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C - FINANCE AND DEVELOPMENT DURING THE POST-
NATIONALIZATION AND POST-PLANNING PERIOD

Extract from

DEVELOPMENT OF THE EGYPTIAN FINANCIAL SYSTEM
UP TO 1967

BY

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C. FINANCE AND DEVELOPMENT DURING THE POST-
NATIONALIZATION AND POST-PLANNING PERIOD

Discrepancies Between Investment and Growth:

We have noted that the most striking development during the Pre-Liberation Period was the near-stagnation rate of growth inspite of a relatively high rate of investment and conversely, the achievement during the Post-Liberation Period of a higher rate of growth than was warranted by the then prevailing rate of investment. It was also suggested that during these two periods financial policy played an active role in bringing about these two unexpected results. During the third period, the Post-Planning and Post-nationalization period, investment increased considerably when compared with the previous period, but the rate of growth of the economy did not increase to the same extent. Moreover, both the rate of investment and the rate of economic growth continued to fall sharply during the fifth year of the plan and the following two years (1964/65 to 1966/67), that is untill the war of June 1967 started a new phase which falls outside the scope of this study.

In principle, nationalization and planning should lead not only to a higher rate of investment, but also to a higher rate of returns from any given rate of investment. They should also lead, if not to a continuous increase in the rates of investment and growth (especially during the first decades) at least not to a decline in both. That both results did not takes place requires an explanation. Naturally, the thorough-going explanation could only be found in the specific features of the economy and of society, that is, in socio-economic factors. These factors, however, manifested themselves in the clearest way in the financial sphere. We shall begin here by giving a brief factual account of the basic developments of indicators relating to economic growth during that period (they can be studied in greater detail from tables I to IV). This will be followed by an account of their reflection within the financial sphere, which, in its turn, will be traced back to its origin within the sphere of socio-economic relations and developments.

I. GROWTH RATE INDICATORS

43. The First Five Year Plan (1961/62-1964/65) started with a rate of gross investment of 15.5% of gross national product. This rate continuously increased until it reached 19.7% in the fourth year. Then it fell to 17.5% during the fifth year. Taking the five years together, total investment reached 17.5% of total gross national product, as compared with 13.8% for the five years (taken together) from 1955/56 to 1959/60, thus making a difference of 3.7%. This increase of 3.7% accounted for only less than one per cent rate of growth when the two five years periods are compared with each other. This is indicated by the fact that whereas gross national product grew by an annual average rate of 5.6% during 1955/56 to 1959/60 with gross national income growing by 6.08 during the same period) gross domestic income grew by an average annual rate of 6.5% during the First Five Year Plan. In view of the limitations imposed by the available statistics, the basis of comparison is not the same for the two periods, since for one period the calculation relates to gross national products or gross national income whereas for the other it relates to gross domestic income, but the conclusion drawn from it is not far wide from the truth. This can be substantiated by two other facts. First, according to another official estimate, national income grew between 1955 and 1960 by an average annual rate of 6.83%. Second, the rate of growth in the services sector during the First Five Year Plan was greater (6.8%) than the rate of growth in commodity sector (6.4%), thus causing the latter's contribution to national income to fall from 55.9% to 55.4%, and it is well known that the real contribution of the services sector to economic growth is difficult to measure and the basis for calculating this contribution can be open to much controversy and uncertainty.

TABLE XI

GROSS DOMESTIC INCOME DEVELOPMENT DURING THE FIRST FIVE - YEAR PLAN (60-61 - 1964/65)
(in million pounds at 1950/1960 constant prices)

Sectors	Gross Domestic Income Base/Year 1950/1960	Gross Domestic Income in					Increase in Gross Domestic Income in fifth Year over Base Year	Rate of Increase %
		1st Year. 60/61	2nd Year 61/62	3rd Year 62/63	4th Year 63/64	5th Y. 64/65		
Agriculture	405.0	402.7	373.0	426.4	452.9	477.9	72.0	17.8
Industry	256.3	285.6	209.9	329.2	369.6	385.0	128.7	50.2
Electricity	8.8	12.3	16.3	18.6	18.6	22.4	12.6	128.6
Construction	47.1	44.2	73.6	83.5	96.0	92.6	45.5	96.6
Commodity Sectors (total)	718.2	744.7	772.8	857.5	937.1	977.0	258.8	36.0
Transport & Comm.	92.9	102.2	116.9	127.1	144.0	157.6	64.7	69.6
Trade & Finance	129.2	145.1	151.6	154.0	148.3	151.9	22.7	17.6
Housing Buildings	73.0	73.8	76.2	77.6	78.7	80.1	7.1	9.7
Public Utilities	6.4	6.8	7.0	7.4	7.6	7.7	1.3	26.3
Other Services	265.5	290.9	287.6	313.1	354.0	387.9	122.4	46.1
Services Sectors (total)	567.0	618.8	638.3	679.2	679.2	705.2	218.2	38.5
GRAND TOTAL	1285.2	1363.5	1411.1	1536.7		1762.2		37.1

(1) Other Services Sector includes education and scientific research, health, social and religious services, cultural, recreational and touristic service, security justice and defence, personal and other governmental services.

