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Travel Briefings: United Arab Republic (EGYPT) - Travel briefs 02

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B. FIVE-YEAR OUTLOOK

## UNITED ARAB REPUBLIC

### 1. Introduction

Any projection of economic prospects in the U.A.R. must assume a minimum of political stability. Apart from the threat of further violence the present political situation in the Middle East affects the economy of the U.A.R. in three main ways. The first is the closing of the Suez Canal. For the present the foreign exchange earnings from the Canal are being replaced by aid received from Kuwait, Saudi Arabia and Libya but if this aid were to cease or be substantially reduced before the Canal was reopened the economic pressure on the U.A.R. would be greatly increased. Secondly, some form of political modus vivendi in the Middle East might improve relations between the U.A.R. and the west and thus reopen channels of aid (other than supplier credits) from the major western donor countries. Thirdly, political events in the Middle East will influence Egyptian expenditure on defense which at present takes a relatively large proportion of available resources. The significance of these factors will become clear from the projections which follow. These are purely illustrative and are in no way intended to indicate what may happen in the U.A.R. during the next five years. It may be useful to speculate in this way for countries which have provided us with sufficient information about their present economic situation and future intentions and commitments. This is not the case with the U.A.R. It is for example too soon for many statistical series to refer to the period after the June war and though it is known that the armed forces have been replenished by the U.S.S.R., we are unaware of any obligation which the U.A.R. may have undertaken in return.

### 2. Major Development Problems

#### (a) Population Growth

The development problem in the U.A.R. is dominated by the pressure of a population growing at about 2.7% per year. The total population is estimated at 31 million almost all of which is concentrated in the Valley and the Delta of the Nile where irrigated agriculture is possible. The population density in this restricted area is around 1,200 per square mile which is one of the highest in the world. The Government has recently introduced a program of population control but it is too early to say how effective it will be. The initial response in the towns appears to have been good but that in the agricultural villages seems much less so.

#### (b) Making the Best Use of Nile Water

In the long run population control in the U.A.R. is

particularly important because of the limits on agricultural land which are set by the availability of water from the Nile. Ever since the time of the Pharaohs the Egyptians have been concerned with the problem of making the best use of the water from the Nile. Beginning in the early nineteenth century a series of barrages have been constructed on the Nile to hold back some of the flood water for irrigation. The High Dam at Aswan is the culmination of this process in that it will prevent any loss of water to the Mediterranean. It is expected to permit a 25% increase in the cropped area. This would offset some eight or ten years of population growth at the present rate. Apart from the High Dam there is still some scope, although not a great deal, for increasing the amount of Nile water by constructing works on the Upper Nile in Sudan and Uganda. There is also some possibility of utilizing underground water but it is not yet clear how much can be done in this way. Apart from these resources, the future growth of agricultural production in Egypt will have to depend on making more efficient use of the presently available water at least until the cost of desalinization has been sufficiently reduced to make its use for agricultural purposes economic.

(c) The Management of the Balance of Payments

The U.A.R. has incurred balance of payments deficits more or less continuously since the end of World War II, which have been financed first by the use of reserves and then by foreign borrowing. The resources represented by this deficit have been used to maintain a reasonably high rate of investment with the result that since around 1956 Egypt has managed to maintain a rate of growth of probably between 4% and 6% per year. However, the accumulation of external debt, much of it in the form of supplier credits, has now reached a point at which the U.A.R. finds it difficult to maintain its debt payments; arrears on supplier credits and other debt now amount to about U.S. \$ 100 million. This problem of managing its short term balance of payments position is Egypt's most acute difficulty and it was of course made worse by the consequences of the conflict with Israel. The recent agreement between Egypt and the IMF may, however, give some indication that the government is making a serious effort to cope with this problem.

(d) The Level of Internal Savings

An increase in the level of internal savings has now become necessary if the Egyptian economy is to maintain a satisfactory rate of growth and at the same time achieve a tolerable balance of payments situation. Since 1960 when Egypt began its first five-year plan the increase in the rate of investment

was made possible by the use of imported resources, that is by a deficit in the balance of payments, but with hardly any increase in internal savings. The reason why internal savings did not increase is largely to be found in the insistent pressure to increase expenditure on social services and defense. Expenditure on defense has recently accounted for over 30% of the current budget and is equivalent to some 9% of gross domestic product. Defense expenditure as large as this clearly has a decisive influence on the behavior of the economy as a whole. In theory more resources could be found for development by increasing the level of taxation but the tax burden is already fairly high by comparison with other similarly situated less developed countries.

(e) The Process of Economic Decision Making

In Egypt all the major utilities and industrial enterprises are Government owned and the regime has a clear ideological inclination towards some form of socialism which is not very clearly defined. The organizational system under which the nationalized industries are operated has been based on those of Eastern Europe and some of the problems which have appeared recently in the economies of Eastern Europe are also present in the U.A.R. Price controls have created disparities between domestic and foreign prices and within the domestic price system. This together with a virtual absence of competition have led to problems of inefficiency and lack of incentives in many industrial enterprises. The solution of these problems requires that more autonomy be given to individual enterprises but it will be difficult to move in this direction until some improvement in the foreign exchange position has been achieved so that imports can be liberalized. The degree to which different industries have been affected by this situation varies greatly. The textile industry which was established many years ago, which exports a large proportion of its output and which does not require much in the way of imported materials seems to have been hardly affected at all either by the nationalizations or by the new controls. The principal industries affected are the newly established import substitution industries mainly the steel, metal using and engineering industries which have been greatly expanded over the last five years.

(f) Sector Allocation

On the whole the problem of sector allocation has not been a serious one in Egypt. In the last few years there has been some tendency to neglect investment in transport with the result that some bottlenecks have arisen. Investment in import substituting industries has proceeded too fast with the result that many of them are now operating well below capacity owing to the shortage of foreign exchange.

3. Policies

Although it is a political rather than an economic decision, the reopening of the Suez Canal must be given the first priority. The aid which Egypt is now receiving from Saudi Arabia, Libya, and Kuwait does compensate for the loss of earnings from the Canal so that at the moment the economy is not affected by the closure of the Canal. But until the Canal is reopened Egypt is not standing on its own feet but depends for its support on the charity of its friends.

Another important decision which faces Egypt concerns the reopening of the aid channels from the West. This is both a political and an economic matter. Politically it requires some improvement in relations with the major western donor countries particularly the United States, Germany and the United Kingdom and economically it requires improved management of the short term balance of payments problem including a rescheduling of the heavy burden of payments for supplier credits. But it seems very clear that only if this is done will Egypt be able to obtain any significant quantity of aid on reasonable terms.

In the longer run Egypt's most important problem of overall economic policy is to increase the level of internal savings sufficiently to permit the execution of an adequate development program without too much reliance on imported capital. In absolute terms the increase required is not particularly large -- the savings rate needs to be increased from around 13% or 14% of gross domestic products to perhaps 17%. In practice, however, the decisive role will probably be played by the level of defense expenditure. If defense expenditure could be regarded as a policy variable rather than a given datum the problem of increasing the availability of domestic resources would be very much easier.

Since Egypt's external debt is already high it is important that the volume of foreign exchange earnings should increase in order to provide a base for some further external borrowing. Here once again a great deal will depend upon controlling the level of internal consumption. Egypt is an export oriented economy producing cotton, rice and other exportable agricultural products as well as petroleum. It also receives substantial sums in foreign exchange from the Suez Canal and tourist trade. There is no economic reason why the proceeds on these various sources should not increase in the long run in a satisfactory manner, for example by 6-8% per year.

If in the longer run the shortage of foreign exchange can be eased this would permit a liberalization of imports and some relaxa-

tion of the price and physical controls over the internal economy. It would then become possible to correct the disparities in the price system and to take measures to increase the autonomy and efficiency of economic enterprises.

Whether or not the above changes in policy can be implemented will be greatly influenced by the course of political developments in the Middle East.

4. Five Year Projections

At the moment the U.A.R. has no five year plan. A plan which was to have covered the period from 1965 to 1970 had to be abandoned almost before it started. The Ministry of Planning is now preparing a new plan for the period 1968-69 to 1974-75. When this plan appears it may give some indication of the methods which the Government is proposing to adopt to tackle the problems outlined above.

*done when?*

In the absence of any firm plan prepared by the Egyptians the projections which follow are merely illustrative. There are two projections. The first is a so called "high gap" projection which illustrates what might happen if a sizeable development program were to be carried out assuming that present basic policies remained unchanged. The second or "low gap" projection shows how the same amount of investment expenditure could be financed if policies were adjusted. The assumptions lying behind the projections are as follows:

- (1) It is assumed that after 1969-70 investment will grow at 7% per year. This gives a total investment over the five year period of about EE 2 billion which is of the same order of magnitude as the Egyptian plan for the period 1965-70 which had to be abandoned. Using a capital output ratio of 2.5 this gives a rate of growth of GDP of 5.6% over the period. It will be surprising if the new Egyptian plan is as modest as this. This, therefore, can be regarded as the smallest development plan which any Egyptian Government could put forward without being accused of aiming too low.
- (2) The high gap projection assumes that the rate of internal savings remains approximately as it is at present, with a marginal savings rate of 20%. This gives a net capital requirement for the five years of U. S. \$1,480 million and a gross capital requirement of U. S. \$ 2,860 million.



- (3) The low gap projection assumes that the marginal savings rate is 25% instead of 20% and that there is a simultaneous reduction in defense expenditure amounting to EE 50 million per year below its 1966-67 level. On these assumptions the net capital requirements would amount to U. S. \$ 734 million and the gross capital requirements to U. S. \$ 2,040 million.
- (4) It is assumed that exports grow at 5.5% per year in the high gap assumption and 8.2% per year in the low gap assumption. These are higher than the rate in the past and is in effect an assumption that appropriate policies will be followed to encourage exports, in particular that domestic demand will be sufficiently restrained to permit the emergence of an exportable surplus.
- (5) It is assumed that the net capital requirements will be financed equally by Eastern European and Western countries. The projection of financing for the high gap assumes that Western aid will take the form of 80% supplier credits and 20% soft aid. This again is a rough attempt to project present borrowing patterns. On the other hand if Egyptian policies were such that the channels of soft aid from the West could be reopened, aid from the West could be on much better terms. Hence the financing of the low gap assumes that only 50% of aid from the West will take the form of suppliers credit and the remainder will be soft aid.

The results of the two projections with given sets of assumptions are therefore the end points of a considerable range. The first projection shows what might happen if, without any change in present policies, Egypt attempted to finance a development program of a size which it is likely to require in the same manner as the balance of payments deficit has been financed in the past. The consequences would be that by 1972/73 the debt service ratio would increase from just below 20% to around 30%. Under the same assumption they will reach much higher levels in the following years. If

exports do not increase at the projected rates the debt service ratio would probably be considerably higher. In fact, of course, if policies are not changed, it is hardly possible that Egypt could carry out investment on this scale since aid would simply not be available. There would therefore be quite a marked slowdown in economic growth. On the other hand, as the second projection shows, given the necessary changes in internal policy a program of this size would be carried through with quite a manageable gap in the balance of payments, which if financed on reasonable terms need not result in any increase in the debt service ratio. Neither of these projections however makes any provision for service on military credits, which might make a significant difference to the size of the capital inflow required and the burden of debt service.

## 5. Bank/IDA Operating Strategy

### (a) General

#### (1) UAR Policies

Some steps taken recently by the Government particularly in the field of internal finance have stabilized the economic situation but this has been done largely at the expense of development expenditures. On the whole the UAR's economic performance cannot be considered satisfactory. A key issue is the effect of defense expenditures on the country's development effort. Foreign exchange policies, poor public savings performance, and harmful controls over domestic economy are other areas of deficiency. It is not practicable to expect all these to be changed markedly for the better quickly. The proposed strategy therefore has two phases: first to demonstrate the Bank Group's willingness to help the UAR and open a dialogue, and second to help bring about the major changes in the policy which would permit lending on the scale needed to sustain reasonable growth. The first phase (which would include some minor lending) would call only for a continuation of the restraints in internal financial policies and of the steps taken towards clearing the arrears and compensation for nationalized properties. The larger scale lending envisaged for the second phase would become possible only if an improvement in foreign exchange policy took place and steps were taken for the rescheduling of the external debt and for a definite improvement in the policies regarding the areas of deficiency mentioned above.

