UNITED ARAB REPUBLIC

THE INSTITUTE OF NATIONAL PLANNING

التخطيط القومي

Memo. No. 211

FINANCING CAPITAL FORMATION IN U. A. R.

by

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24th August, 1962.

CAIRO
3, MOHAMED MAZHAR - ZAMALEK

International Association For
Research in Income and Wealth

Middle East Regional Conference
Istanbul 24th – 29th August 1962.

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PRINTED IN
INSTITUTE OF NATIONAL PLANNING
3 MOHAMED MAZHAR STREET
ZAMALEK CAIRO
U. A. R.

Introduction

This paper is an exercise in the analysis of the saving - investment account and the national financial accounts in U. A. R. the objective of the study is the investigation of the pattern of financing fixed capital formation. Two issues are discussed.

Part 1. investigates the ultimate sources of financing fixed formation.

For this study, the appropiate technique is the Saving - investment account.

Part 11. investigates the mechanism of financing capital formation, i.e. how savings are channelled to finance fixed capital formation.

For this purpose, the national financial accounts are the appropriate technique.

Part 1.

The Sources of Finance

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The first issue which requires investigation is: What are the sources of financing fixed capital formation in U. A. R. ?

The answer is well known. Capital is financed from two sources: domestic savings and foreign lending.

The identity of savings and investments is inquestionable. But there are two questions which have certain significance, from the point of view of economic development:

1. What is the relative importance of domestic savings as a source of finance?
2. What is the relative importance of institutional savings, as compared with household savings?

The answer to these two questions, is provided by the saving - investment account. The system of national accounts used in U. A. R. does not show this account explicitly, but records the savings and investment of the defferent sectors in the capital accounts.

Table (1) gives a saving - investment account for 1958, which is privately compiled, using revised estimates of savings and investments.

The Account shows that total investments in 1958 amounted to £.E. 135.5 millions, out of which £.E. 133.5 millions for fixed capital formation and £.E. 2.0 millions for the increase in stocks. These investments were financed as follows:

Domestic Savings	£.E. 115.4 ms.
Foreign Lending	£.E. 20.1 ms.

These figures indicate that the U. A. R. economy depends mainly on domestic savings for financing capital formation. About % 85 of total investments are financed from this source. The saving - investment ratio was about % 11, which was a reasonable one, if compared with saving - income ratios of other developing countries.

The investigation of the composition of domestic savings reveals are of the important characteristics of the saving pattern of the economy. Household savings amounted to £.E. 12.5 millions, and institutional savings (including the Budget surplus) amounted to £.E. 102.9 millions. That is to say, household savings amounted to about % 10.8 of total domestic saving.

The same pattern is exhibited by saving - investment account in 1959/60, the basic year for the Five-years Development plan. This Account is given in table (2). Total investments amounted to to £.E. 203.9 millions out of which £.E. 11.1 millions for the increase in inventories, and £.E. 192.8 millions for fixed capital formation. These investments were financed as follows:

Domestic Savings	£.E.	181.0 ms,
Foreign Loans	£.E.	22.9 ms.

This pattern supports the proposition made above about the relative importance of domestic savings as a source of finance. The saving - income ratios in 1959/60 Suggests that:

The rate of savings was relatively high as compared with the rates of other developing countries. National income amounted to about £.E. 1378 millions, out of which £.E. 181 millions was saved. Thus, the rate of savings was about % 13.

This high rate of domestic savings was net due to the behaviour of the household sector. Private disposable income amounted to about £.E. 1014 millions, out of which £.E. 22.7 millions was saved. This means that the propensity of the household sector to save was extremely low. The saving-income ratio for this sector was about %2.2.

The relatively high rate of savings for the economy as a whole was due to the behaviour of Business and Public Administration. Total institutional savings realized in these two sectors amounted to about £.E. 158 millions, i.e. about % 87 of total domestic savings.

The major part of these institutional savings was generated in the business sector as follows:

Corporate savings	£.E.	71	ms
Non-corporate business savings	£.E.	25	ms.
Pensions & insurance reserves	£.E.	16	ms.
Total	£.E.	112	ms.

Corporate business has been able to realise that amount of savings by virtue of the low governing the distribution of profits at that (1). It required the private enterprises established before 1958 to distribute profits at a maximum of % 120 of the profits distributed in 1958. Those enterprises established after 1958 were allowed to distribute profits with a maximum of % 10 of paid up capital. The law did not apply to Public enterprises, whose profits were distributed to Public Administration by administration regulation.

Total corporate profits, amounting to about £.E. 148 millions, was appropriated as follows, (£.E. millions)

Distributed profits		52
Household	7	
Business	11	
Public Administration	34	
Undistributed profits		96
Net corporate profits		148

(1) The law was suspended in 1961.

This pattern of profit appropriation suggests that more than %65 of net profits was retained.

The behaviour of the non-corporate enterprises was somewhat diffirent Net non-corporate profits amounted to about £.E. 475 ms., out of which £.E. 450 millions were transfered to the household sector, and the rest, amounting to about £.E. 25 millions was used for self-financiry investments in the business sector. That is to say, only 5% of non-corporate business profits was retained.

The reason between the behaviour of the corporate and non-corporate enterprises is that the first is governed by certain regulations while the other is net. Moreoner, Small farms represent a big part of non-corporate enterprises, and for these units, little investments are required, since the major part of fixed capital formation is undertaken by the government.

