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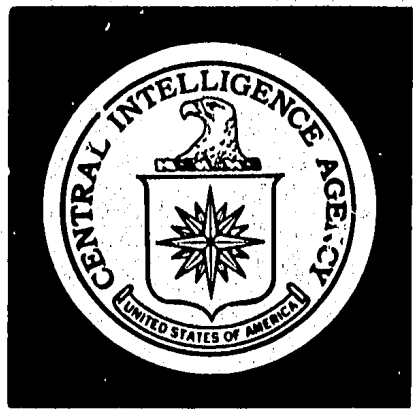

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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Soviet-Egyptian Financial Relations

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
August 1970

INTELLIGENCE MEMORANDUM

Soviet-Egyptian Financial Relations

Introduction

The USSR in recent months has provided Egypt with new types of sophisticated military equipment and has increased both the number and the responsibilities of its military personnel in Egypt. By comparison, the current level of Soviet support for the Egyptian economy is small indeed. This memorandum examines the nature of the financial flows between the USSR and Egypt in the past few years, the importance of these flows for the Egyptian economy, and prospects for the near future.

Nature of Soviet-Egyptian Economic Relations

1. When Farouk was in power, occasional barter trade provided the only economic contact between the USSR and Egypt. In 1953 the new revolutionary government signed a trade and payments agreement and, after a brief contraction, trade expanded rapidly. The first economic and military aid agreements, which came in 1957,* vastly expanded the scope of Soviet activities in Egypt. During the following decade, \$1,010 million in economic

* *Czechoslovakia was the supplier for military agreements signed in 1955 and 1956.*

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

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aid credits were extended, and new military aid agreements were concluded in every year but two (see Table 1).

Table 1
Egyptian-Soviet Aid Agreements

<u>Million Current US \$</u>			
<u>Amount of Aid</u>			
<u>Date</u>	<u>Value</u>	<u>Credits</u>	<u>Grants or Discounts</u>
<u>Economic</u>			
Jul 1957	8.6	8.6	
Jan 1958	175.0	175.0	
Dec 1958	100.0	100.0	
Feb 1960	225.0	225.0	
May 1964	0.3		0.3
Sep 1964	324.4	324.4	
	110.0	110.0	
	66.7	66.7	
<i>Total</i>	<i>1,010.0</i>	<i>1,009.7</i>	<i>0.3</i>
<u>Military</u>			
1957	155	50	105
1958	60	20	40
1960	150	50	100
1961	270	90	180
1962	150	50	100
1963	100	35	65
1964	250	125	125
1965	25	15	10
1967	150 a/	75	75
1968	75 a/	40	35
1969	50 a/	25	25
<i>Total</i>	<i>1,435</i>	<i>575</i>	<i>860</i>

a. Proration of these amounts between grant and credit assistance is based on analogous arrangements and may distort the magnitude of repayment obligations.

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2. Most Soviet economic aid to Egypt has been tied to specific aid projects, including the Aswan High Dam and its hydroelectric power producing and transmitting facilities, the Alexandria shipyard, expansion of the Helwan steel complex, and many smaller industrial installations. The terms of Soviet economic aid have been typical of the Soviet program in the less developed world. Interest on project aid was 2½% annually and a 12-year amortization period was allowed for, with repayment in commodities. Two major exceptions were the \$177 million in credits extended for land reclamation and capital goods. These credits were to be repaid in five years.

3. Military aid consisted of a combination of price discounts and liberal financing. Interest rates were at least as low for military as for economic credits, but amortization was originally scheduled over shorter periods (3-5 years for early agreements). Because of the much more rapid implementation of military aid agreements and the shorter amortization period, substantial repayments of military aid began as early as 1959, while repayments of economic aid became significant only in 1964.

