PD-ABF-092
XD 80420

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

CASH TRANSFER FOR SECTOR POLICY REFORM
263-K-626
PROJECT ASSISTANCE
APPROVAL DOCUMENT (PAAD)

TECHNICAL SUPPORT FOR POLICY REFORM
263-0233
PROJECT PAPER

Dated signed: 08/23/92

UNCLASSIFIED

PD-ABF-092

CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number: 263-K-626
2. Country: Egypt
3. Category: Cash Transfer
4. Date: August 20, 1992
5. To: Henry H. Bassford, Director USAID/Egypt
6. OYB Change Number:
7. From: Samuel Skogstad AD/EAS Samuel L. Skogstad
8. OYB Increase: None
To be taken from:
9. Approval Requested for Commitment of $ 200,000,000
10. Appropriation Budget Plan Code:
11. Type Funding: ☐ Loan ☒ Grant
12. Local Currency Arrangement: ☒ Informal ☒ Formal ☐ None
13. Estimated Delivery Period: FY 92 - FY 93
14. Transaction Eligibility Date: As per Block 20
15. Commodities Financed:

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	$ 150,000,000 imports from U.S.
Limited F.W.		Industrialized Countries	
Free World		Local	
Cash	$ 200,000,000	Other	$ 50,000,000 U.S. debt

18. Summary Description

The purpose of the Cash Transfer for Sector Policy Reform Program is to support increased Egyptian economic growth by promoting increased macro-economic stability, market pricing and greater private investment and trade. $200 million in performance-based disbursements will be provided in FY 92-93. An initial tranche of $60 million, based on previous Government performance, will be disbursed upon satisfaction of boilerplate conditionality. Disbursements of subsequent tranches will be based on GOE performance toward an agenda of policy reform measures that address four sectors: financial, fiscal, trade and privatization. An initial assessment of performance will be made no later than January, 1993, and will provide the basis for disbursement of the next tranche. A determination will be made at that time regarding the need for an additional tranche in CY 92.

Cash Transfer dollars will be used primarily for the import of commodities from the U.S. and to a lesser extent for the payment of USG debt. The dollars will be deposited into a separate account.

Local currency in amounts equivalent to the dollars used for commodity imports will be deposited by the GOE into a separate account. The local currency will be used for budget support to development ministries; USAID administrative and operational costs; and permissible uses as established in the AID-GOE Trust Fund Agreement.

19. Clearances	Date
Paul Mulligan, EAS	PM 8/23/92
Robert Jordan, (A)AD/PDS	8/23/92
Theodore Carter, AD/LEG	8/23/92
Douglas Franklin, AD/FM	DCF 8/23/92
Priscilla Del Bosque, AD/TI	PDB 8/23/92
George Wachtenheim, DD	GW 8/23/92

20. Action

☐ APPROVED ☐ DISAPPROVED

Authorized Signature: [signature] Date: 8/23/92

Title: Henry H. Bassford Director, USAID/Egypt

AID 1120-1 (5-82)

CLASSIFICATION:

dUSAID

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR, NE BUREAU

FROM: NE/DR, Acting Director, John Balis

SUBJECT: Egypt - Sector Policy Reform Program (263-K-626)

ISSUE: Your approval is required for an *ad hoc* Delegation of Authority (DOA) to permit the USAID/Egypt Mission Director to approve the Sector Policy Reform Program notwithstanding the [illegible] (PAIP).

BACKGROUND: Per Cairo 12474, dated July 15, 1992, USAID/Egypt requested Delegation of Authority to approve the PAAD for its Sector Policy Reform Program. The Program is a two-year, $400 million Cash Transfer. Its purpose is to support the implementation of Egypt's Economic Reform Program, which aims to liberalize the economy and increase its market orientation. Under this sector program, USAID will negotiate with the GOE, a set of yearly policy reform benchmarks covering four sectors: financial, fiscal, trade, and enterprise. USAID will disburse cash to the GOE over two years of the program, according to the GOE's policy reform performance in these four sectors. The Program also allocates $10 million for technical support under the Sector Policy Reform Project (263-0233) for a three-year period.

DOA 653 requires the Mission to submit all PIDs and PAIPs, with a life-of-project (LOP) funding in excess of $20 million, to AID/W for review. However, although the Bureau did not review a formal PAIP in this instance, Bureau representatives were informed of the major elements of the Program during Program week in Cairo, in May 1992, and concurred with USAID's negotiating strategy. In addition, the general outlines of the Program appeared in the FY 1993 Congressional Presentation (CP) which were under discussion with the Mission for almost a year.

DISCUSSION: The AA/NE chaired a Committee Review Meeting on July 29, 1992 to review the Egypt Sector Policy Reform Program. The Reviewers commended the Program for its clarity, completeness, and its well-presented analytical framework. All of the concerns raised at the meeting have been adequately addressed, either by GC/NE or by the Mission (ref: Mulligan-Coulter telefax).

Following is a report of the major points discussed.

A. Issue: The question was raised as to whether the proposed disbursement plan is too flexible and leaves too much room for interpretation (even disagreement) by either side as to how much a particular reform is worth.

- Discussion: The current disbursement plan requires, inter alia, that "if all policy reforms identified for 1992 have been implemented then the $140 million will be disbursed. If not, then USAID will determine the size of the disbursement based on the importance of the reforms accomplished to date". The Committee's concern was that the Mission may find itself in the difficult position of having to determine how much a specific reform is worth and that the disbursement plan may not permit the Mission to allocate resources in such a way as to provide sufficient incentives/sanctions for the GOE to undertake the more difficult reforms, such as privatization.

- Resolution: This concern has been satisfied by the Mission's message of 8/2/92 (Mulligan-Coulter telefax). As reported by the Mission, they had originally planned to divide the $200 million per year among three or four equal disbursements tied to packages of policy measures. However, after preliminary discussions with the GOE, it became clear that the Mission and the GOE would not be able to agree on specific packages on an _a priori_ basis. Indeed, the GOE preferred the program as presently proposed, partly because of its experience under the Agricultural Production and Credit Project (APCP), a similar policy based program. Under the APCP, when the agreed upon performance was not met, the USAID Mission Director, on the advice of his technical staff, decided how much the reforms were worth. The Mission reports that, this system worked well and that there is no reason to believe that it will not work under the proposed Sector Policy Reform Program.

B. Issue: Mention was made of a cable in which World Bank officials gave a presentation to the U.S. Ambassador to Egypt and described Egypt as doing poorly on its reforms.

- Discussion: It was noted that a recent American Embassy/Cairo cable gave an unfavorable assessment of the GOE's progress in the policy reform area. Mission

3

is, no doubt, aware of this assessment. This report is of interest to AID/W because of the GOE's past reluctance to move on reforms in certain areas, such as privatization.

- Resolution: The Committee recommended that the Mission incorporate its views of this assessment into the PAAD if the assessment is likely to affect the program negatively.

C. In response to a question raised about the cotton study, the Mission stated that this study was included to complement and broaden the scope of the "Cotton Marketing and Growing" study currently underway through the APCP. The latter study was limited to those areas under the purview of the Ministry of Agriculture. The introduction of this study into the Sector Policy Program will involve the Ministry of Industry and potentially lead to a more comprehensive and fruitful policy dialogue on cotton.

To enable AID/W to stay abreast of the Program's progress, the Committee requested that the Mission send in periodic status reports. These reports would include, but not be limited to, information pertaining to the GOE meeting the Conditions Precedent (CP) and USAID's disbursement of funds. Before amending the PAAD to authorize FY '93 funding, the Mission will be requested to report on the accomplishments of the FY '92 program and set out the reform agenda for FY '93.

Given the Bureau's familiarity with the Program and the excellent quality of the Program outline (Cairo 12474) which the Mission sent in for review, we are satisfied that the Program is sound and that the Mission can implement this Program successfully without sending in the additional PAIP documentation for review.

<u>RECOMMENDATION</u>: That you approve the <u>ad hoc</u> Delegation of Authority to the USAID/Egypt Mission Director to approve the Sector Policy Reform Program notwithstanding the absence of an AID/W-approved Program Assistance Initial Proposal (PAIP), subject to the Congressional Notification being cleared by Congress.

Approval: R J Brown

Disapproval: ____________

Date: 8/14/92

4

XD-ABF-092-A

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE
A = Add
C = Change
D = Delete

Amendment Number

DOCUMENT CODE
3

2. COUNTRY/ENTITY
Egypt

3. PROJECT NUMBER
263-0233

4. BUREAU/OFFICE
Near East Bureau

5. PROJECT TITLE (maximum 40 characters)
Technical Support for Sector Policy Reform

6. PROJECT ASSISTANCE COMPLETION DATE (PACD)
MM 08 DD 31 YY 95

7. ESTIMATED DATE OF OBLIGATION
(Under 'B.' below, enter 1, 2, 3, or 4)
A. Initial FY 92 B. Quarter 4 C. Final FY 95

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 92 B. FX	FIRST FY 92 C. L/C	FIRST FY 92 D. Total	LIFE OF PROJECT E. FX	LIFE OF PROJECT F. L/C	LIFE OF PROJECT G. Total
AID Appropriated Total	10,000		10,000	10,000		10,000
(Grant)	(10,000)	( )	(10,000)	(10,000)	( )	(10,000)
(Loan)	( )	( )	( )	( )	( )	(
Other U.S. 1.						
Other U.S. 2.						
Host Country						
Other Donor(s)						
TOTALS	10,000		10,000	10,000		10,000

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. PRIMARY TECH. CODE 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. OBLIGATIONS TO DATE 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. AMOUNT APPROVED THIS ACTION 2. Loan	F. LIFE OF PROJECT 1. Grant	F. LIFE OF PROJECT 2. Loan
(1)									
(2) ESF						10,000		10,000	
(3)									
(4)									
TOTALS						10,000		10,000	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE C

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)
A. Code
B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

To help the GOE develop, carry out, monitor and evaluate its sector policy reform program

14. SCHEDULED EVALUATIONS
Interim MM YY MM YY Final MM 05 YY 95

15. SOURCE/ORIGIN OF GOODS AND SERVICES
[X] 000 [ ] 941 [X] Local [ ] Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ___ page PP Amendment.)

Mission Controller has reviewed and concurs with the methods of implementation and financing included herein.

Douglas J. Franklin
Douglas J. Franklin

17. APPROVED BY

Signature

Title
Henry Bassford
USAID/Cairo, Director

Date Signed
MM 09 DD 23 YY 92

18. DATE DOCUMENT RECEI IN AID/W, OR FOR AID/W DO MENTS, DATE OF DISTRIBU
MM DD YY

AID 1330-4 (8-79)

5

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

PROJECT AUTHORIZATION

Name of Country: Arab Republic of Egypt

Name of Project: Technical Support for Sector Policy Reform

Number of Project: 263-0233

1. Pursuant to Section 531 of the Foreign Assistance Act of 1961, as amended (the "Act"), I hereby authorize the Technical Support for Sector Policy Reform Project (the "Project") for the Arab Republic of Egypt ("Cooperating Country") involving planned obligations not to exceed Ten Million United States Dollars ($10,000,000) in grant funds over a three year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. Operating Year Budget/Allotment process, to help in financing the foreign-exchange and local-currency costs of goods and services required for the Project. The estimated life of the Project is three years from date of initial obligation.

2. The Project will assist the Cooperating Country to achieve its economic reform program, specifically those sector policy reforms related to the A.I.D. Cash Transfer for Sector Policy Reform.

3. The Project Agreement may be negotiated and executed by the officers to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority. The Project shall be subject to the following essential terms, together with such other terms, conditions, and covenants as A.I.D. may deem appropriate.

a. Source and Origin of Goods and Services

Goods and services financed by A.I.D. under the Project, except for ocean shipping, shall have their source and origin in the United States, or in Egypt as authorized pursuant to the requirements of State 410442, except as the USAID/Cairo Mission Director, or his/her designee, may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Project shall, except as A.I.D. may otherwise agree in writing, be financed on flag vessels of the United States.

6

4. Based upon the justification set forth in the Project Paper, I hereby determine, in accordance with Section 612(b) of the Act, that the expenditure of United States Dollars for the procurement of goods and services in Egypt is required to fulfill the purposes of this Project; the purposes of this Project cannot be met effectively through the expenditure of U.S.-owned local currencies for such procurement; and the administrative official approving local cost vouchers may use this determination as the basis for the certification required by Section 612(b) of the Act.

Henry H. Bassford
Director

8/23/92
Date

Clearances:
A/AD/EAS, PMulligan PM
EAS, MGellerson MG
AD/TI, PDelBosque PDB
PDS/PS, MJune
AD/FM, DFranklin
A/D/DIR, CCrowley
Drafted:LEG:VMoore:7/3/92:authctta
VM

- 1

Table of Contents

LIST OF TABLES IN TEXT

ANNEXES

Glossary

AID	Agency for International Development (Washington)
IMF	International Monetary Fund
MIC	Ministry of International Cooperation
MOU	Memorandum of Understanding.
PIL	Project Implementation Letter
SAL	Structural Adjustment Loan (World Bank)
SPR	Sector Policy Reform (Program)
TSSPR	Technical Support for Sector Policy Reform (Project)
USAID	U.S. Agency for International Development (Cairo)

\\\

I. Executive Summary

A. Overview

The Cash Transfer for Sector Policy Reform (SPR) is a two year $400 million grant program (263-K-626). Its purpose is to support the implementation of Egypt's economic reform program, which aims to liberalize the economy and increase its market orientation. As such, it is an integral part of the overall mission goal of enhancing Egypt's role as a model of stability, democracy, free markets and prosperity in the region. One of the three Mission subgoals is to increase economic growth. The SPR program will help achieve this subgoal by promoting macroeconomic stability and market pricing, and by encouraging private investment and trade.

The SPR will take the form of a $400 million policy-based cash transfer, divided equally between the two years. The accompanying $10 million Technical Support for Sector Policy Reform (TSSPR) Project (263-0233) will provide TA over a 3 year period to help carry out the reform measures. The SPR will provide the GOE with foreign exchange, generate local currency--thereby reducing the fiscal deficit, supply technical assistance to help with the identification and implementation of needed reforms, and generally support the GOE as it undertakes difficult economic stabilization and adjustment measures.