Source: National Bank of Egypt Bulletin (1968 III) and follow-up and evaluation report on the first five year plan.

TABLE XII

ANNUAL GROWTH RATES OF GROSS DOMESTIC INCOME AND INVESTMENT RATIO DURING THE FIRST FIVE-YEAR PLAN
(1960/61 - 64/65)

Sectors	First Year 60/61	Second Year 61/62	3rd Year 62/63	4th Year 63/64	5th Year 64/65	Annual Growth Rate (Average)	Sectoral Allocation of investment as % to total plan Inv.
Agriculture	- 0.6	- 7.4	14.3	6.2	5.3	3.6	23.4 (1)
Industry	11.4	8.5	6.2	12.3	4.2	8.5	26.7
Electricity	- 24.5	33.6	12.9	1.1	20.4	18.5	7.4
Construction	- 6.2	66.5	13.5	15.0	23.5	17.1	0.9
Commodity Sectors Total	3.7	3.8	11.0	9.3	4.3	6.4	58.4
Transport & Communication	10.0	14.4	8.7	13.3	9.4	11.2	19.5 (2)
Trade & Finance	12.3	4.5	1.6	- 3.7	2.4	3.4	1.3
Housing & Buildings	1.1	3.3	1.8	1.4	1.8	1.9	10.7
Public Utilities	6.3	2.9	5.7	2.7	1.3	3.8	3.3
Other Services	9.6	- 1.5	9.2	13.1	9.6	8.6	6.8
Services Sector (Total)	9.1	3.2	6.4	7.9	7.2	6.8	41.6
Grand Total	6.1	3.5	8.9	8.7	5.5	6.5	100.0
Total Investment % gross domestic Income	16.5	17.8	19.2	21.7	19.5		
Total Investment % gross national product	15.5	16.6	17.8	19.7	17.8		

(1) This figure includes 9.1 % for irrigation and drainage and 6.5 % for the High Dam.

(2) This figure includes 1.6 % for the Suez Canal.

Source : Follow-up and Evaluation Report on the First Five Years Plan (Part I. February 1966, Cairo).

Table XIII

Structural Changes in Gross Domestic Income During the
first five year plan.

Sectors	Base	Plan Years				
	Year 59/60	1st Year 60/61	2nd Year 61/62	3rd Year 62/63	4th Year 63/64	5th Year 64/65
Agriculture	31.5	29.5	26.4	27.8	27.1	27.1
Industry	19.9	21.0	22.0	21.4	22.1	21.8
Electricity	0.8	0.9	1.1	1.2	1.1	1.3
Construction	3.7	3.2	5.2	5.4	5.8	5.2
Commodity Sectors (Total)	55.9	54.6	54.8	55.8	56.1	55.4
Transport and Communication	7.2	7.5	8.3	8.3	8.6	-9.0
Trade & Finance	10.0	10.7	10.7	10.0	8.9	8.6
Housing	5.7	5.4	5.4	5.0	4.7	4.6
Public Utilities	0.5	0.5	0.5	0.5	0.5	0.5
Other Services	20.7	21.3	20.3	20.4	21.2	22.0
Services Sector (Total)	44.1	45.4	45.2	44.2	43.9	44.8
GRAND TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

Source: Follow-up and Evaluations Report on the First Five Year Plan.

TABLE XIV

NATIONAL INCOME AT FACTOR COST DURING THE YEARS 1965/66 AND 1966/67 AS
 COMPARED WITH THE BASE YEAR 1964/65 (IN MILLION POUNDS AND AT 1964/65
 BASE YEAR PRICES)

Economic Sector	Base Year 1964/65	The Years		Annual Rate of growth %		Percentage of increase in the year 1966/67 over 1964/65
		1965/66	1966/67	1965/66	1966/67	
Agriculture	582.1	588.1	569.5	1.0	- 3.2	- 2.2
Minining & Industry	432.4	433.8	436.9	2.5	0.7	3.2
Construction	92.6	94.9	88.5	2.3	- 6.7	- 4.4
Electricity	23.2	24.3	25.2	4.7	3.7	8.6
Total Commodity Sectors	1121.3	1141.1	1120.1	1.8	- 1.8	- 0.1
Transportation Communi- cation and Storage	176.0	194.7	201.3	10.6	3.4	14.4
Commerce & Finance	168.0	180.2	190.7	7.3	5.8	13.5
Total of Distribution Sectors	344.0	374.9	392.0	9.0	4.6	14.0
Housing	74.9	76.1	78.8	1.6	3.6	5.2
Public Utilities	8.2	9.1	9.4	11.0	3.3	14.6
Other Services	414.2	447.7	462.4	8.1	3.3	11.6
Total of Services Sectors	497.3	532.9	550.6	7.2	3.3	10.7
Grand Total	1962.6	2048.9	2062.7	4.4	0.7	5.1
Price Correction	12.4	14.4	14.4	-	-	-
	1975.0	2063.3	2077.1	4.5	0.7	5.2

Source : Ministry of Planning, Cairo, cited by Dr. Mohamed Adel Elhamy in
 a paper entitled : Problems of War Economics : The Case of the
 United Arab Republic.

