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SOME PROBLEMS FACING THE EXTERNAL FINANCIAL POSITION OF EGYPT

BY

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SOME PROBLEMS FACING THE EXTERNAL FINANCIAL POSITION OF EGYPT

A Research Paper

By

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FOREWORD

Perhaps the most serious defect of post-World War II planning in developing countries was the adoption under the prodding of international agencies, of the policy of import substitution to the neglect of the export sector and wider participation in international markets. Compounded with inflexible exchange rates, domestic fiscal and monetary mismanagement, and a misplaced faith in central planning, this policy led to the stagnation of traditional industries and the private sector.

Professor Yousry Ismail's concern with the foreign trade and payments sector of the Egyptian economy is therefore a welcome recognition of its importance in development. While it is only a short, the study provides a basis for inter-relating domestic economic policies with international policies to achieve rapid and stable growth of the Egyptian economy.

As a post-doctoral fellow at the University of Pittsburgh, Professor Ismail's interests have led him to include studies of multi-national corporations and project analysis as well as trade and payment problems. We are extremely pleased that he chose to spend a period of his study in this country with us to our mutual benefit, and hope this marks a beginning of a long-lasting interchange with Egyptian universities and the University of Cairo in particular.

Raymond L. Richman
Raymond L. Richman
Professor of Public and
International Affairs and
Professor of Economics

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Preface:

Recent development of the study of business administration is directed to the international fields such as international finance, international marketing and multinational corporations. In this research we are dealing with one of these fields which is international finance.

The reason of this recent development is the change towards operating across the national boundaries. As the main objective of operating in other environments is to increase profits, the corporate financial manager has become concerned with the international economic changes that affect the international business. The deficit in the balance of payments, the fluctuating foreign exchange rates, and the power of multinational corporations have become an important problem facing companies which operate internationally.

This new field so called "International Business Finance" provides a framework to understand the environments where the international business operates. It provides different methodologies to resolve the problems facing the corporate financial manager. The framework of this field covers both the macro and micro economic environment. The macro economic environment studies the balance of payments and government policies. The micro economic environment analyses how the corporate manage its exposures to foreign exchange risk and faces its demand for foreign funds.

Introduction

The external financial position of any country could be studied through the analysis of the following variables:

- The international trade movement with other countries that show its inflows and outflows of goods and services.

- The ability of the country to meet its foreign exchange obligations.

- The influence of foreign transactions on income and development of the country.

The record that illustrates these transactions is the balance of payments of the country. The balance of payments shows all transactions between the residents of one country and the residents of other countries. It includes several accounts which record these transactions and indicate its current external financial position and whether it is a surplus or a deficit country.

Any country that has commercial relations with other foreign countries, has to sustain a sound financial position to facilitate further dealings and create a situation of trust in its economy and currency which in turn depends upon its exports, investment, income and other inflows of foreign exchange, and the deficit in the balance of trade ....etc. A Country with increase in imports over exports and a persistent deficit, may not be able to prevent its financial position from declining. Such a country needs a short-run stabilization program and a long-term plan to repair its situation. Egypt as one of the developing countries faces a persistent deficit in the balance of payment because of the continuous increase in imports over exports, in addition to other problems concerning the GNP and the structure of the economy as a whole that influence its financial positions. This situation needs a rapid solution to continue its economic development.

Accordingly the objective of this research is to analyse the external financial position of Egypt showing the main problems that face the economy, which have led to persistent deficit in its balance of payments and suggesting the different ways for repair and improvement.

This study is divided in two main parts. The first part presents the theoretical background which includes the following topics:

a. Definition of the balance of payments.
b. The transactions of the balance of payments.
c. How to analyze the financial position of a country.
d. The reasons for a deficit.
e. How to correct the deficit.

The second part is the applied study for Egypt. This part includes the following subjects:

a. The basic statistical data and information.
b. Analysis of the problems facing the external financial position.
c. Results, projection and suggestions to improve the financial position.

