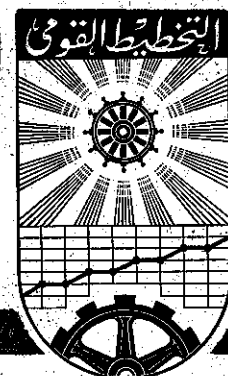


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CURRENT STATE AND DEVELOPMENT
POSSIBILITIES OF THE MONEY
MARKET IN AFRICAN COUNTRIES
THE CASE OF THE UAR

by

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I. MAIN FEATURES OF A DEVELOPED MONEY MARKET

1.1- DEFINITIONAL:

It is a common practice in economic literature to consider the credit market as composed of two parts: The first is associated with the use of funds for long term purposes, especially those related to fixed capital formation. The second is predominantly a market for funds required to finance working capital, hence ideally concerned with short-run transactions.⁽¹⁾ The former is called the capital market, while the second is referred to as the money market. However, there might arise certain cases where a separate discount market is identified, although it is usually considered as an integral part of the money market.⁽²⁾

The distinction between the two main types of markets goes beyond the nature of uses of funds, to cover specific rates of interest and sources of funds. Careful examination of each of these three aspects reveals a certain degree of overlapping and a good deal of the literature is concerned with setting the rules by which a more or less, clear subdivision can be established. It is not our intention here to take part in this interesting discussion as a means of defining the borderlines of our study. A broad and a rather pragmatic definition of the money market and its scope would enable us to switch over to the main task of considering the development of that market within the framework of the U.A.R. economy.

There is no definite market for money in the sense of a place where purchases and sales are concluded. The money market refers rather to a body of dealers in short-term money, namely, bankers, bill and stock brokers, discount and acceptance houses, etc., who either have money to lend or who seek to borrow money. This body of money dealers is not clearly defined into two unequivocally distinct classes: lenders and borrowers, in the manner by which an ordinary market is divided into two classes, buyers and sellers. Furthermore, dealers in the money market are not by definition different from dealers in the capital market. A distinct feature of this market is that all dealers are ready to sell the use of funds at certain price and to buy the use of money at another price.

The main function of the money market is to avail to those who need funds for a short period, the necessary amounts which would exist at the disposal of others who are ready to part with them for a period which might be as short as one night only. With development of the market it moves from the mere provision for the needs of borrowers to a more direct consideration of the needs of lenders. The creation of the so-called "call money" opens a possibility for the latter to invest a part of their funds in such a way that perfect liquidity is practically preserved. A further stage of development would carry the activities of the market beyond domestic frontiers, and avail its services to foreign dealers.

(1) Considering that the London money market is a model market, it is quite indicative to notice that the Radcliffe Committee was "impressed....by the fact that the market for credit is a single market.....it does not seem that any hard and fast lines are drawn between the supply of short finance and the supply of long finance; and borrowers seem to be ready to switch to some extent from one to another.." Report of Committee on the working of the Monetary System - p. 42 London, HMSO., 1959

(2) See p. 3 below

1.2- STRUCTURE:

A fact which hardly requires mention, is that a money market assumes the existence of a developed money economy. The use of money should have for long superseded the stage of barter; and the credit system should have attained the stage of wide acceptance. In particular, the so-called banking habit should have attained that level which would put at the disposition of the banking system, not only those funds which are considered by the population as genuine savings, but also all those balances which they hold in monetary form, for current and future use. Such developments have as a necessary condition the issue of laws of money reform which establish a widely accepted and respected national currency, and which assure a favourable atmosphere for credit creation.

Unlike many other markets, the money market needs an institutional regulator. Thus in England, where the history of the London money market dates back to the 18th century, the Bank of England has been described as the axle on which the whole wheel of the market's business turns.⁽³⁾ In developing countries, it is most likely that the money markets are far from being perfect, if they do ever exist. Even if money is there, the market is without a central bank, i.e., without axle. There is no dispute as regards the importance of the existence of an effective money market as one of the necessary conditions for healthy economic development. It is quite natural, therefore, that as soon as political independence is established, one of the first steps usually taken by those countries is the establishment of a central - and by definition national - bank.