In the fifth year of the plan (1964/65) the rate of growth of gross domestic income fell from 8.7% to 5.5%. More important still, the growth rate in the commodity sector fell from 9.3% to 4.3% while it fell in the services sector from 7.9% to 7.2%. During the same year investment rate fell from 21.7% to 19.5%. In the following year (Table XIV) national income growth rate fell further to 4.4% and in 1966/67 that rate fell to 0.7%. Bad crops - which caused income from agriculture to decrease during that year by 3.2% - accounted for much of this result, but it was not the sole, and perhaps not the main reason. Industry and mining achieved only a 0.7% rate of growth, and construction rate of growth decreased by 6.7%. Taken together, income from commodity sectors decreased by 1.8%, while the services - customarily expandable - increase by 3.3%. At the time of writing, official investment figures for these two years are not available, but there can be little doubt that it experienced a sharp fall.

II. THE FINANCIAL ASPECT

44. Turning now to the financial sphere which, as was suggested before, mediates between these results (unexpected from an economy in which, outside agriculture, the main modern large scale enterprises and institutions are nationalized and the principle of comprehensive planning is formally adopted) and the basic factors which brought them about, we note that during that period there was a considerable increase in total money supply, from 404.8 million pounds in 1960 to 652.4 m.p. in 1965. This makes a total rate of increase of 61.17%, or an average annual rate of 10.02%, as compared with an average annual rate of increase of 3.55% during the previous five year period. By far the greater part of this increase was in the net currency circulation (the total currency issue itself having increased between the beginning of 1961 and the end of 1965 by 109%). Private demand deposits increased only very moderately during that period. Other expansionary factors affecting the money supply by far outweighed the contra-actionary factors, as can be verified more systematically and in greater detail by reference to table I. To cite the more

important factors, claims of the banking system on government, which were the main expansionary factor, increased from 350.6 m.p; in 1960 to 838.1 m.p. in 1965, that is, by 139%. During the following years monetary expansion tended to slow down, if not actually to take the opposite direction of contraction. Full information is not yet available for the full year 1967, but we note, for example, that net currency circulation in 1966 showed, for the first time since 1959, a decrease of 5.5 million pounds over the previous year. Private deposits showed at the same time an increase of 37.7 million pounds, but the rate of increase during that year (1966) was less than the corresponding rate for 1965. It would also seem that this counter-expansionary tendency continued during the following year, at least until June 1967, the date for which statistics are available at the time of writing.

Government deficit spending was the main factor behind the considerable monetary expansion during the First Five Year Plan. This is evidenced by the fact that, whereas budget deficit was 159.6 million pounds in 1960/61 (or 29% of budget revenues), by 1964/65 it had reached 356.1 million pounds, or 44% of budget revenues. Budgetary deficit then decreased to 248.9 m.p. in 1965/66, that is, by 107.2 m.p., thus causing the counter-expansionary tendency to which we have just referred. This tendency continued, though at a much slower rate, also in 1966/67, the deficit amounting to 239.4, that is, 8.5 m.p. less than in 1965/66.

The official cost of living index number (1939 = 100) showed rise from 306 in 1960 to 377 in 1965, compared with a rise from 283 in 1955 to 306 in 1960. More indicative perhaps, are the movement in the index number for foodstuffs and wholesale prices, which were as follows (1939 = 100).

End Year	Foodstuffs	Wholesale prices	Cost of living
1955	322	351	203
1960	388	418	306
1965	499	490	377
1966	568	526	394
1967	618	553	332

The considerable increase in prices between 1960-1965 as compared with 1955-1960 accords well with the rate of monetary expansion in the two periods: moderate in the earlier period and great in the 1960-1965 period. That prices continued to increase after 1965 inspite of the adoption of a counter-expansionary monetary policy is due to the fact that this policy was coupled at the same time with a considerable increase in direct taxation on some important consumption items and with a planned rise in the price of others as a means of counter-acting the inflationary tendencies which were apparent in the economy.

Excessive deficit financing and the resultant pressure towards general price level increases could not but affect the country's balance of payment position and the value of its currency, greatly increasing the deficit in the former and depreciating the value of the latter in relation to other currencies. When previous "foreign hoardings" were exhausted at the beginning of this period, and foreign borrowing was resorted to on a large scale to meet this deficit, the process of deficit financing, deficit balance of payment, and increased foreign borrowing, is apt to become cumulative, especially in view of the additional burdens imposed by the servicing (interest and repayment installments) of foreign debt. The factual information provided in paragraph 37 absolves us from the need for any further repetition. We need only remark here that this cumulative process takes place even when foreign borrowing is mostly used to finance investments and not current consumption, unless these investments lead within a reasonable period to a considerable increase in the

ability to export, or to a decrease in imports. This, however, was not the case during the First Five Year Plan, for reasons connected with the pattern of investment which had taken place and with the efficiency of this investment, that is, with the general performance of the economy as a whole, though of course other external factors contributed to this result, such as the general deterioration of the terms of trade which developing countries experience. These remarks take us naturally to an attempt-- however brief - to consider the real factors, that is the socio-economic factors, which lie at the root of the pattern of performance of the financial system which was outlined in the previous pages.