Part One: Theoretical Background

The International Financial Position and the Balance of Payments

I. Definition of the Balance of Payments:

"The balance of payments is a system of accounts designed to show how a nation finances its international activities and what role the country plays in the world economy."[1] It shows the flows of economic transactions in monetary units between the residents of the reporting country and the residents of other foreign countries during a certain period of time. "The main purpose of keeping this record is to inform all concerned authorities of the international position of the country to help in reaching decisions on monetary and fiscal policy on the one hand and trade and payment questions on the other."[2] Concerning monetary and fiscal policy, the balance of payments is a systematic statistical record showing the flows of payments and receipts that measure the basic inflows and outflows which constitute the foreign exchange budget of the country. The balance of payments also answer the questions of trade and payments as it shows the monetary authorities what the country requires to meet all due payments in foreign currency. "The balance of payments of a country is

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[1] Stefan H. Robock; K. Simmonds; Jack Zewick, International Business and Multinational Enterprise, New York, Richard D. Irwin, 1977, p. 57.

[2] C.P. Kindleberger, International Economics, Illinois, Richard Irwin, Inc., 1973, p. 303.

very similar to a statement of sources and uses of funds of a firm."[3] For a country, sources of funds represents an increase in external purchasing power. This increase comes from the increase in liabilities to foreigners (or a decrease in assets) as a result of exporting and obtaining loans. Uses of funds of a country is a decrease in the country's purchasing power that results from increasing assets (decreasing liabilities) because of imports and repayment of loans.

II. The Transactions of the Balance of Payments:

The balance of payments includes all economic transactions that can be valued in terms of money. These transactions between the residents of one country and the residents of another country are tabulated in the following accounts which are kept in standard double-entery bookkeeping system:

a. The current account.
b. The capital account.
c. The official reserves.

A. The capital account: It includes three types of accounts that are:

1. The balance of trade: This balance records the trade in goods which composed of exports and imports. Exports are source of funds. Imports are uses of funds. When exports exceed imports, there is a surplus in the balance. On the other hand when imports exceed exports there is a deficit in the balance.

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[3] Rita M. Rodriguez and E. Eugene Carter, International Financial Management, New Jersey, Prentice-Hall, 1976, p.9.

2. The balance of invisibles (services); It shows all kinds of flows of services like travel expenses, interest, dividends.....etc. Every country has payments and receipts resulted from receiving or offering services.

3. The unrequetted transfers: (unilateral transfers): This account shows the flows of all kinds of unrequetted money, gifts to or from other foreign countries, and money inflows from emigrants or money outflows from immigrants.[4]

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[4]The current account is the point of juncture between the international payments statistics and national income accounts. Gross national output (GNP) consists of:

$$GNP = C + I + G + (X-M)$$

where C = Private consumption
I = Investment
G = Governmental consumption
X = Exports
M = Imports

The current account balance in the payment statistics is closely related to the concept of net foreign investment appearing in the national accounts. After we subtract the value of output donated abroad by government from the balance of goods and services, we get in the current account balance a measure of the net increase in the country's claims on foreigners, the net payments due to the country for goods and services sold abroad. These net claims - net foreign investment - appear in the national accounts as a component of gross investment of the country.*

*See: C.P. Kindleberger, op.cit., pp. 306-309.

B. The Capital Account:

The capital account includes the following transactions:

1. Long-term capital movements.
2. Short-term capital movements.

1. Long-term capital: It shows the flows of capital movements that have a maturity longer than one year. It could be divided to private and governmental capital transactions including loans, financial support and credits by government agencies for longer than one year.

2. Short-term capital: Short term capital movement induced by transactions referred to as compensatory or accommodating accounts. Such movements may be caused by credit suppliers, short-term loans....etc.[5]

C. The Official Reserves:

The country's reserves look like the cash and near cash assets of the firm. They provide the liquidity to pay for imports of goods, services and investment. The reserves are officially treated i.e., they are government owned assets and all transactions are done by the government (National or State Bank). They consist of all convertible holdings by the government that include:

1. The foreign convertible currencies.
2. Gold.
3. The monetary gold.
4. Special drawing rights (SDRs) or paper gold.[6]

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[5]Stefan H. Robock; K. Simmonds; Jack Zewick, International Business and Multinational Enterprises, op.cit., p. 64.

[6]SDRs are the assets created by the international Monetary Fund and allocated among the member countries according to special rules. See:

IMF, Special Drawing Rights, No.13, 1970.