The axle, however, is of a very limited use without the constituent parts which are represented by the joint-stock banks, the discount and acceptance houses, the bill and stock brokers, and the other financial institutions. The structure of the constituent parts differs from one country to the other. Thus it is customary to distinguish the New York discount market from its money market, where operations are based on securities rather than on bills of exchange. On the other hand, the famous London money market depends in an integral way on its discount market. In fact, its main characteristic is the powerful intermediary of discount houses between the Central Bank and the banking institutions. The role of those houses in providing short-term and call money and in transmitting the policies of the Bank of England to the money market in a quick and effective manner need not be emphasized. "In the strict English sense of the term 'money market', the London discount houses make up the London money market."⁽⁴⁾ The action of the Bank of England as lender of last resort to discount houses rather than to commercial banks can be considered as the foundation for the art of central banking. The phenomenon has been long well established by Walter Bagehot's 1873 classic "Lombard Street". In the United States, borrowers from Federal Reserve Banks at the discount rate are commercial banks. The rediscount mechanism is replaced by an important alternative, namely the Federal-Funds market, which enables the member banks to accommodate each other in their cash reserve obligations on a day-to-day basis.

(3) Spalding, William: The London money market - 3rd ed., P. 54 Sir Isaac Pitman & Son, London 1924.

(4) Aschheim, Joseph: Techniques of monetary control - p. 85; The Johns Hopkins Press, Baltimore 1961.

Apart from the London and the New York money markets, few other markets can be classified as money markets in the full sense of the word. Thus the Paris market centered for a long time around the "Banques d'Affaires", or investment banks, hence developing capital rather than money market operations. Its money market does not play as important a role as in the case of the U.K. and the U.S.A., and it is strictly regulated by the Bank of France.⁽⁵⁾ Even the rediscount houses are affiliated to investment banks, and are thus classified under financial institutions. Bank funds are placed in the money market by the intermediary of brokers. Bank's orders for securities are transmitted to the stock exchange dealers through commission men. A large share of money market funds belong to savings banks, whose relationships with commercial banks are rather limited. Their contribution to the money market is affected through the "Caisse des Dépôts et Consignations" which used to hold the larger part of the reserves of the savings banks. The Caisse devotes a fraction of its resources to demand and short-term loans, and holds a voluminous portfolio of Treasury notes and of Crédit National acceptances. It provides substantial facilities for medium-term credit.

Another sample of developed economies shows a still limited status of the money market. Thus the Canadian system leans heavily on the Chartered Banks and its numerous branch-offices, strictly dealing in the provision of short-term funds for working capital purposes. Apart from this regular banking activity there exists only a rudimentary money market dealing in short-term securities.⁽⁶⁾ In Australia there has been no great demand for short-term investments at low rates of interest nor did the very necessary middlemen emerge. There is no commercial bill market owing to the limited amount of such bills, which has been even tending to contract. Treasury bills are taken up by the Commonwealth Bank and sold to the commercial banks.⁽⁷⁾ "In spite of" the slow development of the capital market in Western Germany since the war, the development of the money market has been limited by the fact that commercial banks as a whole did not possess excess reserves. The most important lenders on the money market are the central giro institutions, large deposit banks, and certain public administrations which place in the market part of their funds and of those of allied agencies. The activities of the market do not cover granting short-term credits to non-bank customers, but they are largely confined to the purchase or sale of the so-called "money-market securities", viz., Treasury bills, medium-term treasury bonds, bankers' acceptances and first-class commercial bills endorsed by banks.⁽⁸⁾

1.3- ACTIVITIES:

Although the operations of the money market are strictly related to the trading of short-term funds for purely monetary purposes, they are made possible only through ultimate uses for economic purposes. Let us therefore attempt a general classification

(5) Beckhart, Benjamin Haggott, ed.: Banking System - 3rd printing, Columbia Univ. Press, 1959, pp. 242

(6) Ibid., p. 125

(7) Ibid., pp. 41 - 42

(8) Ibid., p. 363

according to the ultimate uses of funds.