The SPR builds upon the policy-related activities that the Mission has engaged in for many years. USAID was the first major donor to recognize the necessity for taking a broad, policy-intensive approach to economic restructuring. This was reflected in the policy reform components of USAID projects in the agricultural and energy sectors.

At the macroeconomic level, USAID has also played an important role in supporting Egyptian economic reform. USAID's previous cash transfers provided support for the GOE as it undertook sporadic economic reforms. In addition, USAID funded a variety of policy studies and technical assistance in the financial, fiscal, and enterprise sectors. The results of these activities not only influenced GOE thinking, but also helped shape the comprehensive economic reform program that the GOE has recently adopted.

This economic reform program focuses on macroeconomic stabilization and medium term structural adjustment. It is anchored by the IMF Stand-By Agreement and the World Bank Structural Adjustment Loan (SAL). These agreements spell out the principal objectives of Egypt's economic reform and identify in broad terms the reforms necessary to accomplish these objectives.

The SPR is designed to support Egypt's economic reform by complementing the World Bank and IMF programs currently underway. It does this by identifying intermediate or supplementary policy

\12

measures which the GOE should implement if it is to achieve the goals of the overall reform program agreed to with the Bank and Fund. The SPR places particular emphasis on extending the effects of policy reform to the private sector. It also calls, where necessary, for studies to determine the specific nature of GOE reforms to be undertaken, and provides the technical assistance needed to help the GOE carry out the studies and implement the reforms. Overall, the SPR adds specificity to the reform agenda which the GOE has adopted.

Under the SPR, USAID will negotiate with the GOE a set of yearly policy measures covering four sectors: financial, fiscal, trade, and enterprise. Cash will be disbursed by USAID to the GOE over the two years of the program according to its policy reform performance in these four sectors. The policy measures are designed to complement and reinforce the reform program that the GOE has already agreed to with the World Bank and IMF. The SPR's policy reform agenda for each of the four sectors is described in general terms below. More details are provided in Sections III and IV of the PAAD.

B. The SPR Policy Reform Agenda

USAID's financial sector program is directed towards strengthening and deepening Egypt's financial system so that it can more effectively mobilize the resources needed to support the privatization of Egypt's economy. Specific policy measures concentrate on: strengthening the banking system by requiring higher capital/asset ratios and by permitting a greater role for foreign and private banks; deepening the securities market by providing a sounder legal framework and more equal treatment of debt and equity and by permitting a greater role for foreign and private securities firms; and liberalizing interest rates.

The GOE has already committed itself in broad terms to fiscal reform directed towards reducing the size of the fiscal deficit and improving the efficiency and elasticity of the tax system. USAID's fiscal sector program concentrates on establishing specific tax policy and expenditure measures--the attainment of which assists the GOE in meeting its broad fiscal sector commitments. Specific policy measures focus on broadening the general sales tax, adopting the global income tax, and improving the availability of GOE revenue and expenditure data.

USAID's trade sector program promotes policy measures which help open Egypt's economy to international competition--thus encouraging domestic producers to become more efficient and hence more competitive in world markets. Specifically, policy measures promote further lowering of non-tariff trade barriers, the reduction of GOE control over export and import industries, and the reform of customs duties and procedures.

13

Policy measures in the enterprise sector support the overall SPR objective of promoting a greater role for the private sector in Egypt's economy. The reforms described above for the financial, fiscal, and trade sectors contribute to this objective by addressing the overall economic climate within which the private sector operates. The enterprise sector program builds upon this with specific measures aimed at the privatization of public enterprises, the reduction of public sector impediments to private sector growth, and the introduction of new business laws.

C. Project Assistance

$10 million in project assistance will finance a program of long term and short term technical expertise to help the GOE achieve the agenda of policy measures. The grantee will be the GOE (Ministry of International Cooperation). Technical assistance will be carried out under direct AID contracts. Long term teams will provide assistance relating to banking and securities, public expenditure control, and trade policy. Short term assistance will be related to a number of policy measures.

D. Financial Plan

Program disbursement will occur as follows: upon signing of the grant agreement, $60 million will be disbursed. This amount is based on the progress that the GOE already has made on USAID-identified policy measures since they were first discussed with the GOE in January 1992 . The balance of the first year monies, $140 million, will be disbursed as follows: there will be up to two performance reviews between the signing of the grant agreement and the end of CY 1992. If all policy reforms identified for 1992 have been implemented, then the $140 million will be disbursed. If not, USAID will determine the size of the disbursement based on the importance of the reforms accomplished to date. The GOE will have until the end of June 1993 to complete implementation of remaining 1992 reforms and thus receive the rest of the $140 million. However, if complete implementation does not occur by July 1 1993, then the undisbursed residual will be carried over to next year's sector policy program and the funding for that program will be reduced by an equivalent amount. A similar disbursement mechanism will be followed in the second year.

Dollars will be disbursed into a separate special account. Approximately 75 percent of these dollars will be used for the importation of equipment and commodities from the United States, and up to 25 percent for the payment of U.S. debt. The GOE will deposit into a separate account an amount of Egyptian pounds equivalent in value to the U.S. imports financed by the dollars disbursed under the program.

II. Background

A. Setting for U.S. Economic Assistance

1. Political Environment and U.S. Goals for Economic Assistance

The overall goal of U.S. economic assistance to Egypt is to enhance Egypt as a model of stability, democracy, free markets and prosperity in the region. Economic assistance is a major aspect of broader U.S. support to Egypt to facilitate the maintenance and broadening of permanent peace in the region.

Egypt has traditionally played a leading role in the Arab, Islamic and African worlds by virtue of its history, size, and strategic location. It will be able to continue to play this role, however, only so long as it is politically and economically stable. Sustained and equitable economic growth is a necessary condition for this stability and thus one of the three sub-goals of the USAID program. The proposed program assistance directly supports the strategic objectives of: 1) increased macroeconomic stability in the context of competitive price-directed markets; and 2) increased private saving, investment, and trade. Attaining these objectives is essential if the Egyptian economy is to meet its external financial obligations while improving the economic well-being of its citizens.

2. Post-War Economic Conditions

The Gulf war produced a disastrous drop in tourism, temporarily reduced worker remittances, and boosted military expenditures. Although these costs were partially offset by higher Suez Canal and petroleum revenues, along with exceptional payments to defray military outlays, the Egyptian economic outlook was still very fragile--at least for the short term. Uncertainties associated with the war and its aftermath, together with the structural imbalances that permeated the economy, raised serious questions as to the prospects for a real recovery.

Egypt's external current account deficit had been near the $3 billion mark annually for the past three years with no improvement in sight. The GOE was accumulating large, unsustainable arrears of debt service. In addition, the budget deficit was about 20 percent of GDP and both inflation and unemployment were serious problems. Fortunately, Egypt pressed forward with formulation of its own reform program in concert with the IMF, the World Bank, and USAID. The United States also took the lead in a program of debt forgiveness, writing off military debt of approximately $6.7 billion. Paris Club negotiations resulted in a program to forgive approximately one-half of official external debt, bit by bit provided Egypt adhered to its comprehensive economic reform program.

Under the stabilization program undertaken pursuant to its IMF

15

Standby Arrangement, Egypt's short-term external financial position has improved significantly. The currency was floated and the various exchange markets were unified. Interest rates were freed and rose to about 18 percent per annum on long term deposits and short term treasury bills. In response, Egyptian-owned foreign currency, most of it counted as workers' remittances, flowed into the country. Remittances have recovered from the slump of the war and tourism is hitting record levels. New economic programs with the IMF, World Bank, and bilateral donors are in place. At the same time, debt forgiveness and rescheduling plus weak demand for imports have reduced the demand for foreign exchange, leading to a substantial buildup in reserves and, unfortunately for export development, a stable exchange rate despite continuing inflation. The balance of payments position is currently very strong, though finding an exchange rate consistent with sustained economic growth and improvement in the trade balance remains a problem.

Egypt's economy has begun to stabilize. An expected drop in real GDP for FY 1992 did not materialize. Various revenue measures and greater control of expenditures have cut the budget deficit in half, to less than 10 percent of GDP, and inflation is down. The economy remains stagnant, however. Public sector restructuring and market liberalization, if fully implemented, will certainly result in significant economic dislocations in the short to medium run. Considerable donor support will be required if the Government is to keep its economic policy reform program on track and at the same time adopt measures to provide a safety net for the poor.

3. Economic Reform and USAID Support

The GOE's plan for economic reform is spelled out in its Memorandum of Economic Policy and its Economic Reform and Structural Adjustment Program. If successfully implemented, the plan should ensure Egypt's transition from a centrally planned economy characterized by macroeconomic imbalances, inefficiency, and over-reliance on foreign inflows to a market-based economy that relies on the predominant private sector to allocate resources efficiently based on domestic and international market forces, and which is less dependent on foreign resources.

The GOE has made a good start in reforming its economy in line with the objectives described above. Significant policies aimed at stabilizing the economy and achieving key sectoral reforms have been implemented since 1991--mostly as part of the Stand-By Agreement with the IMF and the SAL with the World Bank (see Section II. D for details). Nevertheless, many of the most difficult reforms--especially those pertaining to the restructuring of the public sector--remain to be implemented.

This situation presents an unusual opportunity and challenge for USAID. The time is ripe for a policy-based program, supported with appropriate technical assistance, which identifies and leverages those intermediate policy actions needed to be taken by the GOE if it is to accomplish the reform targets it has set for itself. Moreover, the financial support provided to the GOE through the program can help alleviate the cost of adjustment and ease its burden on the poor.

B. Economic Overview

1. Growth Performance of GDP by Sector

Over the past three decades, the Egyptian economy has grown erratically. From 1965 to 1975, the annual real growth rate of GDP averaged 3 percent. In the decade following the 1973 war, Egypt's average real growth of GDP jumped to over 8 percent on the strength of a strong surge in petroleum exports, Suez Canal dues, worker remittances and tourism (see Table 1). Private sector activities also expanded but, unfortunately, the boom was accompanied by a large increase in imports rather than in production of non-oil tradeable goods; thus the boom resulted in relatively little additional productive capacity in other sectors of the economy. By 1985/86, Egypt's creditworthiness had worsened significantly. Import restrictions were imposed, investment was reduced, and as a result real growth over the rest of the decade slowed dramatically to 2-3 percent per annum.

Table 1
Gross Domestic Product by Sector
(In 1974 LE Million)

	1974	1981/82	1985/86	1988/89	Avg. Annual Growth 1974 - 89
Agriculture	3,122	3,932	4,353	4,732	3.6 %
Manufacturing	1,545	2,670	3,384	3,720	6.5 %
Construction	483	1,055	1,273	1,294	7.6 %
Petroleum	481	2,668	3,500	3,746	18.4 %
Utilities	80	128	191	282	10.1 %
Commerce&Finance	1,544	3,795	5,098	5,634	9.8 %
Transport	267	1,358	2,024	2,197	17.4 %
Suez Canal	7	642	653	649	108.4 %
Housing	207	373	513	563	7.5 %
Services	1,993	3,477	4,068	4,423	6.1 %
Government	766	684	853	929	3.5 %
GDP (at F.C.)	9,729	20,098	25,057	27,240	7.7 %
GDP (at M.P.)	10,495	20,782	25,910	28,169	7.4 %

Source: World Bank Reports; USAID estimates for the last year.

While the services and petroleum sectors grew at high annual rates during the period 1974-89 (17 percent for transportation, 10 percent for utilities, 10 percent for commerce and finance, and 18 percent for petroleum), the productive sectors (agriculture and industry) lagged behind. This structural imbalance impeded efforts to achieve sustained growth. Market distortions such as price controls and subsidies, as well as the domination of industry by

\\1'

grossly inefficient public enterprises, were major factors behind the weak performance of the productive sectors.

2. **Other Economic Indicators**

Investment, Savings and Consumption. The Egyptian economy has been characterized over the past three decades by a high propensity to consume -- government and private consumption accounted, on average, for about 85 percent of GDP (see Table 2). The GOE policy of subsidies contributed to the high level of private consumption. This high consumption level had at least two pernicious effects. First, it fostered large budget deficits due to the GOE's policy of subsidizing a wide variety of consumer goods and services. Second, it resulted in fewer domestic resources being available for productive investment by absorbing private savings.

Investment has ranged between 20-30 percent of GDP during the last three decades. Approximately two-thirds of this investment was made by the public sector. Because the domestic savings rate has been relatively low, investment has consistently exceeding domestic savings and hence been partially financed by foreign savings. By the mid-1980s, however, reaction on the part of lenders to the "debt crisis" caused less foreign savings to be available to finance Egyptian domestic investment. Increasing domestic savings filled only part of this gap so that domestic investment declined to about 20 percent of GDP by 1989/90.

Table 2
Consumption, Investment and Savings
Percent of GDP

	1966	1974	1981/82	1985/86	1988/89
Consumption*	86.1	104.2	84.8	83.1	76.9
. Public	19.3	22.9	17.8	17.9	13.3
. Private	66.8	81.3	67.0	65.2	63.6
Investment*	16.8	22.7	30.1	26.0	23.6
. Public	n.a.	17.6	22.9	17.4	16.3
. Private	n.a.	5.1	7.2	8.6	7.3
Savings	13.9	-4.2	15.2	17.5	23.1

Sources: World Bank Reports; USAID estimates for the last year.

Monetary Conditions and Interest Rates.

During the late 1970s and early 1980s, Egypt's money supply (M2) expanded rapidly at an annual average rate of 30 percent, reaching 80 percent of GDP. In the second half of the decade, the

* Central government only is included here. However, a proportion of military spending whose size is unknown, is not included in these estimates.

growth rate declined to 21 percent. Money supply growth hit a peak in 1991 when M2 grew by 37 percent, compared to 18 percent in 1989 and 29 percent in 1990.

Increases in net domestic credit accounted for most of the monetary expansion over the last decade. Before 1985, net domestic assets grew at an annual average rate of about 80 percent, but the growth slowed to about 25 percent annually during the second half of the decade before increasing to about 35 percent during the 1990s prior to the signing of the IMF Stand-By Agreement.