#### (2) Priorities

The sectors to which the Bank Group can at this time give priority both for lending and technical assistance (preparation of projects and surveys) are agriculture and transportation. A very important sector is industry. It is difficult, however, to do something in industry before measures are taken to give more autonomy to the industrial enterprises.

(3) Aid Coordination

There is at present no mechanism, such as a consultative group, for coordinating aid for the UAR. Some form of coordination will be highly desirable should substantial efforts in debt rescheduling and/or aid be made eventually. There would have to be an improvement in the present international political atmosphere and diplomatic relations between the UAR and the USA and Germany would probably have to be restored before a useful and workable coordinating mechanism could be established.

(4) Lending Terms

Except for possible "enclave" projects connected with the Suez Canal, the UAR is not creditworthy at present for Bank financing. Considering the basic resources, the long-run economic potential and the capital requirements of the country, there would be scope for a substantial lending program which may be beyond the possibilities of IDA. The UAR may, however, become creditworthy for Bank lending in a foreseeable future, provided definite action towards improving economic policies is taken and the service on external debt is rescheduled.

(b) The Proposed Five Year Lending Program

The five year lending program amounts to \$217 million, of which \$117 million from IDA and \$100 million from the Bank. The latter would be for the expansion of carrying capacity across the Suez isthmus whether by increasing the capacity of the Canal or building a pipeline system or both.

	<u>1968/69</u>	<u>1969/70</u>	<u>1970/71</u>	<u>1971/72</u>	<u>1972/73</u>	<u>Total</u>
Sectors						
Transportation	20		50		75	145
Agriculture	10	15	15	20		60
Education			12			12
Total	30	15	77	20	75	217

At present the U.A.R. has no development plan. The two illustrative projections show a need for gross capital inflow of \$ 2.9 billion for the first and \$ 2.0 billion for the second alternative. Table III - 3 of the Five Year Program report assumes that \$ 29.0 million would be disbursed by Bank/IDA during the coming five years (i.e. 1% and 1.4% of gross capital inflow, respectively). This amount is based on the average rates of disbursement for past Bank/IDA projects in general. However, in the case of the UAR, some projects in the transportation sector (Railways and Suez) are likely to be quick disbursing and Bank/IDA disbursement of about \$ 100 million for the next five years could be expected. This would correspond to 3.4% of total gross capital inflow for the first and 5% for the second alternative projection.

The main constraint other than "economic" on the Bank/IDA program would basically be the limited availability of IDA funds. There are numerous projects which would be suitable for Bank Group financing, but our knowledge about the degree of project readiness is limited. Some

projects are in an advanced stage of readiness but since the UAR had not had any experience in Bank Group financing other than the exceptional Suez Canal loan, it may take considerable time to reach the necessary degree of readiness for other projects. Our own capability to help prepare and process projects will very much depend on the number of projects undertaken. Several essential studies and surveys leading to project preparation would require substantial manpower on the part of the Bank.

(c) Alternative Lending

Lending in the UAR could be increased in the agricultural sector if projects could be prepared more rapidly than projected in our lending program. Poor policy performance would probably affect the whole program but agriculture and the Suez Canal should be given priority, if possible.

The UAR government emphasized development of the fertilizer industry. If industrial policies improved, the fertilizer industry in particular and industry in general would deserve special attention. With a grave population problem, the UAR should be a candidate for financial assistance in population control should the Bank devise a practical means of attacking this problem with money.

(d) Other Activities and Issues

Studies on inland transport, use of Nile waters and transport across the Suez isthmus are closely related to the lending program. The UAR might be a candidate for being a "laboratory" for population studies. The future of the Bank's relationship with the UAR is too unclear at this juncture to know with any certainty what "other activities" might usefully be projected over the next few years. However, a study of industry might be undertaken within the framework of the Middle East Task Force.

ANNEX:

U.A.R.: Assumptions Used in Illustrative Projections

- 1) Investment: Treated as an independent variable. It is assumed that investments will show substantial increases in the first two years arriving at the pre war level of fixed investment; after that they grow at 7% per annum.
- 2) Capital Output Ratio: 2.5 starting in 1967/68 with one year lag. This relatively low capital output ratio is considered to be feasible in view of (1) past performance; (2) existence of excess capacity in industry; (3) possibilities of quick yielding investments complimentary to the High Dam.
- 3) Marginal Rate of Saving:
  - Alternative I : 20% starting in 1968/69 (this is the continuation of the past performance)
  - Alternative II: 25% starting in 1968/69. It is also assumed that the military expenditure will decline to the immediate prewar level and the difference will be shifted to savings.
- 4) Exports:
  - a) Commodity Exports: Same in both alternatives. 1967/68-1969/70 were projected separately; resulting average rate of growth applied to the period 1970/71 to 1972/73.
    - (i) Commodity exports other than cotton, rice and fuels are projected on the basis of increases during the period 1964/65 to 1966/67.
    - (ii) Cotton: Availability of exportable surplus estimated in relation to expected increase in land under cotton cultivation. Expected price levels in the Commodities Division's price forecasts used to reach the value of exports.
    - (iii) Rice - same as cotton.

(iv) Fuels: Projections provided by the General Organization for Petroleum - these projections are based on proven reserves actual exports may turn out to be higher.

(b) Invisible Earnings:

Alternative I

- (i) Suez Canal: earnings same as 1966/67 level either because it remains closed and Arab assistance continues or due to new super tankers traffic does not increase.
- (ii) Travel and others: It is assumed that it will reach the prewar level in 1969/70 and continue to increase afterwards by the rate of increase of prewar years.
- (iii) Other invisibles - assumed to increase at the rate of prewar years.

Alternative II

- (i) Suez Canal: Revenues increasing at the prewar rates.
- (ii) Travel and Others: Increases at prewar rates until 1969/70 and increases 12% per annum thereafter.
- (iii) Other invisibles: Same as alternative I.

5) Net Capital Requirements and Imports: Treated as residuals.

6) Gross Capital Requirements: It is assumed that the U.A.R. will borrow half of its net capital requirements from western sources and the other half from eastern European countries. It is also assumed that borrowings for service payments on existing debt and new capital inflows will be made from the countries to which the service payments are due. Pipeline of the capital inflow assumed to be constant and gross requirements are estimated as gross disbursement requirements. A rescheduling operation is assumed for the arrears. According to this, arrears will be paid in five years starting 1968/69 with an interest rate of 6%.

Alternative I.

- (a) Borrowing from Western Sources: 80% in the form of suppliers' credits (6% interest 2 years grace and 8 years term to maturity) and 20% in the form of soft aid (1% interest 10 years grace and 40 years term to maturity).

Alternative II.

- (a) Borrowing from Western sources: 50% suppliers credits and 50% soft aid.
- (b) Borrowing from Eastern European countries: Same as alternative I.

7) Central Government Accounts:

- (a) Current revenues: Increases at the growth rate of GDP after 1967/68 (5.6%).
- (b) Current expenditures:

Alternative I: Same as current revenues.

Alternative II: Non defense expenditure increases by 4% after 1967/68. Defense expenditure in 1968/69 is reduced to the prewar level (1966/67) and remains unchanged through the period.

8) Public Sector Savings:

- (a) Central Government: Same as above.
- (b) Local Authorities: Remain unchanged after 1967/68.
- (c) Social Securities: Increases by GDP.
- (d) Business Sector Savings:

Alternative I:

Savings other than Suez Canal savings increase at the rate of increase in GDP.

Alternative II:

Everything increases at the rate of increase in GDP.

Q. CURRENT BANK POSITION



1. Economic Policy Memo  
Minutes of EC Meeting

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EC/O/68 - 48/1

May 21, 1968

ECONOMIC COMMITTEE

Economic Policy Memorandum from the  
Middle East and North Africa Department

UNITED ARAB REPUBLIC

I. Introduction

1. The last time the Committee considered the United Arab Republic was in July 1966. The Committee had before it an economic report prepared by a mission which had visited the UAR in February 1966. This mission had been sent in the expectation that one of the major issues which had stood in the way of Bank lending in the UAR, namely, the question of compensation for nationalized enterprises, would soon be largely settled. It was also expected that the UAR would soon undertake a stabilization program and a reform of its exchange system in connection with a proposed standby agreement with the IMF. The Committee took the position that because of the seriousness of the country's short-term balance of payments problem, such measures would be necessary before the UAR could be considered eligible for any lending by the Bank or IDA. The Committee also felt (See EC/M/66-34 of July 13, 1966) that if a successful development program were to be carried out there would have to be some retrenchment in non-development expenditure, a shift of resources to production for export, some decentralization of economic decision making together with greater reliance on price and market incentives and an external borrowing policy which would keep the burden of debt within tolerable limits. The Committee recommended that a mission should visit the UAR to convey the position of the Bank and to discuss with the Government the Bank's latest economic report and to identify possible projects for financing.

2. A mission went to Egypt in September 1966, timed to arrive immediately after a Fund mission which was to work out the details of the stabilization program. In the event, however, the government and the Fund failed to reach an agreement. At the same time there was a rather far-reaching change in the government in which the Prime Minister, Zakaria Moheiddin, and Dr. Kaissouni, who had been the principal minister dealing with the Fund, lost their positions. As a result, negotiations with the Fund were temporarily discontinued. Another

Fund mission visited the UAR in October 1966. Although there was an agreement in principle, the views differed on the extent of necessary adjustments and an agreement could not be reached. In December 1966, the UAR stopped making payments to the Fund, claiming among other things that it was unable to repay because the U.S. had not renewed PL 480 assistance which amounted to more than U.S. \$ 150 million annually. In the absence of this assistance, the UAR had to apply its foreign exchange resources to buy wheat in the open market.

3. After further discussions between the Fund and the UAR, in early summer 1967, an agreement was reached on the terms of a stabilization program including an adjustment of the exchange system. However, before the agreement could be formally approved the Arab-Israeli war broke out. The discussions were resumed again in late 1967. A Fund mission returned from Cairo towards the end of November with a proposal providing for a Fund drawing, plus compensatory finance, to enable the UAR to roll over completely its immediate liability to the Fund. In previous talks, measures directly and indirectly intended to adjust the exchange rate had been the key elements in the discussions. In the November discussions the UAR representatives argued that, for the time being, such adjustments would not be advantageous since foreign exchange earnings were determined by other factors. They expressed their willingness to make adjustments when normal circumstances returned. The Fund accepted this position. With the help of some bank credits from U.K., Germany and Italy, the UAR repaid the outstanding arrears. Following this repayment the IMF approved in March 1968 two drawings by the UAR amounting to US \$ 63 million. They consisted of (a) a US \$ 40 million drawing in support of efforts by the national authorities to strengthen the UAR's domestic economic situation as well as its payments position, and (b) a US \$ 23 million drawing to assist the country in meeting payments difficulties caused by a temporary shortfall in export earnings during the year ended November 30, 1967. In connection with these operations the UAR Government undertook to take action on the rate of exchange as soon as conditions permitted.

## II. Issues

4. The issues before the Committee are:

- (i) the creditworthiness of the UAR;
- (ii) the eligibility of the UAR for IDA credits.

### III. Discussion of the Issues

5. Any discussion of economic issues concerning the UAR at the present time takes place against the background of the recent war with Israel and the great political uncertainties which hang over the immediate future. Egypt's most important source of hard currency, the Suez Canal, is closed and the economy is largely being maintained by emergency aid from Saudi Arabia, Libya and Kuwait. In these circumstances Egypt cannot be regarded as creditworthy for Bank lending. Moreover, the debt service ratio, even without any allowance for military credits, the amount of which is not known, amounts to 18 $\frac{1}{2}$ % of total foreign exchange earnings and the burden of debt service is likely to rise. The only exception might be an enclave project such as the enlargement of the Suez Canal or the construction of a pipeline across the isthmus, for which specific security could be obtained.

