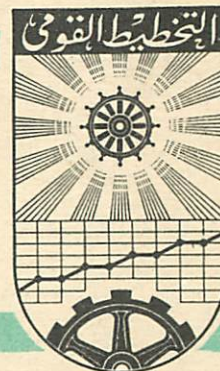


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Planning Financial Flows in
the Egyptian Banking Sector

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PLANNING FINANCIAL FLOWS IN THE
EGYPTIAN BANKING SECTOR

Introduction

The Egyptian banking sector was completely nationalized in 1961. A search is going on to establish the sector's mode of operation under the new circumstances. Resources mobilized and created by banks are to be utilized to serve social ends. Definitions of social goals are in most cases fluid. This affects in the same quality the operating rules designed by policy makers. Experience is gained and learnt by doing i.e., trial and error. This method of management cannot go on forever. Because market mechanism is suspected, resource allocation is effected by direct controls. The latter method entails differentiation among borrowers on non-price criteria. A priority scale for distributing resources is developed to dictate who gets funds first. Demand by borrowers on the bottom of the scale is satisfied according to

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availability of resources. Whatever the method of allocation, productions of supply of-and demand for- resources are prerequisites for scientific planning. Excess demand or supply can be trimmed by policy instruments. The level at which instruments are used depends on their impacts and the level of goals both in financial and real sides of the economy. This paper is elaborating a mode of operation for the Egyptian monetary policy in a market-like framework.

The paper is composed of two sections:

Section I: gives the institutional background and the financial position of the banking sector,

Section II: shows the mechanism of planning financial flows,

Conclusion : advocates a mutual interaction between physical and financial planning.

SECTION I : FINANCIAL FLOWS IN THE BANKING SECTOR

1.1. Institutional Background

The banking sector of the Egyptian economy consists of the Central bank, commercial banks, and specialized banks. A brief history of each component is due. The starting year will be 1898 when the National Bank of Egypt was established. The National

Bank of Egypt became known as the Central Bank in 1951. It was operating as a commercial bank as well as a Central Bank. This mixed character of activities was ended in 1961. As late as 1952, the Central Bank acquired the power to control money and credit. A full history of how the Bank became an independent institution goes hand in hand with the political and economic development of Egypt. The same can be said about commercial banks. Excluding Bank Misr (1920) and Bank of Cairo, all commercial banks operating in Egypt were owned by foreigners. The participation in ownership by nationals came with the Egyptinization Act of 1957. The Nationalization Acts of 1960 and 1961 put an end to foreign ownership of commercial banks. The last component of the banking sector is the specialized banks whose operations comprise agriculture, real state, and industry. Unlike commercial banks, their number remained the same after the Nationalization Acts of 1961: an agricultural bank (1930), an industrial bank (1947), and 3 real state banks (the oldest goes back to 1880).

An intruding event came with the establishment of the Banking Association in 1961. The Association was a subordinate

institution to the Central Bank. It was mainly concerned with administrative tasks such as employment regulation in the banking sector. In spite of the fact that the administrative functions of the Association do not overlap with the technical function of money and credit control by the Central Bank, the existence of a dual supervising bodies was seen as unnecessary. In so far as the Association was deprived of the genuine function of co-ordinating credit policies of its subjects, it can be said that the event was a blind imitation of Public Associations created for non-banking activities. The Banking Association abolished after about 2.5 year and the Banking Relations Department of the Central Bank took over.

Administrative changes-as distinguished from ownership changes-came in 1964 and 1972. The year 1964 witnessed administrative allocation of banks to serve specific sectors. By then-after liquidation of some banks and affiliation of the rest into larger units-the banking system structure became as follows:

The Central Bank of Egypt,

5 commercial banks ,

3 real state banks ,

An industrial bank ,

An agricultural bank ,

While the sectoral allocation of specialized banks did not change, the sectoral operations of the five commercial banks were regulated in such a way that each bank deals mainly with specific sectors.¹⁾

The aims of such specification are :

1. to orient each bank with the activities of the sectors it deals with,
2. to contain the financial flows of non-banking sectors within the purview of the banking sector, and
3. to help planning the financial flows between the banking and non-banking-sectors.

Eight years elapsed till a new administrative allocation

1) Specification by Sector :

- I. National bank of Egypt operates with:
 - a. Associations under the control of the Ministries of Agriculture, Land Reform, Transport and Communications, and Defence.
 - b. Suez Canal Association.
 - c. Some activities of the Ministry of Supply.
- 2) Bank Misr operates with enterprises under the control of the Spinning and Weaving Association.
- 3) Bank of Alexandria operates with Industrial Associations (and enterprises) excluding Spinning and Weaving enterprises.
- 4) Bank of Port Said operates with:
 - a. Insurance companies.
 - b. Associations under the control of the Ministries of Health, and Supply & Local Trade.

of banks was introduced.¹⁾ The aims of the new change are not different from the old one of 1964. The only difference is that each bank should operate with a homogeneous economic activity such as industrial and foreign trade operations. This new change may pave the way towards a full-fledged specialized banking system a la socialist type.

