

U N C L A S S I F I E D

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LSN 2 5355

AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D. C. 20523

PROGRAM ASSISTANCE
APPROVAL DOCUMENT
(PAAD)

EGYPT: Cash Transfer (263-K-614)

March 5, 1987

U N C L A S S I F I E D

215 1120-1 PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT	263-K-614
	PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. COUNTRY Egypt
3. TO: Frank Kimball, Director, USAID/Cairo		2. CATEGORY Cash Transfer
4. FROM: George Laudato, AD/PPP		3. DATE March 1987
5. APPROVAL REQUESTED FOR ACQUISITION OF: \$115,000,000		4. OVD INCREASE None
6. TYPE FUNDING <input type="checkbox"/> LOAN <input checked="" type="checkbox"/> GRANT		5. OVD INCREASE None
7. LOCAL CURRENCY ARRANGEMENT <input type="checkbox"/> INFORMAL <input type="checkbox"/> FORMAL <input checked="" type="checkbox"/> NONE		6. OVD INCREASE None
8. ESTIMATED DELIVERY PERIOD 10 days (Disbursement)		7. TO BE TAKEN FROM: Economic Support Fund
9. TRANSACTION ELIGIBILITY DATE N.A.		8. APPROPRIATION - BPC QES7-87-37263-KG-31

10. PERMITTED SOURCE U.S. only Limited F.W. Free World Cash	11. ESTIMATED SOURCE U.S.: Industrialized Countries: Local: Other:
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14. SOURCE DESCRIPTION

Egyptian political and economic stability is essential to achieving a comprehensive peace in the Middle East. New economic policies are gradually being adopted by Egypt to better manage its resources and to discourage uneconomic consumption. At the same time, social equity issues are being dealt with. Cash assistance is needed by Egypt to help manage its balance of payments and budgetary deficits and to assist in this adjustment process.

As part of our continuing policy dialogue, far reaching economic consultations have been undertaken between the U.S. Mission and the GOE with special reference to balance of payments, budget deficit and debt management.

It is recommended that you approve a Cash Transfer Grant in the amount of \$115,000,000. This amount will be disbursed after execution of the Grant Agreement and satisfaction of legal requirements.

Controller concurs in the methods of financing and implementing stated herein.

19. CLEARANCE PPP/E, PGajewski AD/EM, WMiller LEG, KO'Donnell	DATE 3/5/87 3/5/87 3/5/87	20. ACTION <input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED Frank B. Kimball AUTHORIZED SIGNATURE DATE 3/5/87 Director, USAID/Cairo TITLE
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17

Program Assistance Approval Document

I. U.S. OBJECTIVES

AID has made six cash transfers totaling \$811.9 million to the government of Egypt since September 1984.

Sep.	84	\$101.894 million
Mar.	85	\$100.0 million
Sep.	85	\$250.0 million
Jan.	86	\$100.0 million
Apr.	86	\$150.0 million
Aug.	86	\$110.055 million

Total \$811.949 million

The September 1984 and March 1985 transfers totalling \$201.0 million were not tied directly to macroeconomic policy dialogue or an economic reform program. They were linked to a requirement that Egyptian pounds equivalent to the amount of the cash grant be used for development purposes. The later disbursements totalling \$610.055 million were, however, linked to far reaching economic consultations and achievement of economic reform objectives. The FY86 and FY87 Foreign Aid Authorization Act conditions the \$115 million cash transfer proposed to be made in March 1987 on "the understanding that Egypt will undertake economic reforms or development activities which are additional to those which would be undertaken in the absence of the cash transfer."

The FY 1987 cash transfer program has both political and economic objectives. The immediate political objective is to demonstrate the continuity of U.S. support for the Egyptian Government and its efforts for a comprehensive and durable peace settlement in the Middle East. Over the longer term, our policy is to support a satisfactory evolution of political and economic relations among all countries in the region. The active

participation of Egypt, the largest Arab country, is essential for these purposes. The continuing ability and willingness of Egypt to proceed toward this ultimate goal will depend on its economic strength, and its ability to

- (a) sustain domestic political stability;
- (b) avoid short-term deterioration in the standard of living of the population; and
- (c) obtain sufficient foreign resources to foster economic and social development aided by a vigorous economic reform effort. The fragile state of the Egyptian economy, which is presently highly dependent on foreign assistance, justifies and necessitates the exceptionally high level of present and proposed U.S. assistance to Egypt.