6. As regards eligibility for IDA, the UAR is eligible on grounds of poverty with an income per head of about \$ 160 and on grounds of lack of creditworthiness for the reasons given above. There remains the question of economic performance. The principal aspects of performance are those of economic growth, balance of payments management including the question of arrears, fiscal performance including the question of defense expenditures and the compensation problem.

7. Measured by the increase in GDP the memorandum on the current economic situation indicates that the performance of the UAR over the last decade has been satisfactory. In many respects the management of economic affairs in the UAR is fairly sophisticated as compared with many other countries at a similar stage of development. The whole irrigation system, for example, is reasonably efficient, and so are some of the older industries such as textiles. On the other hand, there are a number of problems arising from the introduction of a form of centralized control after the nationalizations of 1961 which are reflected in the difficult situation faced by many of the newer industrial plants established in the last decade. The UAR is no longer wedded to the present rigid system of central control and it is recognized that changes need to be made. Thinking has not, however, reached the stage of defining a new system of organization to leave more initiative with individual undertakings. Liberalization of essential imports would be an important factor in this connection, but the weak external payments position in any case probably precludes significant progress in this direction at the present time.

8. The measures to maintain revenue that have been introduced since the June war show that a determined effort is being made to improve the services budget; the investment budget indicates that expenditure is being kept down to hold in check resort to deficit financing.

9. The balance of payments' deficits which the UAR has been incurring for many years are the reflection of the economy's most pressing problem, namely to carry out an adequate investment effort without undue reliance on foreign resources. This has created the short-run difficulty which has appeared in the form of substantial arrears in debt payments, mostly for suppliers' credits. These amounted to \$ 95 million at the end of December 1967. The arrears on all commercial bank credits have been rescheduled and are being paid on time. For the suppliers' credits, rescheduling agreements have been reached with Germany and Italy, which account for \$ 29 million and discussions are taking place with Japan, Canada, Denmark and the Netherlands regarding another \$ 9.4 million. A "temporary arrangement" has been agreed with the U.K. for \$ 6.1 million. This leaves some \$ 50 million, of which \$ 38 million was payable to the United States on account of loans from AID, Eximbank, and CCC. Egypt ceased to make payments on these debts after diplomatic relations with the United States were broken last June. The government has made a statement reflecting a desire to discuss some arrangements for dealing with these payments, but as of the present moment, no new developments have taken place.

10. It is clear that much the most important factor which will influence both the budget and the balance of payments in the future, will be the course of defense expenditure. In the short run, defense spending determines the budget deficit and in the long run a reduction in defense expenditure is the most obvious way in which additional internal resources could be found to support a new development plan.

11. Some progress has been made with the problem of compensation for sequestrated and nationalized properties. The main outstanding matters are the nationalized UK properties, the Belgium tramways and the Dutch brewery; the amounts involved are not very large.

#### IV. Conclusion

12. For several years the government of the UAR has been facing a situation in which it was becoming increasingly difficult to find sufficient foreign aid to meet the gap in its resources produced by high investment and current government expenditure and a level of savings which, while not low, was nevertheless not high enough. At first, in 1962 and 1964, the government's efforts to adjust to its problem came to very little, but as the position grew worse it became increasingly evident that stronger measures were necessary. In

practice, economic policy was determined by the degree to which those members of the government, who attached importance to sound economic management, were able to prevail against political and military considerations. However, after some false starts, the government had by May 1967 reached an agreement in principle with the Fund which did include a de facto devaluation. This reflected the government's acceptance of the point that the improvement in the balance of payments should be given a higher priority than it had been accorded in the past. There is little doubt that the lessons of the experience of the last few years have been learned by many in the government so that, in this respect, the prospects for the future have improved. The war of last June did not really bring any fundamental change to this picture except that it left Egypt dependent on its Arab neighbors instead of on the Suez Canal. It also provided the government with the political circumstances necessary for it to make the further retrenchments which were required.

13. A decision regarding IDA eligibility must be taken with this history of evolving policy in mind. Although much remains to be done regarding settlement of arrears, rescheduling of debt, compensation and, not least, exchange rate policy, much has been done in all of these respects. A justification for IDA lending would therefore have to rest on a record of improvement and would have to include an expectation that the record would be continued. Whether it will or not depends very largely, of course, on political events in the Middle East. Finally, it is relevant to note that, unless some lending operations are undertaken in Egypt, the Bank can have little further influence on economic policies.

14. In the light of these considerations it is my opinion that, at the present time and subject to the continuation of the improvement in economic policy experienced over the last eighteen months, the UAR should not be regarded as ineligible for IDA lending.

Michael L. Lejeune  
Director

# ECONOMIC COMMITTEE

EC/M/68 - 24

May 27, 1968

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## Conclusions and Recommendations on the Economy of the United Arab Republic

### I. Introduction

1. The Economic Committee met on May 23, 1968<sup>1/</sup> to consider the Economic Policy Memorandum on the U.A.R. from the Middle East and North Africa Department (EC/O/68-48/1, dated May 21, 1968), attached herewith. The Committee also had before it the draft economic report "Current Economic Situation in the United Arab Republic".<sup>2/</sup>

2. The main issues before the Committee were:

- (a) the U.A.R.'s economic performance and creditworthiness, and
- (b) its eligibility for IDA credits.

### II. Conclusions and Recommendations

#### Economic Performance and Policies

3. The Committee concluded that the U.A.R.'s economic performance could not be considered satisfactory. In addition to the concern about the effects of defense expenditures on the country's development effort (public investment expenditures have been declining for the last three years), the following were flagged as the main areas of deficiency.

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1/ Members of the Economic Committee present: Messrs. Friedman (Chairman), Kamarck, de Vries, Larsen, McDiarmid, Sadove, Thompson, van der Mel, Wright.

Also present: Messrs. Lejeune, Benjenk, Stevenson, Collier.

Messrs. Gunter, Gerakis (IMF).

2/ Report MA-4, distributed to the Economic Committee on May 20, 1968 (EC/O/68-47).

#### D I S T R I B U T I O N

##### Committee:

The Economic Adviser to the President, Chairman  
Director, Economics Department  
Director, Special Economic Studies  
Director, EDI  
Special Adviser to the President (Mr. Rist)  
Senior Adviser, Economics Department  
Economic Advisers, Area and  
Projects Departments

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Directors, Area Departments  
Secretary  
Treasurer  
Director, Information Department  
Director, European Office  
Secretary, Loan Committee  
Executive Vice President (IFC)

- (a) harmful controls over the domestic economy (mainly industry and agriculture);
- (b) inefficiencies in publicly-owned enterprises;
- (c) price/wage structures (price controls with increases in wages);
- (d) poor public savings performance; and
- (e) exchange rate policies.

The Chairman commented that the exchange rate was important to the Bank as well as to the IMF, because of its significance for the country's basic resource allocation.

(The Government has indicated to the Fund its intention of making adjustments in the exchange rate as soon as conditions permit.)

Economic Justification for Bank Group Assistance

4. Notwithstanding its assessment of economic performance, the Committee agreed that exceptional circumstances existed and that at this time a small amount of Bank Group assistance on soft terms would be justified, if it helped to establish a dialogue with the Government on the means for improving economic performance. ✓

5. Furthermore, the Committee considered that with the country's basic resources, long-run economic potential, and capital requirements, there could be the opportunity for a substantial lending program (including Bank loans), if there were adequate improvements in economic performance. ✓

6. Some improvements had occurred in the past year. Austerity measures were introduced to help meet the financial problems created by the June 1967 war, and there was more effective utilization of domestic resources. Also, the agreement reached with the IMF in March 1968 was being implemented.

7. The Chairman said that the economic performance and policy issues applied to both Bank and IDA operations. At this time the Committee would confine itself to the proposed lending on soft terms. The Committee would consider the question of creditworthiness for Bank loans if and when the occasion arose.

8. Economic Policy Conditions: In response to the proposal that some policy conditions, even minor items, be required for the proposed assistance, Mr. Lejeune commented that once the Bank Group undertook to start operations in a particular sector there would be many items whereby the Bank Group could test the authorities' good faith.



9. Initially, with the proposed level of assistance, the Bank Group could not expect to exercise any significant effect in realizing improvements in economic performance. Hopefully, this could occur over a period of time as mutual confidence became established. Moreover, the Chairman suggested, and Mr. Lejeune agreed, that it would be very helpful for strengthening the Bank's leverage even at this time to indicate to the U.A.R. authorities that given proper economic policies the World Bank Group regarded the U.A.R. as a recipient of much larger funds than now being discussed.

10. Meanwhile, the Bank's assessment of the main existing deficiencies, as mentioned above, would be conveyed to the appropriate authorities.

11. Bank Loans: Risks would be involved in both IDA and Bank operations. In the possible event of Bank loans being considered, it would have to be kept in mind that, with the U.A.R.'s debt problems, some debt rescheduling exercise would be inevitable.

C. F. Owen  
Secretary

Attachment: Economic Policy Memorandum on the U.A.R. from the Middle East and North Africa Department (EC/O/68-48/1, dated May 21, 1968).

Secretary's Department

2. Joan Com. Meeting  
memo, June 4 and Minutes

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LC/O/68-44

May 31, 1968

LOAN COMMITTEE

Memorandum from Middle East and North Africa Department

UNITED ARAB REPUBLIC

Background

1. The Bank has made only one loan for a project in the United Arab Republic. This was a loan of \$56.5 million, made in December 1959, for the deepening of the Suez Canal. On April 30, 1968, \$33.5 million of this loan was held by the Bank. An economic mission visited the UAR in 1962 but further lending has been prevented both by a deteriorating economic situation and because, in 1961, the UAR Government nationalized almost all the industrial, commercial and financial enterprises of any size in the country both Egyptian and foreign, and negotiations concerning the payment of compensation for these properties have been proceeding ever since.
2. Another economic mission visited Egypt in February 1966. By that time the Government had made substantial progress with its compensation negotiations, particularly with regard to the important case of the Shell Oil Company. It had also indicated its desire to reach a new agreement with the IMF and discussions for this purpose were expected to take place in the Spring. After considering the mission's report the Bank took the position that it could lend only after an agreement with the Fund was reached. However, during the course of 1966 Egypt's position became more difficult. The withdrawal of Egyptian troops from Yemen did not take place as expected and after June 1966, the United States ceased to provide wheat under P.L. 480 arrangements. Finally, in September 1966 the Government and the IMF failed to agree on the conditions for a drawing and Dr. Kaissouni, the minister chiefly responsible for the negotiations on the Egyptian side, lost his post in a cabinet re-shuffle. After an interval, however, negotiations between the IMF and the Government were resumed and an agreement in principle was reached just before the June war. In view of these developments, the Bank was planning to send a mission to the UAR in the summer of 1967 to update the 1966 economic report and to prepare projects for later financing. This mission did not materialize because of the war.
3. Later last year negotiations with the IMF were again resumed and I visited the UAR in December 1967 as a part of a series of visits in the area covered by the Middle East and North Africa Department. During this visit I tried to find out how we could take up where we had had to leave off in June 1967. We agreed with the Minister of Economy that the first step would be an economic and project identification mission, possibly in February or March.

4. An agreement between the IMF and the UAR was finally approved by the Executive Directors of the IMF in March 1968. Whereas, however, the agreement in principle reached early in 1967 envisaged a de facto adjustment of the Egyptian exchange rate, the present agreement contains a statement of intention by the Government that it will consider an adjustment of the exchange system when circumstances are more propitious. The Egyptians argued that an exchange adjustment would not be effective in present circumstances and the Fund accepted this.

#### Present Status of Major Issues

5. Economic Situation: A mission from the Bank visited Egypt in March 1968 in order to obtain up-to-date information on the economic situation and to identify possible projects. A memorandum describing its findings has been presented to the Economic Committee (see paragraph 11). The mission concluded that the UAR government had taken some determined steps since the June war in the field of internal finance and had made some efforts towards clearing the problem of arrears on external debt, and that the economy had potential for satisfactory future growth provided political stability was established and the government continued taking effective policy measures.

