls and taxes, many feel the sector's full potential is yet to be realised. A loosening of government control in recent decades has resulted in diversification within the sector, a change from certain traditional crops and a rewarding insight into possibilities for the future.

Earnings from the Suez Canal, tourism and the oil industry have been very substantial in recent decades, however, as is the case with so many other economic concerns in Egypt, the maximum utilisation of revenue and the long term prospects for development are severely hampered and under extreme pressure. This pressure is largely attributable to a population growth rate estimated currently to be 3% per annum. Should this rate continue throughout the 1990's, Egypt's population, already considered excessively large, will amount to seventy five million by the end of the decade.

The phenomenon of urbanisation, not unique to Egypt but common throughout the developing world, has compounded social and economic problems in areas of the country far from naturally conducive to population increase and change. The provision of extra housing, education and employment opportunities in already crowded towns and cities burdens the existing infrastructure in addition to distorting wages and the cost of living.

Abd al-Nasser's successors live with the legacy of his employment guarantee to every graduate - a vast and inefficient body of civil servants, an estimated one third of whom could be made redundant without there being any substantial or significant change in output.

A system of consumer good subsidies, implemented to ensure a fair distribution of income but never administered in the most effective or efficient of manners is one of the means by which the government has attempted to redress some of the social and economic imbalances of recent decades. With an annual cost of £4 billion, the government is under considerable pressure to reform this system, and indeed that of its debt problem as a whole. However, popular political pressure has ensured that government's response has only been hesitant and underscored with caution.

Confronted with problems at the popular, political and economic levels, Egypt's planners are faced with the task of implementing investment programmes throughout every sector of the economy, of mobilising, allocating and ensuring the effective utilisation and distribution of scarce resources, and of fostering an environment conducive to economic growth and development.

1.2 The Contribution of Finance

If we are to acknowledge that two key elements of economic growth and development are saving and investment, it would appear that there is a role within the developmental process to be played by the financial sector. To examine this role more fully, it is worth exploring these key terms, and indeed the term 'financial sector' itself.

A financial intermediary, a single component of a financial sector, can be said to undertake the basic task of bringing together savers and investors. As a part of this process, the well functioning intermediary will bring about a productive and efficient allocation of money, encourage saving, and contribute ultimately to a tempering of the economic climate.

The execution of these functions is essentially dependant upon the saver and his willingness and ability to save and invest. The saver's ability to save relates directly to his willingness and ability to avoid total consumption of his income, and his willingness to invest to the terms and returns on the potential investment. To maximise the returns and achieve the best possible results requires a degree of specialisation, and the saver is not necessarily the most efficient of investors.

By the same token, the entrepreneur requiring capital to finance a project, is not necessarily the best suited of individuals to finding a source of finance on terms agreeable to both himself and the provider. This task also requires a degree of specialisation.

As has been suggested, these specialist roles can be undertaken by a financial intermediary. The greater the degree of specialisation within a financial sector, the greater the specialist's and the sector's potential contribution to promoting economic growth and development. The political, social and economic environment in which a financial sector is required to operate is among the factors which determines the degree of efficiency and success of the sector, something enjoyed ultimately the customer. However, reconciling a financier's aspirations with those of a government can be complex and at times a conflicting process.

A well functioning financial sector has the potential to augment quantities of real savings and capital formation; to facilitate and possibly even encourage capital inflow from abroad; and to raise the productivity of investment by improving investment allocation. Such roles are important enough in any country but in a state where the economic climate is not necessarily naturally conducive to growth and development, these roles are clearly crucial.

1.3 The Statement of Inquiry

This thesis essentially amounts to an investigation of the financial sector in Egypt up until the late 1980's. The manner in which the sector has developed is examined, along with the manner in which it has responded to and been adapted to the country's changing economic circumstances and political outlook. The sector today is examined in the light of the social, political and economic environment in which it is required to operate, and an attempt is made to ascertain how well equipped it is to contribute to the resolution of some of the problems currently burdening the country.

To achieve this end, I examine initially some of the theories relating to finance and development, and more particularly, the path of development charted frequently by financial sectors in the developing world. An 'ideal' role for the financial sector and its various components is considered alongside the reality that so often exists; and the manner in which the sector can be subject to intervention, alongside the impact which intervention can have on the manner in which the sector functions.

In the third chapter, the changing structure of the Egyptian financial sector is considered in the light of historical and economic change. This enables us to appreciate why it is shaped and structured as it is today. In the chapter dealing with the activities of the sector today, the regulatory environment in which the sector and its institutions are required to operate is considered. In addition, the activities of the sector, according to a variety of different institutional categories - banks, insurance companies and the stock exchange are examined.

The penultimate chapter details some of the broader issues relating to financial development in Egypt and attempts to identify some of the major shortcomings of the sector today. Confidence, at the domestic, political and international levels is considered along with some of the attitudes prevailing in Egypt today. The information which forms the basis of this section was largely obtained through interviews and discussions conducted in Cairo, along with the findings of a variety of reports and general observations.

The final section, which takes the form of the conclusion, brings together the main ideas of the thesis in an attempt to satisfy and answer the statement of inquiry posed earlier in this chapter.

Chapter 2 Finance and Development

Recognition of the importance of a financial sector in contributing to the growth and development of an economy appears evident if we acknowledge that the most basic functions of the sector are the mobilisation and utilisation of savings, and that economic growth is dependent on savings. These, however, are specialist functions and the factors which determine how successfully they are pursued are complex and varied, relating to the component parts of a financial sector, whether they be the institutions or their customers, and that of the general political, economic and social climate in which the entire process operates.

The underlying aim of this chapter is to outline the potential of a financial sector to aid economic growth and development, and consider alongside this the broad historical pattern of sectoral development in the developing world. This approach enables us to identify why the sector's contribution is not always to maximum effect, reasons for this and some of the areas of reform governments in the developing world and elsewhere are being urged to undertake to rectify the situation.

2.1 Financial Systems and Development

A financial system at its most basic level contributes to economic growth and development through the provision of a medium of exchange,[1] that is to say removing the necessity of the 'mutual coincidence of wants'[2] characteristic of a barter economy. Acting as an intermediary, a financial system brings together potential savers and investors, performing the specialist functions of search, discrimination and allocation.

Finance, or credit, can take two different forms, direct and indirect.[3] Direct finance is the term used to describe the transfer of capital directly from a saver to a spender, a process dependant on the saver's willingness and ability to save and invest. His ability to save relates directly to his willingness and ability to avoid the total consumption of his income; and his willingness to invest to the terms of, and the returns on the potential investment. To maximise the returns and achieve the most suitable terms requires a degree of specialisation, and there is every possibility that the saver will lack either the inclination, or the ability and expertise to go about this fruitfully. The saver is not necessarily the most efficient of investors.

On a similar basis, it is conceivable that the potential investor, requiring capital to make practical an entrepreneurial idea, lacks the inclination, expertise or ability to find a saver looking for a mutually appealing financial transaction.

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1 Von Pischke, J D et al Eds, Rural Development of Financial Markets (Baltimore & London: The John Hopkins University Press 1983) p 26

2 World Development Report 1989 published for the World Bank (Oxford: OUP 1989) p 26

3 Von Pischke, J D p 50

Indirect finance is the term used to describe the transfer of capital from a saver to a spender by means of a financial intermediary. As is the case with direct finance, indirect finance is dependant on the saver's willingness and ability to save and invest. However, if possessing a degree of expertise, the intermediary can possibly ensure a more effective and efficient allocation of capital than that achieved through 'coincidence', something of benefit ultimately to both saver and investor.

The greater the degree of specialisation within a financial sector and the range of options or types of finance available to potential savers and investors, the greater the appeal in saving, and ultimately the prospects and possibilities of economic growth.[4] The very presence of a financial institution, operating successfully and under favourable conditions, is such that people might be encouraged by the potential yield on savings to set aside a portion of their income. The absence of an institution might only prompt such action if an investment opportunity is directly at hand.

It has been suggested that a financial intermediary, as a specialised institution, has a greater chance of ensuring a more effective and efficient use of capital than that achieved through 'coincidence'. Nevertheless, there is always a certain degree of risk associated with any transaction, no matter how specialised the intermediary. The returns on and the terms of certain investments are less guaranteeable than others. A financial system can reduce such risk, however, either through avoiding risky areas of economic activity altogether, or by demanding greater compensation, in the form of higher prices and profits to compensate for the higher risk.[5]

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4 Goldsmith, R W Financial Structure and Development (New Haven, Conn: Yale University Press 1969) p 27

5 Von Pischke J D p 27

Through the management of risk, the reduction of the need for 'co-incidence' and the employment of specialist skills, finance can pervade all areas of economic life.

Given this, and the fact that the control and management of finance can contribute greatly to determining national levels of immediate and long-term consumption, a financial sector is greatly prone to government intervention. The form that this takes and its effects are detailed later in the chapter, more immediately, however, it is worth considering the main sources of saving. This section acts as a prelude to tracing the growth of financial sectors within developed countries, those states which are defined as having, amongst other things, low levels of domestic saving.[6]

2.2 Saving and Development

It would appear evident, from what has already been said, that a scarcity of capital is a fundamental obstacle to economic development. Within the developing world, wages are low and so, consequently, are savings. As suggested, the availability of savings determines the availability of resources for investment.

Sources of saving can be categorised broadly as foreign and domestic, public and private.[7] Foreign savings, used as investment capital, can take the form of loans or grants and might come from a public agency, government or the private sector. Due to the low levels of domestic saving in developing countries, this has historically been a popular and common source of capital, the nature of cultural and political relationships between donors and recipients often determining the nature of the

6 Selim, H M Financial Structure & the Role of the Financial Institutions in the Economy of the UAR (Egypt): An Evaluation & Policy Implications (Phd Thesis University of Colorado 1969) p 12

7 Selim, H M p 14

transfer of capital, whether as a loan or a grant, and the manner and time scale over which repayment is made. The transfer of capital can be made on a purely commercial basis.

Domestic saving can come from the public sector in the form of a budget surplus, from the private sector, or by means of the implementation of various monetary devices, such as inflation or credit control. A budget surplus amounts to a financial unit's income being in excess of its expenditure. Where that financial unit is a government, one of its sources of income is taxation. However, the use of taxation as a means of generating surplus income is somewhat restricted. There are levels beyond which taxation is not socially acceptable or tolerable, and sometimes problems relating to its administration and collection. The use of inflation, credit expansion and other monetary devices, such as forced saving, are partly dependant on the sophistication of the county's financial sector and economic infrastructure. At the same time the risk of mismanagement is great, something potentially damaging to the economy.

Private savings include enterprises' accumulated reserves out of previous profits; those of household units consist of savings held in financial institutions, invested in securities or possibly lent privately in the form of a direct transaction.

Household units represent a most significant source of saving.[8] A survey conducted in Asian countries revealed that one half to two thirds of gross saving was done by such units, however, much of the saving was held in a form inappropriate for direct investment.[9] One of the functions of a financial system is to exploit and realise the

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[8] Drake, P J Money, Finance & Development (Oxford: Martin Robertson 1980) p 123

[9] Von Pischke, J D p 52

potential of this category of saving, converting it to a form appropriate for investment.

The nature of 'non-institutional' or 'traditional' savings is governed by factors concerning both the saver himself and his economic circumstances. These include the size and regularity of his income, the form of his income and his earning status. Within a developing country traditional savings are generally found to a greater degree in rural areas where they might take the form of land holdings, land improvements or simple agricultural tools. Livestock, inventories of foodstuffs, and precious metals and stones are also common, and such non-institutional savings are by no means restricted to rural areas.[10]

As is the case with institutional savings, traditional savings are held on account of their relative liquidity, their divisibility and sometimes because they offer a degree of protection and stability against inflation. This is the case with foodstuffs although the disadvantage relating to them concerns the costs of storage and the risk of spoilage. Metals and stones have traditionally been held on account of their high value in relation to their size, their universal wealth and because they are both familiar and trusted. One of the important and notable features of traditional savings is that they are generally under the direct control of their owners. This possibly explains a hesitancy and reluctance by some to invest in institutional savings.

In order to bring about change in the nature of savings, from that of an unproductive to a productive form, a financial institution must be able to offer an alternative with high appeal and qualities greater than those attached to the traditional savings.[11] In addition to offering better liquidity, divisibility and security there must be a means of

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10 Drake, P J p 123

11 Drake, P J p 38

ensuring the productivity of the savings. This is achieved through the process of the financial institution channelling the savings, in the form of loans, to entrepreneurs and those requiring capital for investment. If not done, there will be no productivity or yield following the conversion of the savings and their contribution to financial and economic development will have ultimately been of little benefit.

In many parts of the developing world the 'tapping' of traditional stores of wealth and their conversion to productive, commercial forms is of relatively recent origin. This has been due to both the nature and appeal of traditional banking practice, and at the same time the form of institutional banking in existence.

Barter economies, those in which a rudimentary or 'traditional' banking system might be found, are highly restrictive of economic growth and development when considered in the light of more fully developed monetised systems. Such traditional systems, when considered within their own self defined bounds can, however, be functionally adequate to the extent of satisfying immediate, perceived and desired needs.[12]

The movement of a barter system towards that of a monetary system creates a situation where an individual or institution is required to undertake the role of the 'intermediary' in transactions, facilitating the movement, and a better use of capital.[13] An intermediary is required in the event of payments and receipts not being bridged immediately and the consequent and inevitable hoarding of assets by some individuals. The intermediary adopts the role of a centralised deposit facility, reducing the need for individual hoarding and as a result, the costs associated with

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12 World Development Report 1989 p 26

13 Wilson, R Banking & Finance in the Arab Middle East (London: Macmillan Publishers Ltd 1983) pp 1-2

ensuring the security of the hoarded asset. An extension of this function allows the intermediary to offer a service, by ensuring that the deficit resulting from a delay between payment and receipt is bridged.

The assets employed in a barter economy can be held in many different forms, and as such, a movement to a monetary system creates the need for some form of exchange system to be developed. This function, alongside the above mentioned ones, is normally undertaken by a money lender or money changer.

Whilst a system revolving around the activities of money lenders and changers can assume complex and sophisticated proportions, there are associated drawbacks. Customer - client relations are often based on ties of a religious, cultural or familial nature and as a result can be exclusive of certain groups requiring capital, or aspiring to its acquisition. Through the money lender or money changer's willingness to deal in traditional monies and savings in a variety of forms, the wholesale adoption of 'institutionalisation' is not seen as a necessary path to pursue, thus ensuring that only a portion of savings remain tapped.

Monetisation, and the adoption of 'institutional finance', is by no means a perfect system either. Along with other systems of finance, it shares a susceptibility to faults and flaws which can perpetuate exclusiveness, make it subject to intervention and thus impede the process of economic growth and development.