III. THE SOCIO-ECONOMIC FACTORS

Two Major Questions Relating to Finance

45. In a study devoted to finance and not to a general analysis of socio-economic development, and in the light of the previous observations about the working of the financial system, the relation between finance and socio-economic factors can best be approached by way of answering the following two questions:

1. Why, in an economy formally committed to comprehensive planning and in which the major modern sectors are in the hands of the state, deficit financing, allowing inflationary pressures to appear and accumulate, was resorted to?

2. Given the fact that deficit financing was motivated by the desire to achieve a high rate of investment, to what extent did the pattern of investment and its results alleviate or enhance the inflationary pressures which may normally be expected to arise from this method of financing investment?

We shall deal with these two questions in succession.

1. THE SOCIO-ECONOMIC BASIS FOR DEFICIT

FINANCING OF INVESTMENT

46. Two points must be clarified before an answer to the first question is attempted. The first point is whether the rate of investment actually achieved during the plan years was too high in relation to the potentialities of the economy. The second is whether measures of income redistribution and social reform undertaken during the five year plan period were in some way or other responsible - by way of lowering the economy's capacity to save and invest - for the deficit financing of investment.

Regarding the first point, all available criteria indicate that - given certain requirements - the achieved rate of investment cannot be considered too ambitious in relation to the potentialities of the economy. Whether compared with rates of investment achieved, during certain periods, without considerable inflationary pressures, in highly developed capitalist countries, or with the rates of investment achieved without inflationary pressures at all in socialist countries which began their socialist transformation at a low level of industrial development, the actual rate of investment achieved in Egypt during the First Five Year Plan, which ranged between the upper and lower limits of 15.5% and 19.7% of gross national product, cannot be considered too high. When the post-nationalization five year period is compared with the pre-nationalization five year period, in which the greater rate of the economic resources were at the disposal of capitalist or feudal classes and were thus liable to wasteful consumption, illegal smuggling abroad, or immobilization, the difference in the average rates of investment between the two periods (about 3.7%) does not warrant the marked rate of deficit financing and inflationary pressure which appeared after planning and nationalization.

It is well known that beside the rate of investment, the type of investment - whether it is long-term or short-term investment - has a direct bearing on the degree of inflationary pressure which deficit financing of investment may generate, and it seems certain that there was a greater proportion of longer term investment (e.g. the high dam project and the land reclamation projects associated with it) during the post-planning and nationalization period than during the previous period. The effect of this factor, however, could have been neutralized, as we shall see, had the medium and short term investment projects been of the type which, being directed towards popular consumption goods for which demand is enhanced as a result of increased employment, complement the longer investment plans. This factor thus reduces itself to the question of co-ordination, on the aggregate demand level, between the various investment projects, which question will be discussed below.

The last question which needs to be considered in the present connection is that of hoarding. Here a distinction should be made between foreign hoarding or dishoarding, and internal hoarding or dishoarding. As we have seen, the pre-planning and - nationalization period was characterized by drawing on whatever was left of the accumulated sterling balance (or hoardings) which since it meant an increase in the supply of goods from foreign resources, had the effect of counteracting the expansionary pressures resulting from deficit financing. The post-planning and - nationalization period was, on the contrary, characterized by a marked rate of foreign borrowing. The effect of foreign borrowing, however, is similar to foreign dishoarding in so far as counter-acting the inflationary pressure is concerned, though certain reservations should be made in this respect. If the local productive resources which are necessary to complement imported capital-goods are not available in sufficient quantities this might lead to certain "sectoral" inflationary pressures which can spread to other spheres, a process which was occasionally noticed in the Egyptian economy during that period (e.g. cement).

All in all, however, foreign borrowing during that period cannot be held - as such - responsible for the basic inflationary pressure which accumulated in the economy, especially since a considerable part of foreign borrowing was tied to the importation of certain food stuffs, particularly wheat. The question internal hoarding and dishoarding shall be discussed below.

The second point is the effect of changes in the distribution of income on the rate of consumption, hence on the rate of saving, hence on the necessity to resort to deficit financing as a means for securing the required rate of investment. A considerable literature has grown around this point, propagating the thesis that as a result of "socialistic" measures, lesser inequality in the distribution of income, increased employment, and a rising standard of life, the rate of consumption increase had greatly outrun the rate of increase in the national income, thus reducing the rate of savings and the country's ability to invest. Thus for example, it is stated, in support of this thesis, that whereas gross domestic income had increased at current prices, during the five years by 46.6%, wages increased, also at current prices, by 59.9%. It is to be observed that this - fashionable - way of reasoning does not attempt to break down the category "wages", which includes all kinds of salaries and remunerations, to its various components according to class or type of work. It also does not attempt to translate current prices into constant prices, which are quite different for wages from what they are for the gross national product. The same source which calls in evidence the previous figures indicates that the share of wages in the national income rose from 42.8% in the base year to 46.7% in the fifth, years and property returns fell from 57.2% in the base year to 53.3% in the fifth year without breaking these property returns to the various types of private and public property. It also cites that employment had increased during the period by 22%, a figure which shows the increase - at constant prices - in total wages of 59.9% to be not as great as it at first appears.