4. Bilateral commercial trade has been economically far more advantageous to Egypt than to the USSR. From the Soviet point of view this trade represents an accommodation of Egypt's needs for mainly political reasons. From the Egyptian point of view the trade provides major economic benefits. Egyptian exports to the USSR consist primarily of relatively low grade cotton not readily marketable in the West (see Table 2). A dependable Soviet and East European market for cotton provides a useful buffer to fluctuations in world markets and shipment of surplus cotton to the USSR and East European countries is a major stabilizing influence on the world prices for Egyptian cotton. The major Soviet commercial export has been petroleum, which was in critically short supply in Egypt until 1967 when the El Morgan fields went into operation. The USSR has also agreed to supply other key materials, such as wheat and solid fuels. Moreover, in addition to its official aid program, the USSR provided Egypt with large credits on bilateral commercial account. The 1953 payments agreement specified settlement

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Table 2
Egyptian-Soviet Trade

	Value in Million US \$															
	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968
Egyptian imports a/	15.54	8.82	11.55	40.32	86.31	92.09	92.40	73.29	114.14	108.07	141.96	162.54	219.14	208.64	295.37	207.90
Of which:																
POL (percent)	N.A.	63	71	49	32	39	34	27	19	16	10	7	7	8	7	8
Egyptian exports b/	12.00	8.90	15.30	50.30	110.90	107.10	75.06	101.79	96.20	73.00	123.60	123.60	163.40	150.00	145.10	170.70
Of which:																
Cotton (percent)	99	99	79	87	91	97	98	99	98	87	73	58	68	63	46	39
Balance	-3.54	+0.08	+3.75	+9.98	+24.59	+15.01	-17.34	+28.50	-17.94	-35.47	-18.36	-38.94	-55.74	-58.64	-150.27	-37.20

a. All non-military goods, including capital goods for development projects.
b. All exports, including those for interest and amortization payments.

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in hard currency of debts over an agreed limit, but a subsequent 1963 agreement was deliberately vague on this point, and at least after 1963 the USSR allowed the Egyptians to accumulate large bilateral account deficits.

5. Soviet assistance to Egypt has included essential services as well as critical goods. In addition to imports of capital goods, long term credits have paid the salaries of Soviet economic technicians working in Egypt. The military aid program has involved both professional assistance and training operations. Some of the Soviet military personnel have been provided free of charge, but most such services are believed to be charged to Egypt's bilateral clearing account. Transportation of goods moving by sea between the USSR and Egypt has been covered since 1958 by a separate maritime agreement, which specifies that shipments be assigned equally to the Soviet and Egyptian merchant fleets. Because of the limited size and erratic scheduling of the Egyptian merchant marine, however, far more than half of all goods have been transported in Soviet owned or leased bottoms and charged, presumably, to the bilateral clearing account.

The Soviet-Egyptian Balance of Payments

6. The main elements in Egypt's balance of payments with the USSR since 1962 are shown in Table 3.* Since the mid-1950s Egypt has imported large amounts of military equipment from the USSR. Indeed, in some years military deliveries exceeded Egyptian imports of civilian goods from the USSR. The military shipments have fluctuated greatly from one year to the next, however, peaking in 1961 and 1967, with considerable declines in the interim and since 1967. Civilian imports grew steadily and rapidly between 1960 and 1967. Egypt ran large deficits on trade accounts every year during 1961-68 even if military deliveries are excluded. On services accounts, interest payments and payments to cover the repatriated portion of the salary of Soviet technicians in Egypt and the expenses of Egyptian student trainees in the USSR have considerably exceeded Soviet payments for use of the Suez Canal. On capital account, the major elements are Soviet

* *The derivation of Table 3 is explained in the Appendix.*

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Table 3
Main Ingredients of Egypt's Balance of Payments with the USSR