1.2. Intrabank Financial Flows :

A common feature of the Egyptian banking sector is the relatively small operations of the specialized banks. If that is a common characteristic shared by most of developing countries, it is most obvious in Egypt. The first reason is that the socialist transformation gave rise to an increasing role of the national budget in financing economic development in particular long-term projects. The second reason of the small

5. Bank of Cairo operates with :

- a. Enterprises of the Foreign Trade Association.
- b. Associations under the control of the Ministries of Construction, Tourism, and Information.

It should be noted that banking operations in marketing of agricultural crops in particular cotton and rice were left without specification—they are common operations to all banks.

1) Specification by Activity :

1. National Bank of Egypt is specialized in Foreign Trade.
2. Bank Misr (and its affiliate : Bank of Port Said) is specialised in local Trade (including marketing of agricultural crops).
3. Bank of Alexandria (and its affiliate : The Industrial Bank) operates with Industrial and Agricultural enterprises.
4. Bank of Cairo is specialized in Services.

It is worth noting that the Specification by Activity extended to real State Banks. Two of the Real State Banks (L'Egypte Hypothecaire and its affiliate : Real State Credit Bank) are specialized in Housing and Construction.

scope of financial operations of specialized banks is the scarcity of financial resources mobilized by these banks owing to financial investment preference in the liquid range by the public. The result is that internal resources of finance are not sufficient to cover demand for credit from each type of these banks. Trials to raise funds by selling debentures to the public is out of question. The experience showed that such issues were covered by monetary institutions or by commercial banks with the guarantees of the Central Bank. Even the supplement of internal resources by debt issues fell short of the financial needs. The restriction of operations to the extent of internal resources of finance means a constriction of the role of these banks. This cannot be accepted in so far as other credit institutions cannot extend their services to the activities in the domain of specialized banks and at terms of credit specified by the Central Bank. There is an indispensable need to enrich the financial resources of specialized banks by other credit institutions : the Central bank and commercial banks. In this respect, Tables (1.1)-(1.3) provide data for real state banks industrial bank, and the agricultural bank respectively.

Each type of banks borrowed from the Central Bank and commercial banks. The reliance on loans from the Central Bank were most obvious till 1968. The loans from commercial banks became dominant in the last two years (1969 and 1970): the industrial and the agricultural bank replaced the loans of the Central Bank by resources of commercial banks. The latter resources are relied upon more by the real state banks. Throughout the period, the average percentage ratio of borrowed funds to total assets (or liabilities) is 19.1% for real state banks, 46.7% for the industrial bank, and 48.6% for

for the agricultural bank. Two important remarks are due. The first remark is that the claims of monetary institutions on specialized banks represent the demand by the latter for credit. This demand should be taken in consideration in planning the demand for credit on the national level. The second remark is a consequence of the first in so far as the monetary institutions will fully cater for the credit needs of the specialized banks (the difference between their internal sources of finance and credit granted by them), planning the supply of financial resources in the banking sector could be confined to monetary institutions.

Commercial banks are in a much better financial position than specialized banks. Table (1.4) shows that the outflow of transfers from commercial to the Central Bank and to other banks is larger than the opposite inflow during the period 1958-1966. This trend is reversed in the following three years. In 1970, outflows overgrew inflows once again. The borrowing of commercial banks from the Central Bank was pronounced during the period 1965-1970: the stock of borrowed funds increased from LE 82.7 million to 378.0 million. It should be noted that the reliance of commercial banks on loans (transfers) from the Central Bank means that commercial banks are in short of resources or/and they perform certain operations on behalf of the Central Bank. For the latter purpose, funds are entrusted to commercial banks. Whatever the interpretation, the net outflow from commercial banks to other banking institutions as a percentage of total assets (or liabilities) averaged 9.1% during the period 1958-1966. The percentage ratio of net inflow averaged 4.1% during the following

three years. It happened that during the years 1967-1969, monetary policy was deflationary. Any complaint of nowadays excess liquidity within commercial banks as a whole or within few of them is due to the lending policy of the Central Bank in deflationary years.

Table(1.1): Intrabank Financial Flows-
Real State Banks, 1958-1970

End of June	Inflow from		(Stocks in LE million)		
			(3)	(4)	(5)
			Total	Total	(3) % (4)
	Central(1) Bank	Commercial(2) Banks	(1)+(2)	Assets	
1958	0.1	-	0.1	20.8	-
59	0.1	-	0.1	20.9	-
60	0.1	0.2	0.3	21.0	1.4
61	4.7	-	4.7	28.6	16.4
62	5.0	0.3	5.3	29.6	17.9
63	4.7	0.3	5.0	29.8	16.7
64	4.7	0.3	5.0	26.1	19.1
65	5.0	0.1	5.1	28.8	17.7
66	5.2	-	5.2	28.9	17.9
67	5.2	0.8	6.0	28.9	20.7
68	5.2	1.6	6.8	29.5	23.0
69	2.7	5.3	8.0	31.3	25.5
70	1.3	11.1	12.4	36.1	34.3

Source : Central Bank of Egypt - Credit and Financial Developments,
1967/68- 1969/70.