The pattern of credit allocation has remained stable over the last decade, with about 70 percent of total credit directed to the public sector for financing of the fiscal deficit or support of public sector entities. In the next stage of Egypt's market-based development, the private sector's share of domestic credit will likely increase since preferential lending to the government and public enterprises has been eliminated.

Based on the agreement with the IMF in May 1991, the Central Bank of Egypt imposed quarterly quantitative credit ceilings. Such monetary control aims at reducing demand side inflationary pressures on prices, the exchange rate and interest rates. As a precondition to the agreement, the Government took initial steps to reform the monetary system by liberalizing most interest rates and introducing a Treasury bill market as the centerpiece of a system of market-based interest rates. The Central Bank discount rate is set at 2 percentage points above the 3-month Treasury bill rate, which has stabilized at 18-19 percent. Banks are now free to set their own interest rates.

Inflation and Prices. During the past decade, the real annual growth rate of GDP averaged about 4 percent, while the money supply was growing at an annual rate of 21 percent. This divergence in growth rates led to a persistently high rate of inflation. Official statistics reveal that this rate increased from about 10 percent in the 1970s to 15 percent in the first half of the 1980s and 21 percent in the second half.

The liberalization of prices for many items (agricultural, industrial, energy, and others) in the early 1990s as part of the economic reform program kept inflation at or above 20 percent between 1990 and 1992.

Nevertheless, a stable exchange rate, tighter credit, higher interest rates and the reduction in monetary expansion kept inflation from being even worse and should contribute to an environment which is conducive to diminishing inflation and a positive supply response to the reforms implemented so far.

Table 3

Monetary Survey (1984 - 1991)

	1984	1985	1986	1987	1988	1989	1990	1991
	(End-period Stocks, LE Billion)							
Broad Money Supply(M2) (of which)	25.93	30.68	37.10	44.88	54.55	64.09	82.51	92.53
Foreign Currency Deposits	6.53	7.68	11.49	16.09	21.61	27.34	38.05	47.09
Restricted Deposits	1.75	1.94	3.11	5.08	5.07	6.02	7.42	8.06
Other Items	4.02	5.70	5.92	4.99	5.65	7.21	8.34	12.27
Domestic Credit (of which)	31.55	37.67	44.75	52.48	63.05	78.80	99.50	110.68
Claims on Central Government(Net)	14.73	17.05	19.48	23.46	29.19	37.94	47.58	54.08
NonFin.Pub.Enterprises	7.48	8.95	10.18	11.69	13.65	17.31	23.75	26.05
Private Sector	8.28	10.15	12.89	14.88	17.33	20.43	24.45	26.47
Other Banking Insts.	1.06	1.52	2.20	2.44	2.89	3.12	3.72	4.08
Net Foreign Assets	0.15	0.64	1.39	2.48	2.22	-1.48	-1.23	2.18

Source: International Financial Statistics

Debt and Debt Forgiveness. Egypt's external debt grew dramatically over the last two decades as it borrowed from abroad to finance the fiscal and balance of payments deficits (See Table 4). External indebtedness, which was US$ 8.3 billion (about 56 percent of GDP, with a 15-20 percent debt service ratio) in 1976, increased to US$ 40 billion (about 120 percent of GDP) in FY1986/87.

Table 4
EXTERNAL DEBT
(US$ Billions)

June	1974	1982	1986	1989	1990	1991
Debt Outstanding	3.1	20.5	37.8	44.2	46.1	34.4
Long Term (incl. IMF)	3.0	16.3	30.2	38.6	38.1	28.4
Short Term	0.1	3.8	4.9	4.3	6.9	5.1
Private Sector	-	0.4	2.8	1.3	1.1	0.9
Debt Service Ratio (% of current receipts)	n.a.	20.0	34.1	43.7	46.3	27.0

Sources: IMF reports.

ν

A Paris Club debt rescheduling provided some temporary debt relief in May 1987; but by FY90, total external debt reached about US$46.1 billion (representing 150 percent of GDP or a debt service ratio of 46 percent). Paris Club creditors reached agreement on another debt restructuring plan in May 1991. The U.S. forgave $7 billion and other bilateral donors negotiated agreements during the remainder of 1991 and early 1992. In some cases, debts were forgiven and in other cases they were rescheduled over a longer time period with lower interest rates. Much of this debt relief was conditioned on continued adherence to IMF stabilization targets. Consequently, Egypt's outstanding debt amounted to about US$ 35 billion at the end of 1991, but it will be reduced further with good policy performance. Egypt's debt service ratio fell from 46 percent in 1990 to 27 percent in 1991 due to the forgiveness and rescheduling.

3. **Balance of Payments Analysis**

Balance of Payments Disequilibrium in the 1980's. In the first half of the 1980s, key foreign exchange sources--petroleum exports, Suez Canal and tourism receipts, workers' remittances and foreign borrowing-- started to decline or stagnate. By 1981/82, the value of imports was growing about 20 percent per year, and deficits in the trade and current account balances reached $7.6 billion and $3.5 billion respectively. In 1985/86, a further decline in petroleum exports accelerated the deterioration in both the current and capital account balances. By 1989/90, the trade deficit reached $7.6 billion. Interest payment obligations increased to $3.0 billion, while the capital account balance declined sharply to -$1.2 billion, down from $1.9 billion in 1985/86, largely on account of lower inflows of loans and grants (Table 5).

Several remedial actions were taken by the GOE in the second half of the 1980s to alleviate the balance of payments problem. These included: a large real depreciation of the Egyptian Pound and import restrictions (1985/86), GOE agreement with the IMF on an economic stabilization and adjustment program supported by an IMF Stand-By Agreement--which the GOE subsequently failed to comply with (1987), and a Paris Club deferral of $6.4 billion in debt service arrears (1987). Despite all this, the balance of payments disequilibria persisted--exacerbated by a growing budget deficit, excess money creation, and persistent inflation.

The Gulf Crisis and its Impacts. Contrary to expectations at the time, the net impact of the Gulf war on Egypt's balance of payments was positive. Despite the decline in tourism revenues and non-petroleum exports, the growth in the remaining foreign exchange current receipts (principally from shipping services, Suez Canal tolls, investment income, and remittances) resulted in an improvement in the net current account deficit (excluding official transfers) from -$3.1 billion in 1989/90 to -$2.6 billion in 1990/91. Higher oil prices and capital inflows disguised as

21

TABLE 5

Balance of Payments: Selected Years & Items, 1981/82-1990/91

(US $ Billion)

	1981/82	1985/86	1988/89	1989/90	1990/91
Trade Balance	-7.6	-5.9	-7.5	-7.6	-7.5
Commodity Exports, FOB:	5.8	3.4	2.8	3.2	3.9
*Petroleum	4.7	2.2	1.1	1.2	2.0
*Other	1.1	1.2	1.7	2.0	1.9
Commodity Imports, CIF	-13.4	-9.3	-10.3	-10.8	-11.4
Tourism Inflows	0.6	0.8	2.1	2.2	1.5
Suez Canal Proceeds	0.9	1.0	1.3	1.5	1.7
Workers' Remittances	1.9	3.0	3.5	3.7	3.8
Interest Obligations	-0.9	-2.3	-2.5	-3.0	-3.7
Current Account Balance (1) (Excl.official transfers)	-3.5	-3.2	-3.4	-3.1	-2.6
Current Account Balance (2) (Incl. Official Transfers)	1.4	1.2	0.8	1.1	4.8
Direct investment	0.9	0.2	0.1	0.1	0.1
Private Loans	-		-1.3	-	-
Capital Account Balance (3)	2.3	1.9	-0.4	-1.2	-1.0
Errors & Omissions (4)	1.2	-	1.1	2.5	1.3
Over-all Balance (1+2+3+4)	1.4	-0.1	-1.9	-0.7	2.5
Net International Reserves (increase -)			-0.4	-1.1	-6.0
Exceptional Financing:			2.1	2.3	4.0
*Arrears			2.1	2.3	-9.6
*Debt forgiveness			-	-	7.7
*Rescheduling			-	-	5.9

remittances also contributed to the improvement. Official transfers also surged from $1.1 billion in 1989/90 to $4.8 billion in 1990/91, largely because of $4.0 billion in assistance to be provided by donor countries over the two year period 1990/91-1991/92 to mitigate the effects of the Gulf crisis. Consequently, the current account balance, including official transfers, moved from a deficit of $2.0 billion in 1989/90 to a surplus of $2.2 billion in 1990/91.

In addition, debt forgiveness amounting to $13 billion was provided in late 1990, reducing total debt outstanding from $46 billion to $33 billion. Overall, Egypt's balance of payments went from $-700 million in 1989/90 to $2.5 billion in 1990/91.

Balance of Payments Prospects and Reserves. In the short run, the improvement in the services account of the balance of payments is expected to continue as a result of growth in tourism and Suez canal receipts and a sharp decline in interest obligations due to debt relief. With the anticipated increase in workers' remittances following the Gulf war, the current account deficit is envisioned to decline rapidly despite a continued trade deficit. According to the IMF, the debt service relief provided by the Paris Club will sustain a net surplus in the capital account. This surplus, together with the high level of official transfers expected over the next few years, should support a positive overall balance of payments and a net increase in international reserves. This increase in net international reserves is, however, expected to decline from $6 billion in 1990/91 to $2.3 billion in 1991/92.

4. The Fiscal Deficit

Egypt's budget deficit grew absolutely from LE 5 billion in 1981/82 to LE 20 billion in 1990/91 (see Table 6). As a percentage of GDP, however, the budget deficit remained roughly constant--fluctuating around 20 percent before declining sharply to about 8 percent in 1991/92 as a result of stabilization measures adopted by the GOE.

Bank finance accounted about half of total deficit financing between 1981/82 and 1989/90. However, this share dropped to 8 in 1991/92 as a result of the credit ceilings imposed under the IMF's Stand-by Agreement. Non-bank domestic finance and foreign finance accounted for about 29 and 21 percent, respectively, of total deficit financing over the last decade. With the increased capital inflows to Egypt after the Gulf crisis, the share of foreign finance increased significantly to 73 percent in 1990/91. This source of financing is not sustainable, however.

5. Labor Force Issues

In recent years, Egypt's labor force growth averaged 5 percent per year--roughly twice the population growth rate. Employment opportunities increased more slowly, however, so that unemployment rose from 5.4 percent in 1981 to 12 percent in 1991.**

Approximately 73 percent of the labor force are employed in the private sector--35 percent in agriculture and 37 percent in other activities--while the remaining 27 percent of the labor force works in the public sector. If one excludes agriculture, however,

---

**This is the case despite the fact that during much of this period approximately 2.2 million Egyptians worked abroad, and the GOE in principle guaranteed a job to all graduates of higher education.

TABLE 6

Government Fiscal Operations (1981/82–1990/91)

(in LE billion)

	Actual									Pre.Act.
	81/82	82/83	83/84	84/85	85/86	86/87	87/88	88/89	89/90	90/91
Total Revenue	8.3	[illegible]	10.4	11.3	12.7	13.5	15.9	18.4	20.0	28.2
Central Government Revenue	6.6	7.8	8.2	8.7	9.7	9.9	11.4	13.6	15.7	23.6
Tax Revenue	4.5	5.2	5.4	6.0	6.5	6.9	8.1	9.9	11.8	15.5
Direct Taxes	1.6	1.9	1.7	2.1	2.5	2.4	2.8	3.4	4.4	6.9
Indirect Taxes	2.9	3.3	3.7	3.9	4	4.5	5.3	6.5	7.4	8.6
Consumption/Sales Tax	0.8	1.2	1.3	1.4	1.5	1.7	1.9	2.4	2.9	3.4
Customs Duties	1.6	1.7	1.9	1.9	1.8	1.9	2.4	2.8	2.9	3.3
Stamp Duties	0.2	0.2	0.3	0.3	0.4	0.4	0.5	0.7	1.1	1.4
Other	0.3	0.2	0.2	0.3	0.3	0.5	0.5	0.6	0.5	0.5
Nontax Revenue	2.1	2.6	2.8	2.7	3.2	2.7	3.3	3.7	3.9	8.1
Local Government Revenue	0.3	0.3	0.4	0.4	0.5	0.6	0.6	0.8	0.8	0.9 1/
Public Service Authorities	0.1	0.1	0.2	0.2	0.2	0.3	0.3	0.5	0.4	0.7 1/
Investment Self-Financing	1.3	1.5	1.6	2.0	2.3	3.0	3.6	3.5	3.1	3.0
Total Expenditure	13.20	14.50	16.80	18.48	21.60	21.17	26.81	30.20	34.68	48.00
Current Expenditure (of which)	8.1	8.8	10.8	11.9	13.6	13.2	15.8	18.6	22.2	29.3
Wages	2.0	2.2	2.6	3.2	3.4	3.7	4.6	5.2	6.1	7.1
Interest	0.5	0.9	1.1	1.3	1.5	1.8	2.3	3.0	3.7	6.9
Subsidies 2/	2.9	2.1	2.0	2.0	3.0	2.3	2.7	3.3	4.7	6.2 3/
Defense 4/		1.7	2.1	2.4	2.6	2.7	3.0	3.4	3.8	4.2
Capital Expenditure	5.10	5.70	6.00	6.58	8.00	7.97	11.01	11.60	12.48	18.70
Investment 5/	4.5	5.0	5.5	6.6	8.2	8.0	11.0	11.5	12.5	13.0
Net Capital and Investment Fund	0.6	0.7	0.5	0.0	(0.20)	(0.03)	(0.01)	0.10 6/	(0.02) 6/	5.70 6/
Budget deficit	4.9	4.8	6.4	7.2	8.9	7.7	10.9	11.8	14.7	19.8
Total Finance	4.9	4.8	6.4	7.2	8.8	7.7	10.9	11.8	14.7	19.8
Foreign	0.8	0.9	1.1	1.5	1.8	1.8	2.5	3.0	3.1	14.4
Domestic Nonbank Finance	1.0	1.2	1.5	1.8	4.8	2.8	3.7	3.7	3.8	3.8
Domestic Bank Finance	2.8	2.3	3.1	3.1	2.2	3.6	4.1	5.1	7.7	1.6
Discrepancy 7/	0.3	0.4	0.7	0.8	0.0	(0.5)	0.6	0.0	0.1	0.0
Budget Deficit as a % of GDP	23.4	19.6	22.6	21.0	23.3	17.4	19.7	18.0	18.2	20.4
Memo Item										
GDP (at current market prices)	20.9	24.5	28.3	34.2	38.2	44.1	55.3	65.4	80.8	97.2

Footnotes

1/ Revised estimates
2/ Excludes GASC bank borrowing.
3/ Includes Social Fund outlays in 1991/92.
4/ Domestically financed expenditures only. Information on foreign-financed outlays is not provided.
5/ Net of estimated re-evaluation of capital stock as from 1986/87, and for 1990/91 based on data provided by the National Investment Bank.
6/ Includes extra budgetary outlays and outlays for restructuring.
7/ Reflects primarily different compilations of domestic bank finance between the fiscal and monetary accounts.