	Million US \$							
	1962	1963	1964	1965	1966	1967	1968	1969
Current items (net)	-191.55	-195.90	-124.32	-141.13	-164.45	-339.37	-172.01	-122.94
(Excluding military deliveries)	(-41.55)	(-45.90)	(-49.32)	(-61.13)	(-64.45)	(-169.37)	(-72.01)	(-32.94)
Total goods	-185.47	-168.36	-113.94	-135.74	-158.64	-320.27	-137.20	-84.47
Non-military goods	-35.47	-18.36	-38.94	-55.74	-58.64	-150.27	-37.20	+5.53
Exports (f.o.b.)	+73.00	+123.60	+123.60	+163.40	+150.00	+145.10	+170.70	
Imports (c.i.f.)	-108.47	-141.96	-162.54	-219.14	-208.64	-295.37	-207.90	
Military goods	-150.00	-150.00	-75.00	-80.00	-100.00	-170.00	-100.00	-90.00
Services	-6.08	-27.54	-10.38	-5.39	-5.81	-19.10	-34.81	-38.47
Interest	-3.58	-5.14	-7.28	-8.19	-9.81	-12.10	-15.81	-18.47
Suez Canal use	+5.10	+4.30	+6.90	+9.90	+11.00	+2.00	+1.00	--
Technical assistance	-9.40	-24.10	-12.00	-9.90	-10.00	-12.00	-19.00	-20.00 a/
Other services (net)	+1.80	-2.60	+2.00	+2.80	+3.00	+3.00	-1.00	-- a/
Long term capital	+159.56	+190.49	+85.10	+102.87	+145.76	+248.00	+163.95	+107.54
Economic development loans (net)	+52.56	+83.49	+53.10	+44.87	+67.76	+78.00	+63.95	+17.54
Drawings	+55.00	+87.00	+64.00	+57.60	+82.00	+90.10	+84.50	+46.00
Repayments	-2.44	-3.51	-10.90	-12.73	-14.24	-12.10	-20.55	-28.46
Military grants b/ Military loans (net) b/	+106.00 +7.00	+100.00 +7.00	+50.00 -18.00	+36.00 +22.00	+45.00 +33.00	+85.00 +85.00	+50.00 +50.00	+45.00 +45.00
Drawings	+50.00	+50.00	+25.00	+44.00	+55.00	+85.00	+50.00	+45.00
Repayments	-43.00	-43.00	-43.00	-22.00	-22.00	--	--	--
Short term financing c/	+31.99	+5.41	+39.22	+38.26	+18.69	+91.37	+8.06	+5.40
Of which:								
Bilateral trade credits	+34.99	-8.29	+42.50	+46.82	+24.89	+93.37	-2.49	0

a. Mostly military technicians.

b. [redacted] some portion of the cost of rearming Egypt after the June 1967 war is considered a loan. In lieu of more precise information the loan/grant proportion is presumed analogous to Soviet terms elsewhere.

c. Residual which includes errors and omissions. Short term financing covers in particular the bilateral trade gap, Suez Canal use, part of technical assistance, and "other services". Of the total amount, only a sum equivalent to Suez Canal payments is believed to have been settled in hard currency.

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development loans and military loans and grants. In some years Egypt has also received a substantial capital inflow by accumulating deficits on clearing account.

7. For almost a decade Egypt has run deficits on its current account transactions with the USSR. These deficits have averaged about \$175 million a year and they add up to more than \$1 billion over the 9-year period. The bulk of these deficits are attributable to Soviet deliveries of military goods. If these deliveries are excluded but repayments of military loans are included (giving a balance on transactions in productive goods and services), the deficits fall to well below \$100 million in every year except 1967.

8. The net Egyptian deficits, excluding military deliveries, increased markedly in the mid-1960s, but have since declined. The increase reflected primarily a stepup of Soviet deliveries on both commercial and aid accounts to offset a restricted flow of imports from the West, which was partly the result of a worsening hard currency balance. The record deficit in 1967 was primarily the result of emergency shipments of Soviet grain after PL 480 assistance from the United States ceased. Since 1967, however, Egyptian exports to the USSR have grown while civilian imports have returned to the pre-1967 level. Consequently the deficit shrank greatly in 1968 and almost disappeared in 1969.

9. The overall balance-of-payments trends reflect the following elements:

a. A rapid buildup in Soviet deliveries of goods under economic aid agreements until 1963, followed by a decline in 1964-65, then by a leveling out at a high level of about \$75 million in 1966-68, when the bulk of the equipment for the Aswan High Dam was delivered. Since 1968, aid deliveries have declined because major deliveries for the Aswan High Dam project have been completed and the USSR has extended no new investment credit since 1964.

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b. A marked increase in repayments of economic credits in 1964-67 and even larger increases in 1968-69.

c. The provision of substantial credits to Egypt on clearing account every year during 1963-67, with the credit reaching \$93 million in 1967 alone. There was a shift, however, to a clearing accounts surplus in 1968.

d. A rapid buildup of military repayments until the mid-1960s followed by a decline in 1965-66, reflecting the stretching out of scheduled repayments. Since 1966 there has been a moratorium on military credit repayments.