2.3 Foreign Commercial Banks in the Developing World

During the period of the West's colonial expansion, foreign commercial banks were generally the only institutionalised forms of financial institution in existence within what we now know as the developing world. Local financial practices generally centred on the activities of money lenders and changers, or alternatively took the form of barter systems. The foreign banks were often based in ports or centres of agricultural or industrial production, their activities revolved largely around trade, occasionally production.[14]

With their head offices based overseas, these banks were, and indeed acted, as mere branches, allied to a system which failed to take account of local interests. Bank policy was directed from abroad, savings channelled home, and strict home country credit standards applied to potential customers. The severe nature of these standards had the effect of ensuring that most customers were of expatriate origin and that the natives were almost automatically and totally excluded from banking and financial activity. This served to restrict the growth towards monetisation through denying the natural spread of the banking habit. At the same time, the effect of economic growth and development, with its knock-on potential, was limited as a result of the bankers' reluctance to engage in activities other than trade.

Two systems of finance existed, one a muted and underdeveloped form of the other, each one largely exclusive of the other. The broad reaching benefits associated with finance and financial development were slight.

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14 Drake, P J p 158-160

Whilst institutional exclusivity certainly existed, financial technology did gradually seep out into the countries in which the banks were based. In some cases this resulted in the natives establishing private institutions of their own run on 'Western' lines. In other cases, such projects were pursued by governments with the advent of independence. Ambitious plans aimed at promoting social welfare and economic development and diversity required substantial capital input, and financial sectors were rightly perceived as one of the means through which the necessary capital could be procured.[15] Where an adequate financial sector did not exist, many governments took it upon themselves to create one. Where a sector did exist, governments often changed operational conditions, thereby facilitating and ensuring a greater management of, and access to the system and its assets.

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15 World Development Report p 54

2.4 State-led Approaches to Financial Development

The process of a government or central administration electing to create a financial institution, or sector is known as the 'supply-lead' approach. Such a pursuit is normally aimed at transferring resources from traditional or non-growing sectors of the economy to alternative, 'would-be' growing sectors in an attempt to promote an entrepreneurial response.

The opposite process is known as the 'demand-follow' approach, an advocate of which might argue that, '...where enterprise leads, finance will follow...' This is a process perceived as being devoid of, or having limited government input.

Given finance's all pervading nature, as detailed elsewhere in this chapter, there is a clear temptation for the government of any country to channel financial resources into areas which lack resources. Whilst many would conclude that such a course was not necessarily a bad thing, one would find amongst others widespread recognition of the potentially detrimental consequences of such action. The judgement of a government might be subject to clouding by the pursuit of short term political gain, as opposed to honed and sharpened by economic reality and expertise; a government might be tempted to take upon itself the management of ever increasing portions of the economy, excluding competitors possibly through the denial of financial resources; a government might lack the necessary expertise to make accurate and appropriate judgements relating to areas of life where others might be better suited to manage. All such reasons, of course, pre-suppose a particular form of government. Such criticisms could be equally levelled at non-governmental power groups including financial and economic monopolies, whether publicly or privately owned.

Speaking generally of the developing world, the adoption of the supply-lead approach was generally driven by government, reflecting as much as anything else the under-developed, ill-equipped and disorganised nature of the private sector, and indeed the state of the existing institutionalised financial sector.

The need to create a central bank to manage and regulate the sector was generally evident, and if such an institution already existed, the need to reform it was also there. Existing financial institutions, surviving relics of colonialism, were generally directed from abroad, frequently from a variety of different countries. These institutions often dealt in an array of different currencies. Consequently, financial sectors frequently lacked unity, co-ordination and purpose, and governments any degree of control or authority over banking or financial activity - not to mention over economic growth or development.

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The role of a central bank encompasses a number of different areas, including banker to the government, the bankers' bank and lender of the last resort. Its overall role concerns the cultivation of active and healthy business through identifying the country's economic potential and encouraging enterprise and finance to help stimulate and realise this. In having to achieve and maintain financial stability it must regulate existing institutions to ensure sound financial practise, and administer the issue of notes and the supply, cost and availability of money.

The ability of a central bank to regulate financial and economic activity is often impaired on account of the absence or the shallowness of existing markets and more particularly the under developed nature of local bond and security markets.[16] Such a situation leads to commercial banks holding reserves and instruments in external securities. This not only inhibits local markets but stems the effectiveness of the central bank in exercising the tool of bank rate policy. Likewise, the presence of international banks can offset attempts to work open market operations.

A market for securities, including company shares and debentures, and government bonds and bills provides potential liquidity to the owners of otherwise illiquid assets. In fostering intermediation, such a market is seen to encourage financial development, and in introducing an element of competition, to improve allocation procedure.

Security markets do not provide a key to rapid economic growth but can help reduce the monopolistic powers of other financial institutions. However, those companies which issue securities tend to be large, well known and long established firms, often of foreign ownership or control. The buyers of securities generally have a high level of financial sophistication and appreciation of finance beyond saving and spending.

A securities market is seldom an early creation when 'scratch' financial development is undertaken, specialised institutions dealing with specific sectors of the economy are more likely to be established first. These might range from development banks to institutions supplying finance for agricultural, industrial or small business projects, post office saving schemes or insurance companies. Essentially, all are concerned with mobilising domestic saving and spreading the banking habit.

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16 Drake, P J p 173

The establishment of a central bank frequently led to the spawning of an array of other institutions to fill potential and immediate investment and finance gaps, all enabling the state to pursue programmes of social welfare and economic development and diversity. Conceived of by government, these programmes were often also owned, administered and financed by government. Great reliance was placed on financing them through domestic credit channels and heavy foreign borrowing.

The use of foreign channels was particularly prominent during the 1970's when the world was awash with petro-dollars as a result of the oil boom. Western banks were encouraged and proved themselves enthusiastic to lend to the developing world at low rates of interest - even negative rates in some instances. Although the long term benefit and effect of these loans has been questioned of recent, they were not seen as a problem at the time they were received.

Debt in itself is not a problem, providing there are means of ensuring its repayment in a form and at a time agreed by the lender and the borrower. However, many of the projects financed by these loans were of limited productive and economic benefit. This, coupled by the fact that the interest charged on the loans was variable resulted ultimately in disaster. In the late 1970's the governments of the West moved to clamp down on rising inflation rates through exercising strict monetary policy. This had the effect of forcing up the interest charged to borrowers.[17]

Domestic productive capacity was not sufficient in many cases to accommodate these rises, necessitating the adoption of rescheduling initiatives, and in some cases it resulted in governments defaulting on repayment.[18] The International Monetary

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[17] Knox, David Third World Debt - First World Responsibility a talk given at Edinburgh University by Mr David Knox, former Vice President of the World Bank, for the Centre for Theology and Public Issues, 17 November 1990

[18] Long & Evenhouse Restructuring Distressed Financial Systems an article by Millard Long and Eirik Evenhouse taken from Finance & Development (September 1989) p 2

Fund and the World Bank, aware of the threat this posed to international economic stability, were prominent in attempting to contain the 'debt crisis', advocating and urging governments to adopt structural reform programmes and re-consider their stance on development, particularly the tools that had been exercised in an attempt to bring it about.

Financial reform was considered imperative. In many cases individual institutions, in others sectors as a whole had failed to bring about an effective and efficient allocation of capital; poor financial performance had often resulted in mobilised savings being transferred overseas. The processes of reform continue to this day.

2.5 The Consequences of Intervention

The failure of finance often occurs as a consequence of government intervention and the economic climate in which institutions are required to operate.

Within the developing world, the fact that most development schemes were enacted and managed through a central plan had a great bearing on the financial sector's performance and the scope for sectoral development. Under a system of central planning, contracts and transactions are made more through planning bureaux and less through financial markets and institutions. 'The order of the day is internal finance and balanced budgets, not external finance and the issue of new securities.'[19]

Institutions, as already suggested, were subject to intervention, something largely pursued by government because of a fear that the private sector, or market forces

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[19] White, Lawrence H Privatisation of the Financial Sector (Washington DC: AID International Conference on Privatisation 1986) p 6

could deny finance and expertise to government favoured areas of the economy. The risk associated with such favoured areas often deterred financial sector involvement, in some cases despite the areas having the potential to serve well the country's long term economic interests. Trade finance, for instance, is a far less risky business than the provision of finance for agriculture, it requires a lesser degree of specialisation and by its nature it is short term.[20]

A variety of forms of intervention exist, from the extremes of direct ownership and the appropriation of institutions, to the more commonly practised 'directed credit' approach. This is a system whereby financial institutions are forced by government to lend to state enterprises and priority economic sectors at below-market interest rates, despite the fact that they may not be the most productive of investments. Paid for through cross-subsidisation, whereby higher rates are charged to some borrowers and lower rates paid to some lenders, bank profits are reduced and the danger exists that the categories of borrowers discriminated against will seek finance on the informal, more expensive credit markets.

To ascertain the effects of directed credit is nigh impossible as it is necessary to ask whether the recipients use their resources more productively than those denied the credit. It is clear, however, that the provision of cheap credit often encourages less productive investment, thus increasing the possibility of non-payment of loans. Where loans are not repaid, there is a danger of lending institutions becoming insolvent, even failing, although politically this is often not permitted to happen.[21]

Although a government might attempt to stimulate a flow of resources into, or away from particular sectors of the economy through adjusting interest rates, there is no

20 Knox, David

21 White, Lawrence H p 13

assurance that this will in fact be effective. If such 'favoured areas' are perceived as too risky, they may be altogether avoided, even if there are short term tangible incentives. Governments have frequently attempted to divert funds from trade finance in an effort to boost other sectors, to reduce the volume of imports by increasing the interest charged to those desiring trade finance. The cost of an additional service charge, however, is all too easily passed on to the customer, defeating - at a blow - the government's intentions.

An inflationary environment is something that severely hampers the prospects of financial development and optimal financial performance. As was mentioned earlier, during the 1970's there was a great dependence on foreign borrowing to finance both public sector deficits and supply capital for domestic government projects. By the 1980's, this source of capital had largely dried up and governments were forced to consider domestic sources. Domestic financial markets being too shallow, the central banks were required to print themselves out of the crisis, inevitably forcing up the rate of inflation. Financial institutions were frequently forced to buy low yield government bonds and through 'reserve requirements' make available loans at below-market rates. Faced with such a situation, institutions were put in the position of either reducing profits, or passing on the costs to customers by charging high lending rates and offering low deposit rates. Under such circumstances, the combination of high inflation and low deposit rates can result in capital flight and a reduction in the volume of capital available for lending.[22]

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22 Selim, H M p 26

The governments of many countries have been urged in recent years to review their interventionist approach to the financial sector and undertake broad reaching programmes of reform. For most, the urgency with which this must be done stems not least from the fact that foreign sources of capital are no longer as plentiful as in the past, and consequently a greater reliance must be placed on domestic savings and home grown enterprise. The impact of popular opinion and heightened individual and collective expectation has also forced a change of course by certain governments.

Ideologically, these reforms can involve a fairly major change for some governments. 'Country experience has shown that a reduction or removal of control promotes growth, both in the financial system and the economy, but it must be accompanied by a loss of power some governments would like to exercise over the changing shape of their economies.'[23]

Reforms are not only required to be directed at the loosening of government control on interest rates, directed credit programmes and exchange rates but at legal and accounting procedures and in some cases the ownership of the financial sector. The availability of information concerning the sector's activities is often considered wholly inadequate, as is the state's willingness to admit that certain institutions might be insolvent.

It would not be a generalisation to suggest that the governments of many developing countries have been urged to adopt a change of attitude and outlook in order to create '...a policy environment in which finance can become less a tool for implementing

23 Von Pischke, J D p 28

development strategies and more a voluntary process for mobilising and allocating savings.' [24]

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24 Long & Evenhouse p 7

Chapter 3 Economic and Financial Development in Egypt

The aim of this chapter is to make apparent some of the economic issues in Egypt which have had a bearing on the development of the Egyptian financial sector, its performance and the extent to which it has been able to contribute to economic development.

3.1 The Origins of Financial Development

The history of modern finance in Egypt, and indeed the Middle East as a whole dates to the reign of the Egyptian ruler, Muhammad Ali (1805 - 1848).[25] Although his period of rule was characterised by marked economic activity and the establishment and growth of an industrial sector, there was, unusually, little corresponding financial development at the domestic level.

Such was the monopolistic manner in which Muhammad Ali controlled the economy, market relations were constrained and the need for money reduced.[26] This, in effect, served to perpetuate existing financial practices - those that centred largely upon the activities of money lenders and money changers who dealt in a variety of different currencies. In 1834 an attempt to establish a single Egyptian currency failed, and it was only fifty years later that Egypt's monetary system took a more structured form, when it was aligned with the United Kingdom's.[27]

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25 Wilson, R Banking & Finance in the Arab Middle East (London: Macmillan Publishers Ltd 1983) p 19

26 Mansour, Fawsy Development of the Egyptian Financial System up to 1967 (Cairo: Ain Shams University Press 1970) pp 6-7

27 Mansour, Fawsy p 8

On the international level, growing trade links with Europe proved to be a significant stimulus to the development of foreign financial institutions. This integration was compounded by the opening of the Suez Canal, the growth of cotton exports and the increase in foreign debts amassed by Muhammad Ali's extravagant heirs (an estimated £91 million by 1876). Between 1858, when the Egyptian bank was established, and the appearance of the Banque Misr in 1920, over a dozen financial institutions came into being. Table 3.1 details the ownership of the main institutions and their locations, the majority being of foreign origin and based in the capital, Cairo.

Table 3.1 **The main commercial banks in operation 1856 - 1920**

Year of establishment / Institution		Location	Ownership
1856	The Egyptian Bank	Cairo	Foreign
1864	The Anglo-Egyptian Bank	Cairo	Anglo India & French
1867	The Ottoman Bank	Alexandria	Ottoman Bank Branch
1870	The Yokohama	Cairo	Japanese Specie Bank
1872	The Ottoman Bank	Port Said	Ottoman Bank Branch
1875	The Credit Lyonnais	Port Said	Credit Lyonnais
1880	Credit Foncier Egyptien	Cairo	French
1881	Societte Financiere	Cairo	French
1887	Cassa di Sconto e di Risparimo	Cairo	Italian
1887	The Ottoman Bank	Cairo	Ottoman Bank Office
1895	Bank d'Athenes	Cairo	Greek
1898	The National Bank of Egypt	Cairo	mainly British
1902	The Agricultural Bank	Cairo	owned by NBE
1920	The Banque Misr	Cairo	Egyptian

Source: Compiled from Wilson, R Banking and Finance in the Arab Middle East (London: Macmillan Publishers Ltd, 1983) pp 19-29

Diverse though the nationalities of the owners might have been, the financial activities pursued by the various institutions were essentially not. Most were concerned with commercial activities, the cotton industry and the finance of trade, whilst their customers frequently shared a common national or ethnic identity. Of all the institutions mentioned in the table, it will be noted that the only one owned by Egyptians was the Banque Misr. Even the National Bank of Egypt was in the hands of the British.

The exclusive nature of these foreign commercial banks and their inaccessibility to all but a select number of Egyptians provoked a general desire for a bank owned and staffed by Egyptians, serving Egyptian interests.[28] In 1920 well over one hundred Egyptians subscribed £E 80,000 towards the establishment of the Banque Misr. The institution proved to be most popular, its appeal stemming, not least, from its all Egyptian board of directors. Many of the customers used it merely as a savings bank, depositing small sums which might well have been directly consumed in the absence of a similarly appealing institution. In its intention to promote industry and find a non-agricultural outlet for investment, the bank was forthright. Its interests ranged from shipping, weaving and insurance, to a cinema chain and agriculture, a total of twenty seven different industrial and commercial concerns.