6. Compensation for Nationalized Properties: Since the nationalizations of 1961, the UAR has concluded a number of compensation agreements with foreign governments. These agreements concern the procedure whereby the amounts paid in compensation are made available for use in the receiving country. They are not concerned with the valuation of any of the properties nor with questions concerning the legitimacy of specific claims. In its contacts with the foreign diplomatic missions in Cairo, the economic mission was given the understanding that the implementation of these agreements is proceeding without major difficulties.

7. Agreements of this type have been concluded with Switzerland, Italy, France, Lebanon, Denmark and Greece. The most important countries remaining are the United Kingdom, Belgium and the Netherlands. Negotiations with the U.K. have been delayed by a series of prior difficulties and negotiations about sequestered property. These difficulties now appear to have been overcome and payments for sequestered property began to be made in March. The way is therefore open for discussions with the U.K. about the nationalized properties to begin.

8. In the Belgian and the Dutch cases there is a problem concerning the valuation of certain specific assets. In the case of the Belgian-owned Cairo Tramway Company, a Government commission stated that its value was nil. Apparently the Egyptian Government had at one time levied some fines against the company which had not been paid. The company did possess, however, some assets in Brussels when it was nationalized and it may be that some agreement might be reached whereby the Egyptian Government gives up its claim to these assets.

9. The Dutch case concerns a brewery in which Heinekens had a participation. This property was sequestered before it was nationalized. Normally when any property was sequestered all trading in its shares was stopped. However, owing to some administrative oversight, trading in the shares of this brewery was allowed to continue and the shares fell from around £E 10 to around £E 2. The latter therefore became the value for compensation purposes in accordance with the nationalization law. The Egyptians claim that they cannot ignore the law without inviting claims based on "most favored nation" treatment from many other claimants. The Dutch claim that their case is exceptional and should be treated as such. The amount involved for the Heinekens claim is about \$1 million equivalent.

10. Arrears on External Debt Repayments: The UAR has arrears in debt payments mostly for supplier credits. These arrears amounted to \$95 million at the end of December 1967. Arrears on all commercial bank credits have been rescheduled and are being paid on time. For the suppliers' credits rescheduling agreements have been reached with Germany and Italy, which account for \$29 million, and discussions are taking place with Japan, Canada, Denmark and the Netherlands regarding another \$9.4 million. A "temporary arrangement" has been agreed with the U.K. for \$6.1 million. This leaves some \$50 million of which \$38 million was payable to the United States on account of loans from AID, Eximbank, and CCC (Commodity Credit Corporation). Egypt ceased to make payments on these debts after diplomatic relations with the United States were broken last June. The Government has made a statement reflecting a desire to discuss some arrangement for dealing with these payments but as of the present moment no new developments have taken place.

#### Proposal for Bank Position

11. The main elements in a decision on beginning to lend to the UAR are the adequacy of the economic performance and particularly the immediate balance of payments position and the questions of compensation and arrears on external debt. The Economic Committee in its meeting on May 23 noted the efforts towards stabilization but found that performance continued to be unsatisfactory and, indeed, that the stabilization was achieved at the cost of reducing development expenditures and that problems such as exchange rate adjustment, high military expenditures and inefficiency of industry were still outstanding. The Committee considered that with the country's basic resources, long-run economic potential, and capital requirements, there could be opportunity for a substantial lending program, including Bank loans, provided there were adequate improvements in economic performance. In view of the exceptional circumstances which existed, the Committee agreed that at this time a small amount of IDA financing would be justified if it helped to establish a dialogue with the Government on the means for improving economic performance. A continuation of lending beyond an initial credit, however, would have to depend on significant changes in development policies.

12. As to creditworthiness for Bank loans, one must note that the present debt service ratio is around 18.5% of export earnings, including earnings from the Suez Canal at the 1966/67 level. This is relatively high but would in itself not necessarily preclude Bank lending if economic performance in other respects were satisfactory. Today, however, not only is performance unsatisfactory but, with the Canal closed, Egypt's balance of payments problem would probably be unmanageable were it not for heavy subsidization from Saudi Arabia, Libya and Kuwait. In these circumstances I would not recommend Bank lending except possibly for some "enclave" operation, such as for the Suez Canal, which would permit any lending to be directly secured by foreign exchange earnings.

13. The situation with regard to compensation is somewhat similar to that of the arrears on external debt in that, while it has not been finally resolved with all countries, a great deal of progress has been made. Thus a lending operation at this time could be justified by reference to what has already been achieved and to the Government's declared readiness to discuss arrangements for settling the outstanding cases. We should make clear the need for further progress in this regard.

14. In taking a decision on lending to the UAR it would be unrealistic not to consider the factors mentioned above against the background of the political situation in the Middle East and the Bank's whole relationship with the UAR. Apart from the Suez Canal loan, which was of a somewhat exceptional nature, the Bank Group has never had a lending program in the UAR. While the responsibility for this lies with the Egyptians and not with the Bank, it combines in Egyptian minds with the general suspicion of the motives and sincerity of the West and creates a feeling that the Bank may be discriminating against Egypt. In 1964 the Egyptians were told that the Bank could not consider lending until after the Shell compensation case had been settled. In 1966 the Egyptians were told that the Bank could not proceed with lending in the absence of an agreement with the IMF. Both these conditions have now been met and, although it was always made clear that these were necessary but not necessarily sufficient conditions, the Egyptians have some justification for their expectation that the Bank Group should now lend. This is no doubt reinforced in their minds by their having met their obligations to the Bank at a time when they were so short of money as to have to choose between creditors.

15. Egyptian foreign policy is still based on the notion of "neutralism" despite the country's present close association with the Soviet Union. This association is based on a straightforward coincidence of immediate political interests, i.e. Egypt's need for military equipment and political support in its contest with Israel and the Soviet Union's desire for friendly powers and general political influence in the eastern Mediterranean. Egypt's relationship with the West is much more complex. Because of its strategic position its history has been closely bound up with that of the major western powers. A large proportion of its educational and scientific elite has been educated in the West. For this reason the links with the

West go much deeper into Egyptian society than do those with the Soviet Union. On the other hand there is also the attitude of hostility and suspicion of the West arising from the memories of Egypt's colonial past and from the territorial settlements in the area after the Second World War. Nevertheless, there are elements in Egypt who appreciate the wisdom, both political and economic, of keeping open the lines of communication with the West and their influence is reflected in the recent agreement with the IMF, the efforts to bring more orderly management to the balance of payments and the desire for assistance from the Bank. If the Bank Group is to play any part in Egyptian development efforts and to have any influence on economic policies aimed at improving the situation, then, in my opinion, it would now be appropriate to respond by showing our readiness to undertake operations, albeit initially in a small and exploratory way. It is clear that any large scale operation in Egypt could be undertaken only when we were satisfied that Egypt's economic performance would be improved.

#### Possible Operations

16. The economic mission collected information on projects which might be suitable for financing. They are summarized in the attached note. For reasons stated above, any initial lending would have to come from IDA, with the possible exception of an "enclave" project. When informing the UAR authorities about our readiness to consider operations, we should point out that the eventual approval of any initial financing will depend on continued progress being made in improving the short-term balance of payments position and in settling compensation issues, and that any large-scale financial assistance would depend on improved economic performance.

17. There are a number of possible projects which have already been identified. However, both irrigated agriculture and the expansion of carrying capacity across the Suez isthmus (whether by increasing the capacity of the Canal or building a pipeline system, or both) require extensive feasibility and optimization studies before we could reach the stage of making final appraisals. Moreover, because of the unfamiliarity of the Egyptians with Bank procedures, the initial operation should be one which would not raise particular problems on the project side. The railway financing mentioned in the attachment \* would seem to be suitable in this respect and is given priority by the Egyptians. "Engineering credits" for the preparation of agricultural projects based on the Aswan water or of a Suez Canal or pipeline project might also fit. There would furthermore be the possibility of lending for the clearance of the Suez Canal, but any consideration of this would depend on enough progress being made in reaching a political settlement to permit free and safe activity in the Canal zone. ✓

#### Recommendation

18. I recommend that the Government of the UAR be informed: ✓

\* See "Note on Possible Projects" (Item DL)

# LOAN COMMITTEE

**DECLASSIFIED**

LC/M/68-19

**APR 01 2013**

June 17, 1968. **WBG ARCHIVES**

Minutes of Loan Committee Meeting held on  
Tuesday, June 4, 1968 at 3:00 p.m. in the Board Room

**A. Present:**

- |                              |                                |
|------------------------------|--------------------------------|
| Mr. J. Burke Knapp, Chairman | Mr. M.L. Hoffman               |
| Mr. G. Alter                 | Mr. M.L. Lejeune               |
| Mr. A. Broches               | Mr. S.N. McIvor                |
| Mr. I.P.M. Cargill           | Mr. F.R. Poore                 |
| Mr. B. Chadenet              | Mr. A. Stevenson               |
| Mr. D.J. Fontein             | Mr. M. Cherniavsky, Secretary. |

**In Attendance:**

- |                    |                       |
|--------------------|-----------------------|
| Mr. L.W. Bartsch   | Mr. A. Karaosmanoglu  |
| Mr. W.C. Baum      | Mr. M. Karcher        |
| Mr. M.P. Benjenk   | Mr. K.S. Krishnaswamy |
| Mr. D.H.F. Bickers | Miss A.L. Maher       |
| Mr. J.H. Collier   | Mr. J.L. Upper        |
| Mr. K.D. Hartwich  | Mr. P. Sella          |
|                    | Mr. W.A. Wapenhans    |

**B. United Arab Republic**

1. The Committee considered the memorandum from the Middle East and North Africa Department " United Arab Republic" (LC/O/68-44 dated May 31, 1968) and noted that the "exceptional circumstances" which might be held to justify a small amount of IDA financing in the UAR in spite of its serious deficiencies in economic performance were that : (i) the Bank had done no recent business with the UAR, which was an important member country; (ii) the sole Bank operation in the UAR (the Suez Canal Loan of 1959) was an enclave loan of a special character; (iii) economic missions had visited the UAR in 1962, 1966 and most recently in March 1968 and the

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Committee:

- Mr. J. Burke Knapp, Chairman
- Mr. S.R. Cope, Deputy Chairman
- Mr. S. Aldewereld, Vice President
- Directors, Area Departments
- Director, Projects Department
- General Counsel
- Director, Economics Department
- Director, Development Services Department
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- Executive Vice President (IFC)
- Vice President (IFC)



Egyptians had come to expect some action, particularly as they had now arranged for some drawings on the IMF and in other respects felt they had met some of the Bank's prior conditions; (iv) a small amount of lending would be taken by the UAR as an earnest of the Bank Group's intention to be helpful, which was important for establishing a dialogue with the Government on the means for improving economic performance and (v) since the UAR was the most important Arab country, the Bank's relations with it were inevitably bound up with the Arab world as a whole.

2. The Area Department recalled that the Economic Committee had agreed that these exceptional circumstances qualified the finding of poor economic performance. The Department was therefore recommending a two-phase approach, the first designed to win the confidence of the Egyptian Government and to open a dialogue with it and the second to be a substantial contribution to the UAR's economic development, to be entered upon only after its economic performance was judged more satisfactory. To implement the first phase the Department was recommending a small initial amount of lending with some needed technical assistance, and to this end proposed that the Bank inform the UAR that it was prepared to proceed with the appraisal of a railway project for a credit of up to \$25 million and to make "engineering credits" (totaling some \$2 to \$3 million) for specified preinvestment studies, subject in both cases to continued progress being made in improving the short term balance of payments position and in settling compensation issues. The Department explained that the railway project had been selected because it was ready for appraisal, was of economic priority and was unlikely to produce controversial issues between the Association and the Egyptian Government in the course of appraisal and negotiation. The Egyptian Railway Administration was financially sound, well organized and well managed. The project (principally track renewal) could be quickly appraised and was undoubtedly of high priority whatever the subsequent findings of a transport survey. The Department added the following points :

- (i) that given the history of the Aswan Dam, it would be disastrous for the Bank's relations with the UAR to embark on appraising a project for financing and then to draw back from consummating the credit;
- (ii) that because of the UAR's acute balance of payments problem and their hopes of help from the Bank and IDA, any initial lending program of less than, say, \$15 million ran the risk of being thought derisory; and
- (iii) that to move ahead with the engineering studies but not a significant loan for an investment project would probably be insufficient to win the UAR's confidence that the Bank Group meant business.