24

the situation changes considerably with more than half of non-agricultural workers employed in the public sector. In urban areas, the share of the labor force employed by the public sector is even higher.

The policy reforms proposed in the sector program highlight several key labor market-related issues. First, there is the displacement of over well over 100,000 public enterprise workers that is likely to occur with public sector restructuring and privatization. This group of workers, while not large relative to the overall labor force, constitute a potentially significant impediment to public sector reform.

Second, structural reforms of the labor market will be necessary if it is to efficiently accommodate the reform measures being implemented throughout the economy. This will require making labor market information more readily available, establishing a clearer linkage between wages and productivity, and doing away with government regulations which promote the use of capital intensive production techniques and generally hinder employment creation in the private sector.

C. Egyptian Economic Reform Program

The GOE began serious discussions in 1990 with the IMF and the World Bank over the major elements of economic reform and signed a Stand-By Arrangement with the IMF in the spring of 1991 and a Structural Adjustment Loan with the World Bank in the fall. Details of these programs are summarized below.

1. Stabilization - IMF/GOE

The 18-month Stand-By Arrangement has as its main objective the restoration of macroeconomic balance and the reduction of inflation so as to provide a stable basis for resumed growth. The prior actions that were completed by the GOE before the signing of the Standby were the implementation of the General Sales Tax, the restoration of customs duty rates to the levels that were in effect in early 1989, and increases in energy and domestic petroleum product prices towards their economic levels.

Performance criteria were set for monitoring the program. The targets for the first phase (before December 1991) were: (1) specific ceilings on net domestic assets; (2) floors on net international reserves of the Central Bank of Egypt; (3) elimination of all past arrears and any new arrears incurred after June 1990; (4) specific constraints on the stock of public sector borrowing; and (5) the unification of the exchange system. Subsequent review by the IMF indicated that most criteria were met, although public sector borrowing remained excessive.

The main targets after December 1991 were quite different. The overall fiscal deficit was be reduced to no more than 9.5 percent of GDP for 1991/92 (subsequently revised downward to 7 percent), will probably be no more than 6.5 percent for 1992/93, and will progress towards a level of no more than 3.5 percent by 1995/96. As for monetary and credit policies, the government will limit the growth of total net domestic assets of the banking sector to a specified level. The continuation of a competitive exchange rate policy is required in order to maintain an external balance.

2. **Structural Adjustment - World Bank/GOE**

The World Bank Structural Adjustment Loan ($300 million in two tranches) supports the Government's Economic Reform and Structural Adjustment Program (ERSAP) in the areas of public sector deregulation, privatization, price liberalization, foreign trade liberalization, and private sector development. Its objective is to promote sustainable medium-term economic growth.

Privatization is a main theme of public sector reform, together with the reform of the organizational and management structure of public enterprises. The GOE will liberalize prices for industrial goods, energy, cotton and agricultural inputs by allowing prices to rise to market levels. The GOE will promote the development of the private sector by reducing investment and production licensing and product mix requirements, and by eliminating the distribution monopolies for fertilizer and cement.

Foreign trade will be liberalized. On the import side, the GOE will reduce the coverage of bans and prior government approvals, and will reform the tariff system. On the export side, the government will reduce the restrictions on exports and will develop a plan to improve the drawback and temporary admissions regimes.

Since the economic reform program will entail social adjustment costs, the GOE has established, with the World Bank's support, a special Social Development Fund. This Fund is intended to alleviate severe economic pressures on the poor by providing retraining programs, as well as developing and implementing job mobility programs.

26

III. Program Rationale

A. Overview

The Sector Policy Program is an integral part of the overall mission strategy. It is designed to support the objective of increased Egyptian economic growth by promoting increased macro-economic stability, market pricing, and greater private investment and trade. The Sector Program has been carefully structured so as to complement and reinforce the reform program which the GOE has agreed to with the IMF and World Bank. It extends, however, beyond the end of these programs and contains policy measures different from those in these programs. The SPR also will provide the GOE with resources to ease the adjustment process and technical assistance to support the reform process.

A wealth of experience suggests that a country must have a strong market orientation, with sound fiscal policies, a relatively open trade regime, and an effective financial system if it is to experience sustained private sector-led growth. As described in detail below, none of these conditions currently exist in Egypt. Thus the Sector Program is designed to address constraints in the financial, fiscal, trade, and domestic enterprise sectors.

B. Financial Sector

1. Analysis of Sector

The banking sector is dominated by four public sector commercial banks (PSCBs), which currently hold about 65 percent of total deposits. Overall, there are 44 commercial banks (including the PSCBs), 33 business and investment banks (11 joint ventures and 22 foreign branches), and 4 specialized banks for a total of 81 banks. PSCBs and government entities have ownership in many of the joint venture commercial, business and investment banks.

Interest rate ceilings in the banking system existed until early 1991. These ceilings were imposed by the Central Bank on borrowing and lending in local currency. Nominal interest rates were below the inflation rate, however, resulting in negative real interest rates. In contrast, interest rates on foreign currency deposits were based on international market interest rates and thus offered positive real returns. This real interest rate differential encouraged Egyptian residents to hold a disproportionate share of their assets in foreign currency deposits.

Non-bank Islamic investment companies evolved in the mid-1980s in response to the distortions in interest rates and the inefficiencies in the financial sector. By offering interest rates significantly in excess of those available from banks, they succeeded in mobilizing large amounts of deposits. In addition, Islamic investment companies rendered foreign exchange transfer services more efficiently--at lower transactions cost--than the banking system. However, these companies collapsed in 1987. The high interest rates on deposits, losses from gold speculation, and the maturity mismatch between assets and liabilities were the main factors accounting for their collapse. Nevertheless, they taught one important economic lesson--Egyptian savers respond positively to interest rate incentives.

Until recently, the banking system made preferential interest rates available to certain sectors of the economy. Aside from government entities, industry and agriculture got the most concessional interest rates--not exceeding 17 percent. Loans and overdraft facilities to public sector enterprises were also available at even more concessional rates (7-11 percent). These concessional rates distorted the price of capital and thus resource allocation in the economy. Lending to public sector enterprises not only crowded out private investment but led to the erosion of banks' capital since loans went mostly to loss-making enterprises.

Financial sector reforms aimed at correcting distortions in interest rates were introduced by the Central Bank in January 1991. The government liberalized most interest rates and introduced a treasury bill market as the centerpiece of a system of market based interest rates. The result was higher market-based interest rates--although at the current 15-20 percent inflation rate, real interest rates remain very low. Higher rates on deposits have encouraged the holding of LE deposits. Reinforced by the stability of the now free-market exchange rate, a repatriation of savings from off-shore accounts has been another response. Lending rates that reflect the real cost of capital, particularly with the elimination of the preferential rates to targeted sectors and to the government, are expected to lead to a more competitive, and hence more productive allocation of credit.

Improving prudential regulations and strengthening banks' capital structure are key elements in the financial reform program. Recapitalization of the four public sector banks took place in 1991. The Central Bank issued a circular in January 1991 regulating bank capital adequacy using the Basle risk-weighted guidelines, and implemented by July a system for classification and provisioning of banks' assets.

The Central Bank's control over the money supply was not effective until 1991. During the past 5 years, the average annual growth rate of the money supply was about 25 percent, compared to only 2.5 percent GDP growth. The discontinuation of overdrafts by the Ministry of Finance, the introduction of the treasury-bill market, and the quarterly quantitative credit ceilings imposed by the CBE in agreement with the IMF have enabled the CBE to exercise more effective control over the growth of the money supply. Nevertheless, policy instruments available to the Central Bank are not yet sufficient. Development of a secondary market for securities would permit more efficient open market operations. A stronger banking system would permit more effective use of reserve requirement adjustment. Both issues will be addressed as part of the Sector Policy Program.

2. **Barriers and Constraints to Growth and Development**

Despite the reform of the monetary system to date, efficient allocation of financial resources is still adversely affected by various interest rate distortions. These include below market interest rates for: Housing Bank loans to finance low-income housing and for refinancing of export credit; CBE deposits; National Investment Bank loans to the housing sector; and loans to strategic projects, such as food security and land reclamation.

The growth of a safe and stable financial system depends, *inter alia*, on banks' capital adequacy levels. By the early 1990s, capital levels of the four PSCBs were inadequate due to the long-existing system of sectoral allocation of credit, including overdraft facilities, to loss-making public sector companies at negative real interest rates. This increased the level of non-performing assets on banks' balance sheets, and adversely affected their solvency. Recapitalization of the four PSCBs began in 1991. Under the IMF agreement, they should reach the 8-percent target for the capital adequacy ratio by the end of 1993. They have not yet reached the target, and thus the absence of adequate capital persists as a barrier to the stability of the financial system.

Domination of the banking system by PSCBs and barriers to free entry limit competition in the banking system and hinder the efficient allocation of financial resources. In addition, PSCBs do not provide the wide range of financial services which can reduce transactions cost and increase efficiency of the financial system. Moreover, PSCBs still receive preferential treatment on branching--thereby reducing competition in the financial sector.

Private sector participation in the banking industry is restricted by PSCB ownership in many commercial, business, and investment banks. Such ownership limits the banking sector's access to the better expertise and management associated with the private sector.

An amendment to the Banking Law was passed by the People's Assembly in June, 1992, which is expected to remove many of the current restrictions on private and foreign banks. These restrictions include laws and regulations that do not allow them to operate in local currency. Under Investment Law 43/1974, for a bank to operate in local currency, foreign ownership must not exceed 49 percent. This deprives the financial sector of the expertise which such banks bring with them and thus reduces competition and efficiency in the sector.

Inequitable tax treatment of financial instruments and institutions is a major constraint to development of the securities market. Bank deposits and the resulting interest are tax exempt. Securities, on the other hand, are subject to a number of taxes including the annual stamp duty and the taxes on mobile capital revenue, general income, and corporate income. The favorable tax treatment of bank deposits does not take into consideration the inherent risk in securities, and discriminates against corporations*.

Growth of the securities market is also restricted by the statutory 7 percent ceiling imposed on interest paid on corporate bonds or other debt instruments. This ceiling has become obsolete and does not take into consideration the present market (treasury-bill anchored) interest rate, which is in the range of 17-19 percent. Elimination of this 7 percent ceiling is both inevitable and desirable. Moreover, high fixed brokerage fees discourage dealing in securities. The People's Assembly also passed a new Securities Law in June, 1992, but the details of its operation are not yet known.

The growth of non-bank financial institutions is currently stifled by various laws and regulations. Law 146/1988 organizing Fund Receiving Companies (FRCs) has negative tax implications for financial instruments. FRCs, essentially Mutual Funds (MFs), can issue investment debentures which commingle the capital paid by shareholders and funds raised from the public. These debentures are treated as though they were an equity shareholding in the MFs. Income from MF investments is subject to the corporate income tax before being distributed to the holders of the investment debentures, who in turn pay tax on this income**. Such double taxation reduces the attractiveness of such debentures.

Various provisions in the legislation allowing corporations to establish corporate pension funds serve, in practice, to discourage their formation. Legislation stipulates that 1 percent of the revenues of a private pension fund (both subscriptions and investment income) must be paid to the Ministry of Social Affairs, and that 50 percent of a Fund's assets must be deposited with the National Development Bank. The second stipulation in particular needs to be abolished since it restricts pension fund asset management.

---

* Corporations are taxed for capital gains realized on securities, while individuals are not.

** This, however, contradicts Tax Law 157/1981 according to which any company which holds more than 90 percent of its assets in the form of financial securities is exempted from the corporate income tax.

3. **Strategy for Addressing Constraints**
As discussed above, the development and growth of the financial sector faces a number of barriers and constraints. The goals of the financial sector reform program are to: improve credit allocation by the banking system, eliminate disincentives to the activation of capital and securities markets, and strengthen the financial structure of the banking system.

The Sector Program's conditionality in the financial sector concentrates on:

* increasing private sector participation, both domestic and foreign, in the banking system;

* removing remaining interest rate distortions;

* passing a new securities market law;

* achieving equitable treatment for different financial instruments; and

* strengthening banks' capital structure.

The principal counterpart organizations will be the Central Bank, the Capital Market Authority, the Ministry of Economy and the Ministry of Finance.

4. **Impact**
Successful implementation of the reforms identified in this program will likely have the following impacts: the financial sector should become more competitive, with greater opportunities available for private and foreign banks and financial institutions. This enhanced competition will ensure that a more complete range of financial services is available. The securities markets should develop extensively once debt and equity instruments are put on a more equal footing. This will help mobilize the resources needed to finance a growing private sector in Egypt. Finally, the financial sector should become more efficient--attracting savings and then channeling them to investments which offer the highest returns.

C. FISCAL SECTOR (GOVERNMENT REVENUES AND EXPENDITURES)

1. **Analysis of Sector**
Sector Role. Egypt's fiscal sector has a key role to play in the transition towards a market economy. It can help foster sustainable private sector-led growth by providing a stable fiscal environment which promotes efficient allocational decisions, savings, and external resource inflows. Stability requires prudent fiscal deficits, controlled inflation, and external creditworthiness. Efficiency depends on fiscal policies that encourage resources to be used where they are most productive, and

on a regime of public sector expenditure which effectively complements a growing private sector.