Saving by the Public Adminstration is net subject to any regulation or a Systemmatic behaviour. It depends on the policy of the Government concering public renevue and public expenditions.

These findings lead to certain propositions about financiry capital formation in developing countries. It is usually proposed that the defiancy of capital in these countries is one of the bottlenecks which impede accelerated growth. The alleged low rates of savings is the justification for claiming for aid from highly developed countries.

The example of the U. A. R. suggests that:
to through foreign capital is needed, but its importance is exaggerated.

Moreover, it suggests that the proposition of low rates of saving in the developing countries refers to rates of savings by the household sector business. It does not apply to corporate savings. Household savings were only % 12 of total domestic savings. It is possible for the developing countries to raise its ability to save, not only by raising per capita income, but also by introducing institutional reforms in the business sector to transform non-corporate business. This reform shifts the power of taking decisions concerning savings from individuals to institutions. The reform may not be possible in many cases, where agriculture is deminatry, since corporations are an unusual type of organisation in this sector.

In industry and trade, it may be possible to replace corporations for non-corporate enterprises.

Financing the National Plan

The objective of the National Development Plan is to double national income in ten years. This means that the planned rate of gouvt is % 7.2 per annun. The target of the First Fince Teurs Plan 1959/60 - 1964/65 is to revise income by % 40 from a level of £.E. 1378 millions in 1959/60 to £.E. 1913 millions in 1964/65.

Total investments required to achieve this target to about £.E. 1697 millions. Thirds of these investments have to be financed from domestic savings. This means that the maximum amount of foreign loans is about one-third of total investments. It is also planned that by the 1962/65, the economy starts to repay the foreign debts obtained to finance the first Five-Years plan.

To attain these targets, the rate of savings has to rise to % 20 per annum, to raise total savings from £.E. 203.9 millions in 1959/60 to £.E. 391.6 millions in 1964/65.which will be used as follows:

Financiry capital formation	£.E. 351.2 ms.
Repayment of foreign debts	£.E. 40.4 ms.

The question which arises is: How savings are planned to reach that level?

The answer to this question is provided by the national budget. It shows that total savings available for financiry capital formation are planned to be generated as follows:

Corporate savings	193.9
Pensions & Insurance Reserves	30.8
Budget surplus	90.1
Household savings	76.8
Total savings	391.6
<u>minus</u>	
Repayment of foreign loans	40.4 –
Net savings available for financiry investments	351.2

Institutional savings are planned savings determined by the decisions which are expected to be taken by the concerned institutions, whether in the business sector, or the Public Administration.

The estimate of household savings has a different nature. It is not an estimate of the savings planned by the household sector. It is rather an estimate of the target which has to be attained by the household sector to maintain economic stability. Personal disposable income is planned to be £.E. 1331.3 millions. Resources available for private consumptions, valued at 1959/60 prices, is planned to be £.E. 1254.3 millions. Hence the household has to save £.E. 77.0 millions in order to maintain price stability. This means that the household sector has to raise its saving-income ratio from % 2 in 1959/60 to about % 6 in 1964/65. But there is no guarantee that the household sector will be have in this way, since no measures are taken to control consumption expenditure. Changes in the behaviour of the household is very slow and gradual. To be more realistic, one has to assume that the household will maintain the pattern of the base year. If it does so, household savings should be estimated at a level of £.E. 26.7 millions. This means that there will an excess demand for consumption goods about £.E. 50 millions. In other words, the balance of the national budget contains an inflationary gap of £.E. 50 millions.

Though the gap is a narrow one, the maintainance of stability requires that it should be eliminated. Given the production and investment targets of the Plan, one, or a combination of the following measures can be taken:

1. To increase imports, or reduce experts, of consumption gards by £.E. 50 millions. This produces a deficit in the balance of payment amounting to £.E. 10 millions, instead of the planned surplus amounty to £.E. 40 millions.

2. To reduce private disposable income by £.E. 60 millions to increase the budget surplus or corporate savings or Pensions & Insurance reserves.

The second procedure is the our preferred by the Authorities . One of the objectives of the Socialisation Acts of July 1961 is to shift the distributed profits of the nationalized enterprises from the household sector when they are partly saved, to the Public sector where they are completely saved. The rise of tax rates announced in 1962 is another measure to wind up the gap.

The experience of the first two years of implemtation 1960/61, and 1961 - 62 gives confidence that the economy is able to develop at the planned rate of %7 without creating inflatianary pressures.

Part 11.

The Mechanism of Finance

The second issue which requires investigation is hcw available financial resources are mobilised and channelled to finance fixed capital formation.

The Financial Accounts

The appropriate techniques for this study is national financial accounts, The experience of constructing Financial Accounts in U.A.R. in a new our. An experimental account has been constructed for 1957, but a more elaborate account has been constructed for 1958, For later years, the accounts have not been constructed yet (1) to the borrowing sectors.

To fill this gap, Financial Accounts are constructed. The system of the accounts is designed to emphasize the role of financial institutions as intermediaries between lending and borrowing sectors. For this purpose, the financial institutions are segregated from the business , The financial sector is further divided into sub-sectors, to allow for the financial operations of different financial institutions to appear in the Account.

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(1) Those accounts will be constructed as a part of a research on "Credit Budgeting" undertaken at the Institute of National Planning.