Moreover, from the information at hand it seemed unlikely that significant projects in other sectors (such as agriculture) could be so easily and quickly worked out. It was stated that a grain storage project ✓

initially involving an IDA credit of \$15-\$20 million might take about 12 months to work out, as would a Delta drainage project requiring a credit of \$10-\$12 million. There was some danger that a complicated initial program would compromise the objective of trying to establish a constructive relationship with the UAR. ✓

3. The Chairman commented that even if a decision was made after consultation with the Part I countries that IDA should commence lending operations in the UAR, he had difficulty with the recommendation that there should be an immediate commitment of IDA funds of the order of \$20 to \$25 million. This amount would represent a sizable slice of second replenishment resources when they became available. He also felt that the Bank's first, pace-setting credit should be in a sector (probably agriculture) where the Bank could have a greater impact on economic development problems and policies than it would have by simply being the purveyor of foreign exchange for a routine track renewal credit.

4. Some Committee members felt that the proposal put forward by the Area Department might well be the "price" that the Bank would have to pay for establishing a relationship with the UAR after so many years of inactivity and lack of agreement, while others were of the opinion that the Bank should not put itself in the position of proffering a credit to the UAR in order to "buy" a dialogue with the Government or to get them to swallow some preinvestment studies. On the economic performance issue it was, on the one hand, argued that the Bank should not water down its normal criteria by introducing "special circumstances" and, on the other, that performance criteria could not after all be very precise and the Bank should consider the UAR case on its over-all merits. In this connection, it was suggested that the unsatisfactory economic performance of the UAR really consisted of its large defense expenditures, which it would be difficult for the Bank to criticize in the light of the tense situation in the Middle East.

5. Other comments which were offered on the Area Department's recommendation were that the caveat that the initial lending program would be subject to progress with the short term balance of payments and with compensation (Paragraph 2 above) would not be enforceable if failure by the Bank to follow through would in fact give serious offense; that in the absence of a massive aid effort and debt rescheduling it would be foolhardy for the Bank to go it alone in the UAR, since only a coordinated assault by a group of countries would have any lasting effect; finally, that a start should not be made with preinvestment studies unless they had the keen support of the Government and until country economic performance had improved sufficiently to justify the follow-up lending program.

6. In conclusion, the Chairman observed that no problems had been raised about a possible Bank loan to the Suez Canal Authority for canal investment or pipelines; this would be a service to the international community and such a loan would be an enclave operation, presumably secured by a firm pledge of foreign exchange revenues. On the choices the Committee faced on the IDA side, preinvestment studies along the lines recommended by

the Area Department were obviously needed and would represent an appropriate initial contribution from IDA funds; however he felt that one of the drainage or grain storage projects mentioned in the attachment to the Area memorandum would provide a much better vehicle for a first substantive lending operation. The fact that such a project would take longer to prepare and appraise and would probably call for a somewhat smaller credit than the railway project should in the circumstances be considered an advantage. He (the Chairman) would meanwhile report the Committee's views to the President in anticipation of the President's visit to Cairo in July, and no further steps should be taken until the President had decided on the best course of action. ✓

C. Adjournment

The Committee adjourned at 5:00 p.m.

Secretary's Department  
June 17, 1968.

D. POSSIBLE PROJECTS

1. Agriculture and  
Transport

UNITED ARAB REPUBLIC

Note on Possible Projects

1. A list of projects discussed in a preliminary way by the economic mission in March 1968 is attached as Annex 1. This note comments in particular on the status of readiness and the priority of these projects.

Agriculture

2. A review of the tentative projects in agriculture indicates that none of the proposed nine projects is at a sufficiently advanced stage of preparation to be ready for submission to the Bank Group for consideration for financing in the immediate future. Most of them would appear to require extensive feasibility studies before that stage could be reached. However, three projects appear to be more ready for submission to the Bank than the others and it is probable that during a period ranging from 6 to 18 months one or more of them could be brought, by additional studies, to a stage at which appraisals could be made. Assuming the appraisals went smoothly, negotiations would follow about four to five months later at the earliest.

3. These projects, the time which is likely to be needed for additional studies, and the expected cost of the studies are as follows:

Project	Estimated Total Cost <u>(US \$ million)</u>	Estimated Preparation Period <u>(months)</u>	Estimated Cost of Studies <u>(US \$ '000)</u>
A. Grain storage	57.6	6-12	75-150 ✓
B. Major drainage pumping stations	18.4	12	not known
C. Field drainage	25.2	12-18	not known

Of these, the grain storage project is not only the most suitable for immediate Bank financing of studies - which could be carried out by consultants - but it is also given the highest priority by the Government of the UAR. It is described in detail in Annex 2. Annexes 3 and 4 describe the drainage pumping stations project and the field drainage project respectively, for which we consider that either preparation or identification missions are necessary before we could make an estimate of the probable cost and duration of the additional studies which would be needed. ✓

4. The other six agricultural projects (items 4 to 9 in Annex 1) are also given a degree of priority by the Government but are less known to us and may require substantially more preparation. We know from the past discussions that the Salhia and Daba's irrigation projects in particular need much more preparation and that severe soils problems have to be anticipated in the case of the Salhia, Bahr Tira/Lake Burullus and El Hager projects.

.../..

5. Apart from project considerations, policy issues in the field of agriculture such as compulsory cropping patterns, marketing controls and price policies might present substantial obstacles to Bank/IDA lending in this sector. If any one of the projects mentioned is thought to be suitable for Bank/IDA assistance in project preparation, early attention should also be given to the relevant aspects of agricultural policies and the need to bring about a policy framework conducive to efficient utilization of these investments.

#### Transport

6. The two transport projects which were discussed by the recent economic mission in addition to the Suez Canal, i.e. the railways and the Nubaria Canal, are both in a fairly advanced stage of preparation and would offer scope for relatively straightforward lending. It is unlikely that either of them would require additional study before appraisal.

7. The Egyptian Railways have on the whole demonstrated considerable efficiency in their operations as well as financial responsibility, and the management appears to be sound and competent. It may be expected, therefore, that lending for a track renewal project, which would be carved out of their overall investment program, would not raise any problems which it would be difficult to resolve. The pre-appraisal mission which visited the UAR in October 1966 reported that a considerable backlog of track renewals existed at that time, amounting to about 2,300 track-kms, of which only a small share have been replaced in the meantime. Therefore, Bank Group participation in a program covering only, say, 500 km of track renewal, as recommended in the Loan Committee memorandum, could be limited to that portion of the overall program which would comprise the most immediate renewal requirements. This would avoid also the question whether the renewals might be deferred until the early or mid-1970's when heavy-gauge rails might be produced at the expanded Helwan steel mill. Track renewal of 500 km would require foreign exchange of about \$18 million which corresponds to about 50% of total cost. Certain other priority items in the Railways' investment program, such as signalling, might be added, depending on the amount of lending envisaged.

8. The recent Economic Report states that there has been a tendency to neglect investment in transport with the result that some bottlenecks have arisen. This would appear to be particularly true of the track renewal program since other parts of the railway investment program have been carried forward proportionately faster. It would be highly desirable to obtain the Government's agreement to an overall study of transport investment needs which would examine the question of rail, road and waterway competition and the investment priorities between and within transport sectors. Assuming that answers to a detailed railway questionnaire which has already been sent to the railways at their request would become available in August, an appraisal mission might be able to visit the UAR in September and the project might be ready for Board consideration early next year.

9. The Nubaria Canal, which was constructed as part of an extensive irrigation project and is now being widened to increase the flow of water to further areas of cultivation, offers attractive possibilities for providing a new route for water transport between Cairo and Alexandria. This could be done

at little additional cost (US \$17.4 million equivalent of which about \$3 million in foreign exchange), namely the costs of raising bridges, enlarging locks, widening 20 km of the existing canal, and building 18 km of new canal purely for transport purposes. Detailed engineering is available for all the transportation works proposed for the existing canal. For the remaining 18 km of new construction, detailed engineering is expected to be completed by September 1968. It could be possible, therefore, to send a Bank mission to review the detailed engineering by September/October 1968.

10. The economic mission felt that this project should have a high priority since much of the dry cargo traffic moving between Alexandria and Cairo would be well suited to movement by inland waterway. Additional benefits may result from direct overboard loading and unloading in the port of Alexandria, thus reducing the handling costs and, possibly, the investment requirements in the port.

#### Suez Canal and Pipelines

11. A memorandum on this subject was sent to Mr. McNamara on May 17, 1968 and is included as item D 2 in the briefing.

12. The clearing required for the reopening of the Canal would from a technical point of view probably be neither a larger nor difficult task. However, before we could reach the stage of considering a loan for enlarging the Canal or building an associated pipeline system, the alternative systems of transporting oil from the Middle East would have to be studied very carefully. A British consulting firm, the International Management and Engineering Group (IMEG) submitted a preliminary report to the Government of the UAR in April 1967 on the feasibility of a pipeline system, and reports appeared in the press on June 10, 1968 that this firm had signed a contract to do an additional three months' study for the Government. In their preliminary report the consultants emphasized the need for much more detailed study, and it is very doubtful that the many questions involved in this complex investment decision can be covered adequately by one firm in a period of three months. We have no basis for estimating without more detailed investigation how long an adequate study would take nor how much it would cost.

Attachment

June 18, 1968  
Middle East and North Africa Department





U.A.R.Tentative List of Projects

<u>Project</u>	<u>Description</u>	<u>Estimated Costs</u> <sup>1/</sup>	
		<u>Total Cost</u>	<u>Foreign Exchange</u>
<u>Agriculture</u>			
1. Grain Storage	376,000 tons capacity	57.6	31.7
2. Major Drainage	15 pumping stations	18.4	11.6
3. Field Drainage	360,000 feddans <sup>2/</sup>	25.2	5.0
4. Rayan Valley	20 km major drainage	9.2	?
5. Basin Conversion	191,000 feddans	43.0	3.0
6. Salhia Reclamation and Irrigation	First stage of 95,000 feddans out of total 312,000 feddans.	85.5	20.0
7. Daba's Reclamation	100,000 feddans	65.6	?
Bahr Tira and Lake Burullus Reclamation	25,000 feddans	17.3	?
9. El Hager Reclamation	25,000 feddans	16.7	4.0
<u>Transport</u>			
1. Railways	Track renewal (assumes 500 km which could be increased)	37.0	18.0
2. Nubaria Canal	Inland water transport	17.4	3.0
3. Suez Canal	Reopening of Canal	?	20.0
4. Transport across Suez Isthmus	Expansion of Suez Canal, construction of pipelines or combination of both.	250.0	125.0

<sup>1/</sup> The degree of accuracy of the cost figures varies considerably. In some cases, e.g. the projects connected with the Suez Canal, the figures indicate tentative orders of magnitude only.

<sup>2/</sup> Feddan = 1.038 acres



Grain Storage Project ProposalBackground

Large preventable losses of grain in the distribution channels from the producer or from the importer to the consumer now occur due to spoilage, insects and rodents. The present system of handling grain by hand in sacks and storing in open sheds or merely stacked in yards is inefficient and wasteful. This system is completely inadequate to cope with the increasing volume of grain requirements for the concentrated and rapidly growing populations of the cities.