Revenues. Total GOE revenues more than tripled between 1981/82 and 1990/91 with central government revenues accounting for 85 percent of this increase. Preliminary data for FY 1990/91 indicate that total GOE revenues were LE 28.2 billion or 29 percent of GDP (see Table 6). The increase in GOE revenues is a result of the increase in central government revenues to LE 23.6 billion. About 65 percent (LE 15.5 billion) of central government revenues came from tax sources, with the balance (LE 8.1) from non-tax sources. Direct income taxes accounted for 45 percent (LE 6.9 billion) of tax revenues, while indirect taxes accounted for 55 percent. Non-tax revenues result from the transferred profits of public authorities (mainly petroleum, the Central Bank and the Suez Canal) and public sector companies. Public authorities and companies accounted for 70 percent of non-tax revenues in 1990/91.

The 40 percent increase in revenues in 1990/91 resulted from the GOE's adoption of various revenue generating measures agreed to under the IMF program. These included: the implementation of the general sales tax in May 1991; restoration of customs duties to their pre-July 1989 rates; increases in energy and tobacco prices and taxes; higher fees, charges and railway fares; and the full and timely transfer of taxes and profits from the Suez Canal and the petroleum authority.

Expenditures. Over the last decade, nominal GOE expenditures grew at an average annual rate of 13 percent, although in real terms they fell by about 5 percent annually. Preliminary actual data for 1990/91 indicate that total expenditures reached LE 48 billion or about 49 percent of GDP. The shares of current and investment expenditures in total GOE expenditures have remained fairly constant at about 62 and 38 percent, respectively, over the last decade.

Wages, explicit subsidies, defense, and interest on public debt account for about 80 percent of current expenditures. Over the last decade, wages, subsidies, and defense each accounted for about 20 percent of current expenditures. Hidden subsidies resulting from the use of an overvalued exchange rate were also very large. Debt interest payments increased more than fourteenfold between 1981/82 and 1990/91, with their share in current expenditures increasing from 6 to 24 percent.

About 44 percent of investment expenditures were directed to the economic services sector over the last decade, while 39 and 17 percent went to the non-financial public enterprise and the social services sectors, respectively. The economic services sector includes transport and communications, electricity, and agriculture, which accounted for about 14, 13, and 6 percent, respectively, of public sector investment. Housing was the principal element in the social services sector accounting for 13 percent of public investment.

The Budget Deficit. The overall budget deficit increased from LE 4.9 billion in 1981/82 to LE 19.8 billion in 1990/91. As a percentage of GDP, it fell from 24 percent in 1981/82 to 18 percent in 1986/87 before rising to 20 percent in 1990/91***. As discussed above, reduction of this deficit is a key element of the GOE's economic stabilization plan.

Borrowing from the banking system, including the Central Bank has financed roughly half the budget deficit in recent years. Credit ceilings imposed under the IMF's Stand-by Agreement contributed to a drop in domestic bank financing of the deficit from LE 7.7 billion (26 percent of total finance) in 1989/90 to LE 1.6 billion (8 percent of total finance) in 1990/91. Non-bank domestic finance (which includes pensions and social insurance, post office savings, self-financing surplus, and government bonds) and foreign finance accounted, on average, for 29 and 21 percent of total deficit financing. With the increasing capital inflow after the Gulf crisis, the share of external finance in total finance increased significantly from 21 percent in 1989/90 to 73 percent in 1990/91.

2. Barriers and Constraints to Growth and Development

Fiscal revenues in Egypt are heavily dependent on the external sector, e.g. Suez Canal earnings and oil revenues. Adverse external circumstances thus impact directly and substantially on government revenues, in addition to their indirect effects on the general level of economic activity and consequently on other tax revenues.

The tax system as a whole is characterized by relatively low revenue elasticity. The present schedular income taxes combine the undesirable features of high marginal tax rates with eroded bases. The latter is due to tax avoidance and evasion, various tax holidays, and the vulnerability of tax revenues to inflation due to both the long lags between assessment and collection of taxes, and the inadequate penalties applied to delayed payments. In addition, customs receipts are limited by a tariff structure characterized by many specific tax rates and the widespread use of exemptions.

The complex structure of income, property and inheritance taxes creates high costs of administration and virtually guarantees continued poor compliance. Indirect taxes, such as the development duty and the social solidarity tax, are often levied on bases which

***The deficit in FY 1990/91 was increased by a one-time effort on the part of the GOE to recapitalize public sector banks. In the absence of that effort, the deficit would have been closer to 14 percent.

overlap with those for other taxes, thereby increasing both compliance and administrative costs. In addition, the wide variation in tax rates on different types of income, together with the wide range of customs duties on various types of imports, introduce significant economic distortions in the economy. These hinder the efficient allocation of resources. Moreover, the structure of the tax system, together with problems of tax avoidance and evasion, do little to ensure horizontal and vertical equity.

3. Strategy for Addressing Constraints

The success of the GOE's economic reform program depends critically on both the attainment of macroeconomic stability and the reduction of distortions in the economy which cause resources to be used inefficiently. As discussed above, Egypt's current tax system is relatively revenue inelastic and also highly distortionary. Consequently, tax reform can potentially play a key role in both stabilizing the economy (by reducing the budget deficit) and making it more efficient (by allowing resources to be used where they are most productive).

The GOE has demonstrated commitment to fiscal reform. The budget deficit is on track to be reduced, through expenditure restraint and resource mobilization, as targeted under the IMF Stand-by Agreement. On the tax side, the GOE has adopted a general sales tax, which will ultimately evolve into a full blown value added tax, and plans to implement a global income tax to replace the series of schedular income taxes now in effect.

In this context, USAID policy conditionality in the fiscal sector concentrates on establishing specific tax policy and expenditure benchmarks--the attainment of which will assist the GOE in meeting its broad fiscal sector commitments. These benchmarks will focus on:

* broadening coverage of the sales tax;
* detailing the structure of the global income tax;
* limiting the growth of certain components of GOE expenditures; and
* improving public access to GOE fiscal data.

4. Impact

Implementation of the fiscal sector policy measures should contribute to a fiscal system which is not only more elastic and efficient, but also easier to administer. Moreover, the publication of relevant fiscal data in a timely fashion should provide a more open environment within which fiscal policies can be assessed and made.

As the tax system becomes more elastic, tax revenues will increase relative to the level of economic output. This trend, together with reasonable controls over expenditures, will help to

reduce the fiscal deficit and thus contribute to macroeconomic stability. Moreover, the structural reform of the tax system that results from the adoption of a global income tax and the broadening of the general sales tax will encourage resources to be used more productively and consume fewer resources in administration--thus contributing to increased economic growth.

D. Trade Sector

1. **Overview of the Sector:**

General Description. In recent decades, Egypt has followed an import substitution strategy that placed little emphasis on export promotion. Nasser initiated a strong industrialization drive headed by the public sector in 1960. The government monopolized imports, and barter deals were introduced to exchange Egyptian goods for military imports. By the early 1970s, the economy was in recession and foreign exchange was scarce due to reduced foreign aid and increased military outlays.

Egypt's 1974 Open Door Policy began to liberalize trade and foreign exchange practices. Receipts of foreign exchange surged because of the boom in oil exports, increases in tourism revenues, and drastically higher Suez Canal earnings, workers' remittances and foreign aid. Real GDP grew at an annual rate of 9.5% between 1975 and 1983/84. Total current account receipts and transfers increased from \$2.8 billion in 1975 to \$12.5 billion in 1983/84. While oil exports increased from zero to \$3.0 billion during this period, non-oil exports remained stagnant, in nominal terms, at \$1.4 billion. Imports tripled from \$3.6 billion in 1974 to \$10.7 billion in 1983/84, thereby absorbing around 60% of the increase in foreign exchange receipts. Overall, the trade deficit increased from \$1.8 billion in 1974 to \$6.4 billion in 1983/84.

Egypt's heavy reliance on oil exports made it especially susceptible to the fall in oil prices which occurred in the mid 1980s. Oil export revenues declined sharply from \$4.2 billion in 1984/85 to \$2.7 billion in 1988/89. Despite the fact that non-traditional exports (non-oil industrial exports such as textiles and chemicals) increased by 220% between 1984/85 and 1989/90 (from \$0.74 billion to \$1.64 billion), and that imports remained roughly constant (from \$10.5 to \$10.7 billion), the significant decrease in oil exports throughout the period resulted in an overall worsening of the trade deficit (from \$6.3 billion in 84/85 to \$7.6 billion in 1989/90).

Exports. In 1974, the major Egyptian exports were raw cotton (36%), textiles (20%) and agricultural commodities (11%). Starting in 1975, however, oil became the principal export commodity while cotton and textiles declined in importance. With the fall in international oil prices in 1982/83, proceeds from oil exports decreased (see Table 7). By 1989/90, oil exports constituted 39.8% of total exports--down from 68% in 1983/84. Exports of cotton also

declined from $356.1 million (10% of exports) in 1985/86 to $220 million in 1989/90 (7% of exports), as a result of the continuing government policy of suppressing cotton farmgate prices.

Between 1986/87-89/90, non-traditional exports grew rapidly--although from a very low base. These included food processing (21% per year), chemicals & pharmaceutical (51% per year), wood products (109% per year), knitted products & garments (65% per year), iron & steel (134% per year) and aluminum (19% per year). While the share of primary commodities declined from 68% of total exports in 1986/87 to 50% of total exports in 1989/90, the share of semi-finished products remained roughly constant at 20%, and the share of finished goods increased from 16% to 30% in 1989/90.

The public sector still monopolizes the export of petroleum, raw cotton, cotton yarn and alumina. The private sector is responsible for most non-traditional exports such as processed food, pharmaceuticals, furniture, garments, and metal products. At USAID urging, rice recently switched from the public to the private sector.

Imports. Between 1974 and 1983/84, the total value of imports tripled from $3.6 billion to $10.7 billion (see Table 8). The share of capital goods increased from 16% to 26% with the growth of new capital intensive investments, while the share of intermediate goods decreased from 42% to 34%. Total imports declined between 1984/85 and 1986/87 by 26% due to foreign exchange constraints, but reverted to their 1983/84 level by 1989/90.

Table 7
Composition of Exports
(US $ Million)

	1974	83/84	86/87	89/90
Total Exports:	1754	4350	2831	3145
-Oil	187	2957	1470	1229
-Cotton	663	452	343	220
-Other agricultural goods	194	211	124	187
-Other industrial of which:	710	730	894	1509
*Yarn	366	267	241	446
*Ready made garm.&other textile			28	189
*Chemicals & Pharmaceutical			95	248

Source: CBE & EAS estimates

The public sector monopolizes the import of wheat, flour, edible oil, and cotton. Only recently was the private sector allowed to

36

import fertilizer, sugar and tea. On average, the public sector imported about 75% of total imports between 1983/84 - 87/88.

Table 8
Composition of Imports

	1974	1983/84	86/87	89/90
Total Imports($ million)	3618	10738	7952	10773
Percent Composition:				
-Foodstuff	29%	28%	25%	21%
-Intermediates	42%	34%	32%	38%
-Capital goods	16%	26%	23%	22%
-Other including grants	13%	12%	20%	19%
	-----	-----	-----	-----
	100%	100%	100%	100%

Source: CBE

2. **Barriers and Constraints to Growth and Development**

Export Restrictions. In June 1991, after reducing export bans from 20 to 6 items, export quotas from 17 to 4 items and prior government approvals from 37 to 1 item, production coverage of all non-tariff barriers on exports was reduced from 11.9% to 4.2% of manufacturing and agricultural output. The impact was essentially equal on the private and public sectors, with a reduction of 65% for the latter and 67% for the former. In addition, public sector domination of key export activities, e.g. cotton and textiles, has likely limited their growth.

Drawback & Temporary Admission Systems. **Exporters who use imported raw materials can benefit from either the drawback or the temporary admission system, provided they export the finished product within one year from the importation of the raw materials. Under the drawback system, exporters have to pay the custom duties and sales tax, but are entitled to claim them back upon exportation of the final product. Under the temporary admission system exporters can import banned commodities for the production of exported goods. Also, they need not pay duties and sales tax on regularly imported materials. Instead, private sector firms submit a cash or bank guarantee equivalent in value to the required duties and taxes.** The public sector is only required to make a commitment to pay the custom duties in case of failure to export. To obtain the Letter of Guarantee (L/G), the exporter must make an interest free cash deposit amounting to 15%-100% of the value of the L/G (depending on the relationship between the exporter and the bank) and pay a fee of 2% of the value of the L/G per quarter. Despite the major improvement in the pace at which applications under both systems are processed, exporters still complain about the time to complete the paperwork and prepare the applications in the acceptable form.

__Export Regulations.__ Products are exported through Customs without an export permit, with the exception of the commodities subject to quota (4 items) or quality restrictions (52 items--mostly agricultural). Such commodities, which represented 5.5% and 6.5% of total exports in 1988/89 and 1989/90 respectively ($150 million and $205 million), require the approval of the General Authority for Export and Import Control (GAEIC). Quality control on exports has been criticized by many exporters on two grounds: 1) they are sometimes used to favor the public sector; and 2) GAEIC does not have the expertise to undertake quality inspection and hence its involvement is unjustifiable.

__Tariff Barriers.__ At present, import tariffs range between 5-100 percent (except for certain luxury commodities such as cars which are subject to a rate of 160%). This range will be reduced to 10%-80 percent as a condition for release of the second tranche of the World Bank SAL. A sales tax on the value of the imported commodities, inclusive of custom duties, is also levied. The lowest tariff rates apply to basic foodstuffs and raw materials (5%-30%), while the highest rates apply to finished goods especially luxury commodities such as cars (85%-160%), cosmetics (85%), and various textile fabrics (85%). Certain commodities, such as electrical appliances for domestic use, for which local substitutes are available, also are subject to high tariff rates (100%). On average, import duties and taxes added 10% ($1.1 billion) to the cost of imports in 1989/90.