Table (1-2): Intrabank Financial Flows -

Industrial Bank, 1958-1970

(Stocks in LE million)

End of June	Inflow from		(3)	(4)	(5)
	Central (1) Bank	Commercial (2) Banks	Total (1)+(2)	Total Assets	(3)%(4)
1958	5.9	1.1	7.0	9.0	77.7
59	5.9	0.1	6.0	8.0	75.0
1960	6.9	0.1	7.0	9.2	76.0
61	6.9	-	6.9	12.7	54.3
62	6.3	-	6.3	12.3	51.2
63	6.1	-	6.1	12.1	50.4
64	5.6	-	5.6	11.6	48.2
65	5.0	-	5.0	10.7	46.7
66	5.4	-	5.4	11.8	45.7
67	7.9	0.9	8.8	14.8	59.4
68	4.0	6.1	10.1	16.6	60.8
69	-	7.3	7.3	18.6	39.2
70	-	5.8	5.8	18.1	32.0

Source :

Central Bank of Egypt - Credit and Banking
Developments, 1958-1970.

Table (1.3) : Intrabank Financial Flows-

Agricultural Bank

(Stocks in LE million)

End of June	Inflow from		(3)	(4)	(5)
	Central (1) Bank	Commercial (2) Banks	Total (1)+(2)	Total Assets	(3)%(4)
1958	11.8	-	11.8	65.8	18.0
59	24.6	0.4	25.0	72.8	34.3
1960	30.9	1.3	32.2	78.8	40.8
61	24.6	1.5	26.2	78.9	33.0
62	38.4	14.3	52.7	121.6	43.3
63	42.2	29.8	72.0	128.2	56.1
64	36.8	46.0	82.8	151.7	54.5
65	33.4	74.0	107.4	181.7	59.1
66.	46.8	64.7	111.5	188.8	59.0
67	16.2	69.4	85.6	166.8	51.3
68	36.4	74.4	110.8	190.1	58.2
69	-	123.0	123.0	196.8	72.4
70	-	130.7	130.7	177.6	73.5

Source :

Central Bznk of Egypt - Credit and Banking Developments,
1967/68 - 1969/70 .

Table 1.4 : Intrabank Financial Flows-
Commercial Banks, 1958-1970

(Stocks i

End of June	Inflow from		Total (3) (1+2)	Outflow to		Total (6) (4+5)	(7) Net flow	(8) To
	(1) Central Bank	(2) Spec. Banks		(4) Central Banks	(5) Spec. Banks			
1958	1.9	12.1	14.0	44.4	10.8	55.2	41.2	3
59	1.4	17.4	18.8	51.7	15.4	67.1	48.8	3
1960	11.7	14.8	26.5	58.4	14.3	72.7	46.2	3
61	9.4	22.6	32.0	64.5	20.6	85.1	53.1	5
62	5.0	26.5	31.5	74.3	35.5	109.8	78.3	5
63	26.1	28.0	54.1	88.9	46.6	135.5	81.4	6
64	82.7	27.2	109.9	102.0	68.1	170.1	60.2	7
65	153.6	20.1	173.7	99.2	93.9	193.1	19.4	8
66	187.6	31.9	219.5	136.8	97.8	233.6	14.1	9
67	224.5	33.3	257.8	128.4	92.3	220.7	-37.1	10
68	272.0	11.2	283.2	134.8	85.1	219.9	-63.3	11
69	333.0	15.3	348.3	161.7	149.8	311.5	-36.8	12
70	378.0	7.4	385.4	241.3	151.7	393.0	+ 7/6	14

Source : Central Bank of Egypt - Credit and Banking Developments, 1967/68-196

± Net outflow (+) and Net Inflow (-).

1.3 Financial Position of Monetary Institutions :

Intrabank financial flows indicated the extent to which monetary institutions support specialized banks. Claims of monetary institutions on specialized banks are relatively very small compared with claims on other sectors of the Egyptian economy. The study of the financial position of monetary institutions toward non-banking sectors will consequently disclose among other things the extent to which the banking sector contributes to economic development. The non-banking sectors which deal with monetary institutions are three :

1. Private Sector defined as households, private business enterprises, and public business enterprises.
2. Government Administration Sector defined as Ministries, Associations of public business enterprises, and self-administrative government Organizations (e.g. railways).
3. Rest of the World Sector defined as exporters and importers.

It should be noted that what is called private sector includes enterprises of the government business sector. The financial position of monetary institutions towards each sector is arrived at by deducting deposits from claims. Claims are composed of loans and securities held by banks. For the rest-of-the-world sector, claims are represented by foreign assets held by banks and are valued in local currency. Tables (1.5) and (1.6) are worked out on the above basis. The first table gives data in stock terms and