The extent of physical losses under the present system has been conservatively estimated at 3 percent for wheat, 2 percent for corn and 2.8 percent for millet. Applying these percentages to total grain consumption indicates a total annual loss of the three grains of about 185,000 tons, which have a local value of about US\$ 12 million. In addition, hidden losses, due to changes in the physical and chemical characteristics of the cereals and in their palatability, are in all probability equal in amount to the above measured losses.

The 58,000-ton silo in Cairo and the 48,000-ton silo in Alexandria, completed in 1961, have helped to meet critical needs in the two main population centers of the UAR, but these installations fall far short of meeting total needs. The need for modern storage and distribution to serve the other Governorates is completely unfilled.

An economic and engineering feasibility study for a country-wide grain storage and distribution system was financed by USAID and completed by Weitz-Hettelsater Engineers in August 1961. Their recommended system of grain receiving, handling, storage and distribution included the following:

- a) port silos for unloading ships and making possible an even flow of grain into the internal system;
- b) large distribution and terminal silos for receiving grain from ports and supplying large consumer flour mills as well as smaller storage facilities serving the outlying areas; and
- c) small distribution storage facilities to receive from the terminal silos and to distribute to local areas and, in producing areas, to function as gathering silos for the local grain during the marketing season.

The total system would have had a capacity of 622,000 tons of silo storage and 215,000 tons of flat storage. The design system would have handled up to about 3 million tons of grain per year. The Government, at that time, proposed that the system would be built under a two-phase construction program. Phase I would have included storage at 23 sites in Lower Egypt and Phase II additional storage facilities at 30 sites in Upper Egypt. See Map 1 for proposed location of facilities.

The Government called for bids for the construction of Phase I early in 1964 and received tenders from four consortia of US firms on July 30, 1964. The low bid, at 45 percent higher than the engineers' estimate of total cost and almost 150 percent higher than the foreign exchange estimate, exceeded the amount of funds available. The consultants were thereupon instructed to prepare a revised project to fit the availability of funds and they prepared a proposal for 534,000 tons of silo storage and 196,000 tons of flat storage in a project of two stages. The revised project was not constructed because USAID, which was to have financed it, suspended its operations in the UAR in November 1964, and funds have not been provided for the program from other

sources since that time.

Despite anticipated increased domestic production of cereals, it is expected that the UAR will have to continue to import considerable volumes of wheat, flour and maize. In fiscal year 1965/66, 1.22 million tons of wheat and 510,350 tons of wheat flour were imported; in 1966/67, 1.41 million tons of wheat and 522,560 tons of wheat flour; in 1967/68, imports are expected to be the equivalent of 2.5 million tons of wheat rising to about 3 million tons in 1969/70.

#### The Project

The project as discussed by the Government with the economic mission is that which was revised by the consultants in 1964 to suit the availability of funds at that time.

The specific locations, capacities and types of facilities proposed would need to be reviewed in the light of the recent major increase in domestic production of wheat, recent technological developments in storage facilities, and changes both in the pattern of the flows through the ports and the constituents of the grain imports which have resulted from the 1967 war, as well as from the cessation of imports of wheat from the United States under Public Law No. 480. Similarly, it is only to be expected that construction costs will have changed drastically. The project would have to be prepared anew, and this would have to be done by consultants.

#### Estimated Costs

Though costs of construction in the UAR at present are not known, a rough estimate of the cost per ton of storage, based on the 1964 low bid's average cost over the Phase I project then under consideration, plus a contingency of 30 percent, might be US\$ 153.5. Under true international competitive bidding, not restricted to United States firms ~~as~~ as in 1964, the

foreign exchange component might be about 55 percent.

On this basis the cost of providing for the storage capacity envisaged for the 1964 Phase I project as finally revised by the consultants would be:

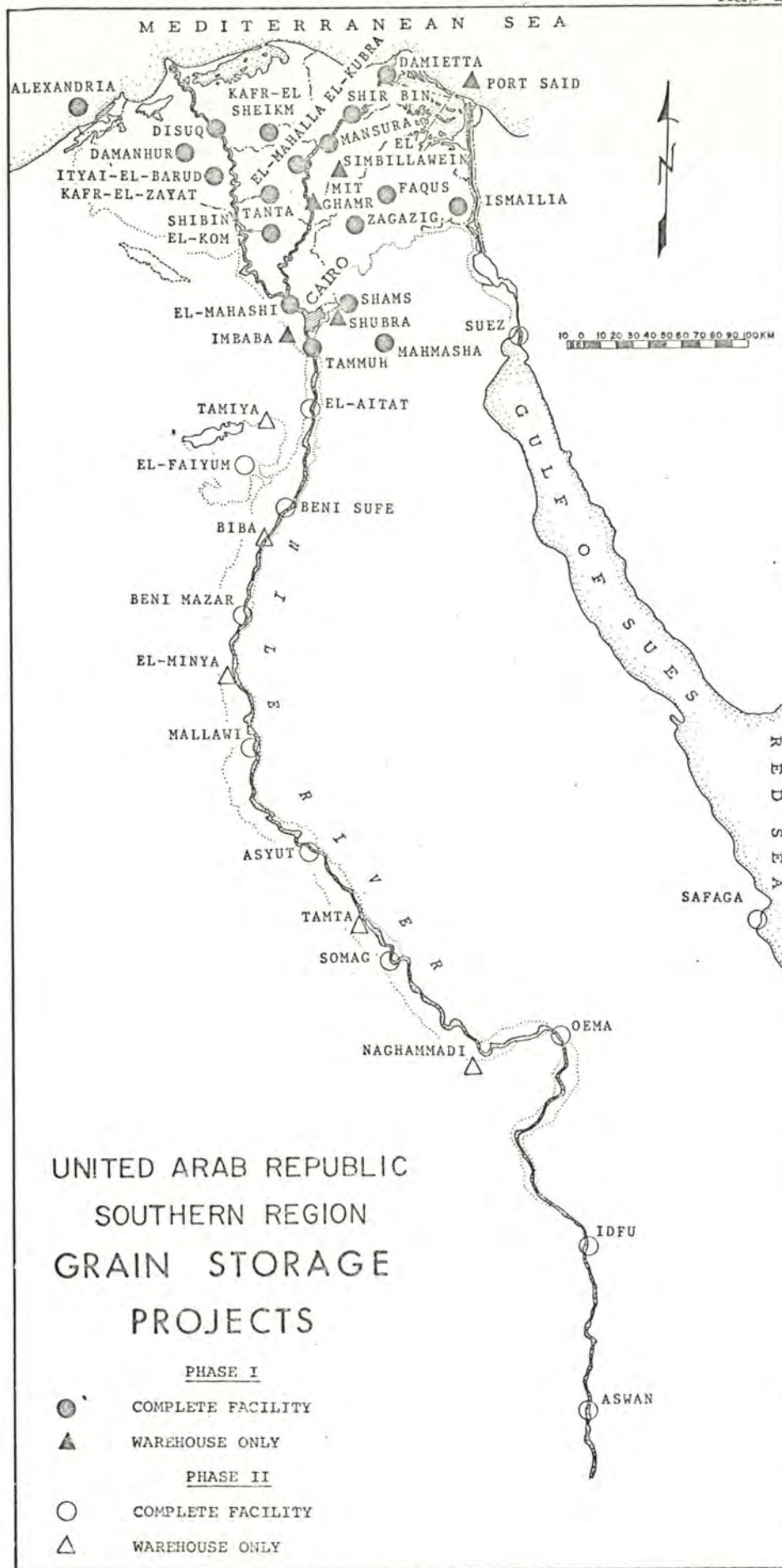
<u>Item</u>	<u>Total</u>	<u>Local</u>	<u>Foreign Exchange</u>
	-----US\$ million-----		
Storage facilities at 16 sites	43.2	19.4	23.8
Contingency, 30%	<u>14.4</u>	<u>6.5</u>	<u>7.9</u>
TOTAL	57.6	25.9	31.7

This estimate is subject to revision in the light of the changed requirements since 1964 as well as of changes in construction costs.

#### Conclusion

The Ministry of Supply, the agency that would carry out the project, and the Ministry of Agriculture both place a high priority on a project for grain storage. Weitz-Hettelsater Engineers have indicated that they could update the feasibility report within about six months and for less than US\$ 100,000. If for any reason another firm of consultants had to be employed, the time required and the costs of preparation could possibly double. It could be expected that a revised project could be developed in phases as was intended for the original project.

Map 1







Drainage Pumping Station Project ProposalBackground

Until the beginning of this century, drainage by gravity was the prevailing system in the UAR. Limited areas of low level lands were drained by pumping. Before World War I, only four pumping stations with a total capacity of 72.50 m<sup>3</sup>/sec were constructed to serve an area of 400,000 feddans out of 5.23 million feddans cultivated by basin irrigation.

From World War I until 1962, additional pumping stations were constructed serving an area of 2.7 million feddans out of a total cultivated area of 6.1 million feddans, shown as follows:

Drainage Pumping Stations and Areas Served up to 1962

<u>Pumping Stations</u>	<u>No. of Stations</u>	<u>Discharge (m<sup>3</sup>/sec)</u>	<u>Area Served (feddans)</u>
Constructed prior to 1952	40	628.20	1,863,850
Constructed between 1953-1962	13	281.00	879,500
Total	53	909.20	2,743,350

The existing network of main drains has a total length of more than 12,000 km. For the greater part, these drains are discharged by means of pumping stations which, in the Lower Delta, discharge into the sea, and in the Upper Delta discharge into large drains or the main irrigation canals. In Upper Egypt, the drains discharge back into the Nile, except for El Fayum, where the drains flow into Lake Karoun.

The drainage system has proved inadequate to maintain groundwater levels at a sufficient depth and difficult problems of rising groundwater tables and a consequent serious decline in productivity of agricultural lands have occurred in both Middle and Lower Egypt. The current program of shifting from basin irrigation, under which system the land was idle during at least one season of the year, to perennial irrigation, will result in increased drainage problems in Upper Egypt.

The Government has adopted a major investment program to improve the situation throughout the irrigated areas. In executing this program the Ministry of Irrigation has already renewed certain stations which have become deficient in coping with drainage requirements in Upper and Lower Egypt. Present plans call for about 80 new and modernized drainage pumping stations to be put into operation by about 1974/75. About 12 stations are now under construction by Hitachi of Japan and by a Yugoslav firm (see Map 2).

#### The Project

A proposed project could include the construction of 15 pumping stations out of the currently scheduled program for which contracts have not been made (see Map 3). These stations would serve the drainage of 820,000 feddans in Upper and Lower Egypt as follows:

<u>Name of Pumping Station</u>	<u>Governorate</u>	<u>Area Served</u> (feddans)
<u>In Upper Egypt:</u>		
1. Ihnasia	Beni Suef	96,000
2. Abou Rahib	El-Minia	41,600
3. Beni Saleh	El-Minia	42,000
4. Maghagha	El-Minia	7,000
<u>In Lower Egypt:</u>		
1. Sibl	El-Menufia	140,000
2. Darwa	El-Menufia	15,000
3. Nashart El-Aala	Kafr El-Sheikh	70,000
4. Tissaa El-Aala	Kafr El-Sheikh	50,000
5. Mahallet Roah	El-Gharbia	70,000
6. El-Mahalla El-Kubra	El-Gharbia	43,000
7. El-Sigawia	El-Gharbia	75,000
8. Number 5	Kafr El-Sheikh	73,000
9. Simtay	Kafr El-Sheikh	55,000
10. Number 8 El-Aala	Kafr El-Sheikh	34,000
11. El-Ganayin	(location not certain)	6,475

In addition to the construction of pumping stations, a project could include equipment for ditch excavation and maintenance. In the preparation of the

project attention would need to be given to the adequacy of the system of drains, including tile drainage, in the areas served by the pumping stations.

Although a great deal of work has probably been done already by the Ministry of Irrigation substantial preparation work is still likely to be required. It would probably take not less than a year to prepare a project for appraisal. The status of project preparation and the possible need of technical assistance by consultants would need to be ascertained by a project identification mission.