__Non-Tariff Import Barriers.__ As of May 1991, 105 commodities were banned from import, down from 210 import nomenclature numbers in 1986. As summarized in Table 9, overall production coverage of import bans decreased from 37.2% in 1990 to 22.7% in 1991 (a 40% reduction), while coverage of other non-tariff barriers--namely, prior government approvals (on 18 items), special conditions (on 15 items)**** and quality standards (on 69 items)--was reduced by 81%, from 15.3% to 2.9%.

Private sector production has been subject to a greater reduction in protection than the public sector. Specifically, private sector coverage decreased by 70% (from 36.3% to 10.9%), as opposed to a 40% reduction,from 76.4% to 47.5%, for the public sector. Production coverage of import bans has been greatly reduced for agriculture (from 35.9% to 9.8%) while the industrial sector (manufacturing & mining) is still subject to a high 28.5% coverage. Industries such as food processing, paper products, printing and non-metallic products experienced significant

---

**** Of the 15 items, 14 are commodities which may not be imported if they are produced by the "Military Production Factories", which include, for example: diesel engines up to 125hp., radiators, agricultural mechanical equipment, and certain types of generators and motors.

38

reductions. In contrast, textiles, beverages and tobacco, rubber products and chemicals, which fall mainly within the public sector domain, received only small reductions in bans.

Table 9
Production Coverage of Non-Tariff Barriers to Imports
(% of domestic output)

	Public Sector		Private Sector		Overall	
	March 1990	June 1991	March 1990	June 1991	March 1990	June 1991
Bans (NTB1)	49.2%	41.2%	29.3%	10.3%	37.2%	22.7%
-Agr. Sector					35.9%	9.8%
-Manufac & Mining					37.8%	28.5%
Other NTBs*	27.2%	6.6%	7.4%	0.5%	15.3%	2.9%
Total NTBs	76.4%	47.5%	36.3%	10.9%	52.5%	25.6%

3. Strategy for Addressing Constraints

As described above, considerable progress has already been made in liberalizing Egypt's trade regime. This is a major focus of the GOE's economic reform program and is supported by the World Bank SAL and the IMF Stand-By. Nevertheless, significant barriers to trade and impediments to better Egyptian export performance remain. USAID plans to assist the GOE in addressing these constraints through a combination of technical assistance and policy conditionality aimed at complementing the World Bank and IMF programs.

GOE trade sector reforms to date concentrate on the reduction of non-tariff barriers to imports and exports and on the downward leveling of import duties. USAID proposes to focus its trade-related policy dialogue and technical assistance largely on GOE policies or procedures which currently hinder private sector led export growth or constitute a bias in favor of the public sector. Areas of focus will include:

* improving the temporary admission and duty drawback systems;

* modernization of the Egyptian Customs Administration so as to fully integrate Customs into the indirect tax system;

* identification and elimination of trade procedures and policies which hinder the ability of Egypt's private sector to compete on an equal basis with public sector traders;

* reducing the production coverage of import bans to improve parity between the private and public sectors.

* eliminating monopoly and monopsony positions of state export and import enterprises.

4. **Impact**

Adoption of the trade sector policy measures will help to open Egypt's economy to international competition--thus encouraging Egypt's domestic producers to become more efficient and hence more competitive in world markets. This should contribute, within the context of Egypt's overall economic reform, to an increased inflow of non-concessional foreign exchange via increased exports and greater foreign investment. All this is essential if Egypt is to attain a reasonable level of sustainable economic growth.

With trade sector reforms in place, there should be a gradual improvement in Egypt's trade balance as exports increase relative to imports. Most of this improvement should originate in the private sector, which will benefit from reform of the temporary admission and duty drawback systems and from the reduction of preferences given to the public sector. Moreover, Egyptian Customs procedures will be streamlined to make them more consistent with international norms.

E. Privatization of the Enterprise Sector

1. Analysis of the Sector

While the Enterprise Sector includes industry, agriculture and commerce, its emphasis is on manufacturing because of the large percentage of capacity that is owned by the Government—nearly three times as many employees in 1987 as their private counterparts. The Government had 565,000 employees in manufacturing firms with 10 or more employees, while the equivalent private sector firms had 193,000. Another 730,000 persons are employed outside manufacturing in public sector companies. Moreover, many joint ventures are majority-owned by public agencies, but are counted as private companies.

The Sector Program's focus on financial, trade, and fiscal policy constraints is an attempt to promote a sound macroeconomic framework within which sustained growth can occur. In contrast, inclusion of the enterprise sector reflects USAID's view that meaningful privatization will require not only the same sound macroeconomic framework, but also very specific actions, reforms, and commitments on the part of the GOE to move the privatization process forward.

Public enterprises are firms owned by the central government or Governorates. The latter are smaller but more numerous and most are in the process of being privatized. Approximately 1,400 Governorate enterprises were put up for sale in 1991 and 250 pieces of property sold. There are more than 700 public sector firms at the national level. 383 State-owned enterprises operate under the Public Sector Companies Law 203 of 1991, (the replacement for Law 97) while at least 250 firms with majority or total Government ownership operate under the Investment Incentives Law 230 and are known as "joint venture companies." Another 90 firms are in the process of establishment, but the outcome is uncertain given the policy against new public investment in enterprises. Many of these firms have private ownership—foreign, Egyptian, or both—and operate under the same law that governs privately owned firms that take advantage of Law 230. They are able to operate, therefore, more like private companies. Privatization may be easier for these companies to accomplish because the State-owned shares can be sold to the private partner or on the stock market to the general public.

Prior to Law 203 of 1991, public sector companies operated under Law 97. Approximately 1.3 million people were employed by such companies, with about half of them in manufacturing, most under the Ministry of Industry. Most Law 97 companies were controlled by "organizations" which were in turn responsible to specific ministries. The structure prior to Law 203 is shown in Table 10. Under this system, the ministries, through the "organizations," controlled virtually everything the individual companies did, including the determination of prices, production quantity and product mix, additions to capacity and new investment (even if from their own resources), the wage structure and wage increases, the hiring of employees (virtually none were ever fired), and the selection (and dismissal) of management.

Law 203 of 1991, which replaced Law 97 and is now being implemented, resulted in sweeping changes. It is seen as a transitional law that will last for about three years after which all Government and private companies will operate under the same laws and regulations. Although Law 203 is not a privatization law, it does permit privatization of Government companies to take place, which is a substantial change. Ministries no longer have any direct role to play in the management of these companies. A new organization has been created, the Public Enterprise Office (PEO), that has the mandate to reorganize the individual public sector companies, now called "Affiliated Companies" (ACs), out of the previous ministry-based "organizations" into new Holding Companies (HCs) responsible to their own boards and general assemblies, and ultimately the Public Enterprise Minister, i.e., the Prime Minister. The PEO is also to insure that the HCs and ACs operate according to guidelines, and more important, to promote and even implement privatization of ACs.

2. <u>Constraints and Barriers to Change</u>

Public sector enterprises dominate manufacturing and are very substantial in a number of other sectors. Although explicit budget subsidies tend to be relatively low, they benefit from a number of other advantages vis-a-vis the private sector. Many receive electricity, fuel and certain raw materials such as cotton and cement at below market rates. Not only does this practice raise

41

the cost of these items to the rest of society, or require subsidies, it also permits unfair competition, thus discouraging investment by the private sector. Public sector companies also have been able to get bank loans at low rates of interest. Even worse, they have been able to draw on unlimited lines of credit to cover operating losses which contributes to their inefficiency and reduces the amount of credit available to the rest of the economy. Because they are public companies, tariffs and non-tariff barriers protect them from the competition of imports to an even greater degree than that which the private sector enjoys. Private investment in various industries has been prevented in order to protect them from domestic competition as well. For many industrial products, the public sector is the only supplier, which has the insidious effect of making the users of these intermediate products and materials uncompetitive by raising their costs or lowering their quality. Consumers also are hurt by having to pay higher prices or buy low quality goods.

Although the public sector is being reorganized, the intermediate stage leaves a lot to be desired. The new HCs are still organized by industry groups. For example, all textile firms are in a single HC. This system continues monopolies, inhibiting competition. Reorganization of the ACs into diversified HCs which foster competition and greater efficiency incentives is desirable.

Finally, few concrete actions have been taken by the Government to mitigate the dislocations caused by the failure or restructuring of public sector firms as they face increased competition or actual privatization. The perceived threat to public stability resulting from layoffs of public enterprise employees is almost universally viewed as the single most serious impediment to public enterprise reform.

3. Strategy for Addressing Constraints

The strategy in this sector, as in the others, will be to supplement the policy conditions of the SAL by targeting reforms that the Government has identified in its ERSAP but which are not SAL conditions.

USAID is well-placed to advance privatization-related reforms. Its Partnership in Development project is already operating and is the main instrument available to the Government for the reorganization of the public sector and its privatization.

The Sector Program will emphasize policy reform and privatization, but will not specifically address the possible labor dislocations except by requiring that the Government's privatization plan include considerations of labor redundancy. The World Bank has designed and provided some funds for a Social Fund for Development (SFD) that is intended to alleviate the suffering brought about by restructuring. A number of other bilateral donors

4V

have pledged substantial amounts to the SFD, although they have been reluctant to allow any of their funds to be allocated to the labor issues. The dollar disbursements resulting from policy reform under the SPR will generate local currency that the Government can use, if it wishes, to increase its expenditures on SFD activities.

4. Impact

Implementation of these policy measures should lead to a more systematic approach on the part of the GOE to privatization. A significant number of public sector enterprises will become private and policy reforms will be adopted that make it easier for private sector enterprises to develop.

TABLE 10
STATE OWNED ENTERPRISES
(Under Law 97)

Ministry	Organizations	Companies	Employees #	Employees %
1. Agr.& Land Reclamation	4	30*****	51419	3.9
2. Public Works	1	7	12273	0.9
3. Industry	6	114	563125	43.4
4. Health	1	11	29095	2.2
5. Military Production	1	11	56022	4.3
6. Petroleum & Minerals	1	12	43211	3.3
7. Electricity & Energy	2	12	66517	5.1
8. Reconstruction, New Communities & Housing	4	56	155428	12.0
9. Transportation, Utilities, Communications & Maritime Transport	5	36	86558	6.6
10. Tourism & Civil Aviation	1	6	5586**	0.4
11. Supply & Int'l	4	43	136789	10.5
12. Economy & External Trade	3	29	47305	3.6
13. Commercial & Specialized Banks		7	39224	3.0
14. Culture	1	3	1847	0.1
15. Information	1	6	636	0.7
Subtotals	35	383	1295035	100.00

***** Not including Salhia

** Not including:
- The Affiliated Hotels
- EgyptAir

** Not Including:
- The Affiliated Hotels
- Egyptair

* Not Including Salhia

F. Benefits of the Program

1. Introduction

As discussed above, the goal of the Sector Program is to help foster sustainable economic growth in Egypt--thereby contributing to USAID's overall goal of enhancing Egypt's positive role in the Middle East. However, a rigorous benefit-cost analysis program is virtually impossible to do. The economic benefits attributable to the program cannot be quantified ex ante. In addition, the anticipated positive impacts of program-related reforms will not happen automatically. A variety of complementary conditions must also be met. That is, the policy reforms identified here should be viewed as necessary, but not sufficient, conditions for accelerated economic growth. Keeping this in mind, the magnitude of likely economic benefits and costs associated with the program are sketched out below. Chapter on monitoring identifies a number of variables that will be used to measure the impact of policy measures.

2. Possible Impacts on Growth

The economy of Egypt has been stagnant for 10 years with the rate of growth about equal to population growth. Given the unused capacity of land, labor and capital, the opportunities to apply more productive technology, available export markets, etc, the growth rate could easily double to 5 or 6 percent annually given an improved economic policy environment. With GDP equal to about $35 billion, an extra 3 percent of growth would amount to additional GDP of about $1 billion or more annually. As mentioned above, such growth is not guaranteed, but will require larger investments, efforts by the private sector, and a variety of complementary policy reforms and actions by the GOE. Many of the policy reforms in the SPR Program are closely related to the IMF Stand-by and World Bank SAL. Attributing specific shares of the benefits to each of these programs will be impossible. Nevertheless, implementation of the reforms identified in this program should make a significant positive contribution to higher growth.

3. Possible Costs

The proposed program of $400 million does not represent the cost of bringing forth more growth, but rather is money that can be used to facilitate the adjustments. The budget deficit is about 7 percent of GDP and a reduction in it is both an objective of the GOE economic stabilization program and a means of increasing economic growth. The cash transfer can be used to finance the budget deficit in a non-inflationary way by reducing the need for the Central Bank to create credit for the GOE. In addition, a variety of short-run costs are apt to be incurred by the GOE during the transition towards a market-based economy. For example, privatization could result in redundancies among the former employees that would impose costs on the government. Tariff reform could reduce GOE tax revenues. The $400 million could be used to at least partially offset these costs.

IV. The Sector Policy Reform Program

A. Description of the Policy Program.

The sector policy program that USAID proposes in this document requires policy reform in four sectors: 1) Financial; 2) Fiscal; 3) Trade; and 4) Enterprise. The policy measures for this program fall into these four sectors and are divided between calendar years 1992 and 1993. The actual measures are listed in the attached Tables 11 and 12. Annex A contains a detailed matrix that lists draft measures together with those that the GOE has proposed or which appear in the World Bank or IMF programs, as well as the justification for choosing particular conditions. Although the final, negotiated conditions are somewhat different, the relationships still hold true.

By signing the Sector Policy Reform Program, the GOE will agree, in principle, to attempt to carry out a program of economic reforms. A separate Memorandum of Understanding will contain the specific conditions for reforms due in 1992. Late in 1992, USAID and the GOE will meet to finalize the conditions for 1993. The complementary technical assistance project described in chapter V will run for three years.