II. RECENT U.S. ASSISTANCE PROGRAM

The United States has committed economic assistance to Egypt totalling \$12.1 billion from FY 1975 through FY 1985. Non-project assistance has totalled \$7.2 billion. Project assistance for physical and social infrastructure and agriculture made up the remainder of this assistance, all of which is detailed in Table I. The FY87 programming levels for the Commodity Import Program and PL480 (Title I) are \$200 million and \$169.1 million, respectively.

U.S. assistance seeks to help sustain Egyptian consumption, production and investment levels by providing a portion of the requisite foreign exchange. The imports needed to support each of these levels are substantial and cannot now be funded out of such market-determined sources of foreign exchange as petroleum exports, workers' remittances, tourism and Suez Canal revenues. Developing exports and import substitutes, and reducing imports of agricultural and industrial products to reduce demand for foreign exchange, will be a lengthy and difficult process. Meanwhile, sustaining the Egyptian economy at its present level of activity requires continuing concessional balance of payments assistance. The GOE will continue to give priority to politically feasible policy changes essential to sustain economic development.

III. ECONOMIC OVERVIEW AND ISSUES

During the period 1965-1974, the Egyptian economy grew in real terms by only three percent annually. Balance of payments problems were also serious. They stemmed from a deterioration in the terms of trade, a rising domestic demand and the burden of defense expenditures. Between 1975 and 1980, Egypt's real economic growth soared to some eight percent annually. Balance of payments pressures were substantially relieved through a surge in foreign exchange receipts from petroleum exports, earnings from the Suez Canal, tourism receipts and workers' remittances.

Subsequently, the decline of oil prices affected all these sources of foreign exchange negatively to varying degrees. Significant increases in per capita energy consumption resulted in a reduced petroleum supply for exports. Government policies relating to management of industry and controls of agriculture resulted in a wasteful use of imported as well as domestic inputs, further aggravating the balance of payments. Finally, inappropriate foreign exchange currency regulations and controls resulted in limiting the inflow of workers' remittances and private investment. The sharp fall in petroleum prices during 1986 has exacerbated the underlying structural weaknesses of the Egyptian economy and made more urgent the need for vigorous economic reforms.

The balance of payments deficit on current account had already risen sharply during 1983/84 as detailed in Table II. A sharp fall in petroleum and tourism earnings during 1986 was offset by tight import restrictions and large increases in external arrears. A recent substantial recovery in tourism earnings and in petroleum prices has eased the BOP pressures somewhat, but the situation is still considerably more difficult than before 1986. The 1986/87 GOE budget deficit is anticipated to reach LE 6.1 billion after exceeding LE 7 billion during 1984/85 and 1985/86. As of June 1985, the estimated total public and publicly guaranteed external debt stood at \$32.5 billion. The external debt servicing schedule for 1986/87 indicates an unsustainable \$3.7 billion due. This represents 30% of total foreign exchange earnings and nearly 40% of earnings through official pools.

Movement towards structural reforms has been slow, but the current crisis has dramatized the necessity to accelerate reforms. Disbursement of this cash transfer is taking place in the context of on-going economic consultations to promote essential economic reforms. The cash transfer will ease the current BOP and budgetary difficulties and thus facilitate the adjustment process necessary to initiate structural reforms. The current BOP and budgetary difficulties are expected to be eased further through the anticipated multilateral debt rescheduling this year.

IV. SATISFACTION OF LEGISLATIVE CRITERIA

This section assesses whether Egypt is undertaking economic reforms "which are additional to those which would be undertaken in the absence of cash transfer". We have accordingly examined the pace of economic reforms actually implemented since August 1986, the date of the previous cash transfer disbursement. Our analysis of recent economic reforms is contained in Cairo 2767 and can be summarized as follows:

- 1) A continuing probable reduction in budgetary subsidies (commitment basis) from LE 2.75 billion in 1984/85 to LE 1.94 billion in 1985/86 and to possibly LE 1.7 billion in 1986/87. This is being achieved through reductions in international prices and through tighter operations of the Ministry of Supply. GASC has been prohibited from further borrowing from the banking system to finance purchases in excess of budget appropriations. Average prices received by GASC have been raised through increased sales of higher quality goods at close to free market prices.
- 2) Temporary authorizations for public sector companies to pay significantly more than LE 1.35 per \$ for foreign exchange. These authorizations might provide irreversible movement in the LE 1.35 exchange rate towards the free market.