Similarly active were the stock exchanges of Cairo and Alexandria, each established in the latter decades of the nineteenth century. By 1906, the British established stock exchange of Cairo was trading 328 joint stock companies with a total capital value of £ 91 million, and the exchange in Alexandria was ranked sixth in the world.

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28 Wilson, R pp 28-31

'Import substitution industrialisation'[29] was the characteristic of the Egyptian economy between the 1920's and the 1950's, a state brought about by a variety of domestic and international factors. Agricultural crises in the 1920's and 1930's, which culminated in the great depression, revealed to the Egyptians the enormous dangers of dependence on cotton, motivating a search for alternatives.

With cotton's decline, industry emerged, prompted by the Banque Misr. This helped to contribute to the country's economic diversification. Under a regime of tariffs imposed by the government, there was scope for industry to flourish; under the conditions imposed by the World War II the process was considerably boosted. The disruption of international trade caused by the war served as a 'super-tariff', whilst the presence of Allied troops ensured a ready market for Egyptian produce.

It was amid this environment of growing national self-reliance and self-esteem, that Gamal Abd al-Nasser grew up. His actions in 1952 and thereafter were to have a considerable impact on Egypt and the region during his own lifetime and well beyond his death. The events of 1952, popularly known as the Egyptian Revolution, brought to power the Free Officers. This group was to oversee the ending of the monarchy and the removal of the British from Egyptian soil and, of even greater significance, the ushering in of a new economic era, rooted in a bedrock of nationalised industry and guided by a central plan.

29 Hopwood, Derek Egypt: Politics & Society 1945-1984 (London: Allen & Unwin 1985) p 17

3.2 The Policies of Nationalisation and Central Planning

The structure of the financial sector in the 1950's broadly echoed that of the first half of the century, that is to say there was a predominance of foreign owned institutions and a considerable concentration of capital in a few institutions. Only the Banque Misr and a portion of shares in the National Bank of Egypt were in Egyptian hands, and of the twenty four commercial banks in existence, a quarter of them, including the Banque Misr, held 78% of all advances and 85% of all deposits.[30]

The Free Officers on their rise to power in 1952 appeared quite content to maintain foreign and private participation throughout the economy. They even encouraged it. Laws were passed in 1953 and 1954 which not only provided tax incentives for private investors but permitted a majority foreign holding in Egyptian companies.

For much of the 1950's, economic policy was also pursued in broadly the same manner as it had been prior to the revolution.[31] Saving and investment ratios remained relatively stable; public investment was financed through the institution acting as the central bank (the National Bank of Egypt); and the balance of payments was financed by running down foreign exchange reserves, worth approximately £425 million, accumulated during World War II.[32]

Such a balance was not to be maintained, as in 1952 the government introduced important legislation concerning the reform of the agricultural sector which had a knock-on effect elsewhere in the economy. The reforms, further developed in 1961,

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30 Wilson, R p 52-53

31 Mabro, Robert The Egyptian Economy 1952-1972 (Oxford: Claredon Press 1974) pp 182- 183

32 Waterbury, John The Egypt of Nasser & Sadat, The Political Economy of Two Regimes (New Jersey: Princeton University Press 1983) p 61

were primarily aimed at redressing the balance of ownership and the size of agriculture holdings through limiting ownership to two hundred, and ultimately one hundred feddans per person. It has been suggested that underlying the reforms was a desire to remove the power base of potential political opponents of the new regime, and at the same time encourage the landed elite to invest in the industrial sector. In effect, the government was looking to forcibly channel savings and investment to the industrial sector by reducing the scope for agricultural investment. This was one of a variety of means to be used by the government in the mobilisation and allocation of finance. Others included adopting fiscal and pricing policies; tapping foreign borrowing; and most dramatically sequestrating and nationalising foreign and privately held economic assets.[33]

The Industrial Plan of 1957 suggested that the government planned to rely heavily on the private sector for investment, 79% of the total of £ 114 million expected to come from that source. Yet, at the same time the state was gradually securing the control of some fairly significant economic levers which would have an inevitable impact on both the economy's development as a whole and the role of the private sector.

Compulsory membership of agricultural co-operatives had been introduced alongside the land reform acts. Through these, the government was able to impose price controls and production quotas, in addition to purchasing crops at artificially low prices and selling them at inflated rates on the international market.

A more direct form of intervention was evidenced in the wake of the Suez Crisis with the nationalisation of the Canal and sequestration of British and French assets held in Egypt. The 'Economic Organisation' was created to control these newly acquired assets, and indeed, all public and mixed enterprises. By the end of 1958

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33 Waterbury, John p 66

these were valued at almost £E 60 million. Within two years the sixty four companies under the control of the Economic Organisation were valued at £E 80 million and employed some 80,000 persons.[34]

In 1957, the tabling of three laws (22, 23 and 24) had a great impact on the financial sector and added to the process of consolidating the government's hold on the economy.[35] Foremost was legislation requiring all foreign owned banks, insurance companies and commercial agencies for foreign trade to become 'Egyptianised' in terms of management and capital within five years.

The availability of liquidity within the Egyptian private sector was not sufficient to acquire the stock of all these institutions, and as a result, six banks were merged with existing banks and a further eight were simply liquidated. Some two hundred foreign owned insurance companies were purchased by three newly opened Egyptian companies. Of the sequestrated banks, Barclays became the Bank of Alexandria, the British owned Ionian and Ottoman Banks were taken over by the Bank al-Goumhouriya, and two French banks were absorbed by the Bank of Cairo.[36] The government's purchase of the foreign held shares of the National Bank of Egypt was of note, not least because of this institution's role of the Central Bank.

In 1960, the National Bank of Egypt was divested of the powers to issue currency and control the volume and direction of credit in favour of the newly created and state owned Central Bank of Egypt. The former bank's shares were nationalised,

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34 Storey, Christopher Middle East Currency Reports, Supplement to International Currency Review Volume 10 Number 1 (London: Christopher Storey [Author & Publisher] 1987) p 19

35 Kerr, David W International Conference on Capital Market Development (Cairo: USAID 1983) p 12

36 Storey, Christopher p 19

and by the end of 1960, in the wake of a further programme of nationalisation, the government had assumed control of 100% of the stock of the Bank of Alexandria, the Banque Misr and the Bank of Port Said; almost 50% of the stock of the Bank of Cairo; and a quarter of the stock of the Bank al-Goumhouriya and the Commercial Union Bank. The following year, all remaining financial stock was nationalised, the institutions' shares converted to fifteen year government bonds with an interest rate of 4%. Through the nationalisation of the Banque Misr, with a deposit base of £E100 million, the government also secured control of twenty seven commercial enterprises with paid up capital of £E 20 million, and a monopoly on the cotton and textile trades.

The establishment of the Public Organisation for Banks, a body which largely assumed the role of the Economic Organisation, heralded a period of consolidation and absorption within the financial sector and by 1964, the sector's reform was largely complete. In addition to the Central Bank of Egypt, there existed five commercial banks, four mortgage banks and a number of industrial banks. Each of the commercial banks was assigned a specific area of economic activity with which to conduct business. Table 3.2 details the areas and hints at the somewhat complex and burdensome nature of the system.

Table 3.2 **Designated areas of specialisation for Public Sector Banks**

The National Bank of Egypt:	Companies attached to the following Ministries and Authorities:- Agriculture, Agrarian Reform, Land Reclamation, Communications, Transport, Electricity, War, Local Government, Suez Canal, Railways, War Factories, Aeroplane Factories.
The Banque Misr:	All companies operating in the field of textiles.
The Bank of Alexandria:	Companies dealing in mining, engineering, oil and chemical industries, food and construction industries, metallurgy and co-operative production.
The Bank of Cairo:	Companies concerned with foreign trade, contracting and housing, tourism, culture and information.
The Bank of Port Said:	Companies attached to the following Ministries:- Health, Supply and Internal Trade, Insurance and Water Wealth.

Source: Mansour, Fawsy Development of the Egyptian Financial System up to 1967

(Cairo: Ain Shams University Press, 1970) p 35

Nationalisation was by no means restricted to the financial sector but was part of a wider programme whereby the government transferred to public ownership shares and physical assets with a value of £ E 700 million, and a probable market value of £E 2 billion.[37] Virtually every sector fell into the state's domain, whether in terms of direct ownership, or control. The government made no attempt to close the stock market. Nevertheless, given the economic climate in which it was required to operate, one characterised by state ownership and central planning, activity at the two exchanges inevitably declined. Between 1962 and 1963 the market value of bond and share trading at the Cairo exchange fell from £E 12.2 million to £E5.1 million, and for the remainder of the decade the value averaged annually £E 4.45 million.[38]

The reasons for the government implementing this process of nationalisation are various, however, it was clearly of great political convenience for the state to control such a significant part of the economy, given that it had launched a five year plan for economic development in 1960. Total investment throughout the period of the plan was to amount to £E 1.6 billion, one third of which was to be procured through foreign borrowing. Within the domestic field, the private sector's contribution was to total 55%. This, it has been suggested, was not an expression of the state's confidence in the private sector but a deliberate ploy to overburden its investment capabilities and hence, provide a rationale for the government to exercise its policies of nationalisation. Against this argument, it has been suggested that nationalisation was needed to counter the actions of a private sector, '...bent on bending the plan, and with it the state, to its own purposes and inclinations'.[39]

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37 Waterbury, John pp 72-75

38 Kerr, David W p 17

39 Mansour, Fawsy p 33

The five year plan was ambitiously launched with the intention of doubling national income within a decade, expanding employment opportunities and ensuring a greater equality of opportunity.[40] This necessitated raising the investment ratio by six or seven per centage points[41] and achieving an annual growth rate of just over 7%. The £E 646 million worth of foreign exchange required to help finance the plan was to be covered by commercial debt, grants, export proceeds and invisible receipts.[42]

Rapid industrialisation was one of the key features of the plan, although irrigation and land reclamation projects and the on-going construction of the High Dam justified the agriculture sector's absorption of a quarter of total investment. The construction of such high prestige projects as the Helwan Works explains the 37% of total investment directed towards the industrial sector. By 1965, industrial output was expected to have risen by 97%, and agricultural output by 28%.

Table 3.3 reveals that by 1963/64 gross investment and consumption had each risen to an all time high, as had domestic saving. Exports, on the other hand, were in decline, whilst imports had almost assumed the level recorded in 1952/53. During the latter half of the decade, public consumption continued to rise, whereas private consumption fell; domestic savings between 1964/65 fell markedly and indirect taxation rose.

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40 Zaalouk, Malak Power, Class & Capital in Egypt, The Rise of the New Bourgeoisie (London: Zed Books Ltd 1989) p 37

41 Mabro, Robert pp 181-185

42 Issawi, Charles Egypt in Revolution, an Economic Analysis (Oxford: OUP 1963) pp 69-72

Table 3.3 Shares in GDP at market prices 1952 - 1970

(Percentages)

(Year)	'52/3	'57/8	'59/60	'63/4	'64/5	'69/70
Gross investment	13.7	13.5	12.5	19.7	17.2	11.8
Public consumption	16.4	16.4	16.6	21.3	19.7	24.1
Private consumption	71.1	71.7	70.8	66.0	66.2	65.3
Net imports	01.8	01.6	-0.1	07.0	02.5	00.4
Domestic savings	11.9	11.9	12.6	12.7	14.7	11.3
Indirect taxes	07.2	08.0	06.6	07.9	10.8	14.1
Imports	28.7	21.8	20.4	26.0	21.1	13.4
Exports	26.9	20.2	20.5	19.0	18.6	13.0

Source: Mabro, Robert The Egyptian Economy !952-1972 (Oxford: Claredon Press 1974) p 177

Rooted in the first half of the 1960's, although increasingly evident throughout the entire decade was a foreign exchange crisis, the causes of which can be attributed to both the government's domestic policies and a variety of external factors. The crisis proved to be one of the root causes of the economic malaise which stretched well into the 1970's. During the early years of the decade, payments in excess of £E 45 million were made to owners of sequestrated and nationalised property and the Sudanese government; the cost of the 40% decline in the cotton harvest of 1961 was an estimated £E 46 million. Alongside these short term 'one-off' payments, a variety of other factors served to compound the balance of payments and foreign exchange difficulties in the longer term.[43] The decline in exports and the growth of the Egyptian population were naturally significant, as was the effect of the United States' Public Law 480 being revoked. This forced the government to purchase foodstuffs at international market rates and in an attempt to offset these costs, the amount of cotton planted was reduced in favour of wheat, despite cotton sales being a major source of foreign exchange.[44] The other great burden on the Egyptian economy during the 1960's was defence expenditure and the broader effects of war.

Between 1963 and 1976, the Egyptian government was heavily involved in the civil war in the Yemen. Estimates for the total cost of the war vary, however, between 1963 and 1965 defence expenditure rose from 8% to 12% of the GNP. Of even greater consequence was the 1967 war with Israel. At 1975 prices the estimated cost of the war was between £E 20 and 24 billion,[45] and in the years following the war, defence expenditure averaged $ 1.61 billion. The on-going and debilitating cost of the war was largely due to Israel's occupation of the Sinai Peninsula. This left the Suez Canal closed and the immediate area economically inoperable until 1975; oil

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43 Mansfield, Peter Nasser's Egypt (Middlesex: Penguin Books 1965) p 184

44 Wilson, R p 53

45 Zaalouk, Malak p 53

production was reduced by half and the country's mineral reserves cut down; and a general fear about security caused the number of tourists visiting Egypt to decline sharply.

At a time when the government had envisaged a period of financial deepening, this was clearly unwelcome. Growth had occurred during the period of the first plan and the GNP had increased at an annual rate averaging between 6% and 7%, however, this was largely attributable to growth in the construction and service sectors, rather than in agriculture and industry.[46] Underlying the first plan were a number of areas of economic concern which, although damaging the prospects for growth and development, were largely ignored during the second half of the decade. These included policies concerning education and employment, the nature and direction of trade and the government's attitude towards the provision of credit for both the public and private sectors.

3.3 The Role of the Financial Sector during the Nasser Era

Under the system of central planning which characterised economic management during the Nasser era, the role of the financial sector was inevitably marginalised. The mobilisation and allocation of savings were functions undertaken by government bureaucracy, markets replaced by civil servants who determined the pace and direction of economic growth and development. As we have seen, the structure of the sector changed considerably over the Nasser years, from a system dominated by private and foreign ownership, to one of sequestration, Egyptianisation and ultimately nationalisation.

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46 Selim, HM p 37

Paramount to the government's plans was the provision of cheap credit for state owned enterprises, and through eliminating competition - in the form of the private sector - it was assumed that all savings would be channelled towards such concerns.[47] Most investment decisions were undertaken by the government, and these were frequently made on a political, rather than economic basis. The government was more concerned with dogma and its political stature than with the productivity and efficiency of investment.[48]

This inevitably distorted the manner in which the financial sector operated, reducing the scope for financial innovation and ensuring that the growth of banks was merely determined by the growth of the market.