For above examples are cited merely to show that variations in the rates of consumption, especially the consumption of various classes, and the relation these variations, to the actual and potential rates of investment have as yet to be scientifically analysed. In the absence of the required data for such a task, the following tentative remarks may be made:

(a) There is no doubt that there was a considerable increase in employment during the post-planning and - nationalization period which outstripped the rate of population increase (15% in five year). The extent of this increase in employment - and the resultant improvement in the standard of life - is greater even than the global figure of 22.1% increase in employment. The most significant figure in this respect is the increase in industrial employment by 37.1%, in construction by 86.6%, and in transport and communications by 27.0. (Their share in total employment rose respectively from 10.0 to 11.2% for industry, from 3.1% to 4.7% for construction and from 3.6% to 3.8% for transport and communications). Employment in agriculture, which more or less has the nature of a residual than an accurate estimate, increased by 16.5%, thus reducing its total share from 54.0 to 51.5.

(b) This shift away from agriculture to industry, construction and transport is itself an evidence of a rise in the standard of living. It represents a definitely established and stable form of income-earning, in contrast with the seasonable employment or disguised unemployment associated with agriculture. In addition, the wage-rates are higher in these occupations than in agriculture. This shift of employment, in addition to certain legislative measures fixing minimum wages for agricultural workers (whenever these were actually reinforced) helped to improve the wage rates for agricultural work, particularly in regions where new industries were introduced. Moreover, as a result of the Agricultural Reform, a certain though limited number of agricultural workers and poor peasants were transformed into middle peasants. Another number of landholders benefited from legislative limitation on land rent and from free supply of agricultural credit, whenever these two measures were not obstructed by rural capitalism.

(c) Though the number of gainfully occupied persons increased, thus raising total family earnings, it is uncertain, when the increase in the cost of living is taken into account, that the real rate of earning per gainfully occupied person had increased, especially at the general level of unskilled and semi-skilled labour. In certain occupations, for example construction, which is characterized by a high ratio of unskilled labour, it had actually decreased, at current prices, by 3.6%. In industry the per capita rate of wages increased during the five years by 22.8 per cent and in transport and communications by 21.6%. These two rates fall short of the increase in the cost of living during the same period. This fact is accentuated when it is remembered that the "wages" which are said to have increased by 59.9% refer to all remunerations which all employers get in return for work, including managers, directors, officials and so on. It had been calculated that though the rate of payment for this upper class of salaried persons had not greatly increased during that period, the opportunities for quick successive promotions which became open to them far out-stripped the total increase in employment, thus not only considerably improving their relative position but also increasing their relative numbers.

(d) As a result of these observations, it would seem difficult to substantiate the theses that the better redistribution of national income, (and we have observed that for a great proportion of those who are at the lower scale of wage-earnings and who were already employed at the beginning of the planning period the rise in the cost of living outstripped wage increases) was responsible for the fact that increase in consumption swallowed up the increase in the national income, thus making it difficult to achieve a higher rate of investment without resort to deficit financing. In view of the steep increase in social insurance contributions and in indirect taxation (see paragraph 34) it would seem, on the contrary, that the contribution of the lower paid groups to budget resources was greater than other sectors and classes of the population.

Having maintained that the rate of investment cannot be considered too high in relation to the potentialities of the economy and that income redistribution measures cannot - especially in the face of rising prices - be blamed for excessive consumption by the lower paid masses of the population, we can more properly seek the major origins for deficit financing in the following factors:

1. The still unbalanced nature of the taxation system, which completely absolves an important class - rural capitalism - from any form of direct taxation, provides many opportunities for tax evasion, especially in the sectors of private commerce, construction, the liberal professions and various parasitic occupations and activities, and which, inspite of a steeper progression in general income taxes, is still not steep enough at the relevant high income brackets (see paragraph 34).

2. The point relating to private commercial, constructional and speculative activities requires further elaborations. Although nationalizations of 1960/1964 were far and wide reaching, important sectors, or parts of important sectors (beside agriculture) remained in the hands of private capital. Internal commerce, (wholesale, half-wholesale and retail) inspite of state control or even state enterprises or monopolies in certain commodities or activities, is an important example, for in this sphere private capital not only mediated between producers and consumers, but also between various state enterprises. Construction, which in a period of rapid development plays a leading role in the economy, and which was only partially nationalized, is another important example. Both exploited to the utmost the various shortages and bottlenecks which appeared in the course of plan execution, and, through various forms of malpractices, manufactured other shortages and bottlenecks of their own creation. The end result was not only extra profits which escaped taxation, but inflationary sectoral rises in prices, both at the production and distribution level, which in view of their wide-spread nature, added to the general inflationary pressure. An important other effect was the artificial increase in the cost of investment, which resulted in

the cost of investment, which resulted in a reduction in the rate of returns from investment. By the end of the First Five Year Plan these effects became manifest and measures began to be initiated aiming at a greater degree of nationalization and re-organization of these sectors.