Agriculture

- 3) Cotton price for the 1987 crop was increased by 21%. This price increase was passed to cotton mills and, as a partial offset to this cost increase, mills were allowed to produce a greater percentage of higher priced goods.
- 4) Procurement prices for rice, sesame, soybeans, wheat, lentils, fava beans and sugar cane were increased by an average of 25%.
- 5) Import quota on meat was removed in July 1986, and delivery quotas were removed for all crops except sugarcane and 50% of rice in January 1987.
- 6) Private sector was permitted to market maize, broad beans, lentils and above-quota rice in January 1987. Public sector competition at subsidized prices continues, however, to be a substantial hindrance to private marketing.

The promised price increase for corn was deferred.

Energy

There has been no movement to increase energy prices since July 1986; the proposed increases in prices of electricity and major fuels for January 1987 were deferred.

Industry and Commerce

- 7) Most of the corporate planning authority and all of the procurement responsibility of GOFI have been transferred to the holding companies and the firms themselves. GOFI opened its first branch office in Alexandria in January and has apparently speeded up the processing of private sector investment applications.

Most of these changes can be categorized as slow movements towards economic adjustments designed to alleviate some of the short-term financial bottlenecks in the Egyptian economy. The adjustments realized during late 1986 are few and do not reflect the full resolve of the GOE as a whole to embark upon a program of comprehensive economic reforms. For these reasons, one point of view within the U.S. Government was that obligation/disbursement of a lesser amount, say \$65 million, of the \$115 million was appropriate at this time. An opposing view, that release of the full \$115 million is now in order, prevailed.

Supplementary material on this issue, is provided separately.

The Conference Committee Report on the FY86 Appropriations act noted that the committees expect to be advised in advance of the FY87 cash transfer as to how the above-stated legislative criteria have been satisfied. State 64766 advised us that this consultative process in Washington has been completed.

V. IMPLEMENTATION AND OTHER DETAILS

A. In line with standard practice, we have raised with the Government of Egypt (GOE) our concern about the possible impact of this proposed cash transfer on the level of U.S. exports to Egypt. In a Program Implementation Letter, the GOE will undertake to do its best to ensure that, during U.S. fiscal year 1988, the dollar level of Egyptian non-defense commercial imports from the United States will not be less than the average level of the past five years. Additionally, the GOE will undertake to continue importing, during fiscal year 1988, bulk commodities under A.I.D. financing, at the same approximate level of bulk corn imported under AID financing during the past three years.

B. A provision of the FY87 Continuing Resolution specifies that countries receiving cash transfer assistance in excess of \$5 million after February 1, 1987 establish a separate account for the dollar assistance. An accompanying House Appropriations Committee Report and State 52618 offered further guidance on interpreting this provision. Accordingly, the following procedures apply to the establishment of this account for Egypt:

- a) This account will be used solely for the receipt of cash transfer assistance from U.S.A.I.D. Such proceeds may not be co-mingled with other funds from whatever source. Should any interest be earned on such account, such interest will be treated as though it were grant proceeds received under the terms of this agreement. Any required redeposits will be similarly treated.
- b) Grant proceeds may be used by Egypt for any or all of the following purposes determined by Egypt to be necessary for balance of payments purposes:
 - (1) financing the importation of services, capital goods, raw materials and other goods deemed essential by the GOE. The source and origin may be A.I.D. Geographic Code 899 countries. The GOE will undertake either in the Grant Agreement or a Program Implementation Letter, to use "best efforts" to avoid using CT proceeds to import from third countries goods which directly compete with similar U.S. exports in the Egyptian market.
 - (2) Servicing of external debt to the United States and other code 899 countries. This would include FMS debt which, by correspondence between USAID/LEG and AID/GC, has been determined not to constitute use of AID funds for military purposes.
 - (3) Other purposes or uses as agreed between the parties. The grant proceeds, by Grant Agreement covenant, will not be used for financing military or paramilitary requirements of any kind, including commodities or services for such purpose.

- c) Egypt will advise U.S.A.I.D. in writing within one year of disbursement of the uses to which such grant proceeds have been put. The accounting books and records will be available for inspection by U.S.A.I.D. for a period of two years following the disbursement of the cash transfer.

Note: In negotiation with the GOE of the Grant Agreement we intend to review details of the necessary "books and records" and to incorporate these details in a P.I.L. or other appropriate document.