Table 3.3 revealed how domestic savings never increased beyond 14.7% and that during the latter half of the 1960's the government became increasingly reliant on indirect taxes as a means of mobilising finance. At the same time a series of laws had been enacted requiring joint stock companies to place 5% of their profits in government bonds, distribute 10% to the workforce in cash, and a further 10% to the community infrastructure. A minimum wage and strict working hours were also introduced.[49]

The nature and the direction of these measures were partly due to the regime's need to command the support of a broad section of the population, something echoed in the consumer credit policies which the banks were required to operate. These policies enabled a fridge, for example, to be bought with a down payment of £E 3

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47 Sayeh, H, Chairman of the Hong Kong Egyptian Bank and former Minister of the Economy in a private interview

48 Hegazi, Abdel Aziz, former Prime Minister of Egypt in a private interview

49 Waterbury, John p 75

and paid off with similar monthly instalments. Of great appeal to the new industrial working class, perhaps, such policies nevertheless contributed to the growth in consumption, and did little to ease the country's serious balance of payments problems.[50]

Saving was not actively encouraged, and over the years of Nasser's rule the importance of deposits in relation to money supply declined, a surprising trend, perhaps, given the increase in sophistication among middle and working class Egyptians and the growth in urbanisation. The gap left by the departure of foreigners from the Egyptian financial scene, had not, however, been filled by middle class Egyptians, as had been expected. A fear of their assets being confiscated and general government interference led many Egyptians to place their wealth overseas.[51]

As was mentioned earlier, the government introduced a system, in the wake of nationalisation, whereby financial institutions were assigned specific areas of economic activity with which to do business. This was implemented to '...prevent the worst features of centralised bureaucracy...', and achieve growth and control. In the event, however, the lack of competition which the system engendered led to a great wastage of resources, and its bureaucratic and cumbersome nature meant that the Central Bank was unable to co-ordinate the country's foreign exchange needs.[52] Consequently, this system of 'sectoral allocation' was abandoned in favour of 'functional allocation'.[53]

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50 Mansfield, Peter p 168

51 Mead, & Irwin Growth & Structural Change in the Egyptian Economy (Illinois: 1967) p 196-197

52 Wilson, R pp 53-56

53 Storey, Christopher p 20

Under this new system, the National Bank of Egypt became the focus for all foreign exchange operations, the Banque Misr for domestic trade, the Bank of Alexandria for agriculture, and the Bank of Cairo for the service sector. At the same time, the Bank of Port Said was merged with the Banque Misr, and the Industrial Bank with the Bank of Alexandria.

The objective behind this system was to promote control and co-ordination, particularly with regard to the management of foreign exchange. However, the system is said to have been lacking in that it provided no scope for competition among these public sector banks; and in addition, it resulted in some institutions facing liquidity shortages, whilst others - generally those engaged in activities with a rapid turnover - such as trade, an excess of liquidity.[54]

In theory the private sector was left free to deal with any bank of its choice, however, the resources available to the sector were constrained as a result of public sector demand and in addition, '...it [the private sector] no longer had any autonomy and was beholden to the state for foreign exchange and controlled by the state in terms of allowable profits, prices, credit and supplies'.[55] As a result, private investment was generally self-financed, the necessary capital coming out of income from privately held savings. The institutional finance available to the private sector came largely in the form of one year loans. Although these could be renewed and assume something of the status approaching term credit, such practice nevertheless limited the scope for long term planning and investment.

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54 Hasan, Mahrous A The Problems of Financing Small Business in Egypt (Phd Thesis Durham University 1990) p 109

55 Waterbury, John pp 76-77

In certain respects, Nasser's management of the economy was stunted by naiveté and idealism. Whereas the country's economic planners had envisaged national income doubling over a twenty year period, the President had insisted on it being achieved in half the time.[56] Similarly, among the reasons for domestic saving not being encouraged was a simple lack of appreciation of the country's investment needs; an over reliance on foreign aid; and an overestimate of the capital accumulation of the state owned enterprises.[57] It is clear that a greater reliance on the financial sector might have alerted the government to the scale and the nature of the difficulties faced, but the role of the financial sector in removing and alleviating these difficulties could only ever have been slight when compared with the input and initiative required from the government itself.

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56 Mansfield, Peter p 165

57 Issawi, Charles p 272

3.4 The Open Door Economic Policy

Egypt's emergence from the 1960's and the era of Nasserism was far from auspicious. The economy was characterised by deficit, a dependence on foreign loans and low levels of domestic production; investment had fallen to the same level as that recorded a decade before; and war and military expenditure had laid claim to many of the country's vital economic resources.[58] It was evident that without an ideological change on the part of the ruling regime, or an acknowledgement that the prevailing system of economic management was ineffective, the chances of recovery from the political and economic stalemate would have been slight.

Following the death of Nasser in 1970, his successor, Anwar Sadat, embarked on a process of reforming the economy through the enactment of a series of pieces of legislation, collectively known as the Open Door Economic Policy (ODEP). Aimed at binding Western technology and Arab capital to the resource base of Egypt, the measures required the state to loosen its grip on many facets of the economy and recognise the potential contribution of the private sector and foreign investors to stimulating growth and development. The policy was essentially concerned with bringing Egypt to the realities of the world market, and exposing the country to the international economy.

The first piece of legislation to be introduced, following the ratification of a new constitution, was Law 65 of 1971.[59] In legalising the ODEP as a framework for the country's economic strategy, it guaranteed foreign investment against confiscation, permitted the repatriation of profits and invested capital, and provided an array of

58 Kerr, David W p 259

59 Zaalouk, Malak p 56

incentives for would-be investors. Agreements were signed on the settling of investment disputes, backed by the International Bank for Reconstruction and Development, and with the Arab League on the provision of guarantees for Arab investments. At the same time, a basis for political realignment was established through the signing of repayment disputes over frozen debts owed to a variety of Western states.

To encourage an inflow of foreign exchange, the government set up the Egyptian International Bank for Trade and Development, and in 1973 it authorised the establishment of a parallel market for foreign exchange, empowering the governor of the Central Bank to fix a US$ - E£ rate of exchange. The private sector was permitted to keep the proceeds of exports in foreign currency in local banks, import its production needs and advertise it products abroad.[60]

Although the economic situation continued to deteriorate during the early years of the decade, with total foreign debts amounting to $3.5 billion by 1973, the new measures did result in some 250 new projects being submitted for approval by 1974. The investment authority deemed 50 of them to be acceptable.[61]

It was not until after the 1973 war with Israel that Sadat embarked more fully on introducing and implementing the ODEP. Peace would eventually restore to Egypt the Sinai oil fields, allow the re-opening of the Suez Canal and encourage tourists back to the country. In 1973, however, with none of these things likely to occur immediately, the need was to stimulate foreign and domestic investment through reforming and developing existing policies and introducing new ones.

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60 Foda, A S Banking Sector Survey (Cairo: Dr A S Foda [Author and Publisher] 1982) pp A1-A2

61 Waterbury, John p 130

Law 43 of 1974, later to be amended by Law 32 of 1977, served two basic purposes. Firstly, it established the areas of the economy available to Arab and foreign investment; and secondly, it provided a series of incentives and guarantees for potential investors, building on the legislation enacted earlier in the decade. Although the areas of investment encompassed virtually every sector of the economy, the government was particularly keen to see the development of projects with a capacity to generate foreign exchange and exports, and those which might result in the development of non-urban areas. Whether concerned with tourism, finance, construction or industry, most projects were to enjoy a number of different incentives and guarantees. The most important of these are recorded below:[62]

1. Projects established would not be subject to sequestration or confiscation, other than through the judicial process.

2. No matter what the distribution of capital ownership might be, a 'Law 43 project' would be treated as a private sector entity, and as such would not be subject to any of the restrictions or conditions imposed on public sector companies.

3. Tax holidays of between five and eight years would be granted to newly established projects, and of between ten and fifteen years to those requiring long term capital input, or based in rural areas. In addition, a number of free zones were established for both the public and private sectors.

Law 43 opened the door to financial innovation through allowing the establishment of new financial institutions which could work alongside, and would ultimately compete with state owned institutions, whether insurance companies, investment companies or banks, according to a variety of different classifications. Depending on the type of institution being established, various requirements had to be satisfied. 'Business and Investment' banks were confined to foreign exchange transactions but

62 Foda, A S p 13

could be wholly foreign or privately owned, whilst those dealing in local currency were required to be joint ventures, the local Egyptian share being not less that 51%.

It was not long before Barclays, American Express, Citibank, Lloyds and many other well known European and North American institutions opened branches or set up joint ventures in Egypt. Among them, the Chase Manhattan Bank of New York and the National Bank of Egypt subscribed, respectively, £E4.9 million and £E5.1 million towards the creation of the Chase National Bank. The Bank of America and the Banque Misr entered into a similar partnership.[63]

To effectively manage and regulate these new institutions, operating in an economic and political climate rapidly accelerating away from the one enshrined by Nasser, the government was required to bring in legislation to delineate the roles and functions of the new institutions, along with ones relating to the Central Bank. 1975 saw the enactment of Law 120 and the implementation of Presidential Decree number 663.

Law 120 empowered the Central Bank and its board of directors with a degree of freedom unknown during the Nasser era, whether concerned with monetary, credit or banking policy, the promotion of economic development or the stabilising of the economy. The Board was permitted to establish interest rates without restriction, and interest on savings accounts and certificates was made exempt from income tax.[64] In a gesture aimed at emphasising the separation between the Bank and the Presidential Office, the Bank's Annual Report was required to be submitted to the National Assembly. In the past it had gone in the first instance to the President himself.

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63 Storey, Christopher p 20

64 Foda, A S p A5

On a practical level, Law 120 sought to free the banks of some of the burdensome employment legislation imposed on public entities, whilst it also allowed the import of computers to improve record-keeping procedures. Law 120 is said to have enabled the Central Bank to operate more like a banking institution than a government agency.

Whilst this legislation resulted in a burgeoning of financial activity, the sector and most areas of the economy remained overshadowed by the four state owned commercial banking institutions. Since 1971 they had each been required to serve a specific sub-sector of the economy. Presidential Decree number 663 of 1975 sought to alter this, enabling the four institutions to compete freely with the newly emerging foreign and joint venture banks.

Further pieces of legislation were enacted through-out the 1970's. Law 97 of 1976 gave Egyptians and foreign residents the right to keep their foreign currency holdings and deal and manage them in registered banks. At the same time, the state's monopoly on foreign trade was abolished on all except eighteen items, leaving the private sector to import freely goods of its choice. In 1979 a Government body known as the Capital Market Authority (CMA) was established with the aim of reviving activities on the stock exchange. Three years earlier this had been recommended in a report by the International Finance Corporation.

As a result of recommendations made by the CMA three laws were drafted in 1981 - Law 121 on General Regulations of the Egyptian Stock Exchanges; Law 157 on Income Tax; and Law 159, the new Companies Law. These were broadly aimed at permitting the stock of foreign companies and stocks in foreign currencies to be listed at the exchange; provide protection for small savers; and, simplify the procedure for establishing a company.[65]

Through broadening the country's financial base and increasing the sources and types of finance available to potential investors, the government believed that a spirit of competition might be engendered within the financial sector and, as a result, the economy as a whole. In addition, it was assumed that the import of modern banking technology would stimulate further reform and development, and most importantly, that the presence of the new institutions would facilitate - if not encourage - an inflow of foreign exchange from abroad. The Egyptian government boldly envisaged Cairo assuming the financial mantle of war-torn Beirut.[66]

The response of the world's financial community to Sadat's programme of liberalisation can be seen in the number of projects approved by the investment authorities by the end of the third quarter of 1979.[67] With the exception of 'other industries', banks and investment companies were not only the most numerous, accounting for almost 20% of all approved projects, but the most highly capitalised (27.5% of the total). In terms of investment outlay, this group was ranked second, and as far as the creation of jobs is concerned, banks and investment companies stood behind all concerns, except housing, contributing a mere 2% to the total number of jobs created.

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65 Mohareb, Nabil S Policy Measures for Development of Money Markets and Capital Markets an article taken from Middle East Executive Reports (Cairo: Middle East Executive Reports 1986) p14

66 Hegazi, Abdel Aziz, former Prime Minister of Egypt in a private interview.

67 Waterbury, John p 146-149

By 1981, the investment authorities had approved the establishment of 62 banks and 129 investment companies, and by the end of 1987 financial institutions accounted for 18.8% of the total number of approved projects.

This growth in the number of financial institutions is indicative of increased financial activity but more importantly, of the changing structure of the economy in the wake of the ODEP and the development of new sources of earnings.

Between 1978 and 1981 deposits increased by 153% to £E10,890 million at an annual growth rate of 36.5%. By 1981 private sector deposits as a percentage of total banking sector deposits accounted for 64%. Loans similarly increased over this period, between these years recording an overall growth rate of 222%, foreign currency credits at a rate of 513% and loans to the private sector at 500%.[68]

When considering deposits more closely, one can observe that between 1978 and 1981 foreign currency deposits increased at an overall rate of 159% with an average annual increase of 38%. This compares with the increase in local currency deposits of 150% over the recorded period, an annual average increase of 36%.

During the early years of liberalisation, foreign currency tended markedly more towards being held in foreign and joint venture banks than in the state owned commercial institutions, despite the enormity of these institutions. Five years after Law 43's enactment the state owned banks' combined deposit base of £E 5.9 billion amounted to 81% of all deposits and their credits were the equivalent of 83% of the total. Proportionally, these banks' local currency holdings were much greater than their foreign currency holdings, unlike the foreign and joint venture institutions. In 1978/79, the foreign exchange accounts held in foreign banks amounted to £E 816

68 Various editions of the Annual Report of the Central Bank of Egypt.

million out of a total of £E 2.05 billion in the banking system, whilst their local currency holdings amounted to £E 284 million out of a total of £E 3.9 billion.[69]

This recorded increase in domestic currency deposits can be attributed to growing confidence and the enhanced status of the private sector under the ODEP; a succession of interest rate increases; and the introduction of legislation ensuring the fiscal exemption of income tax on bank interest. The increase in foreign currency deposits is due to the growth in foreign currency earners. The re-opening of the Suez Canal in the mid-1970's and the return of tourists to Egypt expanded the horizon for foreign exchange earnings, as did the country's export of oil from 1976. The oil price boom of the 1970's helped swell earnings whilst also providing great scope for employment opportunities for Egyptians in the Gulf States. With Egypt's population standing somewhere in the region of 36 million and employment opportunities being limited at home, this was naturally of great convenience to the government. The pressure to create jobs at home was lessened whilst at the same time a potential new source of investment capital was opening up.

These earning trends are reflected in table 3.4 which highlights the main sources of foreign currency over selected years between 1976 and 1986/87. It reveals that remittances were consistently the largest source of foreign exchange, as a percentage of the total rising from 36.4% in 1976 to 58.5% in 1986/87; in terms of their value they rose almost ten times. Earnings from cotton exports, on the other hand, were the least valuable of the listed items in every year except 1976. As a percentage of the total they declined from 14% in 1976 to less than 5% in 1986/87. Petroleum exports proved to be the most erratic source of foreign currency, their value in 1981/82 rising to £E1914 million, yet falling between 1984/85 and 1986/87 by

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69 Waterbury, John p 149

almost two thirds. It is this dramatic fall in the mid-1980's which is most significantly responsible for the total's £E504.1 million decline.