B. Procedures for Disbursement

$60 million will be disbursed upon the GOE signing the grant agreement, based on reforms already accomplished since negotiations began. The balance of the money for the 1992 sector program, $140 million, will be disbursed--subject to satisfactory performance as determined by USAID in one or more reviews. The GOE can call for a review at any time, but one must be held at the end of 1992. A final review can take place any time before the end of June, 1993. The amount of the disbursement(s) will depend on USAID's evaluation of the significance of the reforms. If complete implementation of the reforms does not occur by July 1, 1993, then the undisbursed residual will be disbursed against the following year's Sector Grant Program and the funding for that Grant will be reduced by an equivalent amount. A similar process will be used for disbursing funds under the 1993 program.

The Memorandum of Understanding, which sets out the specific conditions or performance indicators, will not be a part of the project agreement that will be sent to the National Assembly for approval. It will be an official agreement between the two governments, however, and the basis on which disbursements will be made.

47

Table 11

<u>1992 Policy Measures</u>

FINANCIAL	**FISCAL**	**TRADE**	**ENTERPRISE**
1. The GOE will complete a study of the financial sector (including banks, investment companies, mutual funds (if any), insurance companies, etc.) and make recommendations to relax constraints which limit the efficient functioning of private financial institutions.	1. The GOE will establish a system to generate and publish revenue and expenditure data on a quarterly basis with a lag of no more than two months.	1. The GOE will eliminate the requirement that private sector exporters submit letters of guarantee under the temporary admission system.	1. The GOE will undertake a study of: the social and economic costs and benefits of opening the cotton spinning industry to private investment and market pricing of inputs and outputs; and the most appropriate means of accomplishing this opening.
2. The GOE will complete the necessary steps to allow foreign banks to operate fully in the domestic banking system.	2. The GOE will adopt a unitary taxpayer identification number.	2. The GOE will adopt procedures for prompt refunding under the drawback system.	2. The GOE will develop a national privatization plan.
3. The GOE will pass and implement legislation providing equal tax treatment for interest and other forms of capital income.	3. The GOE will present to the People's Assembly a Global Personal Income Tax Law.	3. The GOE will initiate a study to review, evaluate, and recommend alternative options to the present mandatory public sector quality control regulations governing exports and imports.	3. The GOE will bring at least five public sector or joint venture enterprises worth at least LE 100 million to the point of sale. Point of sale includes a valuation, a reservation price and a formal offer of sale.
4. The GOE will remove controls on interest rates for corporate bonds issued in accordance with the Securities Market Law.	4. The GOE will broaden the coverage of the general sales tax to include travel and telecommunication services.	4. The GOE will lower the coverage of import bans from 23 percent to 11 percent of domestic agricultural and manufacturing output. It will structure the reductions in a manner that does not discriminate against the private sector.	4. The GOE will complete a study of the barriers to entry that affect the ability of small businesses to become formally established.

48

FINANCIAL	FISCAL	TRADE	ENTERPRISE
5. The GOE will ensure that all commercial banks reach a capital/asset ratio of at least 5 percent.		5. The GOE will initiate a study of the Egyptian customs system which will result in recommendations to improve the import tax system and administrative procedures.	
6. The GOE will pass a Securities Market Law which provides the legal framework for a stock exchange and issue the necessary regulations.		6. The GOE will conduct a review which develops recommendations for the removal of regulations and laws that impede private sector participation in import and export industries currently dominated by public sector companies.	
		7. The GOE will permit the inclusion in the temporary admission system of firms that export part, but less than 100 percent, of their output.	

Table 12

1993 Policy Measures

FINANCIAL	FISCAL	TRADE	ENTERPRISE
1. The GOE will ensure that all commercial banks will reach a capital/asset ratio of at least 8 percent.	1. The GOE will implement a Global Personal Income Tax that significantly reduces the number of tax rate brackets and exemptions.	1. Based on the results of the study described in (4) in 1992, the GOE will implement changes in Egyptian customs duties and administrative procedures in order to harmonize the Egyptian system with standard classifications.	1. The GOE will have unified all business laws (159, 203, 230) and replaced the current system of licensing with simple registration for all types of companies. The GOE will also publish data on company applications and registrations, including the names and dates.
2. Based on the results of the study described in (1) above, the GOE will begin implementation of a plan to increase the participation of privately owned banks and other financial institutions in the Egyptian financial sector.	2. The GOE will extend the general sales tax to cover the wholesale level of the economy in the evolving process of converting it to a full value added tax.	2. Based on the results of the review described in (5) in 1992, the GOE will embark on a program of opening to full private sector participation those industries currently dominated by public sector companies.	2. The GOE will privatize at least ten public sector or joint venture enterprises worth at least LE 500 million.
3. The GOE will implement regulations governing activities pursuant to the new securities market law.	3. The GOE will prepare a plan to reduce the percentage of wages and subsidies in total government expenditures.	3. The GOE will implement the recommendations of the study described in (3) in 1992.	
	4. The GOE extends the sales tax to the retail level of activity and converts it to a full Value Added Tax (VAT).		

50

C. Use of Dollar Resources

When USAID approves the disbursement of funds because the performance indicators have been achieved, it will deposit the appropriate number of dollars into a dollar special account of the Central Bank of Egypt. The Central Bank will then use these funds to pay for the importation of goods and services from the United States. Within 30 days, the GOE will deposit an equivalent amount of local currency into a local currency special account for use within Egypt. A similar special account already exists and receives funds generated by the Commodity Import Program. USAID will permit the GOE to use up to 25 percent of the dollars for repayments of debts owed by the GOE to the U.S. government or for debts guaranteed by the U.S. Government. If the dollars are used for this purpose, local currency will not result from the transaction.

D. Local Currency Program

The GOE will deposit all the local currency resulting from this program in a special account. This account is owned by the Government of Egypt, but must be used for purposes jointly agreed by the GOE and USAID. The GOE and USAID will jointly program all the local currency resulting from the SPR program, the CIP and other sources of local currency under an annual Memorandum of Understanding. The local currency from each program will be kept separate, and jointly programmed by USAID and GOE as described in section VI B.1. USAID will obtain documentation from the Government of Egypt which is adequate to insure that funds were transferred from the local currency special account to the appropriate ministries or for other agreed uses.

E. Interest and the Special Account

A question has arisen as to whether or not the GOE should receive interest on funds in the Special Account as a result of this program. From an economic point of view neither the Government nor the overall national economy would gain anything from the payment of interest on this account. On the other hand, establishing and operating a system for the interest to be computed, accounted for and paid would have costs. Therefore, requiring interest payments would impose a net economic loss. The reason interest payments would not represent a gain is that both the Central Bank of Egypt and the Ministry of Finance are elements of the Governments of Egypt. Thus the payment received by one unit of government would be precisely offset by the payment made by the other.

V. PROJECT ASSISTANCE (263-0233)

A. Technical Support for Sector Policy Reform Project

In order to assist the GOE to meet the policy reform measures described in Tables 11 and 12, a three year program of technical assistance will be financed under a companion project, Technical Support for Sector Policy Reform (TSSPR, 263-0233). The purpose of the project is to help the GOE develop, carry out, monitor and evaluate its Sector Policy Reform Program. This will consist primarily of specialized technical services to Egyptian policymakers in the relevant ministries and agencies. Individuals or teams will provide advice and counsel, design implementation plans and offer ongoing specialized expertise to carry out identified reform measures. Support will also be provided for the GOE implementation unit of the Grantee, i.e. the Ministry of International Cooperation, to add the staff necessary to carry out the significant monitoring tasks required. Finally, funds for evaluation and audit will be provided from the project assistance.

B. Proposed Technical Assistance

The level of technical assistance estimated for the three year life of project totals approximately 43 person-years in both long term and short term expertise. The estimated LOP cost is approximately $10 million. The principal element of the TA component will be 8 long term expatriate advisors: four to assist in financial sector reforms; two in the fiscal sector; and two in the trade sector. Egyptian staff for MIC will include at least four full-time equivalent professional positions and secretarial support. Technical assistance requirements for privatization reforms are being met under the Partnership for Development Project, and will be continued under its successor, the Privatization Project. Tariff and customs related technical assistance requirements described under the Trade Sector will be financed under the Public Finance Administration Project.

Listed below by sector are possible areas of long and short term technical assistance that will be required to meet the policy measures agreed under the Sector Policy Reform Program. All of these are either directly linked to policy measures or implied by them. Discussions with the relevant ministries will lead to agreement on their needs and then on scopes of work for long and short term assistance.

Financial Sector.

1. Assist in developing legislation, rules, and procedures required to remove barriers to entry of private financial institutions into any and all segments of the financial sector.

52

2. Assist in the development of forward markets for commodities, foreign exchange and other financial instruments.

3. Standardize financial accounting, reporting and disclosure requirements for listed companies in the securities market.

4. Strengthen the financial condition of the banking sector (e.g., asset revaluation, workouts, mergers and acquisitions, portfolio management, and money markets).

5. Assist in the implementation and prudent management of a deposit insurance fund.

6. Assist in the effective development and enforcement of banking standards and supervision of commercial banks.

7. Develop executive regulations for the removal of interest rate limits on corporate bonds.

8. Develop further the T-Bill market, and develop new government securities and primary and secondary markets for these securities.

9. Assist in the establishment of legal and institutional requisites for markets to trade commodities and private financial instruments, including the design of financial instruments.

<u>Fiscal Sector.</u>

10. Assist in developing tax legislation, rules, and procedures. (Financed under Public Administration Project.)

11. Design a system to generate and publish revenue and expenditure data in disaggregated form.

12. Develop increased capacity to plan, execute, monitor and forecast government expenditures and transfers.

<u>Trade Sector.</u>

13. Assist in developing legislation, rules, and procedures governing imports and exports.

14. Develop procedures for prompt refunding under the "drawback" system and the VAT. (TA financed under Public Administration Project.)

15. Develop recommendations to improve and modernize customs procedures, and to integrate Egyptian Customs more fully with the rest of the tax system. (TA financed under Public Administration Project.)

16. Study, evaluate, and recommend alternative options to the present mandatory public sector "quality control" regulations governing exports and imports.

17. Develop recommendations for the removal of regulations and laws that impede private sector investment in export and import industries currently dominated by pubic sector companies.

Privatization.
(TA to be financed under separate project.)

18. Assist in developing legislation, rules, and procedures to further the privatization process.

19. Support the development of private capital markets by, *inter alia*, assisting the design and establishment of a depository/clearinghouse to facilitate market activity.

20. Study the costs and benefits of opening the cotton spinning industry to private investment and market pricing of inputs and outputs.

The tasks listed above are tied to the measures set forth in the Memorandum of Understanding for the Policy Reform Program. The actual terms of reference for the TA would be somewhat different because a team of experts, for example, might provide several types of assistance at the same time. Tables 13 and 14 describe activities that could be handled by individual short-term teams or long-term experts. The actual composition of the teams will be determined during the start-up period based on discussion with the GOE coordinating unit and the specific agency to be assisted.

C. Project Management

1. USAID

USAID's Economic Analysis and Strategy Directorate (EAS), which is responsible for the Cash Transfer for Policy Reform Program, will provide overall management of the Technical Support Project, in coordination with TI/FI. Technical responsibility and general guidance for the activities would reside with the office that is most appropriate. For example the Trade and Investment Directorate (TI) would provide technical direction for privatization and capital markets activities, whereas EAS would be the primary contact for fiscal and tax activities.

2. Host Country

In order to facilitate the effective provision of technical assistance, USAID supports designation of the Ministry of Cooperation (MIC) as the official counterpart for both the both the Policy Reform Program and the Technical Support Project. In the absence of appropriate coordination, the necessary tracking of policy reforms across sectors would be very difficult and the management burden on USAID would be enormous. Therefore, it is proposed that the MIC monitor the GOE's compliance or noncompliance with all sectoral reform requirements, as well as coordinate GOE requests for technical assistance. There will also be monitoring and reporting tasks associated with the local currency program and dollar uses of the cash transfer program. To provide the MIC with the capability to manage and monitor these activities, appropriate support staff will be financed under the project. It is anticipated, for example, that the increased tasks undertaken by the MIC will call for some level of computerized capability for its project-related monitoring and managerial functions. Allowances for the procurement of short-term TA to establish an appropriate MIS system have been incorporated into the budget. Enhanced management capability will also be important in carrying out the evaluation and audit tasks required for AID-financed assistance.

The MIC will provide the office space and secretarial support necessary to sustain program operations.

D. Procurement and Financial Plan

The Mission proposes to finance the major portion of technical assistance through a master contract or cooperative agreement, preferably utilizing a consortia of consulting firms and universities. This competively awarded contract will be the primary vehicle for accessing long-term expertise, but may also be used for supplying short-term technical assistance for 1993. While the bulk of the TA and equipment procurement will be contracted in this manner, the Mission will allocate enough funds to directly contract a limited amount of short-term TA separately, particularly in 1992. Egyptian staff hired to assist the MIC will be contracted under host country contracts.

Table 13
ILLUSTRATIVE COST ESTIMATES FOR PROJECT ASSISTANCE

	Long Term (Per/Yrs)	Short Term (Per/Mos)	LOP ($000)
TECHNICAL ASSISTANCE			
A. Financial Sector			3840 1/ 2/
1. Banking	3		
2. Monetary	3		
(ST monetary and banking experts)		24	
3. Capital markets	3		
(ST capital markets experts)		36	
4. Market information	2		
B. Fiscal Sector			1920 1/ 2/
1. Public expenditure	3		
2. Cost control	3		
(ST experts, e.g, data publication)		24	
C. Trade Sector			1920 1/2/
1. Export policy	3		
2. Tariff	3		
(ST tariff and export policy experts)		24	
D. Privatization Financed under Partnership in Development Project			
E. MIC Support 3/			550
1. Program Manager	3		
2. FSN Economist	3		
3. Support Staff	3		
4. ST assistance (e.g.MIS)		24	
F. Contingency			670
COMMODITIES			600
EVALUATION AND AUDIT			500
LOP Total	32 yrs 4/	132 mos	10,000

9

1) Long term expatriate TA is costed at $240,000 per person year.
2) Short term expatriate TA is costed at $20,000 per person month.
3) Long term TA and support staff requirements for MIC will be local currency expenditures procured under a host country contract(s).
4) Includes 9 person years of local hire TA.