for

- i- Working capital requirements material production purposes. This is the traditional field of operation of commercial banks through their short- and medium-term loans and overdrafts to their business customers, and they do not create the so-called "money-market securities" in the proper sense. Their role is largely that of the creation of funds which provide the banks, between one operation and the other with amounts which can be put on the market for such short periods that are necessary in order to bridge the positive (or negative) time lag between any two consecutive operations. It is clear that with the expansion of industrial activity, the importance of this type of operations has increased, and, which is more important, evenly distributed over time. Agricultural economies are characterised by bulky operations which mature at specific dates, practically the same for most borrowers.
- ii- Finance of trade and commerce. Probably this is the most important use which was responsible for the creation of a regular money market, through the creation of "bills of exchange" or "commercial bills". Dealers in the old London money market found it quite profitable to seek funds in the wealthy rural areas, and to avail them to the quite active commercial centers. The practice of discounting and rediscounting such bills soon created the discount market, which helped to channel liquid money into commerce and hence eventually into material production sectors. The activity was soon extended to the sector of international trade to enable exporters and importers to carry out prosperous trade activities.
- iii- Finance of current government activities. Bagehot's ingenious invention, the Treasury bill proved to be the most lasting of all. Not only did it help to bridge the time lag between receipts and payments, but it also provided the government with a source of finance which could eventually subjugate the traditional techniques of monetary policy to fiscal policy, especially under the new systems of managed money replacing the gold standard. The importance of the technique was intensified by war operations which justified such a tendency. Later, the increasing role played by the government in economic activity, and in particular reconstruction, anticyclical and development activities, provided the money market with a widely accepted security which played the role played by gilt-edged securities in the capital market. The history of modern money markets is largely the history of treasury bills.
- iv- Finance of stock exchange operations. This is a domain where certain dangers of an expansion in the money market might eventually get intensified through a transmission to the long-term capital market, which should be ideally financed out of genuine savings rather than the creation of credit. However, unless there exists a strict control on the activities of the credit market, short-term funds can create unwarrantedly favourable conditions for capital expansion. A speculative mood created by the desire on the side of dealers in the money market to make profits on a rising stock exchange, might eventually encourage a series of new issues. It is this type of activity which makes it difficult to draw a sharp distinction between the two markets.

II - EARLY DEVELOPMENTS OF THE UAR MONEY MARKET

II.1 - The First Half of the 19th Century:

The early developments of Egypt's economic conditions provide an interesting example of the close relationship between the level and nature of economic activity and the development of monetary and financial institutions. The turn of the century brought in the French occupation in place of the already lengthy Turkish one. This was soon terminated and an Albanian ruling family ruled the country on behalf of the Turkish empire. Eventually the British took over until quite recently.

During the Turkish domination the country's economy went on losing its previous prosperity. The maritime route around the Cape deprived the country from transit trade which has been for long an important source of economic activity. The country settled down to a more or less subsistence agriculture economy, with all its savings drained by the imperial power. The system of communication was rather poor and the country was composed of a number of largely isolated provinces, with a not so dense population. The economy was more on the barter rather on the money side.

Motivated by expansionist desires, the new ruler of the country had to seize all possible resources and mobilize them towards the goal of constructing a strong army.

The new economic measures included:

1. The establishment of government monopolies. This was done through the seizure of agricultural land, to be later distributed to members of the ruling family and some collaborators. Further, the government took over the activity of constructing new industries necessitated by the military activities.
2. Expansion of agricultural activity through the introduction of a new system of irrigation, digging canals and construction of barrages.
3. Introduction of long staple cotton to act as a cash crop.

The fact that the bulk of investment activities was carried out by the government left little room for the establishment of financial institutions. The ultimate failure of the military policy led to the close down of many of the new industries, and eventually to the abolishment of government monopolies. The middle of the century witnessed a large scale curtailment of economic activity, and the only lasting effects of the previous developments were the effects of the new irrigation system, and the increasing importance of the new cash crop, cotton.

II.2 - The Second Half of the 19th Century:

The 1850's proved to be fundamental for future developments since they witnessed the construction of the railway system which connected the elongated valley for the first time, and the start of the Suez Canal project. They also marked the beginning of modern commercial banking which was invited as a result of the increase of government activities and the monetization of its receipts. In 1856 the Bank of Egypt was established by foreign capital with its headquarters in London. During the 1860's and 1870's foreign banks started to establish branches in Egypt, but for purposes which differed from those of the main offices. Their major activity was to extend loans and advances to the Egyptian government. The ruthless extravagance of the alien rulers, accentuated by the persuasion of foreign lenders, led to the increase of the floating debt which was eventually turned into long-term debt at very high rates as high as 20%. Total indebtedness was increased from L.E. 3.3 million in 1862 to L.E. 68.4 million in 1873. The management of the debt required also further banking services to enable the transfer of interest charges, which amounted to about L.E. 5 million annually.