Table 3.4 **Foreign Exchange Sources 1976 - 1986 / 87**

(£E million)

Year	Cotton exports	Petroleum	Suez dues	Tourism revenue	Remits	Total
1976	154.8	0149.1	121.7	263.2	0393.8	108
1979	267.3	0635.4	412.1	319.8	1449.8	3084
1981/82	204.0	1914.6	636.2	317.5	1406.7	4479
1984/85	290.0	1843.9	627.7	330.7	2621.6	5713
1986/97	240.3	0634.1	803.6	481.2	3050.6	5209

Source: National Bank of Egypt Economic Bulletin Vol. XL No. 1,2 1987 (Cairo: National Bank of Egypt 1987) p 126

The inevitable impact of many of the country's basic exports continuing this trend of decline can be witnessed in balance of payment figures approaching the end of the decade. Between the mid-1980's and 1988/89 exports overall failed to grow, standing in 1988/89 as they had four years before at $3,600 million; the proportion of the exports derived from oil sales fell to under 40%. Whilst exports declined, imports grew - in less than half a decade by $1,000 million to reach $9,600 million by 1988/89.[70]

Beset by the problems already indicated - difficulties in themselves yet compounded by a growth in already enormous debt servicing costs, a considerable domestic budget deficit and rising inflation, the government in Cairo was - and remains - subject to constant pressure to alter its policies. At the forefront of those lobbying President Mubarak has been the IMF, eager to see him pursue policies of gradual but decisive liberalisation. The areas of reform he is being pressed to adopt have tended to focus on accentuating Egypt's potential - enhancing her international competitiveness; enabling the world to recognise the Nile lands as a place worthy of investment; and most importantly creating conditions whereby Egypt's concealed wealth might be exposed and brought to the benefit of the country.

In short, the focus has been on reducing, if not eradicating those features of economic, political and financial life which have been working against the country's long term advantage.

As far as the financial sector is concerned the desired areas of reform centre on foreign exchange policies, interest rate policies and the growth of the domestic budget deficit.

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70 Butter, David Egypt: Remaking the Arab Connection (London: Middle East Economic Digest 1989) p 14

Egyptian governments have long been criticised for the manner in which they have managed foreign exchange, particularly the way in which they have controlled it through their exchange rate policies. Whilst tight control over the exchange rate was maintained during the 1960's, only partial liberalisation has occurred since then. A recent report suggested that since the mid-1970's the fragmented and highly overvalued exchange rates operating in Egypt have acted as a disincentive for her exporters.[71]

Beyond the fact that the rate is overvalued, further difficulties relate to the fact that the purchase of foreign exchange by Egyptians for almost all personal uses is prohibited. For those purchases that are permitted, two legal rates of exchange exist, the Commercial Bank rate and the Central Bank rate. Both of these are considered overvalued, a problem in itself which is compounded by the fact that demand exceeds supply. The consequent result is the existence of a black market rate, the so-called 'parallel market' rate.[72]

The Central Bank rate is used to record the government's major sources of revenue which include proceeds from the Suez Canal and the Sumed pipeline, and the exports of petroleum, rice and cotton. These funds are then applied to the import of a variety of key commodities at the same rate. The commodities range from foodstuffs to a variety of agricultural products. The rate is also applied to the servicing of the nation's massive external debt.

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71 Sherif, Khaled Fouad Egypt's Liberalisation Experience & its Impact on State Owned Enterprise Industrial Performance (Chicago: University of Chicago 1989) pp 21-23

72 Embassy of the USA in Cairo Egyptian Economic Trends (Cairo: Embassy of the USA in Cairo 1990) p 8

The Commercial Bank rate is calculated daily by a group of public and private sector bankers who, in theory at least, base their deliberations on demand and supply. The rate is applied to the private exchange of foreign currency which the government insists must be by banks or through bank accounts. Banks are authorised to sell foreign exchange from their pool (only) to finance imports, for foreign currency repatriation and to a limited extent for private foreign debt service. The fact that demand for foreign exchange from this source exceeds supply, has resulted in the existence of a third rate. In that this channel involves trading both through private foreign currency accounts in banks and trading outside accounts, it has elements of legality and illegality about it! Whilst at one stage regarded as possibly the most accurate rate (in terms of its response to demand and supply patterns), the efforts of the government and police in clamping down on it has had a distorting effect.

These policies the IMF has urged the government to reform, suggesting that a unified and more accurate rate of exchange might not only deter capital flight but enhance Egypt's international competitiveness, thereby promoting new investment and establishing better opportunities for exporters. The government responded in 1987 by freeing the commercial bank rate with a 40% devaluation. In the two years that followed, a total of $6,200 million flowed into the free commercial bank foreign exchange pool. $17 million was used to settle private sector exchange liabilities.

Since that time, the committee of bankers which regulates the rate has failed to maintain the trend of devaluation at a pace sufficient to preserve the balance between supply and demand. By the end of the decade the rate was again estimated to be overvalued.

A similarly cautious response has been the hallmark of the government's approach to interest rate policies. Whilst the rate has risen during the 1970's and the 1980's, its true significance can only be seen when set alongside the inflation rate.[73] With this currently standing at around 30% and the highest rate of interest at well less than 20% a situation is created which encourages the holding of capital in foreign exchange and capital flight. Inflation has been fuelled by a large budget deficit and excessive monetary expansion, the deficit in the late 1980's being the equivalent to 18% GNP.

The Cairo government has been reluctant to reduce the massive programmes of subsidies which lie behind the deficit on the scale advocated by the IMF. There is, however, growing debate throughout Egypt about the nature of the subsidies and who should benefit by them.

Traditionally, subsidies have been channelled towards state owned enterprises and the general public as a whole. They have taken the form of direct cash subsidies; been channelled through the banks towards particular groups or sectors; or, been exercised as price control measures in the form of tariffs or trade barriers. In implementing a variety of price increases during the late 1980's, the government appeared to recognise that a reduction in the deficit could assist the process of controlling inflation. At the same time it started discussing the problem of the vast and burdensome state owned sector, particularly the ownership of it and the means by which it should be financed.

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73 Annual Report of the Central Bank of Egypt various editions

3.5 Economic Considerations Today

Consideration of the Second Five Year Plan for Socio-Economic Development (1987/88 -1991/2) enables us to see the manner in which the government envisages the economy's development as Egypt edges its way into the 1990's.

The Plan is based on three underlying objectives,[74] the first of which centres upon the need for the Egyptian economy to finance its own development. This, it is envisaged, can be done through reducing imports, increasing domestic production and enhancing export potential. It is considered a crucial goal, given the susceptibility of the economy to 'external currents of change, considerations and influences beyond its control'.

The second objective deals with the social and material infrastructure - reforming it with the goal of stimulating development and investment, enabling the 'negative impact of bottle-necks' to be avoided. The final objective looks to addressing the population's rate of growth and the challenge the government is faced with in trying to cope with it. The Plan states, 'The responsibility for filling the basic needs of nearly 70 million people by the end of the century is fundamentally different from simply providing for quantitative change, since the type, nature and extent of Egypt's requirements will have changed, as will its ability to meet them.' Stark issues face the Egyptian government.

Table 3.5 details the GDP over the lifetime of the Plan, which is in itself expected to rise by 5.8%. The Commodity Sector is the largest of the sectors in terms of

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[74] Second Five Year Plan for Socio-Economic Development 1987/88 - 1991/92 (Cairo: 1987) pp 5-8

relative importance, averaging over the recorded years 48.4%, compared with the Production Services Sector (33.6%) and the Social Services Sector (17.9%). Of particular note in the Commodity Sector is the decline in oil and oil products from 4.1% to 3.5%, a trend echoed in agriculture's decline from 21.1% to 19.5%. In comparison, industry and mining as a unit rises from 17.0% to 19.2%, putting it on a par by the end of the Plan with agriculture.

Table 3.5 **GDP in 1991/92 compared to the targeted in 1987/88 and the expected in 1986/87 at 1986/87 prices**

Sector / Year	Relative Importance (%) 86/87	87/88	91/92	Growth Rate 87/88	91/92
Agriculture	21.1	20.8	19.5	03.7	04.1
Industry & mining	17.0	17.3	19.2	07.4	08.4
Oil & oil products	04.1	04.1	03.5	04.7	02.3
Electricity	01.3	01.3	01.3	08.1	07.1
Construction	04.9	05.0	04.9	07.0	05.9
Total Commodity Sector	48.4	48.5	48.4	05.5	05.8
Transport, communications & Suez Canal	09.2	09.1	08.9	04.6	05.1
Commerce, finance & insurance	23.6	23.5	23.3	04.9	05.5
Tourism	01.0	01.0	01.3	06.3	10.9
Total Production Service Sector	33.8	33.6	33.5	04.8	05.6
Housing & public utilities	02.0	02.1	02.6	09.2	11.4
Personal & social services	04.5	04.4	04.4	04.4	05.2
Government services	11.7	11.4	11.1	06.5	05.5
Total Social Services	17.8	17.9	18.1	06.3	06.2

over/

	1986/87	1987/88	1991/92
Total Value Commodity Sector	019770.2	20863.4	26221.0
Total Value Production Services Sector	013800.8	14470.5	18111.0
Total Value Social Services	007261.1	07716.7	09794.0
Grand Total	408732.1	43050.6	54126.0

Source: Butter, David p13

Although the value of the Production Services Sector increases by £E 4.3102 billion over the period of the Plan, its relative importance declines from 33.8% to 33.5%, the only sector to do so. Tourism is the only area within the Production Services Sector to increase in terms of relative importance, rising from 1.0% to 1.3%. It remains slight in terms of value, being dwarfed over the period of the Plan by commerce, finance and insurance, which averages £E6.59231 billion.

The Social Services Sector is the only one to increase, in terms of relative importance from 17.8% to 18.1%. Housing and public utilities are set to increase, and in the year 1991/92 annual growth is expected to be 11.4%. This is the largest area of growth, followed by tourism (10.9%) and industry and mining (8.4%). At the other end of the spectrum, oil and oil products are only expected to increase by 2.3%, transport, communications and Suez by 5.1% and personal and social services by 5.2%.

Overall, the annual growth rate in 1991/92 is expected at 1986/97 prices to be 5.8%. Many economists, however, believe that the government will be hard pressed to achieve this, particularly as extremely low rates of growth have been recorded in recent years.

Consideration of the sources of investment [see table 3.6] reveals that in both the Commodity and Social Service Sectors the private sector is expected to provide the bulk of the finance. Overall the bulk of investment is directed towards the Commodity Sectors, the least towards the Production Services Sector. Although there are six areas in which private sector investment is excluded, compared with none for the public sector, the private sector is nevertheless expected to provide the lion's share in three specific areas: agriculture, industry and mining, and housing.

Table 3.6 **Investment expenditure by economic sectors in the five year plan (1987/88 - 1991/92)**

Relative Structure (%)

Sectors	Public	Private	Total
Agriculture	03.1	14.7	07.7
Irrigation & drainage	05.1	-	03.1
Industry & mining	20.8	35.6	26.7
Oil & oil products	04.0	-	02.4
Electricity	17.1	-	10.4
Construction	02.3	03.0	02.6
Total Commodity Sectors	52.4	53.3	52.8
Transport, communications & storage	16.9	07.8	13.3
Suez Canal	00.9	-	00.5
Commerce	00.8	00.4	00.7
Finance & insurance	00.5	-	00.3
Tourism	00.8	01.2	01.0
Total Production Services Sector	19.9	09.5	11.8

over/

Housing	00.6	36.6	14.8
Public utilities	14.4	-	08.7
Education services	05.9	00.2	03.6
Health services	02.9	00.3	01.9
Other social services	03.9	00.1	02.4
Total Social Services Sector	27.0	37.2	31.4
Grand Total	100.0	100.0	100.0

Source: Butter, David p53

The challenges faced by the Egyptian government are great, and there can be no underestimating the immediate and constant nature of them. The remainder of this thesis considers the current status of the financial sector and its role in alleviating some of the difficulties.

Chapter 4 The Financial Sector Today

This chapter takes the form of an assessment of the activities of the financial sector in Egypt today. It concentrates initially on the banking sector, considering its structure; the regulatory environment in which it is required to operate, (as controlled by the Central Bank); and the government's approach to monetary policy. It then outlines the activities and roles of the banks in Egypt according to three classifications, namely Commercial Banks, Business and Investment Banks, and Specialised Banks.

In the second section the activities of non-banking institutions are discussed: insurance companies, the stock exchange and Islamic financial institutions.

4.1 The Structure of the Banking Sector

Table 4.1 reveals the structure of the banking sector in Egypt today. From it we can see that three different categories of banks fall beneath the control of the Central Bank of Egypt, that is to say Commercial Banks, Business and Investment Banks, and Specialised Banks. Each of these categories is sub-divided to reveal details of ownership, whether public, joint venture or foreign, and in the case of the Specialised Banks - all of which are publicly owned - the nature of the institutions' business, whether industrial development, real estate or agriculture. These sub-divisions also outline the number of institutions, according to ownership or activity, and the overall number of branches.

Table 4.1 **The structure of the Egyptian Banking Sector**

Central Bank of Egypt	Commercial Banks	4 public sector 633 branches 38 joint venture 221 branches
	Investment & Business Banks	11 joint venture 22 foreign bank branches 46 branches
	Specialised Banks	Industrial Devt Bank 3 branches 2 real estate banks 11 branches Principal Bank for Credit, & 17 subordinate 732 village banks

Source: Central Bank of Egypt Annual Report 1988/89 (Cairo: Central Bank of Egypt 1989) p 135 plus additional information supplied directly by a Central Bank spokesman.

Of the differing types of institutions outlined in the table, joint venture banks and foreign bank branches, operating under the categorisations of Commercial and Business and Investment Banks, are of the most recent origin, their creation dating to the origins of Law 43 in 1974. All other types of institutions were in operation in the period immediately prior to the introduction of the Open Door Policy. In addition to the institutions recorded in the table, there exist three outwith control of the Central Bank. They are the Arab International Bank, the Nasser Social Bank and Manufactures Hanover Trust Company.

An analysis of the figures makes it apparent that commercial banking institutions are the most numerous, accounting for 44% of the total number of institutions. These are followed by business and investment institutions (34%) and then specialised institutions (22%). The domineering role of the commercial institutions is also reflected in the distribution of branches, in that they account for 51% of the total. However, treating 'village banks' as branches boosts the position of specialised institutions to second place (43%), displacing business and investment institutions (5%) to third place.

When we consider the figures relating to ownership, private and foreign combined compared to public, we see that private institutions are almost three times more numerous than public (71 : 25). However, in terms of the number of branches, the public sector institutions have just under five times as many branches as the private and foreign sectors combined (1409 : 310). Within the public sector, this means that there are roughly 56 branches for every bank, compared with 4 in the private and foreign sectors.

