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# The suez crisis – World Economic History Part 3

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By INVC NEWS

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On July 26, 1956, Egypt nationalized the Suez Canal Company and assumed control of the canal from the international consortium that had run it for nearly a century. France, Israel and United Kingdom initiated joint military action, with Israel invading the Sinai on October 29, 1956. The military action lasted two months and in the midst of the turmoil and uncertainty, a financial crisis erupted. Egypt's nationalization of the Suez Canal in 1956 and the failed attempt to recapture it by France, Israel and United Kingdom had significant economic consequences resulting in all four countries seeking IMF financial assistance. It also had a lot of political consequences, Egypt's independence, Israel's survival as a Nation, and a devastating blow to Britain's Victorian aspirations. The Suez Canal was closed for 6 months resulting in trade diversion, cost increases and delivery delays impacting the current account balances of all four countries.

In September – October 1956, Egypt, Israel and France approached the IMF with financing requests, to overcome temporary balance of payments problems arising from the current account. In 1956, Britain had a significant current account surplus. The pound sterling came under heavy speculative pressure and United Kingdom witnessed short-term capital outflows. The Bank of England was forced to deplete its US dollar reserves to defend the fixed value of the pound sterling against the dollar. By December 1956, the risk of currency devaluation or a floating exchange rate was real. The

United Kingdom did not qualify for financial assistance from the IMF. The IMF's Articles of Agreement prohibit its lending finance to "large and un-sustained" outflow of capital, which Britain faced. The Bank of England had enough resources to credit and fend off the outflow without IMF assistance. That said, the IMF financed all 4 countries with on a stand-by basis. This involvement gave IMF the role of an International Crisis Manager. The Suez Crisis was the first major financial crisis of the post war era.

Egypt was borrowing from the IMF for the second time. It was a conventional financing request for US $ 15 million and politics did not intrude in the IMF financing of Egypt. The United States spoke in favor, France consented by noting the absence of any legal basis for objecting, Britain and The Netherlands abstained. The IMF decision stated that the IMF expresses no objection to the financing request. Israel had joined the IMF in 1954 and the economy was not stable enough to sustain a fixed exchange rate for its currency. After resisting for several months, the IMF agreed to set a par rate of 1.8 Israeli pounds to the dollar. It was felt that Israel drawing from the IMF could help supplement its foreign exchange reserves and setting a par value for the Israeli currency was a step in this direction. Israel had a quota of US $ 7.5 million from the IMF in 1957 and the developments in the Mediterranean with consequent rise in military spending contributed to a worsening of the balance of payments situation. With the lone abstention from Egypt, the IMF financing for Israel was approved on May 15, 1957 at 50 percent of its quota.

By September 1956, France witnessed a situation of low and depleting foreign exchange reserves. The French Franc was subjected to a flight of capital. France sought a financing arrangement for 50 percent of its quota of US $ 263.5 million. France was also fighting a war in Algeria and had a sharply reduced agricultural output that year due to frosts. These adverse influences disrupted France's balance of payments position significantly. France's current account position deteriorated by US$ 1.1 billion in 1956 from US $ 409 million surplus to US $ 700 million deficit. In October 1956, the IMF approved France's financing request.

Britain had a significant current account surplus and the second largest quota in the IMF after United States. The Bank of England had a parity of US $ 2.80 to the US Dollar and given the speculation, there was pressure to abandon the sterling parity. Britain viewed the US $ 2.80 as appropriate for trade purposes, regarded exchange rate stability as essential for preserving the sterling area as a preferential trade zone and as a reserve currency. Britain wanted to keep a minimum balance of US $ 2 billion reserves, and to fall through that floor would be interpreted as a signal that devaluation or even float was to be seriously considered. As market sentiments had shifted against the Pound Sterling, British authorities knew that they could not hold the pound at US $ 2.80 per dollar without support of the United States. The IMF financing was to address the psychological impact of a political crisis on financial markets. The Israeli invasion of the Sinai, greatly accelerated the drain on the reserves and the financial pressures drove Britain to accept a ceasefire and full withdrawal in the Mediterranean. The Suez Crisis was suddenly over. Following the ceasefire, American resistance to a British financing arrangement was out of the way and British request for a financing arrangement upto 75 percent of its quota was considered. Britain required US $ 1.3 billion to stem speculation against the pound. It was felt that given the United Kingdom's role as a banker for a large trading area and the status of sterling as an international currency, the IMF agreed to lend in a situation of a large and sustained capital flows.

The Suez Crisis was the first time the IMF played a significant role in helping countries cope with international crisis. The IMF adopted a rapid response to the crisis and placed a large enough number to impress the financial markets, and convince speculators. Britain had faced a speculative attack on a stable currency against a backdrop of sound economic policies. There was a clash between maintaining a stable exchange rate and establishing open markets for the currency. Britain was unable to restore the level of foreign exchange reserves till 1958.

## World Economic History

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