The growing importance of cotton has led to the creation of an organized cotton contract market, thus putting Egypt among the earlier countries in this field. However it provided another channel through which domestic profits leaked instantaneously into foreign hands. Foreign trade increased in importance due to the increasing volume of cotton exports and the revival of transit trade. The American civil war led to large increases in earnings from cotton, thus reinforcing its position as the main crop. Towards the end of the century Egypt's foreign trade increased five-fold as compared with 1836. The foreign bank branches got more involved in financing foreign trade transactions with their respective countries.

The new irrigation system forthcalled both horizontal and vertical expansion in agricultural production, hence increase in the price of land. Large investments were devoted to land reclamation and a land boom started and went on for a considerable time. The new class of big land-owners, together with wealthy merchants and the increased numbers of foreign immigrants helped to form new urban centers. This called for foreign capital to be invested in utilities required by these centers. French capital entered also to start business in industries based on cotton, viz., ginning, pressing, cotton seed oil and soap.

Foreign bank branches helped the start of foreign concessions, and provided foreign companies with all facilities they needed. On the other hand, a number of Europeans found it profitable to establish individual banking business and to provide loans at incredible rates to land-owners. Usurers found their opportunity in the fact that small peasants were in need of working capital for the relatively long period which is required for the maturity of the cash crop, cotton. This group was called the Neo-Monsters (Les Néo Dévorants), who systematically drained out all their fabulous profits to their mother lands. The outcome was lack of confidence

on the part of individuals in the new monetary institutions - apart from the lack of means - and private deposits were quite fractional. In 1913 the most important deposits were those of the Post Office, the Customs and the Debt Fund.

Thus most of the banking institutions were concentrated first in Alexandria, being the principal port, and later in Cairo. The first bank that ventured in the direction of having branches in the provinces was the Casa di Sconto et di Risparmio which was the first bank to be registered as an Egyptian bank, in 1887, with headquarters in Alexandria. Since 1880 mortgage banks started their activity which proved to be quite flourishing, and which fed the spirit of land speculation.

In 1898 the National Bank of Egypt was established with foreign (largely British) capital as a commercial bank, and was given the concession of issuing the first bank-notes Egypt ever knew, and to act as an agent for the government. At that time a lot of foreign gold currencies were in circulation including the Egyptian pound. The English sovereign was highly priced relative to its gold content, which made it dominate circulation, being bad money. This together with the fact that most of the cotton exports were directed towards Lancashire, led the banks get into the habit of importing some L.E. 10 million each year to finance the cotton crop, then re-export them when the season was over. The demand for the new bank-notes which were convertible into gold remained limited, and the total issue did not exceed L.E. 3 million in 1913.

II.3 - The Sterling-Zone Era:

The fear that the deteriorating world conditions in the summer of 1914 would raise difficulties in financing the forthcoming cotton crop, led to the issue of a law which was meant to provide temporary precautionary measures, but which eventually proved to have a fundamental lasting effect. This law suspended conversion into gold thus establishing the N.B.E. banknotes as legal tender. In December 1914, the Minister of Finance permitted the N.B.E. to deposit its gold reserves (which were still required to back 50% at least of the issue) in England. Thus the Egyptian pound became convertible into Sterling at the rate of 0.975.

In 1916 it proved quite difficult to obtain the necessary gold to issue all note required to finance the cotton crop. The N.B.E. was therefore exempted from the 50% gold reserve condition, and was allowed to use instead British treasury bills. Apart from the automatic transfer of the Egyptian currency to the Sterling exchange standard, this had the immediate effect of exempting Britain from paying for its war expenses in gold. The result was that Egypt accumulated about £ 150 million Sterling reserves during the war years. The fall in the sterling's value with respect to the dollar, led to a similar 30% fall in the value of the Egyptian pound. Together with the difficulties of commodity imports, this led to a rapid inflationary process which brought the wholesale price index from 98 in June 1915 up to 127 in February 1920.

The reaturn of Britain to the gold standard in 1925 would have enabled the country to terminate the above-mentioned temporary conditions. For no obvious reason, however, this was not done, and the currency was based on the gold exchange standard. With Britain leaving the gold standard in 1931, the Egyptian pound was finally tied up to the sterling. This enabled Britain to finance its Second World War expenses by mere issue. But unlike the reserves accumulated during the first world war, the £ 430 million reserves accumulated by 1945, were actually "blocked". Thus, not only did the country suffer unnecessarily during the war years, but also it could not make good its losses through use of its reserves for obtaining the necessary imports. Further, the losses incurred in reselling the accumulated British securities were estimated at about L.E. 200 million.