10. Even though a sizable part of Soviet military aid to Egypt has been in the form of grants and Egypt made substantial repayments of military credits until 1967, the net Egyptian indebtedness to the USSR exceeded \$1 billion at the end of 1969 (see Table 4). Only about one-sixth of the economic aid drawings of over \$600 million had been repaid and repayments represented about 40% of drawings on military credits (and only about half of total military goods has been a grant). Accumulated commercial debts totaled over \$150 million.

Economic Impact of Soviet Aid to Egypt

11. Although its economic and military aid to Egypt has been substantial, the USSR clearly has not taken upon itself the responsibility for supporting that country's economic growth. Before 1961, Soviet aid was very small. During the 1961-65 plan period the USSR played a crucial role in the planning and construction of some key investment projects, but financed a relatively small part of total investment. Soviet machinery and technical services financed by credits represented about 30% of the imported goods used in Egyptian state investment and 8% of the total value of state investment. Moreover, the USSR provided only about 15% of the total net capital inflow as repayments on Soviet military debt mounted and Egypt borrowed heavily from the West (see Tables 5 and 6).

Table 4
Estimated Accumulation of the Egyptian Debt to the USSR ^{a/}

	Million US \$															
	1953/57	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969 (Estimate)	Total		
Estimated commercial trade balance	+44.84	+16.49	-5.10	+35.10	-11.58	-34.99	+8.29	-42.50	-46.82	-24.89	-93.37	+2.49	0	-152.04		
Economic aid drawings		-2.00	-13.60	-13.00	-30.00	-55.00	-87.00	-64.00	-56.60	b/	-81.00	b/	-90.10	-84.50	-46.00	-622.89
Military aid drawings	-16.00	-28.00	-10.00	-50.00	-58.00	-50.00	-50.00	-25.00	-44.00	-55.00	-85.00	-50.00	-45.00	-566.00		
Debt accumulation	+28.84	-13.51	-28.70	-27.90	-99.58	-139.99	-128.71	-131.50	-147.42	-160.89	-268.47	-132.01	-91.00	-1,340.84		
Economic repayments			+0.04	+1.72	+1.87	+2.44	+3.51	+10.90	+12.73	+14.24	+12.10	+20.55	+28.46	+108.56		
Military repayments			+16.70	+16.70	+16.70	+43.00	+43.00	+43.00	+22.00	+22.00	--	--	--	+223.10		
Debt retirement			+16.74	+18.42	+18.57	+45.44	+46.51	+53.90	+34.73	+36.24	+12.10	+20.55	+28.46	+331.66		
Balance	+28.84	-13.51	-11.96	-9.48	-81.01	-94.55	-82.20	-77.60	-112.69	-124.65	-256.37	-111.46	-62.54	-1,009.18		

a. Does not include interest.

b. Excluding \$1 million in grants.

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Table 5
Long and Short-Term Capital Flows

	Million US \$						
	Plan Period				Post-Plan Period		
	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u> ^{a/}	<u>1968</u> ^{a/}
Total net capital inflow into Egypt ^{b/}	344	293	281	242	170	159	-9
Net inflow of Soviet capital ^{c/}	42	46	49	61	64	169	72

- a. Net capital flow from non-Soviet sources was negative.*
b. Balance on current account. Financing during 1962-68 included about \$80 million in reserve drawdown.
c. Balance on current account, excluding military deliveries.

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Table 6
Investment and Soviet Economic Aid, by Fiscal Year

	Million US \$											
	Plan Period						Post-Plan Pre-War Period			Post-War Period		
	1961	1962	1963	1964	1965	Total	1966	1967	Total	1968	1969	Total
Egyptian investment	518.9	577.5	689.1	856.5	837.9	3,479.9	690.4	623.8	1,314.2	476.0	685.0	1,161.0
Estimated import content of Egyptian investment	129.7	144.4	171.9	214.1	209.4	869.5	172.6	155.9	328.5	119.0	171.0	290.0
Drawings on Soviet economic aid	21.5	42.5	71.0	75.5	60.8	271.3	69.8	86.0	155.8	87.0	65.0	152.0

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12. During FY 1966 and 1967, Soviet aid became crucial to the Egyptian economy. The net flow of Soviet aid increased sharply at a time when recurrent balance-of-payments deficits had greatly lessened Egypt's ability to obtain a net flow of funds from the West, and had forced substantial cuts in imports from the West and in domestic investment expenditures requiring such imports. In 1967, drawings on Soviet development credits financed more than one-half of capital goods imports and the net capital inflow from the USSR rose while Egypt had a deficit on capital account with the rest of the world. Because of reduced investment expenditures, sharply reduced imports of industrial materials, and a series of poor crop years, the economy stagnated during 1966-67. If work on Soviet projects had not accelerated during these years, there would almost certainly have been a decline in GNP.