3. The Five Year Plan period also witnessed a considerable increase in what is called "public consumption", that is, government current expenditure. The development of both final and government consumption as a ratio of Gross National product (at current prices) is shown by the figures in the following page.

It will be seen from these figures that whereas private consumption as a ratio of gross national product was higher than the base year only in the second and third years of the plan, government consumption was higher - expressed in the same ratio - than the base year in the last three years of the plan, and markedly so in the last two years. Taking the whole five years together, government consumption increased at any average annual rate of 14.2%, whereas private consumption increased at an average annual of 6.5% (both calculated at current prices).

These figures - or such similar calculations - are usually cited to support the view that excessive government expenditure is greatly to be blamed for the inflationary pressures which were generated within the economy. Once the principle of planning and the social responsibility of the state is accepted this argument - when it stops at this point - reveals its vacuity. It does remain necessary, however, to consider the directions of the increased government expenditure in order to evaluate its effect.

No doubt part of this increase was caused by the defence burdens imposed on Egypt. Another part is due to the increasing extent of state activity within the economic and social sphere, (the administration of the greatly extended nationalized sector, education, culture, and health expenditure...etc.). What can be legitimately

observed as contributing to inflationary pressures, however, is not the principle of increased state expenditure as such, but : (1) That there was an overgrowth of the services sectors which was not matched by appropriated corresponding growth in the commodity sectors, this imbalance creating an upward pressure on commodity prices. This observation however, applies not only to the sphere of direct governmental activities but to the economy as a whole. (2) That, whether in the services sphere or in the commodity sphere, expenditure especially in the form of salaries was not matched by a proportionate rise in efficiency or productivity, due, among other reasons, connected with certain shortcomings in planning, to an overgrowth of employment especially among university and high school graduates unprovided with facilities for effective utilization, and to the increasing cost of an expanding and quickly promoted top management and administration.

4. Given the appropriate monetary responses, the inflationary pressure created by the above factors, could not - when the original impulses continue over a defined period of time - but feed upon itself: Rising prices encourage speculation, malpractices and the exploitation of shortages and bottlenecks. A flight from money into durable commodities, that is, a process or dishoarding, takes place, naturally among those classes which have accumulated hoarding, or which have easy access to credit facilities from the banking system. The expectation of further measures of nationalization or of limitations on, for example, land property, adds another motivation this type of useful "accumulation"; that is, accumulation of durable and valuable consumption goods. When these are readily forthcoming, for example by an expansion in the production of these types of goods, this motivation is given an outlet which further enhances the dissaving effects of the inflationary pressure.

Leaving aside the disruptive effects of such process, not only on the required balance between saving and investment, but also the processes of income redistribution, social transformation and of social construction, we turn now to the second aspect of our present subject: the relation between the pattern and results of investment and the inflationary pressures generated by deficit investment financing.

	Base Year. (1959/60) %	1st Year (60/61) %	2nd Y. (61/62) %	3rd Y. (62/63) %	4th Y. (63/64) %	5th Y. (64/65) %
Final Con- sumption :	87.2	85.6	89.1	88.4	87.5	85.9
Government Consumption:	18.3	17.5	16.3	18.9	21.3	21.0
Private Con- sumption:	68.9	68.1	72.8	69.5	66.2	64.9

2. INVESTMENT PATTERN AND EFFICIENCY

In Relation to Deficit Financing of Investment.

47. In the previous pages we tried to trace the financial developments connected with deficit financing of investment of their socio-economic origins. In the following lines, the direction of analysis will be reversed. Starting with the pattern and results of the investment projects included in the plan, themselves in their turns deeply rooted in the socio-economic set-up, we shall attempt to trace down their effect within the financial sphere. Since any pretension to full treatment will take us far afield, only the more important points, immediately relevant to our subject, will be briefly referred to here.

Before coming to these points, by their very nature rather of a negative type, it should be borne in mind, first that is, before any experience in **planning** had been acquired or accumulated; second, that this plan was drawn up before the considerable process of nationalization which took place as from 1960/1961 had started. This means that the plan was drawn up in the hey-day of Egyptian private capitalism; and as a matter of fact, a great many of the investment projects incorporated in the plan were taken over from the Five Year industrialization Scheme drawn up in 1957 and bear the stamp of that scheme. It also means that the continuous process of reorganization resulting from the almost similarly continuous process of nationalizations which extended mainly from 1960 to 1964, with July 1961 as its high mark, could not but affect, on the organizational level, the smooth working of the plan itself (if the agglomeration of the sometimes disconnected projects which made up the plan could have had any pretence to smoothness) although, of course, without such nationalizations the considerable achievements in investment and growth - in spite of all the other shortcomings - could not possibly have taken place. These shortcomings, as far as our immediate subject is concerned, can be summarized as follows:

1. In so far as investment in consumer goods industries is concerned, a disordinate stress was laid on modern durable consumer goods, that is, luxury goods, such as private motor cars, televisions, refrigerators and electrical washing machines. In view of the low level of industrial development prevailing in the country, these industries could only start as assembling industries, by far the greater proportion of the component parts being imported from abroad. Such assembly lines, if they were to be created at all, required a minimum scale of productive capacity. This capacity, as was proved by practice, could not have been channelled to exports: the facts that most of the component parts were to be imported and necessary skill had to be progressively acquired, raised costs and made prices uncompetitive on the world market (sometimes, when such goods were exported, the earnings in foreign currency were less than the foreign currency cost of the component-parts). Hence these goods had to be sold on the home market. The result was setting a higher standard of consumption expectations and consumption levels than was warranted by the requirements of the economy and, as we have seen, encouraging the process of dishoarding, thus adding to the existing inflationary pressures.