C. Section 531 (d) of the CR requires that, as to Commodity Import Programs and "other program assistance", AID funding be used, "to the maximum extent feasible", to generate local currencies for support of AID funded Basic Human Needs activities. This question was examined by the Mission last year and the conclusion reached that there is an ambiguity as to whether "other program assistance" is meant to include cash transfer assistance. Even if it is, we do not consider it feasible or desirable to require a special generation of LC with our cash transfer assistance to Egypt because

- (a) the main purpose of such assistance is EOP support;
- (b) through the CIP-Generated Special Account, and its national budget, the GOE already contributes substantially to LC requirements of AID-funded projects and additional LC generation could also increase the budget deficit; and
- (c) the covenant mentioned under V B above will serve the same purpose and will prove practical to negotiate and implement. Also, the FY87 CR language concerning the segregated bank account refers to LC as "may" be generated by CT Agreement; this statutory language, clearly, does not require that LC, in fact, be generated. For these reasons, no specific generations of LC are proposed for this upcoming assistance.

D.. Following receipt of a statement warranting that the named person or persons have the authority to act as the representative or representatives of the Grantee, the U.S. will make the deposit to the separate bank account designated by the GOE.

VI. RECOMMENDATION

It is recommended that a \$115 million cash transfer to the Government of Egypt (GOE) be approved and authorized for obligation at this time.

Table I

U.S. Economic Assistance to Egypt
FY 1975 - 1987 Cum. Oblig.
(\$ 000)

Program

CIP	3,610,500*
PL-480 Titles I, II and III	2,781,232
Cash Transfer	<u>811,949</u>
Total	7,203,681.

Project

Electricity	915,833
Water/Wastewater	1,145,289
Decentralization	606,200
Other Infrastructure	544,050
Industry	576,529
Agriculture	474,489
Human Resources	529,601
Other	<u>152,769</u>
Total	4,944,760
Grand Total	12,148,441

* Includes Production Credit and Private Sector CIP.

Table II

Egypt: Balance of Payments

Merchandise Trade

(In Millions of Current Dollars)

	<u>1982/3</u>	<u>1983/4</u>	<u>1984/5</u>	<u>1985/6</u>	<u>1986/7</u>
Petroleum Exports ¹	2,807	2,957	2,891	2,220	1,300
- Crude	(2,182)	(2,396)	(2,363)	(1,745)	1,000
Non-Petroleum Exports ²	977	1,283	1,191	1,054	1,200
Imports ³	10,900	12,600	12,300	11,400	10,100
Trade Deficit	7,100	8,300	8,200	8,100	7,600

Services

Shipping & Airline Companies	511	521	606	574	600
Suez Canal Dues	957	974	897	1,028	1,100
Tourism ⁴	1,000	1,050	1,200	950	1,100
Worker Remittances ⁵	4,400	4,500	4,400	4,400	4,000
Investment Income	1,018	1,079	1,044	911	720
Other ⁶	<u>833</u>	<u>789</u>	<u>781</u>	<u>769</u>	<u>800</u>
Total Service Receipts	8,700	8,900	8,900	8,600	8,300
Interest Payments ⁷	1,881	2,035	981	1,321	1,500
Remittances ⁸	200	300	560	810	500
Other Services Payments ⁸	1,186	1,248	1,531	1,525	1,500
Deficit on Current Account	1,650	3,000	2,400	3,100	2,800

Capital Account

Amortization Payments	1,610	1,818	1,415	1,700	2,050
- Public Creditors	(660)	(571)	(580)	(700)	(800)
- Suppliers	(950)	(1,247)	(835)	(1,000) ⁹	(1,250)
Direct Investment ¹⁰	1,314	1,273	1,287	1,265	1,000
International Assistance	1,800	2,000	2,000	2,400	2,100
Supplier Credits	1,200	1,547	850	850	650
Other and Errors					
And Additions to Reserves ¹¹	1,050	0	300	-300	-1,100
	500	-500	-1,000	-1,400	-2,600
MEMO: Rise in External Arrears	495	520	1,332	1,141	1,500

1. Includes bunkers, but excludes foreign partners' profit share and cost recovery shipments.

2. We consider that the official figures of 1,087 1,393 1,294, and 1,191 for 1982/3-1985/6 respectively over-estimate actual exports because they fail to reflect the use of the free market rate for many industrial exports. We have attempted to make this adjustment by utilizing tables 26 and 28 of the Central Bank of Egypt's 1983/4 and 1985/6 annual reports. The export groups of the latter table were compared with the proceeds of exports through the commercial bank pool to arrive at residual industrial exports presumed to have received the free market rate.