These figures indicate the following in relation to the impact of the ODEP on the structure of the banking sector:

- since the ODEP's enactment, the banking sector has witnessed the appearance of new categories of institutions, whether in terms of function or ownership

- 'Business and Investment' banks, a new category of institution in terms of function, operate under new categories of ownership, whether as joint ventures or foreign bank branches

- Commercial banks also operate as joint ventures, although not as foreign bank branches

- the presence of these new institutions has had a marked impact on the total number of institutions in operation, although public sector banks - whilst small in number - remain dominant when the total number of branches is taken into account

- 'Law 43 institutions', totalling 77 in number, account for 74% of the total recorded number of institutions (96), their branches some 18% of the total of 1719 branches.

4.2 The Regulatory Environment

Article 1 of Law 120 of 1975 states that the Central Bank of Egypt is, 'an autonomous public legal entity which regulates monetary, credit and banking policy and supervises its fostering in accordance with the general plan of the State with a view to developing and fostering the national economy and maintaining the stability of the Egyptian currency'.

In seeking to uphold this regulatory duty it employs a variety of tools, including the following:- influencing the orientation of credit; participating in the arrangement for external credit; adopting suitable measures to combat general and local economic or financial disturbances; fixing discount rates; and participating in the preparation of the State's foreign exchange budget.

The most important of these tools and the manner in which they are employed are discussed below:

Reserve Requirement Ratios

Since 1980, banks have been required to place in the Central Bank 25% of their local currency deposits interest free, providing the maturities of these deposits are less than two years old. In addition, 15% of foreign currency deposits are also required to be placed in the Bank but at international interest rates (LIBOR).[75]

Bank Interest Rates

Despite the fact that all rates remain negative, in that they are below the anticipated rate of inflation, interest rates have succeeded in attracting an increased volume of money into the banking system in recent years. Today, rates on deposits range from 7.5% for one to two month deposits to 16% for deposits of seven years and more. These figures compare with 1977's distribution of rates of between 4% and 6%. Whilst in 1977 rates on loans and advances stood between 8% and 9% for all sectors, in 1989 they were differentiated according to sector, a practice dating to 1983. In 1989 agriculture and industry were charged rates of between 13% and 17%, the services sector between 15% and 19% and the commercial sector 18%.[76]

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[75] al-Tahri, Naveen representative of the Commercial International Bank in a private interview

[76] Annual Report of the Central Bank of Egypt various editions

Sectoral credit growth ceiling

This has been employed since 1981 when the CBE started to maintain specific restrictions on growth of bank credit to the commercial and household sectors. Banks are given limits on expansion of their lending to these sectors, recently in the order of 10% per annum, and overall they may not advance total loans worth more than 60% of deposits. Since 1982 no further facilities have been granted for the sale or purchase of imported cars or consumer durables.[77]

Open market operations

These are not regarded as an important tool on account of a shortage of marketable financial instruments. This shortage reflects the gap between issuing rates and market rates. The government depends heavily, as an alternative, on borrowings from the CBE and commercial public sector banks, although efforts have been made recently to increase the rate on bonds and issue new ones denominated in foreign currency.

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77 Egyptian Economic Trends p 11

4.3 Commercial Banks

Law 120 of 1975 defines commercial banks as institutions that, '...usually accept deposits payable on demand or within fixed periods; carry out internal or external financing...in such a manner as to achieve the objectives of the development plan and the State's policy as well as fostering of the national economy; effect operations for the promotion of savings and for financial investment locally and abroad, including the participation in the establishment of projects as well as banking, commercial and financial operations'.

Commercial banks today account for 44% of all banks operating in Egypt, their branches 51% of the total. Whilst the vast majority of these institutions within this category are joint ventures, this particular corner of the sector is overshadowed by the presence of the 'big four' state owned institutions. Not only do these dominate as single entities but also as joint venture partners.

The overall size of these institutions can be seen when we compare both total deposits of the commercial banks (£E48,871 million) and their assets / liabilities (£E70.617 million) with export earnings in the year 1988/89. These amounted to £E3,383.4 million. Figures are not available to assess the collective might of the 'big four', however, an insight to their size can be obtained by revealing that the National Bank of Egypt's deposits amounted to £E11,763 million in 1988/89, a figure representing over 24% of the total commercial bank deposits;[78] those of the Banque Misr represented 25%.[79]

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78 Spokesman for the National Bank of Egypt

79 Banque Misr Annual Report 1988/89

Considering the aggregate financial position of the commercial banks (table 4.2), the most outstanding features are loans and discounting, and deposits. In relative terms these represent 38% and 69% respectively, loans as a percentage of deposits standing at 55%. This figure falls within the upper limit for loans which the Central Bank allows such institutions to advance.

Table 4.2 The aggregate financial position of Commercial Banks, 1989

(£E millions)

	Amount	Relative Importance
Assets		
Cash	00840	01
Securities & investments	07627	11
Balances with banks in Egypt	14960	21
Balances with banks abroad	12755	18
Loans and discounting	27001	38
Other assets	07434	11
Liabilities		
Equities	01784	02
Provisions	03295	05
Bonds & long term loans	00191	--
Obligations to banks in Egypt	03965	06
Obligations to banks abroad	04895	07
Total deposits	48871	69
Other liabilities	07616	11

Source: Central Bank of Egypt Annual Report 1988/89 p 121

Looking at the recipients of these loans by sectoral distribution, we see that the private business sector received 49%, public sector companies and the government 32% and 14%, and the household and foreign sectors 3% and 2%. By economic activity, this distribution works out at agriculture and industry receiving 42% and the trade sector 31%, representing a fall of two percentage points over the financial year. 83% of these loans were of short term duration.[80]

Both agriculture and industry have been targeted by the government as areas where they would like to see growth and development, reducing the nation's reliance and dependence on trade. Accordingly, interest rates for these two sectors were set in 1989 between 13% and 15% for loans of one year or less. Those directed at the trade sector stood at 18% for the same period.[81]

To appreciate the state owned - joint venture split, and something of the impact of the joint ventures on the sector, it is worth comparing two institutions, one state owned, the other joint venture.

The National Bank of Egypt was founded in 1898 with an initial share capital of £E 1 million. Its primary purpose was to serve as a bank of issue, maintain the accounts of the government and undertake commercial banking activities. Since 1960, it has been wholly owned by the government, and on the creation of the Central Bank it dropped its central banking functions to maintain a role within the commercial field. With assets of £E14,677 million, the NBE is Egypt's top ranking bank both at home and abroad, sporting 233 branches and deposits in 1987/88 to the value of £E9,681 million.[82]

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80 CBE Annual Report 1988/89 p 52

81 CBE Annual Report 1988/89 p 132

82 National Bank of Egypt Annual Report (various editions)

The Commercial International Bank cannot match the NBE, whether in terms of longevity, the volume of assets or the number of branches. Within Egypt the bank is ranked tenth, and within the Arab world seventy seventh. This was Egypt's first joint venture, the fruit of a union between the National Bank of Egypt and the Chase Manhattan Bank of New York. In 1987 Chase sold all of its shares bar 0.3% to the NBE, leaving the CIB in the delicate situation of being all but a state owned institution. The bank has a dozen branches, largely located in the capital and Alexandria, assets worth £E1,624 million and deposits worth £E1,163 million.[83]

Great though these discrepancies may be, they are not reflected as might be expected when one compares the profits the two institutions amassed in 1987. In that year the NBE's pre-tax profits, as a percentage of assets, stood at 2.06%, whilst those of the CIB at 3.71%. By 1989 the CIB reported a 35% increase in net profits, topping those of the NBE with a balance sheet more than ten times as large. With the CIB advancing a higher proportion of loans to industry and a lower proportion to trade and finance than the NBE - all areas perceived as being either 'risky' or 'easy' - the following chapter reveals the differences in approaches of such banks, and some of the factors which have enabled the NBE's initial stake in the CIB of £E2.5 million in 1975 to grow to almost £E300 million.

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[83] al-Tahri , Naveen of the Commercial International Bank & Commercial International Bank Annual Report various editions

4.4 Business and Investment Banks

Law 120's definition of business and investment banks enables us to distinguish how they differ from commercial banks. Whereas commercial banks accept deposits, 'payable on demand or within fixed periods', investment banks carry out operations related to the 'pooling and promotion of savings for the sake of investment'. These institutions may establish companies, and also undertake the financing of Egypt's foreign trade operations.

Comparing the aggregate financial positions of the two categories of banks reveals a number of marked differences. (See table 4.3) Taking assets of the business and investment banks, we see that the combined balances with banks in Egypt and abroad is £E 8422 million, 46% in terms of relative importance. This compares with 39% for commercial banks. Lending and discounting balances within the two different types of banks can be broadly equated in terms of relative importance, whilst there is a marked difference between the relative importance of securities and investments. Within business and investment banks this stands at 3%, compared with 11% in the commercial banks.

Table 4.3 The aggregate financial position of Business & Investment Banks, 1989

(£E millions)

	Amount	Relative Importance
Assets		
Cash	0094	--
Securities & investments	0474	03
Balances with banks in Egypt	3341	18
Balances with banks abroad	5081	28
Lending & discount balances	7565	41
Other assets	1811	10
Liabilities		
Equities	1120	06
Provisions	1094	06
Bonds & loans	0029	--
Obligations to banks in Egypt	4511	25
Obligations to banks abroad	2305	12
Total deposits	6961	38
Other liabilities	2346	13

Source: Central Bank of Egypt Annual Report 1988/89 p 122

On the liabilities side, again there is a marked difference between the combined obligations to banks in Egypt and abroad (37% in terms of relative importance for business and investment banks, compared to 13% for commercial institutions). All other items except deposits, can be broadly equated. Commercial banks are considerably more dependent on these (69% of liabilities) than business and investment banks (38%).

Credit classification by sector[84] reveals that the private business sector received 54% of total loans, the foreign sector 21%, the government sector 17%, and public sector companies and the household sector 5% and 3% respectively. Within terms of economic activity, the relative share of agriculture and industry was 20% (a rise of 3 percentage points over the course of the financial year) and trade 26% (a fall of 2 percentage points). The high proportion of loans to the foreign sector can possibly be explained on account of the make up of ownership of this category of banks, that is to say, largely foreign or joint venture, and the banks' facilities for dealing in foreign currency.

Such figures would appear to indicate that despite their name and legal definition, business and investment banks tend not to concentrate on investment but rather loans. They would also appear to act as clearing houses and to a large extent are dependent on interbank activities, whether domestic or international.

Perhaps the most prominent business and investment bank operating in Egypt today is the Misr Iran Development Bank. Founded in 1975, this institution concentrates on investing in the high priority sectors of the economy, as indicated in the government's Social and Economic Development Plans. By the end of 1988 the bank had participated in the establishment of 69 projects in total, the majority of

[84] CBE Annual Report 1988/89 p 55

which were industrial (40%). In its belief that, 'project development does not require financing only - knowledge of the technical process, management and organisation are equally vital' the MIDB is insistent on assessing all aspects of a project prior to considering whether it worthy of funding. With representation on the boards of the General Authority for Investment and Free Zones, the General Organisation for Industrialisation, the Specialised National Councils and a variety of other government agencies, the MIDB feels it is well placed to assess the mood of the government and is also afforded a degree of access to information and data which the market does not readily give up.

The bank claims that one indicator of the quality of its service can be seen in its distribution of loans over time. In 1988 the bank provided loans of medium to long term in duration to the value of $77.9 million, whilst its short term loans stood at $35.49 million. This long term - short term balance is not widely reflected across the banking sector. In both 1987 and 1988 the bank itself received loans from the International Bank for Reconstruction and Development.[85]

When we look at combined loans and discount balances of commercial and business and investment banks over the three years (See table 4.4) we see that the private business sector has consistently enjoyed the lion's share, whilst the household sector has benefited least. At the same time that the government's share has declined, that of the public sector has increased. When considered by type of activity, we see that whilst agriculture has consistently remained the least significant item, industry has risen, in terms of relative importance from 30% to 35%. Most importantly, as far as the government is concerned, trade has dropped from 36% to 29%, although it nevertheless remains an item of great significance and importance.

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85 Misr Iran Development Bank Annual Report (various editions) & Dr Nabil Mohareb of the Misr Iran Development Bank in a private interview

Table 4.4 **Loans & discount balances granted by Commercial Banks & Business & Investment Banks, 1987 - 1989**

(By sector & economic activity.)

(£E millions)

	1987 amount / relative importance	1988 amount / relative importance	1989 amount/rel importance
Total Loans	25276 / 100	30580 / 100	34566/100
by debtors			
Govt sector	04978 / 20	04761 / 16	05341 / 15
Public sector cos.	05587 / 22	07477 / 24	08964 / 26
Private bus. sector	12541 / 50	15234 / 50	17288 / 50
Household sector	00636 / 02	00779 / 02	00994 / 03
Foreign sector	01534 / 06	02329 / 08	02079 / 06

over /

by type of activity

Agriculture	0629 / 03	00783 / 03	00936 / 03
Industry	7699 / 30	10186 / 33	11955 / 35
Trade	9170 / 36	09615 / 32	10201 / 29
Services	5246 / 21	06510 / 21	07904 / 23
Undistributed sectors	2532 / 10	03486 / 11	03570 / 10

Source: Central Bank of Egypt Annual Report 1988/89 p 125

4.5 Specialised Banks

An immediate glance at the aggregate financial position of specialised banks (those institutions said to, 'serve a specific type of economic activity and for which the acceptance of demand deposits is not one of their main fields of activity') reveals [see table 4.5] the overwhelming relative importance of lending and discount balances (72%) in terms of assets, and in terms of liabilities the dependence on obligations to banks in Egypt and deposits (a combined 67%). Securities and investments, and balances with banks in Egypt and abroad are negligible; other assets are, regretfully, not detailed for closer examination.

Table 4.5 **Aggregate financial position of Specialised Banks, 1989**

(£E millions)

	Amount	Relative Importance
Assets		
Cash	0002	--
Securities & investments	0109	01
Balances with banks in Egypt	0047	01
Balances with banks abroad	0041	01
Lending & discount balances	5377	72
Other assets	1856	25
Liabilities		
Equities	0348	05
Provisions	0335	04
Bonds & loans	0715	10
Obligations to banks in Egypt	3312	44
Obligations to banks abroad	0034	--
Total deposits	1679	23
Other liabilities	1009	14

Source: Central Bank of Egypt Annual Report 1988/89 p 127

Details of loans granted by specialised banks [see table 4.6] reveal that they are essentially shared out between the government and private business sectors, the latter receiving almost 75% of all those allocated. The household sector receives a minimal amount, whilst the foreign sector and public sector companies do not receive anything at all. By types of activity, we see that agriculture absorbs 50% of the loans, the services sector almost one third and industry 14%. Trade receives only 1%.

Table 4.6 **Loans granted by Specialised Banks, 1989**

(by sector and economic activity)

(£E million)

	Amount	Relative Importance
Total loans	5377	100
Loans by debtor sectors		
Government sector	1363	25
Public sector companies	0021	--
Private business sector	3792	71
Household sector	0199	04
Foreign sector	0002	--
by type of activity		
Agriculture	2689	50
Industry	0741	14
Trade	0041	01
Services	1701	31
Undistributed sectors	0205	04

Source: Central Bank of Egypt Annual Report 1988/89 p 130

Details are not published enabling us to adjudge the types of loans granted by specialised banks, however, the relative importance of loans granted to the trade sector and the agricultural sector suggests that loans probably do not weigh as heavily on the short term side as we have seen with other categories of banks.