#### Estimated Costs

<u>Item</u>	<u>Total</u>	<u>Local</u>	<u>Foreign Exchange</u>
	-----US\$ million-----		
15 pumping stations	15.4	6.2	9.2
Construction equipment	<u>3.0</u>	<u>0.6</u>	<u>2.4</u>
TOTAL	18.4	6.8	11.6

#### Conclusions

The Ministry of Irrigation places a higher priority on drainage for external financial assistance at this stage than on the reclamation of new areas, because of the urgent need to protect existing agriculture. Drainage works should show immediate high returns on the investment.

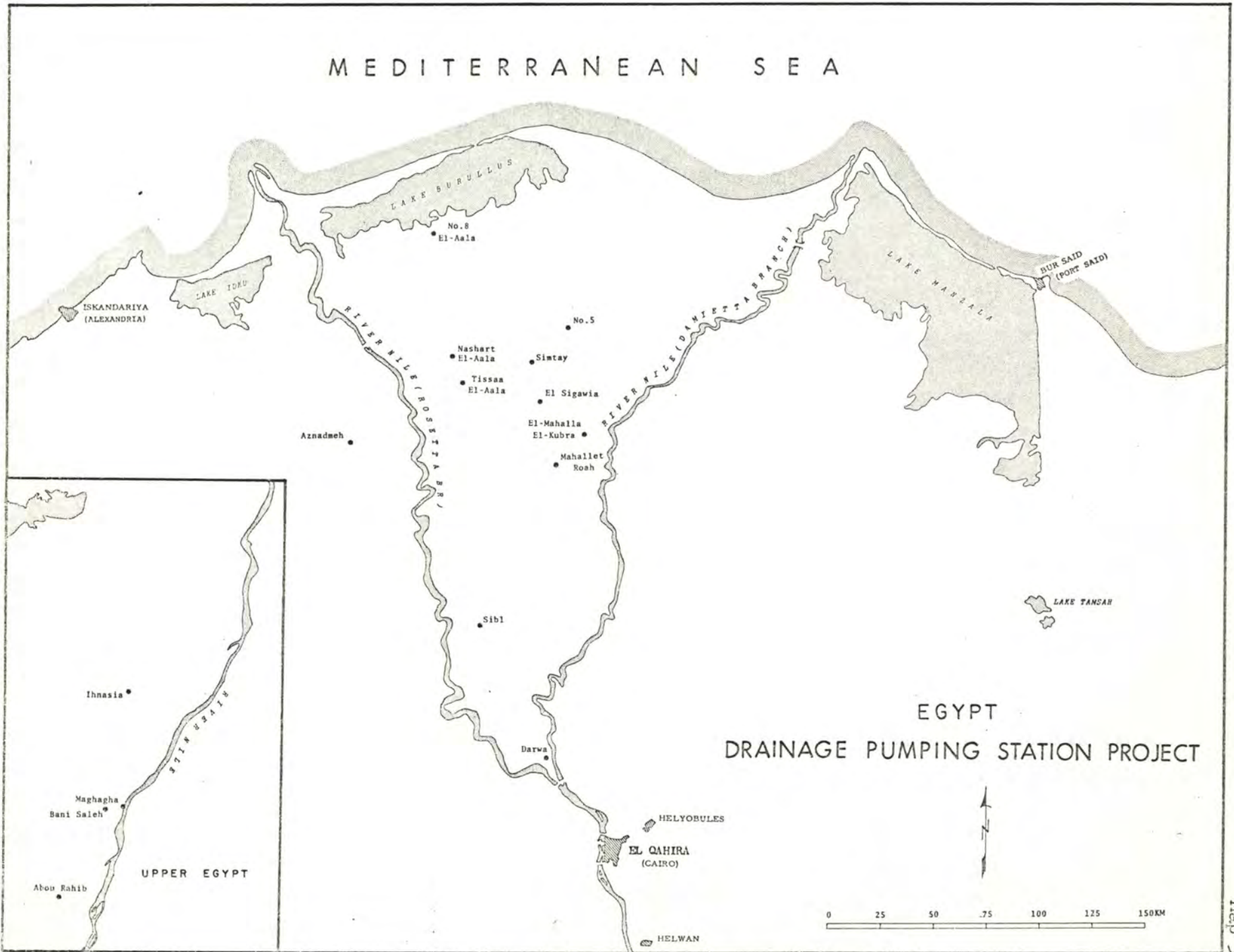
Site locations have been determined but the status of engineering preparation is unknown. The project could include the construction of main drains and tile drainage in addition to the above, but tile drainage should more appropriately be treated as a separate project (see Annex 4).

Maintenance of an adequate main drainage network is essential to the proper functioning of field drains. This project would provide the needed increased pumping station capacity on these main drains. The improvement of the major drainage network should thus precede the Government's

current program for field drains.

Before the project could be appraised a project preparation mission would have to investigate the status of engineering preparation and determine what assistance, if any, might have to be provided by consultants.





MEDITERRANEAN SEA

EGYPT  
DRAINAGE PUMPING STATION PROJECT

0 25 50 75 100 125 150KM

Annex 4



Field Drainage Project Proposal

Background

Farm drainage is by far the most urgent among the various possibilities for the intensification of agricultural production. Along with the expansion of perennial irrigation all over the UAR, the failure to carry out timely and appropriate drainage measures has led to a serious deterioration of soils in many localities. Particularly in the Western Delta, serious soil waterlogging has developed.

Up to 1952 about 50,000 feddans were tile drained in Lower Egypt. These early efforts resulted in yield increases of up to 50 percent, but the design of the tile drainage was not perfected and maintenance of the systems led to many difficulties. Nevertheless, in view of the favorable results achieved, the Government enacted legislation in 1956 under which it assumed responsibility for the execution of field drainage nationally. A 20-year drainage program was planned to cover all areas under perennial irrigation. The capital cost of the program was estimated to be about US\$ 500 million.

During the first 5-year plan (1960-1965) the Ministry of Irrigation completed tile drainage on 248,477 feddans in 10 Governorates, at a total cost of LE 7.64 million (US\$ 17.6 million). The accomplishment has been as follows:

<u>Year</u>	<u>Expenditures</u> (LE '000)	<u>Estimated Area Covered</u> ( '000 feddans)
1965/66	750	25
1966/67	1,708	57

The current program is as follows:

1967/68 <sup>1/</sup>	1,500	50
1968/69	1,800	60

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<sup>1/</sup> The 1967/68 program was planned for 200,000 feddans but was reduced because of lack of funds.

### The Project

Complete drainage requires: (a) a main drainage system (see Annex 3) and (b) field drainage. Field drainage in the UAR is accomplished in three ways: (a) open ditch drains, (b) a network of uncovered drains in addition to tile drains, and (c) complete covered tile drainage. Uncovered ditch drainage has the disadvantages that it absorbs up to about 15 percent of the land surface and divides the land into small tracts which complicate agricultural operations. A further drawback in the UAR, where farmers are not charged for irrigation water, is that open drainage encourages the farmer more than other forms of drainage in the lavish use of irrigation water as the drains are seen to carry off the excess water. However, in certain heavy alkaline soils the use of open drains may be the only feasible method.

A first project could include a progressive program of tile drainage for a four-year period (see Map 4). Such a program could serve an area of about 360,000 feddans. Project preparation would require a review of existing data especially those gathered under a UNDP/Special Fund pilot project completed in 1966. It could involve formulation of a first-phase project which would take into account drainage layouts in relation to main drains and drainage pumping stations. The actual scope of preparation work which should be done and the status of existing engineering preparation would have to be determined in the course of an identification mission, but it can be estimated that project preparation could probably be completed in about 12 to 18 months.

### Estimated Costs

Based on an average cost of LE 30 per feddan of the current program, the estimated cost of the proposed project would be as follows:

<u>Year</u>	<u>Feddans</u>	<u>Estimated Cost</u> (US\$ million)
First	60,000	4.2
Second	80,000	5.6
Third	100,000	7.0
Fourth	<u>120,000</u>	<u>8.4</u>
TOTAL	360,000	25.2

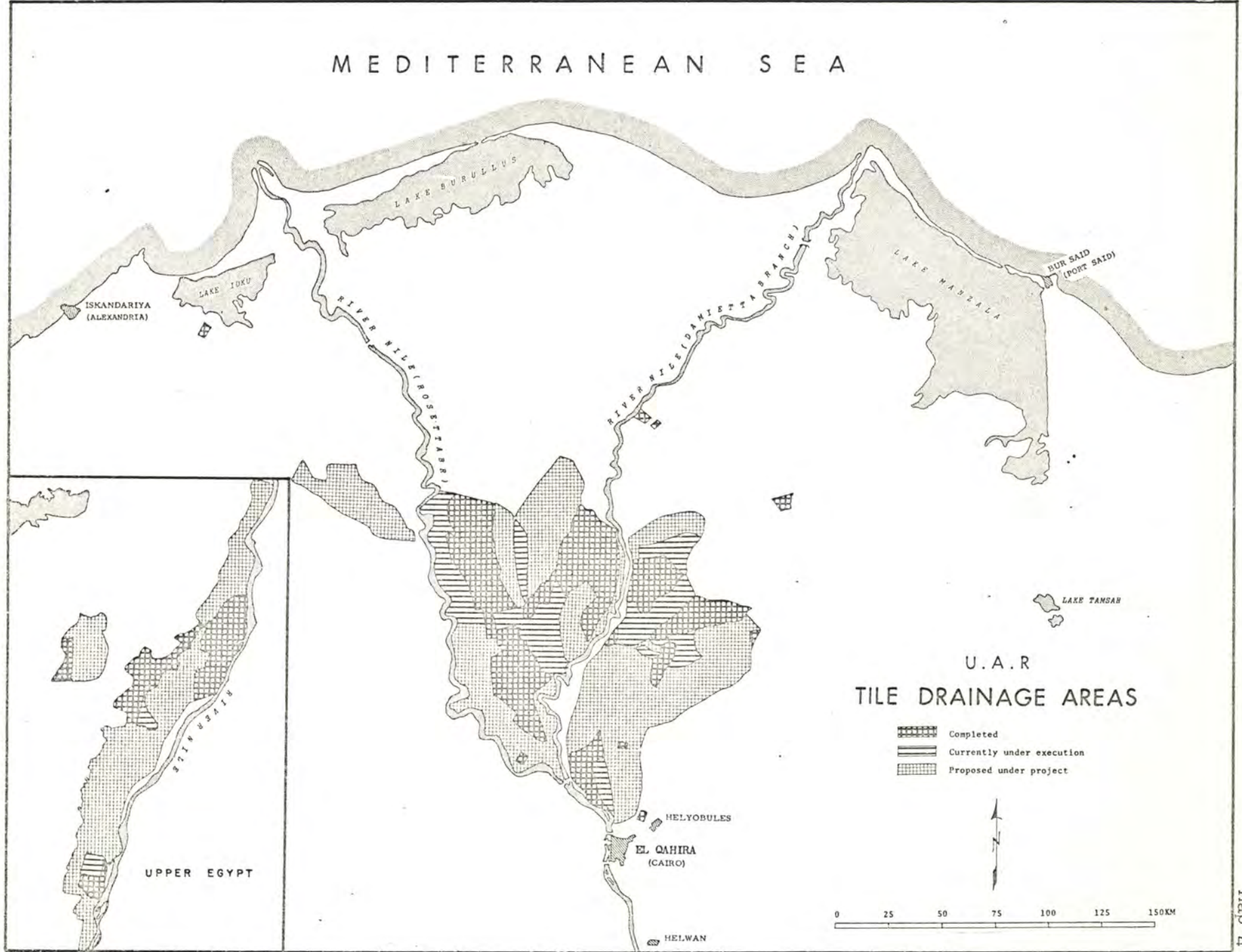
These estimates may be on the low side depending on soil conditions and drain spacing requirements. The estimated foreign exchange cost of the project would be about US\$ 5.0 million.