More important still is the fact that wide-spread new consumption habits made a heavy claim on foreign currency earnings, which was not correctly calculated at the initiation of the plan, and which contributed to the rapidly increasing rate of balance of payment deficit. When, as a result of foreign exchange shortages or as a measure to combat inflation by selective price rise, the prices of these goods were raised, surplus capacity soon appeared and production had to be stopped or greatly reduced, leaving capital resources and labour unutilized.

The excessive claims of these lines of production on foreign exchange required for imported parts, spare parts, capital goods and complementary production or consumption goods, was one of the main factors not only behind the balance of payment crisis which made itself acutely felt at the end of the plan, but also behind the general slowing down of economic growth which took place in the following years, since it also affected the requirements of other more vital industries for capital goods or intermediate goods and also since no rational plan for the priority allocation of foreign currency was immediately put into effect. The faulty orientation of investment in consumption goods towards these industries can, at first remove, be attributed to the application of the import-substitution principle as a basis for investment selection, and to economic miscalculation as to foreign exchange direct and indirect requirements. In the last analysis, however, this orientation cannot be isolated from the class character prevailing at the top technical and economic level at the time of drawing up the plan. Had these investments, instead, been canalized towards popular consumption goods no such results would have taken place and deficit financing magnitude and effect would have been less pronounced.

2. The second major shortcoming, also closely affecting the balance of payment position, is the type of industries which were chosen for export promotion. Because Egypt is a major cotton producing country it was assumed that the natural industries to be greatly expanded were the textiles industries, without taking into consideration the fact that most developing countries start by initiating, for the home market, their own textile industries and that textiles are always losing ground in the international terms of trade. More generally, when preparing the plan, the economizing effect of natural endowments was overestimated and prognostic studies for world market conditions were lacking. The overall result, as far as the textile industry is concerned, and when the foreign currency cost of imported textile machinery is taken into account cannot with certainty be said to have been a net increase in foreign earnings from the greatly expanded textile industry.

3. The third point is connected with the direction of investments in the agricultural sphere. In a predominantly agricultural economy, and leaving aside the possibilities of foreign borrowing, the real - as contrasted with monetary - rate of investment that can be achieved without causing sectoral imbalances in the economy, depends to a large extent on the agricultural surplus that can be withdrawn from the countryside, either for the purposes of exportation, or for feeding the increased industrial population, or for providing industry with raw materials.

Agricultural income, however, increased during the First Year Plan by an average annual rate of only 3%, that is, by less than half the average rate for the economy as a whole and almost just sufficiently to match the rate of population increase (2.8%). This rate falls 40% short of the planned rate (5%) of agricultural growth. One reason for this result is the failure by about 50% of agricultural investment to reach the planned rate. Another reason is the fact that the greater part of achieved investment in agriculture was directed to extensive - rather than intensive - expansion. This type of investment takes time to mature into realized income, but in addition, there are reasons to believe that the active performance of realized investments in this field was less efficient than might have been expected. A greater proportion of this investment directed to intensive expansion, might have gone some way towards reducing both the inflationary pressure and the balance of payment deficit. Such investments, however, in order to achieve maximum efficiency, would have required a greater degree of re-organization in the system of land-tenure and agriculture than the - yet considerable - degree which had taken place during the plan period. It would thus seem that the social forces which made the agricultural sector - despite its great relative importance and despite the existence of considerable variations in holdings of ownerships - contribute only 2% of agricultural income in direct taxation, were also responsible for halting the process of re-organization necessary for efficient intensive investment.

THE FINANCIAL SYSTEM IN RELATION TO EQUILIBRIUM AND EFFICIENCY.

48. To sum up: it can be seen that certain deep-seated socio-economic factors were at the root of the extended resort, during the First Five Year Plan, to deficit financing, and that the use of this method for financing - and not the increase in investment rate as such - had set off certain general and sectoral inflationary pressure which, beside their other unfavourable social effects, pushed up investment costs and reduced its general effectiveness. Deficit financing was also responsible for the appearance of various shortages and bottlenecks (especially in the field of foreign-imported capital and intermediate goods and other production requirements), for the creation of a certain degree of dislocation in the execution of some investment projects and, especially towards the end of that period, for a decrease in the general rate of economic growth.

Likewise, we have seen that the pattern chosen for investment projects - also determined to a great extent by those same socio-economic factors - have reinforced, rather than attenuated the negative result of the extended resort to deficit finance.