Agriculture, on the whole, would appear to be an area from which private or foreign owned institutions shy. This is likely to be on account of the long term nature of investment that this sector requires. Trade, on the other hand, requires short term finance. Where the government has attempted to discriminate throughout the sector against trade by manipulating interest rates, institutions would not appear to have been deterred from advancing trade finance. Additional costs for servicing a loan can easily be passed on to customers. Real estate, although requiring long term investment, is an area of considerable investment, the returns being almost assured and a physical asset being the essential result.

4.6 Insurance Companies

The importance of insurance companies can be seen today in terms of the sheer volume of investments available to them. In the 1970's, insurance companies were among the first group of institutions to be reorganised under the ODEP. Many of the foreign and privately owned firms had been nationalised or confiscated by Nasser.

There currently exist in Egypt four public sector institutions, one of which deals with reinsurance. In addition, there are three private sector companies and two joint ventures.

Unlike banking institutions, insurance companies obtain their resources by means of periodic instalments, in the case of life insurance policies. Instalments due by policy holders or others are paid at the same time. Until required to pay reparations, insurance companies must merely be able to ensure a good return on investments, and ensure the maintenance of an appropriate level of liquidity.

Whilst traditionally insurance companies have dealt with real estate, table 4.7 reveals the sector's investments in 1989. It also reveals the enormity of its investments. The figure £E22.5303 billion can be compared with the total deposits held in commercial banks (£E48.871 billion), the equivalent of 46%.

Table 4.7 **Investments of the Insurance Sector, 1989**

(£E millions)

Real estate & land	00159.1
Government securities	04163.4
Loans	17035.4
Cash deposits at banks	01172.4
Total	22530.3

Source: Central Bank of Egypt Annual Report 1988/89 p136

As can be seen, these investments are directed towards four areas: real estate and land, government securities, loans and cash deposits at banks. The most sizeable item is loans, 99% of which are directed to the government (£E 16.881 billion). In that government securities are the recipient of 18.5% of investments, the state is a beneficiary, to the general exclusion of other sectors.

Given the characteristics of the insurance sector pointed out earlier, there is clearly a great potential for it to make a sizeable portion of its investment available for medium to long term finance. The sources of investment revealed in the table, however, suggest that the general inclination is to pursue business involving the least degree of risk.

4.7 Islamic Institutions

One of the areas of Egyptian finance notable in recent years for its growth and popularity has been that of Islamic finance. This has revolved around the attempts made to reconcile commercial transactions with the teaching of the Quran. Islam preaches that interest should be prohibited on lent and borrowed funds; that hoarding should be discouraged; and that money should be put to productive use for the good of individuals, as well as that of the community.

The use of funds employed by Islamic institutions takes the form of financing projects and operations in partnership with individuals or institutions. These generally take one of three forms:[86]

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86 Structural Development of the Egyptian Financial Market (Cairo: USAID 1984) p 37

Musharkah - the bank finances the project, possibly with the assistance of the client who runs the project. Profits are distributed at pre-determined rates, and any loss falls on the shoulders of the bank. The client may buy out the bank's share in time, enabling the terms of maturity to be reached.

Mudarbah - this is basically the equivalent of short term facilities as found in 'institutional' banking circles. It is used to finance working capital, or trade finance. The bank provides all of the funds needed to finance an operation which can then be repaid on a similar basis to Musharkah.

Murabhah - the bank purchases the commodity or good on behalf of the client and later resells it to him at a price agreed in advance.

The three best known Islamic institutions operating in Egypt today are the Nasser Social Bank, the Faisal Islamic Bank and the Islamic International Bank for Investment and Development.

Set alongside business & investment banking and commercial operations in 1985, the combined balance sheet of these three particular institutions amounts to 50.5% of the balance sheet of investment and business banks and 10% of commercial banks.[87] This gives us an idea of the significance and popularity of such institutions within the financial sector.

The very success of Islamic investment companies succeeded in attracting a significant proportion of private savings and channelling them away from the official banking system during the 1980's. With a rate of return ('interest') often 10 percentage points higher than that offered by traditional banks, between two and

87 Hasan, Mahrous A p 143

three million customers were attracted to such firms as al-Rayan with deposits of $2000 million - $3500 million.[88] The combined assets of all Islamic companies was estimated in the region of $20 000 million.

Speculation on foreign exchange markets led some of these firms into severe financial difficulties in the late 1980's. In an effort to reign in on the institutions, the government enacted Law 146 of 1988. This required them to submit themselves to closer scrutiny by the Capital Markets Authority; lodge funds in government monitored bank accounts; publish balance sheets; pay a certain percentage of deposits into a special indemnity fund in case of losses; and issue stock ownership certificates to depositors as a further protection for their savings.

4.8 The Stock Exchange

In the last chapter the establishment of the Capital Markets Authority (CMA) within the framework of the ODEP was recorded, an act which the government envisaged would boost the activities of the stock exchange. Table 4.8 reveals the historical market value of bond and share trading since the mid-1950's, demonstrating not only the consequences of the CMA's establishment but the impact of Nasser's programme of nationalisation. A trend of decline dates from 1958, falling most dramatically in 1963. Negligible levels of performance, are also the characteristic of the 1970's. It is only over 1982/83 that we see an upward trend significantly increase, a feature of performance reflective of the remainder of the recorded period. This trend marks the impact of the legislation implemented in the wake of the CMA's establishment.

88 Middle East & North Africa 1989 (London: Europa Publications Ltd 1989) pp 387-388

<u>Table 4.8</u> **<u>Historical market value of bond & share trading</u>**

(year / £E millions)

1956 - 57.3	1964 - 04.3	1972 - 03.9	1980 - 009.8
1957 - 32.7	1965 - 02.8	1973 - 04.3	1981 - 009.1
1958 - 66.7	1966 - 04.0	1974 - 04.1	1982 - 007.8
1959 - 43.9	1967 - 06.5	1975 - 07.4	1983 - 025.0
1960 - 38.4	1968 - 02.8	1976 - 07.6	1984 - 047.2
1961 - 23.4	1969 - 06.3	1977 - 05.9	1985 - 077.3
1962 - 12.2	1970 - 03.8	1978 - 04.9	1986 - 111.3
1963 - 05.1	1971 - 03.6	1979 - 06.4	1987 - 177.7

<u>Source:</u> <u>National Bank of Egypt Bulletin</u> (Cairo: National Bank of Egypt) (various editions)

The impact of the ODEP can be noted most graphically when we look at the number of companies quoted on the stock exchange. A decade after the ODEP's inception the number of companies stood in excess of 300 and by 1989 this figure had increased to 490. Of these, under a third (147) were open to public subscription. The listing of the others merely reflects compliance with the Companies Law and Stock Exchange Regulations. Given the increase in the numbers of companies listed since the mid- 1970's, the number of shares naturally also increased, reaching 348 million in 1989. Issued capital stood at £E 2.1311 billion.[89]

Impressive though these figures may appear, they do not reflect the volume of trade in securities. In 1985, 337 companies had their shares listed on the exchanges. The issued capital of the companies, which totalled £E 1.9 billion, represented 244 million shares. Despite this, however, the volume of trade in securities was a mere £E 125.8 million. About 30% of this figure (£E 40.5 million) was traded through direct negotiations outside the exchanges.[90]

The performance in 1985 was not a year in isolation but very much indicative of the depressed nature of the activities of the stock exchange as a whole.

Only two government bonds are quoted on the stock exchange, $US development bonds and housing bonds. The trading pattern of these is similar to that of securities - considerably depressed. Funds needed by the government and the public sector are secured through direct access to the banking system and the great pension and social security fund pools. No market mechanism is followed and the interest rate on these IOU's is fixed by the Central Bank.[91]

89 Mohareb, Nabil S p 16

90 Vice President of the Cairo Stock Exchange in a private interview

91 Mohareb, Nabil S p 16

In the next chapter, some of the measures that could be undertaken to rectify such difficulties and utilise the stock exchange more effectively are discussed.

Chapter 5 The Operating Climate

In assessing the climate in which the financial sector operates and the areas in which its development is possibly hampered we are led into examining the attitudes, ideals and aspirations of all those involved in the 'financial process', along with Egypt's political, economic and social circumstances.

A goodly portion of the information in this chapter was obtained through interviewing - on both a formal and informal basis - a variety of individuals with some insight into the sector. These ranged from members of the general public to bankers, stockbrokers, financiers and lawyers, from members of the government to journalists, academics and diplomats. Of those interviewed, a certain number were eager to ensure that their names were not associated with their remarks. Others stressed that their views were not necessarily reflective of the organisations employing them, or which they represented. This accounts for the fact that some interviewees are not mentioned specifically by name but referred to by their initials, and that certain organisations are only mentioned by way of description.

Conversations with Egyptian friends, chance encounters whilst staying in Cairo, along with the city's taxi drivers, added to the base of the information. Together with news items, information gathered from a variety of other sources and a basic but reasonable understanding of the country and its history on the part of the author - all have contributed to the formulation of this chapter.

5.1 Introduction

Since the introduction of the ODEP in the early 1970's, the number and type of financial institutions operating in Egypt have increased enormously. This has resulted in financial resources being mobilised to a greater degree than ever before, whilst the import of modern banking technology has ensured that Egyptians employed within the financial sector have been able to work to higher degrees and standards of professionalism, serving a growing body of clients whose economic expectations have also increased.

Popular conceptions about the role of the financial sector have changed, with people more willing to entrust savings to institutions, a process which has been aided by the inflow of remittances from abroad. It has been suggested that there is a greater awareness amongst the general public of the potential role of the sector in assisting economic and consequently social development. Whereas many people have readily and willingly accepted the import of Western banking technology, others have preferred to consider and pursue afresh traditional Islamic paths. The fact that Islamic banks and finance houses have proved to be so popular reflects such sentiment, likewise the degree of financial innovation which exists in Egypt today, and the increase in financial sophistication amongst the general public.

Given such success it might be assumed that confidence is buoyant within the financial sector. This, however, is not the case, something indicated in the nature and scope of institutional activities. As has already been mentioned, loans made by banking institutions are, on the whole, short term. Although many of them take the form of rolling credit, thereby assuming the status of term credit, the very reluctance of the majority of institutions to forward a significant volume of capital in the form of medium, and particularly long term loans is indicative of a lack of confidence.

Similarly indicative is the volume of excess liquidity. If externally held savings are taken into account, Egypt's ratio of liquidity to GNP stands somewhere in the region of 160%, a figure under half that size being the norm for developing countries.[92] This reflects not only the lack of confidence within the financial sector as a whole but a lack of perceived investment opportunities.

Confidence can be described as a state and outlook which determines existing levels of performance and activity and has an equally significant impact in determining future levels of performance and activity. Whilst combining elements of the present and a speculative picture of the future, an atmosphere of confidence is also shaped by experience and perception of the past.

One does not need to go as far back as the Nasser era to source why confidence is lacking within the financial community today. The very tools with which the Presidents Sadat and Mubarak have managed the economy have contributed to shaping this climate, as have the actions of the private sector itself. Of recent years, bank debt is considered to have been one of the major contributors to the generation of hesitancy within the sector.

The total sum of bank debt involved currently stands in excess of £E4 billion with over four thousand clients in trouble. This figure represents 16.6% of all clients. The sums they owe represent 23.8% of all loans. Amongst the institutions worst affected are state owned banks, and business and investment banks - the latter being those institutions which deal uniquely in foreign currency. Over 40% of the clients

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92 Sayeh, Hamid Chairman of the Hong Kong Egyptian Bank & former Minister of the Economy in a private interview

of the state owned institutions are 'delinquent borrowers', and in the case of business and investment banks, almost 45% of loans are sour.[93]

The cause of this debt can be traced to a large extent to the 50% devaluation of the Egyptian pound between 1984 and 1987, and the impact of world wide price fluctuations on agricultural goods. Firms which borrowed in foreign currencies but were earning in local currency had great difficulty in servicing loans in the midst of the spiralling downturn of the Egyptian pound. The problem of purchasing already scarce hard currency was made worse when the government clamped down on the 'own exchange' market upon which much of the private sector had previously been reliant. It is also the case, however, that many banks had been rather lax in deciding which projects were worthy of investment, a lesson which has had a marked impact on lending policies today.[94]

One of the most visible consequences of this debt crisis, and the subsequent crisis of confidence has been the departure from Cairo of a number of major players from the financial scene - particularly those institutions denied access to financial operations dealing with local currency. Among the institutions which left were the Bank of America, Lloyds and the Chase Manhattan Bank of New York. Whilst some of the departees had amassed bad debt in other parts of the world, the viability of pursuing business further in Egypt also underscored the reasoning behind their departure. As one senior banker described the situation to me, himself a temporary 'caretaker' for Lloyds in the wake of that institution's departure, "Banking is a risky business. When you lend money out there is only so much control that you can exercise over it and things can occur well beyond the control of anyone. The decision by these banks

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93 Middle East Economic Digest (London: Middle East Economic Digest 20 October 1989) p 8

94 al-Tahri, Naveen in a private interview

to pack up does not mean that they lost money in Egypt - it could just mean that they saw no potential in Egypt for the time being."

Such sentiment is not merely to be found amongst those who had departed the scene but is echoed amongst many of the financiers that remain. Citibank's spokesman told me, "Having forty employees in the bank and merely performing an advisory role is not exactly what we had in mind when we first opened up. If we had more things to do we would gladly do them but at the same time we require guarantees that they might work and not just be a wasted effort."

The financial sector is looking to the government to pursue a consistent line in economic policy which will embrace and exploit the financial sector in both the processes of change and the operation of its desired goals.[95] The current five year plan would appear to suggest that the government has a certain vision as to its chosen destiny in the twenty first century. The utterances of ministers similarly suggest an awareness of the enormous difficulties that must be faced in the pursuit of that goal. They also appear aware of the dangers of pursuing the alternative, in other words, maintaining existing policies. The financial sector claims to have the necessary apparatus and expertise to help bridge the gap.

The most decisive gesture the government could adopt in bolstering confidence within the sector would be to adopt the prescriptive medicine of the International Monetary Fund.[96] This would not merely be an exercise aimed at freeing interest rates, and unifying and liberalising the rate of exchange rate but one entailing the wholesale adoption of market forces.

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95 Fahmy, Maher of the Egyptian American Bank in a private interview

96 Sherif, Khaled Fouad in a private interview

Dr Nabil Mohareb of the Misr Iran Development Bank explained why the sector regards this as so important. "The first thing to be done for any economic reform to be meaningful is to establish markets. If you do not start with this as a first step, all subsequent steps and efforts will go down the drain."

The adoption of market forces as a tool to manage the economy would inevitably create vast short term difficulties. The cost of borrowing would be forced up for the government, necessitating a dramatic change in attitude over subsidies; an increase in interest rates might deter banks from lending as heavily as the government would desire; a liberalisation of exchange rates would result in further devaluation, forcing badly capitalised companies to go under, possibly even some financial institutions; capital flight might also be stimulated in an atmosphere enabling the free transferral of foreign exchange to and from Egypt.