### Conclusions

The UNDP Pilot Project for Drainage of Irrigated Land, completed in 1966 by the Netherlands consulting firms, NEDECO and ILACO, forms a basis on which to evaluate the design and give some indication of feasibility of the proposed project. However, continued evaluation of completed works and application of latest developments in the science of groundwater hydrology and tile design and drainage layouts should be assured through the provision of technical assistance funds and a budget for drainage research.

The UNDP study showed, on the basis of a conservative 10-percent increase in yields, that the internal rate of return on investment in tile drainage would be about 13.5 percent. A 20-percent increase in yield would give a rate of return of 27 percent, which would not seem unreasonable in the light of UAR evaluation studies of drainage benefits. One Ministry of Public Works' study of yields over a 10-year period (1942-1952) in seven locations showed that the installation of tile drainage raised average yields of maize by 53 percent.

The Ministry of Irrigation has considerable experience in this field and it is likely that substantial engineering and design work has already been done. It would, nevertheless, be necessary to ascertain the present state of planning in more detail and to determine the scope of preparation work required in the course of an identification mission.



2. Memo on Suez Canal

Mr. Robert S. McNamara

May 17, 1968

Michael L. Lejeune

United Arab Republic - Suez Canal

1. We have begun to prepare the briefing information you requested for your visit to the U.A.R. We are aiming to have the full briefing ready at the end of the month so there will be time for any further investigation or analysis you wish. A memorandum on recent economic developments and the prospects for the U.A.R., based on the visit of a mission in March, is almost complete and will be reviewed by the Economic Committee and the Loan Committee before the end of this month. The full briefing will incorporate the conclusions and recommendations reached following this review.

2. Meanwhile, I thought it useful to send you some initial information on the Suez Canal both because of its significance for many countries and because of its central importance for the economy of the U.A.R. and its relations with the Bank. The attachment is a brief outline only of the major facts and problems concerning the Canal and we can, to the extent possible, prepare more detailed information as you wish. On some matters, the relevant material is available in the Bank; on others it would have to be collected in Egypt or elsewhere or would require substantial further studies, possibly by consultants.

3. I should like to discuss with you when you are ready what we might do with respect to the Canal. The right time would probably be when the full briefing is ready, since this subject has to be looked at in the context of our overall relations with the UAR and other possible activities there. Obviously, though, discussion would revolve around the following main possibilities.

(a) Mediation. Opening of the Canal is central to a political settlement, and it is not for the Bank to become the principal instrument in working out a general settlement. If, however, the use and opening of the Canal could be separated out as a question of the restoration to service of an important international economic resource, there might be a role for the Bank. It would be fraught with political difficulties.

(b) Clearance. Clearance of the Canal can get underway only when there has been some progress toward settlement generally or toward separating the Canal from the general controversy. As a technical job requiring money it falls well within the Bank's purview if we wish to accept the political problems which go with it. However, it is not either a large or difficult task technically. The Bank's contribution would largely be in terms of its status and stature as an impartial, apolitical international institution capable of organizing the job and finding the money needed.

- (c) Financing Expansion of Capacity. While the Canal Authority has detailed plans for expanding the capacity of the Canal, the economic justification lies solely in oil transport. There are complicated questions of the economics of competing alternative systems consisting of various combinations of carriers and routes. The Authority itself now talks of a pipeline in conjunction with the Canal. The economy of very large tankers using the Cape of Good Hope route becomes greater every year. The alternative systems would have to be evaluated very carefully before the Bank (or the UAR, for that matter) should commit itself to any one. Thus inevitably there is an important phase of project preparation before we could reach the stage of making a loan for enlarging the Canal or building an associated pipeline.
- (d) Project Evaluation and Preparation. The Bank could take part in the project evaluation and preparation referred to immediately above. This could be done as a matter of technical assistance or through the medium of an "Engineering Loan" (or IDA credit).

Attachment

c.c. M<sup>r</sup>. Knapp

D f MLL:ms



SUEZ CANALHistory of Bank Involvement

1. The Bank played a role in the clearing of the Canal which was undertaken under the auspices of the United Nations after the closure during the September 1956 conflict. The services of General Wheeler, the Bank's Engineering Advisor, were put at the disposal of the United Nations for planning and supervising the clearing operations. The clearing was financed by contributions of United Nations member countries and the Bank acted as fiscal agent for the receiving, holding and disbursing of these funds.
2. In late 1957 the Bank was asked by the UAR to provide its services in connection with the problem of agreeing on compensation for the nationalization of the Suez Canal Company in 1956. Mr. Black personally played a prominent part. In actual settlement discussions, the Bank was represented primarily by Sir William Iliff, Vice President of the Bank, and Mr. Woods, acting as consultant to the Bank. Mr. El Beary, then Governor of the Central Bank of Egypt, was chief negotiator on the Egyptian side. A Compensation Agreement was signed in July 1958 under which the Bank undertook to act as fiscal agent for the compensation payments to be made by the UAR between 1959 and 1964. These payments were made on schedule. Other provisions of the Agreement, e.g. on payment of pensions, extend beyond 1964. According to Article 11 of the Agreement, the parties to the Agreement can request the Bank to use its good offices to assist them in composing any differences concerning the interpretation or implementation of the Agreement.
3. Following a request of the Egyptian Government in January 1958, the Bank assisted the Suez Canal Authority in its planning for an expansion of the Canal to meet future traffic demand. In January 1959 the Government requested Bank financing for the expansion. A loan of \$56.5 million (No. 243 UAR) was made in December 1959 to the Suez Canal Authority, guaranteed by the UAR, and has been so far the only operation by the Bank Group in the UAR. The loan is to be repaid by 1974. It is noteworthy that while the UAR has increasingly got into arrears with payments to other lenders, the obligations towards the Bank have always been met, including two payments made since the June 1967 war. The project assisted by the Bank was for the deepening of the Canal to permit passage of vessels of 37 feet draft and for the provision of various equipment and minor works. The Loan Agreement provided for periodic payments into a reserve in local currency from the Canal Authority's current revenues of such amounts as were required to cover the semi-annual payments due to the Bank. The Central Bank was instructed by the Government to provide the foreign currency required for transfer to the Bank. Under the present circumstances, these arrangements have become academic.
4. A transport project identification mission in September 1966 was asked, once it arrived in Egypt, to review plans for deepening the Canal to 48 feet and the possibility of a request for Bank lending was mentioned informally. This phase of the Canal expansion was meanwhile carried out with the assistance of a \$27.4 million loan from the Kuwait Fund. The possibility of Bank financing for the clearing of the Canal necessary after the June 1967 closure and for a further expansion of capacity was raised with Mr. Lejeune during a visit to Cairo in December 1967. These subjects were raised again with the economic mission in March 1968, and the mission had informative discussions with the Suez Canal Authority.

5. The question of Bank participation in the clearing of the Canal was also raised by Mr. Al-Hamad, Director General of the Kuwait Fund, during a visit to the Bank in March. Mr. Al-Hamad said that Mr. Younis, then Deputy Prime Minister for Petroleum and Transport and previously Head of the Suez Canal Authority, had asked him to raise this subject informally with the Bank. (Following the March reshuffle of the Cabinet, Mr. Younis is no longer in the government.). We have since not heard further on this matter.

#### Economic Effects of Closure

6. The receipts of the UAR from Canal tolls in 1966/67 amounted to £E 95 million (\$213 million) and have been increasing at the rate of about 7% per year, so the loss for 1967/68 is close to £E 100 million (\$230 million). The costs of closure to all other countries in terms of higher shipping costs and lost oil profits have been estimated at \$250 million per month in the period immediately after the war, dropping to about \$150 million per month by 1968 after adjustments in shipping patterns were made. The closure of the Canal is estimated to have required an increase of about 10% in tanker capacity to maintain the same overall supply of oil to Europe. Tanker rates jumped to over \$18 per ton, or more than four times the pre-crisis level, for shipments from the Persian Gulf to Western Europe for two or three months, but have since been fluctuating around \$10-12 per ton.

7. One of the most notable effects of the closure has been, of course, the rush by the oil companies to order the construction of very large tankers, and this factor has to be taken into account in the plans for expansion of the Canal. In mid-1962 only about 5% of the world tanker fleet exceeded the pre-crisis capacity of the Canal to take vessels up to 60,000 dwt.; by mid-1967 ships above this size comprised over 40% of the world tanker fleet, and by November 1967 orders had been placed for 171 additional ships of over 100,000 dwt., with capacity equal to one-third of the total world capacity at the time of Suez closure.

#### Projects under Consideration by Canal Authority

##### (a) Reopening of the Canal

8. The clearing and reopening of the Canal is obviously the first step to any further deepening, widening and improvement. So far it appears that nothing can be done without enough progress on political settlement to provide free and safe activity in the Canal Zone.

9. The Chairman of the Suez Canal Authority told the Bank's recent economic mission that once the political questions are settled, the Canal could be reopened to shipping within two or three months of the arrival of the necessary salvage equipment in Egypt. He estimated that the clearing operation and replacement of equipment and buildings destroyed would require about US \$23 million in foreign exchange. However, until the political situation allows a detailed survey of the obstacles blocking the Canal, any such estimates must be subject to wide margins of error.

10. Reports of rapid siltation of the Canal were denied by the Chairman, who maintained that it could actually accept larger ships than before the closure; the latest stage of deepening financed by the Kuwait Fund had been completed in early 1967, and the maximum permissible draft would have been increased from 38 to 40 feet last July if the war had not intervened. This would accommodate ships up to 65,000-75,000 dwt.

(b) Canal Expansion

11. The Minister of Transport told the Bank's economic mission that the program for enlarging the Canal to accommodate tankers in the 200,000 dwt class, drafting up to 62 feet, would proceed as soon as the political situation allowed. Work on the dry earth excavation was started in February, 1967. The total cost was put at US \$240-250 million, of which about one-half would be in foreign exchange. These were only tentative figures and considerably lower than those given to the Bank's mission in September 1966. The Kuwait Fund was said to have offered a loan of US \$28 million if other sources could be found for the remainder. The Minister hoped that the Bank would consider a loan for this purpose.

(c) Suez Pipeline System

12. Both the Minister of Transport and the Chairman of the Suez Canal Authority maintained that the proposal for an Egyptian pipeline system between the Red Sea and the Mediterranean should be regarded as supplementary to the plans for deepening the Canal and not as an alternative. More than commercial considerations appeared to be behind this view, however.

13. In April 1967 the International Management and Engineering Group (IMEG) submitted a preliminary report to the Government of the UAR on the feasibility of a pipeline system. (A copy of this report was obtained by the Bank directly from the consultants and not from the Government). They drew up a plan for staged construction of several 191 mile long, 42" pipelines. The first, which would take about one year for construction, would have a capacity of 50 million tons per year and would cost about \$102 million. Subsequent pipelines would each cost about \$65 million because certain common facilities for storage, berthing and handling would be installed initially. The consultants' conclusions were, briefly, that either a 62-foot Canal or a pipeline system could attract oil traffic to this route, charging tolls that would also make the investment financially attractive to the UAR. Of the two alternatives, however, the pipelines were considered a superior investment for two principal reasons:

- (1) Pipeline construction would take only about one year, compared with seven years for Canal expansion, and thereby bring much quicker returns;
- (2) Pipelines would allow the use of tankers even larger than the 200,000 dwt class, which the expanded Canal could not accommodate without further heavy investment outlays.

The consultants emphasized, however, the need for much more detailed study of the technical problems and all variables connected with Suez transit planning.

Other Alternatives

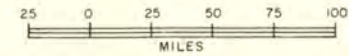
14. We have no information available within the Bank for comparing other alternative means of oil shipment from the Middle East, such as additional transcrabian pipelines. The proposed 160 mile, 42" Israeli pipeline has been estimated to cost about \$113 million for 60 million ton capacity in newspaper accounts, but we have no information on the economics of its operation.

Middle East and North Africa Department  
May 17, 1968

E. MAP OF UAR

# UNITED ARAB REPUBLIC

- MAIN NAVIGABLE CANALS
- IRRIGATED AREAS
- PRINCIPAL OASES



- AREAS BELOW SEA LEVEL
- AREAS OVER 1200 FEET