It was therefore a must that Egypt should leave the Sterling zone which took place in July 1947 and to extend the system of exchange control started at the beginning of the war, to the sterling itself. In 1948 a new law allowed the N.B.E. to use Egyptian treasury bills in place of gold within the 50% limit, while the remaining 50% were to be composed of government bonds or bills, or securities guaranteed by the government. Such developments were made possible by joining the I.M.F. in 1945, and the adoption of the gold parity standard. At that time the Egyptian pound was priced at \$ 4.166 which was the equivalent of its contents of 3.67288 gms. of gold.

II.4 - Developments in the Banking and Financial System:

When the wave of irrational government borrowing came to an end in the late 1870's the individual bankers disappeared from the scene. The acute 1907 economic crisis led to the failure of many other banking institutions including the Bank of Egypt and the Casa di Sconto. In the interwar period a few amalgamations took place among the surviving foreign banks, new joint-stock banks were established, and some foreign bank branches were transformed into Egyptian joint-stock banks. The outstanding event was the construction in 1921 of the first purely Egyptian bank, Bank Misr, which gained rapid success exhibited by the rapid increase in the number of customers, the volume of deposits and the number of branches which now exceed 90.

The practice of banks changed with the change in the monetary system. The seasonal aspect of finance still prevailed. But instead of importing gold, the branch banks obtained transfers from their headquarters. This increased the N.B.E.'s sterling reserves thus enabling it to issue a corresponding amount in Egyptian pounds at a fixed exchange rate. Bills drawn by cotton exporters on spinners and weavers in the importing countries (largely England) were discounted in foreign money markets, especially London and Paris. When the season is over, the branch banks would buy back sterling from the N.B.E. to pay back their head offices. Whatever excess deposits they possess was usually invested in foreign short-term securities, awaiting the new cotton season.

Thus, neither during the cotton season, nor after, did the domestic system develop any transactions which could help to start an effective money market. On the other hand, the increase of the number of commercial banks from 7 in the end of the 19th century to 25 in the 1950's led to an increasing competition among them. Attempts to reduce this competition led to the establishment of two clearing houses, one in Cairo in 1928 and another in Alexandria in 1929, and of a Bankers Union in 1936.

The twentieth century brought in other money institutions. Thus the Post Office Saving Banks started in 1901. As mentioned before, the growth of the deposits of those banks led to some increase in the demand for banking services. A similar growth occurred in the activities of insurance companies. On the other hand the activities of mortgage banks were curtailed. The first world war enabled borrowers from those banks to repay many of their debts, and the total volume of loans fell from L.E. 45 million in 1914 down to L.E. 30 million in 1924. The great depression, which hit the country quite severely, put borrowers in a tight position, and the government had to intervene in order to stop compulsory land sales and to act as intermediary to safeguard the interests of both parties. The second world war and the ensuing inflationary conditions led to a further drop in mortgage banks loans. These banks were forced to invest their resources in construction financing, government securities and 3-years loans to commercial banks.

Agricultural credit received more systematic attention. In 1902 the first specialised institution was created by the collaboration of the government and the N.B.E. The Agricultural Bank of Egypt, though making a successful start, was later faced with difficulties owing to the failure of many peasants to repay their debts, and it was liquidated in 1936. Another important institution, the Credit Agricole, was created in 1931, with the government sharing 50% of its capital. This bank patronized the agricultural co-operative movement, and eventually it changed its name to the Agricultural and Co-operative Credit Bank in 1948. In spite of the fact that it was supposed to finance small peasants and co-operative societies, a good deal of its credit facilities crept into the hands of big land-owners.

The history of industrial credit is more recent. In 1922 government confided to Bank Misr a limited amount to finance small-scale industry. However, the Bank concentrated on the creation of large-scale establishments out of its own means. To solve the problem of dearth of capital, the idea of constructing an Industrial Credit Bank was contemplated in 1939. The project was executed after the war in 1947, with 51% of the capital supplied by the government. The task of the bank is to provide short-as well as long-term capital and facilitate the procurement of materials and machinery, for the industrial establishments.