However, despite the potentially bleak scenario, many believe that the problems are both short-term and containable and that to cope with them the government could rely to a large extent on the private sector and financial community, thereby further stimulating confidence, diversity and development within the sector and elsewhere.

5.2 Management of Domestic Public Debt

By the mid-1980's the government was reliant on the banking sector to the tune of over 50% as its source of finance for the public sector deficit. The rest came from savings that had accumulated in social insurance and pension funds, proceeds from investment certificates and funds from the post office savings organisation. Whilst these sources have been accessible, reliable and cheap for the government, the use of them has served to deter the stimulation of money and capital markets.[97]

As a possible alternative means of managing debt, it has been suggested that the government could tap markets for future borrowings, calculating the volume of treasury bonds and bills to be issued to cover the expected annual budget deficit. If the government was to restrict such borrowing to the financing of purely governmental needs, as opposed to those of state owned enterprises, the volume of bills required to be issued would be inevitably reduced.[98]

The pursuit of such a policy would not only serve to boost the financial community and its regard for government and its policy directions but act as a device whereby the government would be forced to address the whole problem of the deficit.

97 Mohareb, Nabil S in a private interview

98 Mohareb, Nabil S in a private interview

5.3 Monetary Policy

As noted, the impact of the government's monetary policies has been to increase the proportion of savings held as time deposits held in banks. Whilst this is a laudable goal in itself, the fact that this has served as a pool to finance increases in domestic debt is less encouraging.

Similarly, whilst the government has endeavoured to restrain the money supply and reduce inflation through the imposition of a ceiling on aggregate bank credit, this has been applied to all sectors bar the government itself. As such, this has the effect of greatly reducing the desirable impact of such a policy.

Interest rate policies have been similarly distorting. Some of those bankers interviewed considered, from their own lending experience, that the ceilings on loan rates have discouraged investment on high risk projects, particularly agriculture and industry. The result, they claimed, has been to promote investment in capital intensive and short term projects, such as trade. Although the IMF has urged the government to alter such policies, it was suggested to the author that the impact on lending activity of a liberalisation of interest rates would be slight. The experience of bank debt, as mentioned earlier, coupled with the extremely lengthy process of debt recovery, will continue to act as a deterrent, some bankers suggested.

These days, lending practices are underscored with extreme caution, particularly where foreign currency loans are concerned. Lending in foreign currency is now restricted to those economic concerns which generate foreign currency, and even then only after strict credit criterion have been applied and accepted.[99]

99 Various sources

A boost to lending activities could come about, suggested some, through enhanced awareness of the role, techniques and requirements of the financial sector. A good many projects are turned down on account of would-be borrowers approaching institutions with capitalisation as low as 15% - 20%.[100] The danger resulting from would-be clients being turned away is that they will be forced to turn to more expensive, informal sources of finance.

The quality and timeliness of data is another major factor which has deterred lending activity. It has increased risk resulting in projects either being deemed unfeasible, or the levels of guarantees and collateralisation required being increased.

5.4 Management of the Public Business Sector

One of the greatest obstacles to investment perceived by the financial community is the state sector. It is not merely the size of the sector which deters would-be investors - it constitutes 70% of the economy - but the manner in which the government manages the array of state owned enterprises (SOEs) which make it up. Largely the product of nationalisation, these SOEs have been nurtured since the era of Abd al-Nasser by direct subsidies and public investment, and financed with subsidised credit. The cost of running these enterprises in this manner constitutes a major part of the annual budget deficit.[101]

Many in the financial sector are extremely hesitant about backing any private concern which might find itself in competition with such enterprises, as despite their inefficiency and wastefulness, the government has only ever demonstrated great

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100 al-Tahri, Naveen in a private interview

101 Representative of the University of Ain Shams

commitment to maintaining them. Yet, where the private sector has entered into competition with SOEs - according to Khaled Fouad Sherif of the American University in Cairo - it has revealed the extent of the inadequacies of the state sector, whether in terms of management, capital make-up, productivity or efficiency.

Managers are neither accountable nor responsible for their operations, lacking the freedom to hire and fire employees - let alone dictate the ideal numbers who should be employed; they are denied the opportunity to secure finance on properly advantageous and realistic terms; and they are denied the right to determine the inviability of operations where appropriate.

In certain sectors, most notably tourism, the government has actively encouraged the private sector's participation and involvement. The Minister for Tourism and Aviation, Fouad Sultan, reeled off to me the impact he sees the private sector as having made in the late 1980's: the number of tourist arrivals having doubled and the number of tourist nights having tripled; income having risen from $700 million to $2.5 billion in three years; and the total number of hotel rooms approaching 50,000. The act of the government permitting the private sector's widespread participation in the tourism sector has been of enormous encouragement to the financial sector, he claimed, part of a policy aimed at, "...making the private sector feel its contributions are badly needed".

The government has recognised the success of this project and in 1990 it announced a programme for the privatisation of 300 joint venture companies with an estimated total capital value of about £E 1.5 billion; 2000 small firms with capital totalling £E 600 million; and 380 non-strategic public enterprises, of which 200 are in manufacturing. The Minister in charge of the day to day running of the project - again Fouad Sultan - explained to me what the government has in mind in embarking on such an exercise. "I believe in privatisation - not just as an end in itself but as an effective tool in bridging the gap between the central budget of the government and in increasing and improving efficiency in the production process."

Egypt, he suggested, differs from most other developing countries in several respects, notably the presence of a strong production base. That this base is not performing to maximum capacity is not a characteristic unique to Egypt but in her particular case attributable to the lack of resources available to meet working capital needs and renovation. The government can no longer look to living off a budget deficit which impacts in such a negative manner on the economy as a whole.

Clearly, a privatisation exercise could be a most effective tool in bridging the gap in the government's budget, mobilising the resources and savings of the community and binding them to the production base. With liquidity standing well in excess of most developing countries - a vast volume of Egyptian savings being held overseas, there could be scope in absorbing this, helping to satisfy potential investment opportunities to the satisfaction of the financial community. Nevertheless, as was apparent amongst all those with whom I discussed the government's programme, before implementing it the government will be required to enact a great many pieces of supportive legislation for it to be a success.

5.5 Other Issues

An American diplomat spelt out his thoughts about the capabilities of the financial sector in sustaining the exercise. "I do believe that the government is very serious and willing to privatise but they are faced by a great many problems, as essentially there is no market for financial assets and securities. They lack a reference price, the necessary quantity surveyors, assessors and evaluators. They need all of these things to assess how much of this share can be sold to the public."

USAID, he explained, were undertaking feasibility studies to assess some of the issues surrounding these aspects of the exercise. Once complete, the Capital Markets Authority will then report their findings and any recommendations to the government. Some of those who were questioned - the diplomat included - feared that local human resources were inadequate to carry out the exercise, others were deeply defensive of local Egyptian talent, and highly critical of the role of USAID.

If the government intends to privatise through the stock exchange, Maher Fahmy, Vice President of the Cairo Exchange suggested that existing legislation should be amended to ensure that stocks and shares be on the same footing as bank interest. Others suggested that the government should go as far as exercising positive discrimination in favour of stocks and shares. This would certainly be a measure that could enhance awareness in the exchange and act as an incentive for would-be investors.

It is widely hoped that the government's new policy will herald a wider and fresh outlook on management of the public sector as a whole, and particularly for those concerns ear-marked for privatisation. Several bankers said that they would flatly refuse to put money into any concern managed under existing legislation or by means of traditional Egyptian public sector practice. "They must first of all rid themselves of the individuals that led the organisations into that state. If they change the laws, many Egyptians and foreign investors will go in and buy from such a market", suggested one of them.

Whilst there could be clear advantage for investors purchasing shares as a means of hedging their investments against inflation - as opposed to relying on insubstantial bank interest income - the development of the stock exchange could also prove to be of great appeal to 'Islamic investors', those who prefer not to deal in traditional 'Western' banking techniques. With many investors having been bitten and deterred from financial innovation and participation as a result of the al-Rayan scandals, the financial sector is aware of how much work it must do to re-capture these potential investors and indeed restore confidence through-out the economy.

Other groups must also be satisfied. Europe's 1992 venture could provide ready markets for Egyptian products yet at the same time could also result in foreign aid resources being diverted from Egypt to Eastern Europe. Most bankers remain optimistic for the long term, recognising - as they believe the government and the people of Egypt have also done, both the inevitability and the need for change.

The extent to which the government will be able to wrestle these issues through parliament and convince the people of their validity and benefit is questioned constantly. The scale of the doubt certainly underlies something of President Mubarak and his colleagues' hesitancy, although it also reflects the 'old-guard' military-cum-conservative political thinking of many of his Ministers, few of whom have business or commercial experience.

To successfully implement these policies the government must - at least in the short term - adopt a strong hand approach. Yet, the end result of the exercise must be the government relinquishing much of its power, a significant portion of which it has assumed since the 1950's.

Chapter 6 Conclusions

The framework around which this analysis of the growth and development of the modern Egyptian financial sector is structured is sewn in chapter 2 of this thesis. In this chapter we are led through a theoretical-style approach into considering the 'ideal' role for the 'ideal' financial sector before revealing the broad pattern of historical development in the developing world. It also introduces the notion of supply-lead and demand-follow finance - wherein lies the initiative to promote change and development, whether with the government, or the private and financial sectors. The faults to which financial sectors have historically fallen victim in pursuit of development are discussed along with some of the areas of activity governments have been urged to adopt in an attempt to rectify such situations and regain the path towards the 'ideal'.

Applying the findings of this chapter to the information contained in those that follow suggests that Egypt's historical experience of financial development is not unique. Emerging from the decaying Ottoman Empire, Egypt's economy became inter-woven with that of the outside world through both the West's colonial expansionist policies and their immediate impact on the narrow economic practices of the Egyptian government. The cotton trade and the Suez Canal's development compounded this process. Although both involved significant Egyptian input, whether in terms of labour, cost or expertise, access to finance remained well beyond the reach of most native Egyptians. They continued to pursue their financial affairs by traditional techniques and methods but were clearly drawn and attracted to what they saw being operated by the Europeans in their midst.

It was not until the 1920's that local Egyptian input into the financial sector became evident with the creation of the Banque Misr. This was an initiative welling from the private sector, and of significance in that it was neither aided directly by the government, nor the occupying colonial powers. The bank's development was aided indirectly by the government in its determination to support new industries, through the application and maintenance of a programme of tariffs.

This trend of nigh-unique private sector participation in the financial sector continued up until the 1950's when, following the implementation of policies of sequestration, confiscation and nationalisation, the initiative was placed firmly in the hands of the government. Its actions were to suppress the involvement and contribution of the private sector. The government not merely held the reigns enabling it to determine the flow of resources, it also owned or had very significant powers of administration over the generators of wealth.

Although it took the death of Gamal Abd al-Nasser to shake this direct style of economic management from Egypt, his successors have each proved reluctant to rely significantly on the workings of the market and the private sector to aid and facilitate the process of allocation and distribution.

The 1970's were years characterised by phenomenal financial development, the numbers and types of institutions increasing dramatically, patterns of ownership changing and recognition of the importance of the sector growing within government circles. Foreign banks flooded into Egypt, acknowledging the government's determination to accept something of a role for the private sector, keen also to take advantage of Egypt's new found sources of wealth. It is debatable whether the financial community would have emerged as it did had Egypt not suddenly found herself in the position of amassing significant foreign exchange earnings and adopting trade liberalisation policies. It is equally debatable how tolerant the government would have been had the banks not provided such ready access to the government's deficit finance.

Underlying the boom of the 1970's were great economic structural weaknesses and a dominant and overwhelming state sector. When the extent of the weaknesses became exposed in the 1980's and some of the sources of foreign exchange were proving less forthcoming, Egypt witnessed the departure of some of the major foreign financial institutions which had made such a decisive gesture in undertaking operations in Cairo in the 1970's. Such a demonstration of how market forces can operate reminded the government of Egypt of the precarious world it had chosen to admit herself to with the implementation of the ODEP.

Equally indicative of the depressed nature of the economy and the lack of domestic confidence was the volume of foreign exchange held by Egyptians both within and outside the country - good money driving out bad. Yet, this phenomena also suggests something of the heightened financial sophistication of the general public. Traditional saving sources had been tapped and the financial community had enabled them to be converted to a form suitable for productive and efficient investment.

Although many of the institutions which commenced operations in Egypt in the 1970's have done enormously well, and that it is only a minority which fared badly as a result of bad debt, a general lack of investment opportunities points to the shallowness of the sector. Bond and bill markets are underdeveloped; the stock exchange fails to function with any great degree of success, or impact; and, the banks are reluctant to lend much beyond the short, or medium term.

The sector looks to the government for gestures and psychological signals to bolster confidence, whilst at the same time the government would appear to be looking more and more to the sector to aid its way out of some of the great difficulties it faces. It remains to be seen whether the government's signals will be decisive enough to stimulate co-operation with the sector, and indeed whether the sector possesses the necessary expertise, flexibility and commitment to make real the government's vision.

It would be wrong for the government and the people of Egypt to regard the financial sector as a generator of wealth in itself. A well functioning sector acts as a facilitator of wealth creation, capable of exercising the specialist skills of search, discrimination and allocation. Recent history has demonstrated that the government of Egypt lacks these necessary skills and that reliance on the financial sector is paramount. It has also demonstrated that a financial sector can, and indeed will only pursue these functions and operate effectively in a climate shaped with sensitivity by the actions and dictates of government.

An analysis of the concept and practice of development must recognise the inevitability of both change and time, and change occurring over time; it must recognise development as a concept embodying inter-relationships - that one thing cannot develop in isolation and without impact on those that surround; it must recognise that development is not always self-generated but can come from outwith; that development is a timeless process to which labels of success, failure and conclusion cannot be easily attached, yet is a process to which are often attached immediate and popularly conceived goals and ideals.

Egypt has a concept of history, statehood and being more profound than most states. Although change within the financial sector over the past three decades may have been nigh-constant, and masterfully erratic for 'sound-bitten' observers of the twentieth century, the forbearing of the Egyptian people and the very nature of development makes it hard for us to assess now the impact and even significance of all that has been occurring of recent at the banks of the Nile.

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Fahmy Mahmoud	Lawyer, former Chairman of the 1981 Companies Law Committee
Hanna, Fahmy	Egyptian American Bank
Hegazi, Abdel Aziz	Former Prime Minister
Mahmoud, Karim	Misr America International
Mohareb, Nabil S	Misr Iran Development Bank
Sayeh, Hamid	Chairman of the Hong Kong Egyptian Bank, former Minister of the Economy
Sherif, Khaled Fouad	American University in Cairo, USAID, journalist
Sultan, Fouad	Minister of Tourism & Aviation, formerly with the Misr Iran Development Bank
al Tahri, Naveen	Commercial International Bank
Thani, Ashraf	Institute of Banking & Finance

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NB This refers on occasions to individuals who preferred not to have their names associated with their remarks, unlike those in the above mentioned list.

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