13. Since 1967, the net capital inflow from the USSR to Egypt, excluding military deliveries and technicians, has fallen to near zero. The commercial account has become nearly balanced and net development aid has fallen sharply as deliveries declined while payments increased. Military shipments have been large, though much smaller than in 1967.

Outlook

14. Unless the USSR allows Egypt once again to run large deficits on commercial account, a net outflow of non-military goods and services from Egypt to the USSR is likely for at least 3 or 4 years. Expansion of the Helwan steel complex and construction of aluminum and ferroalloy plants to consume Aswan Dam electricity are expected to absorb by 1975 or 1976 most of the \$275 million of credits still to be drawn for these projects. Credit drawdown will probably be at an annual rate of about \$50 million -- a rate likely to be more than offset by scheduled debt amortization and interest payments, which at the very least will level off at about the 1970 level of about \$50 million. A commercial trade surplus seems more likely than resumption of sizable Egyptian deficits. The USSR will probably continue to purchase part of Egypt's share of El Morgan crude oil for shipment to Cuba and possibly elsewhere, and to buy excess

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output of Egyptian manufacturing industries. Egypt probably will obtain substantial new development credits some time in the next few years, but, because of the inevitable lag between extension and implementation, actual deliveries under such credits would not become important for at least 2 or 3 years.

15. The extent and duration of the anticipated outflow from Egypt will depend heavily on Soviet decisions on repayment of military debt. If repayments are resumed in 1972, as the Egyptians recently announced in Moscow, the net outflow from Egypt could increase by some \$80 million in that year.

16. Despite the reduced flow of aid, the USSR probably will maintain and even increase its managerial role in Egyptian economic affairs. Management of economic enterprises on a significant scale dates back to 1967 when Soviet technicians replaced Koppers Company personnel at the Helwan steel mill. The USSR was partly successful in raising output, which had been only about one-third of rated capacity in 1966. Subsequently, Soviet personnel assumed most managerial functions in the Alexandria shipyard.

17. Whatever the eventual Soviet economic role may be, Egypt in the next few years will remain largely dependent on its own resources for economic development. Debt rollover agreements concluded with Western creditors since 1966 in the main restrict new credit extension to the amount of repayment, and in a few cases (such as the United States) a net outflow is stipulated. Egypt is heavily in debt to the International Monetary Fund, and, thus far, there has been only one small new credit from the International Bank for Reconstruction and Development. With only about \$400 million in credits from other Communist countries remaining to be drawn, oil company investment commitments now appear to constitute the most important remaining source of net foreign capital inflow into Egypt. Fortunately for Egypt, its own foreign exchange earnings are expanding. Rising agricultural and petroleum output should continue to raise exports and, with the Arab-Israeli conflict likely to remain intense, subsidies from other Arab states should continue. Thus the absence of any net capital inflow from abroad should not prevent some expansion of the Egyptian economy.

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18. The USSR during the 1960s provided Egypt with considerable economic aid. Soviet aid was especially important to Egypt in 1966 and 1967, when Soviet deliveries rose sharply while credits from Western sources were unavailable because of Egyptian arrears on past debts. Since the 1967 war, however, deliveries of Soviet aid to Egypt have fallen, economic aid repayments have increased, and, excluding military deliveries and technicians, the net flow of Soviet resources to Egypt has shrunk to near zero.

19. Egypt has benefited considerably from its economic relations with the USSR, but Soviet trade with and aid to Egypt have fallen far short of assuring an adequate rate of economic growth. Egypt exports surplus cotton that the USSR does not need and imports machinery and raw materials that it needs very badly. The USSR has been willing to help build selected investment projects to accommodate Egyptian trade needs and on rare occasions has provided emergency shipments of key commodities. But, unlike its relations with the client states of Eastern Europe, the USSR has not taken on the responsibility of assuring Egypt's economic success. In contrast to its growing commitment to Egypt's defense, the USSR's economic involvement in Egypt has been small.

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