It may be added here that these negative effects of the investment pattern are perhaps weightier and more durable than the mere resort to deficit financing, since they directly shape the structure of supply, which is less easy to influence or change than the structure of demand. This was attested in practice by the fact that when the dangers of inflation became apparent and a counter-expansionary policy was resorted to in 1965 (see paragraph 44) surplus capacity and redundant employment (open or disguised) immediately appeared, especially in certain luxury durable consumption goods industries, and a sharp decline in the general rate of economic growth took place during the following two years. The prices of some of these goods - which were raised as one of the measures taken to absorb excess purchasing power - had to be reduced again and purchase by installments had to be reintroduced, although the necessity for reducing the general level of consumption was still being acknowledged.

The above observations should provide an answer - albeit un-systematic - to the questions, raised at the beginning of Part III of this study, as to the extent to which the financial system helped to achieve an overall and sectoral equilibrium between the monetary flows and flows of goods, and helped to promote economic efficiency within the economic system. And indeed a systematic answer to these questions would not be required. For, in the period before planning and nationalization, that is, before 1960, the financial system as such could achieve only that degree of equilibrium (or inequilibrium) and impart that degree of efficiency (or lack of efficiency) that can be expected from an economy obeying the general laws of capitalist development. The one remark worth making, or repeating, here is that the financial expansionary policy adopted after 1955 helped, especially in the context of an economy being successively and successfully liberated from imperialist domination, to achieve the full utilization of capital resources which were being created and accumulation since the end of the second world war, but which were left partly utilized because the double exploitation of the Egyptian masses both by foreign and feudal forces (in addition to local capitalism), coupled with the restriction on Egypt's foreign trade and economic relations imposed by foreign domination, made the necessary purchasing power required to call forth full production lacking; and it is probable, as was suggested before, that this - the monetary expansionist policy - was the main factor directly responsible, in spite of the capitalist framework, for the remarkable rate of growth in conditions of relative price stability achieved between 1955 and 1960.

With the introduction of planning and far reaching nationalization of the modern sectors of the economy as from 1960, the situation becomes more complex because, whereas some of the economic laws of the capitalist system ceased to be operative, the laws governing the operation of the economic system of socialism have not as yet made their appearance felt. The fact is that, though nationalization of the major modern means of production - including financial institutions - is a necessary condition, it is not sufficient one

for the creation of such a system. Limiting ourselves here only to certain economic aspects of the question, it is to be noted that the economic and financial instruments, institutions, techniques and rules necessary for the working of that system have to be set up and utilized and that the economic laws proper to it have to be acknowledged. Failing this, and though advances along other fronts may be achieved, a situation may arise where, the forces and mechanisms working for a certain degree of efficiency in the capitalist system having disappeared, the norms and mechanisms which make for the superior efficiency of the socialist system remain conspicuous by their absence.

In the early stage of the adoption the system of planning,, especially where capitalist and small commodity production prevail in certain important sectors, as it does, for example, in Egyptian agriculture, and accordingly where market forces and capitalist laws rule over an extended area of economic activity, material balances and material controls impose themselves as the one sure means both for the preparation of a realistic and well balanced plan and for securing its proper execution. This tool of economic planning is made all the more easier to utilize since, at these early stages, the varieties of resources are fewer than in a well-developed economy, the possible variants in their utilization are much more limited in number, and the choice between these possible variants is much more clearly indicated, so that reliance on market forces and price mechanisms which - by the very mixed nature of the economy itself cannot be easily controlled - can be greatly reduced without creating unsurmountable difficulties and complications.

As it happened, only financial estimates were used as the basis for plan preparation. These estimates, moreover, were far from comprehensive, being more in the nature of grouped and somewhat - sometimes somehow - co-ordinated investment projects, rather than fully comprehensive and detailed financial plans. In addition, beside the disrupting effects of the market forces emanating from the capitalist and small commodity production sectors, there were no apparatus and no mechanism which ensured that the actual financial flows, both in their global and in their sectoral aspects, still much less at the level of individual enterprises, conformed with the - more or less general - equilibrium norms and criteria set out by the plan. In particular, a ready made and usable - and fairly well developed apparatus which was in the hands of the state, the banking system, failed to perform this essential function of pre-spending control and after-spending evaluation, partly because the financial plan did not easily lend itself to such tasks, and partly because, for various reasons, the banking system and banking management continued to operate with the same concepts, procedures and purposes inherited from pre-planning and pre-nationalization days. That is, apart from certain government controls and directives, they functioned as if they were serving a **purely** market economy. Lastly, profitability, when at all it was used as criterion for the efficiency of management or of enterprises, continued to a large extent to have the same definition it would have in a capitalist economy. As it is well known, this definition is at once narrower and wider than the socialist concept of profitability, which takes into account many other factors affecting the efficient working of the economy both inside and outside the enterprise, and at the same time **eliminates** chance, transitory, speculative and purely price factors. To the extent that this change has not taken place, usually a function of the financial system in planned economies and one of the main springs working for their general efficiency, it may be said that, also in this direction, the financial system has as yet to adapt itself to the changes that are taking place in Egypt's economy and society.