3. The derivation of the IMF estimates is presented in IMF, ARE-Recent Economic Developments SM/85/198 of August 22, 1986 page 127. These IMF estimates for the 1981/2-1984/5 period of 8,978; 9,153; 10,738; 10,516 and 9,560 million dollars (revised) respectively include an adjustment for unrecorded grant shipments. We have made two additional adjustments to the IMF figures to arrive at our figures above: 1) Equipment for exploring and developing oil fields brought in by foreign oil companies of 925, 1,061, 1,128; 1,077 and 1,056 million dollars per year is unrecorded both as imports and as direct investment. 2) Many imports brought back by returning emigrants on ships and planes are unrecorded; some additional imports are also unrecorded with financing from unrecorded worker remittances or unrecorded tourism earnings. These unrecorded imports may total \$600-800 million annually. Military imports and foreign military assistance are excluded from this table.

4. Includes unrecorded tourism receipts resulting from increasing divergence between official bank and free market rates. The total tourist nights spent in Egypt declined by 10 percent from 1981/2 through 1983/4 and recovered slightly during 1984/5, but declined again the next year.

5. The official figures are 2,082; 3,166; 3,930 and 3,497 and 3,036 million dollars respectively. We have made the following three adjustments to these figures to arrive at our figures above; 1) IMF, SM/85/198 pages 55-57 and a later revision indicate that unrecorded flows into foreign currency free accounts may have totalled 1,300; 978; 457; 686 and 860 million dollars respectively. 2) Unrecorded worker remittances financing unrecorded imports may have totalled \$400-600 million annually. 3) An exchange rate deduction of \$100 million for 1981/2, \$200 million for 1982/3, \$400 million for 1983/4 and \$300 million for 1984/5 has been made to reflect the near-market rates actually received for almost all cash transactions rather than the 0.84 rate officially recorded. We have omitted making a similar exchange rate deduction for in-kind transactions. If we were to do so, there would then have to be the same deduction for the own exchange import figures.

6. The jump from 1981/2 to 1982/3 is believed to represent the initiation of military exports.

7. The actual interest payments were obtained by using IMF estimates of interest obligations in IMF, ARE-Recent economic developments SM/86/215, page 49 and subtracting therefrom the figures for annual increases in external arrears. Amounts given here and in IMF presentations include military interest payments.

8. We have obtained a detailed breakdown of the other service payments item from the Central Bank for 1984/5 and 1985/6 and are using those figures except for moving out the capital and investment account transactions component into the item called remittances. The only specifically described remaining item is called retention accounts amounting to \$101 and \$171 million respectively.

We do not have a Central Bank break out for the earlier years. Since the "others" item, including remittances, was only \$549 million in 1983/4 and \$431 million in 1982/3, we hazard a guess that remittances during those years may have been \$200-300 million.

9. We are using the Ministry of Economy figure of \$1,012 million for supplier credits for 1985/6.

10. IMF 1985 figures adjusted by amounts of 925, 1,067; 1,128; 1,077 and 1,058 million dollars annually in foreign oil company equipment imports for exploring and developing oil fields.

11. The second row of figures would have been applicable if there had been no increases in net external arrears. (See IMF, SM/86/215 page and November 23, 1986 IMF Balance of Payments table).

PPP/E, DCarr, hm

Doc., CASHTRAN 03/09/1987

STATUTORY CHECKLIST

ECONOMIC SUPPORT FUND PROJECT

CRITERIA

a. FAA Sec. 531(a).

Will this assistance promote economic and political stability? Yes

To the extent possible, does it reflect the policy directions of FAA Section 102? N.A.

b. FAA Sec. 531(d).

To maximum extent feasible, are funds used available for program assistance being used to generate local currency in support of AID-administered activities? See discussion
in Text of
PAAD

c. FAA Sec. 534.

Will ESF funds be used to finance the construction of, or the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the president certified that such use of funds is indispensable to nonproliferation objectives? No

d. FAA Sec. 609.

If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? N.A.

STANDARD ITEM CHECKLIST

N.A. to Cash Transfer Agreements

OTHER RESTRICTIONS

N.A. to Cash Transfer Agreements