Table 14
Illustrative Estimates of Short-term Technical Assistance

	Person Months
A. Financial Sector	
1. Increase participation of privately-owned banks, other financial institutions and foreign banks, and assist development of new financial institutions. (Banking experts; 2 X 6 mos)	12
2. Remove limits on interest rates on bonds. (Capital markets expert; 1 x 6 months)	6
B. 1. Provide assistance to publish data on government revenues and expenditures on a timely basis.	
C. Trade Sector	
1. Develop procedures for prompt refunding under the "drawback" system.* (Tariff experts; 2 x 4 months)	8
2. Recommend alternatives to the present mandatory public sector "quality control" regulations governing exports. (Export policy experts; 2 x 2 months)	4
3. Develop recommendations removing impediments (regulations and laws) to private sector investment in export industries.(2 x 4 months)	8
D. Privatization**	
1. Study opening cotton spinning industry to private investment. (4 x 6 months)	24
2. Develop national privatization plan; (2 x 9 months)	18
3. Carry out study of the barriers to entry that affect the ability for small business to become formally established.	18

* TA will be financed under the Public Administration Project.
** TA for this sector financed under Partnership in Development and the follow-on Privatization Project.

51

VI. Financial Plan and Cost Estimates

A. Special Account for Dollar Grant Proceeds

The Fiscal Year 1991 Appropriations Act specifies that countries receiving cash transfer assistance must establish a separate account for the dollar proceeds. USAID will deposit the appropriate number of dollars into an interest bearing Dollar Special Account opened in a U.S. bank designated by the Central Bank of Egypt.

This account will be used solely for the receipt of appropriated dollars for this cash transfer program from AID (in accordance to policy guidance on ESF Cash Transfer Assistance in Handbook 1 and AID-issued guidance for Dollar Special Accounts in STATE 194322 on June 17, 1990). The proceeds will not be commingled with other funds from any other source. Any interest earned on such account shall be treated as grant proceeds received under the terms of the Sector Policy Reform program agreement. Likewise, any redeposits due to ineligible use of funds from the Dollar Special Account will be used in a similar manner.

1. <u>Uses of Dollar Grant Proceeds</u>

Grant proceeds may be used by the Government of Egypt for the following two purposes and within certain limits as specified below:

(a) Purchase of goods and services from the United States. i.e. capital goods, machinery and equipment, raw materials and other goods and related services. The source of such goods will be AID Geographic Code 000.

(b) Servicing of U.S Government debt or U.S Government guaranteed debt in an amount not to exceed 25% of the total of the funds made available under this grant or up to $ 50.0 million per year of the two year program.

Ineligible uses from the dollar grant proceeds will be the purchase of commodities for the use of military or police organizations, surveillance equipment, abortion equipment, luxury goods and gambling equipment, or weather modification equipment or payment of debt related to military or police organizations. In case of ineligible uses, the GOE will have to deposit, from its own resources, to the Dollar Special Account, mounts equal to what have been released for ineligible uses.

The use of grant funds, in dollar amounts, is largely pre-determined under this agreement. This determination to require the use of at least 75% of the grant proceeds for commodities and up to 25% for debt payment is justified because Egypt's burden of debt repayment has been reduced by forgiveness of part of the debt and the rescheduling of the remaining debts under the Paris Club agreement. On the other hand, there is an increasing demand for dollars to finance imports for GOE sectors that will no longer receive AID C.I.P. assistance.

2. Financial Management of Dollar Special Account (Accounting, Monitoring and Reporting)

As stated above, the GOE may use the dollars from the Dollar Special Account for payment of U.S. Debt (up to the limit described above) and/or commodities and equipment imported from the U.S. The systems and procedures used by the GOE for payment of U.S. debt are different from those used for purchasing commodities and equipment from the U.S. The systems and procedures for these two distinct methods of using funds from the Dollar Special Account are discussed below. Also discussed below are the actions taken and to be followed by the Mission to ensure proper accountability and compliance with AID regulations.

For past USAID cash transfers, the Implementing Agencies have been the Ministry of International Cooperation (MIC) and the Central Bank. Due to the nature of the previous cash transfers, the Central Bank played a major role in implementing these activities with MIC having a minor role. However, since this cash transfer program is different (e.g. policy reforms and minimum size Letters of Commitments for U.S. commodities) from the previous ones, MIC will be the major Implementing Agency. MIC will coordinate all activities among the various GOE Ministries and ensure that the Central Bank and Ministry of Finance (MOF) properly manage the Dollar and Local Currency Special Accounts. USAID will work closely with MIC to ensure adequate systems and procedures are in place to implement this cash transfer program. Technical assistance will be provided to MIC under the Technical Support for Sector Policy Reform project that will increase its technical and managerial capability.

Payment of U.S. Debt. The GOE currently has adequate procedures in place for managing payments from the Dollar Special Account for U.S. debt. These procedures require that the GOE will maintain records to indicate the amount of debt paid, date of payment, recipient of the debt payment, description of the debt, and evidence of payment. Also, the GOE will submit to AID monthly bank statement for the daily activity of the dollar account showing deposits, withdrawals and balances of such account. The grant agreement and implementation letters will contain detailed provisions for accounting and reporting of the grant proceeds in conformance with the Dollar Special Account guidance issued in STATE 194322, dated 06/17/90.

Even though, the Central Bank is not the Implementing Agency for this year's Cash Transfer agreement, it will continue to manage the Dollar Special Account. The Mission has reached a positive determination that the Central Bank is capable of effectively managing the Dollar Special Account in accordance with AID

requirements. This judgement is based on the Central Bank's excellent management of the FY 1989, 90 and 91 cash transfer special accounts for USAID programs. In addition, the Regional Inspector General/Cairo audit of the FY 89, 90 and 91 cash transfer special account transactions reported no adverse findings related to the Central Bank's management.

Payment for Commodities and Equipment Imported from U.S. **The procedures and systems for using the Dollar Special Account for purchases of commodities and equipment from the U.S. under this Cash Transfer program are different from those previously used in the Commodity Import Program. The Mission has designed this program to substantially reduce the number of transactions to** account for, monitor and report on (Letters of Credits issued by the GOE to procure U.S. commodities should not be less than $500,000) and streamlined procedures for both USAID and the GOE in accordance with the Dollar Special Account guidance issued in STATE 194322, dated 06/17/90. This cash transfer program will allow the GOE to procure commodities and equipment from the U.S. in a timely manner with minimal support and monitoring by the Mission while complying with AID guidance.

USAID is currently working with the GOE to determine the most appropriate systems for accounting, reporting and monitoring dollars used for the purchase of commodities. The GOE will not be able to use the Dollar Special Account for purchasing commodities and equipment until USAID approves the GOE systems to ensure that commodities and equipment procured (1) comply with source requirements; and (2) clear customs in Egypt. This will be stipulated in a PIL to MIC to ensure that the GOE complies with the terms of the agreement and AID requirements.

Once an appropriate system has been implemented by the GOE and approved by USAID, the GOE will be able to use the Dollar Special Account for purchasing commodities and equipment from the U.S. The GOE system will account for, monitor and document the eligibility of commodities under this program to ensure the commodities are of U.S. source, and that such commodities have actually entered the country. The accounting books and records will be available for inspection by USAID or AID's designee for a period of three years following the date of the last disbursement from the Dollar Special Account. The required documentation, maintenance of records and reporting will be outlined in PILs between USAID and the GOE.

USAID or its representatives will examine records and documentation on a quarterly basis in one centralized unit of the GOE, most likely MIC, to ensure compliance with the terms of the agreement. USAID may reduce or increase the amount of monitoring depending on the performance of the GOE. Based on the above analysis, the Mission believes that the GOE has the capability to effectively manage the Dollar Special Account in accordance with requirements. Also, the GOE's past performance of managing the CIP has been excellent and this cash transfer program should be less management intensive.

B. Local Currency Special Account

The GOE shall establish in the Central Bank of Egypt a separate "Local Currency Special Account"in the name of the Ministry of Finance. Funds deposited in such account will not be co-mingled with funds generated from other agreements or assistance. The GOE will deposit in this account, local currency equivalent to dollar disbursements made from the Dollar Special Account for the purpose of commodity purchase.

As stated above, disbursements for debt payments will not result in local currency. Thus the local currency to be generated will be equivalent to not less than $150.0 million. In the event that the GOE does not utilize the full $50.0 million for debt payment and decides to use this amount, or part of it, for procurement of commodities, additional local currency will be deposited in the Local Currency Special Account.

The Mission has determined that funds deposited in the Local Currency Special Account will not earn any interest as stated in IV e.

1. **Deposits and Uses from the Local Currency Special Account (Accounting, Monitoring and Reporting)**

Deposits to the Local Currency Special Account will be made within thirty days of the release of Grant dollars into the Dollar Special Account. The exchange rate applied will be the daily average closing rate of exchange for any transaction as determined by the Free Market Central Chamber, for the last business day immediately preceding the day Grant dollars are released by the AID to the dollar account.

Funds deposited into the Local Currency Special Account will be programmed in accordance with the fourteenth amendment to the Memorandum of Understanding regarding the Special Account, dated June 30, 1980 or its subsequent amendments. Such funds, except as AID may otherwise agree in writing, may be used for the following purposes:

(a) Funding USAID administrative cost.
(b) Budget support for particular Government sectors.
(c) Grantee support of A.I.D.-financed projects.
(d) Activities mutually agreed to between USAID and MIC under AID Trust Fund agreement.

It is anticipated that budget support for particular Government sectors will constitute the major use of the funds. MIC shall maintain accounting records and make available to USAID or its representative such records for review and audit for the period of

61

the grant and up to three years following the last disbursement from the Local Currency Account. The GOE shall provide AID with monthly bank statements showing deposits, withdrawals and balances. Local currency not used for the purposes indicated above will be redeposited to the Local Currency Special Account from GOE resources. Any unencumbered balances of funds which remain in the Local Currency Special Account upon termination of the program will be used for such purposes (subject to applicable law) as agreed upon between the GOE and AID.

The Ministry of Finance (MOF) is responsible for accounting, reporting and monitoring the activity of the Local Currency Special Account. The Central Bank will incorporate the summary of deposits, withdrawals and balances of Local Currency and Dollar Special Accounts and submit them to USAID on a quarterly basis. Even though the Local Currency Special Account is kept in the Central Bank, it is owned and controlled by the MOF. All instructions for opening accounts, issuance of bank statements and their submission to the different recipients are provided by MOF. From past experience and implementation of previous Special Accounts, we believe MOF is capable of managing the Local Currency Special Account under this agreement.

2. **The GOE's Capability to Manage Local Currency from the Special Account**

With the issuance of supplemental guidance on programming and managing host country-owned local currency (STATE 204855 dated June, 1991), the Mission is required to assess the general accountability environment in the host country. The Mission has hired a local CPA firm to determine whether the GOE is capable of managing host country owned local currency generated by USAID programs/projects. Preliminary discussions with the local CPA firm indicate that the GOE has adequate internal controls and accounting systems to manage host country-owned local currency. The study will be completed before disbursement of funds from the Special Account, so any corrective actions that may be required of the GOE will be addressed before local currency is disbursed.

The Regional Inspector General/Cairo audited FY 89, 90 and 91 cash transfers (February, 1992) to determine whether USAID/Cairo ensured that the GOE generated, deposited and reported local currency in compliance with applicable laws, regulations, policies and the terms of the Grant Agreement. The audit reported that GOE complied with the applicable laws, regulations, policies and the terms of the Grant Agreement.

As stated above, most of the local currency will be programmed for general support of designated Ministries. Since the local currency is for general uses, the Mission's monitoring of local currency will be minimal. The actual monitoring responsibility of the Mission will be determined after the completion of the General Assessment by the local CPA firm. The local currency will be

62

jointly programmed by USAID and the GOE, and accounted for by USAID and/or the GOE which will be specified in the MOU and PILs.

Based on the above, the Mission believes that the GOE has adequate internal controls and accounting systems to manage host country-owned local currency and meets AID's requirements.

C. Audit

The GOE will audit the records for both the Dollar and Local Currency Special Accounts, but it is unable to comply with the guidance on audit in State cable 204655 dated June 1991 (see Mission's General Assessment dated March 1991 for additional details). Therefore, funds will be available for audit purposes for both the Dollar and Local Currency Special Accounts under the line item "Evaluation and Audit" of the Technical Support for Sector Policy Reform project. If these funds are not sufficient, additional funds will be added from other Mission resources.

Table 15
ILLUSTRATIVE FINANCIAL PLAN
(US$000)

ELEMENTS	FY 92 CURRENT OBLIGATION (FX)	FUTURE YEARS ANTICIPATED (FX)	TOTAL COSTS (FX)
PROGRAM ASSISTANCE	200,000	200,000	400,000
PROJECT ASSISTANCE			
Technical Assistance	8,900		8,900
Commodities	600		600
Evaluation & Audit	500		500
Total Project Assistance	10,000	0	10,000

63

Table 16
PROJECTED EXPENDITURES
BY FISCAL YEAR
AND PROJECT ELEMENT
(US $000)

	FISCAL YEARS				
ELEMENT	FY 92	FY 93	FY 94	FY 95	GRAND TOTAL
PROGRAM ASSIST.	60,000	200,000	140,000		400,000
PROJECT ASSIST.					
Technical Assist.		2,000	3,500	3,400	8,900
Commodities		600			600
Evaluat. & Audit		30	330	140	500
TOTAL PROJECT		2,630	3,830	3,540	10,000

Table 17
METHODS OF IMPLEMENTING AND FINANCING

Elements	Method of Implement.	Method of Financing	Total Cost ($000)
PROGRAM ASSIST.	PILs	Cash Transfer	400,000
PROJECT ASSIST.			
T.A.	Direct Contract/ IQCS/Cooperative Agreements/ Host Country Contracting	Direct Payments & Reimb.	8,900
Commodities	Direct Contracts/ Cooperative Agreements	Direct Payments	600
Eval. & Audit	Direct Contract	Direct Payments	500
Total Project Assistance			10,000
GRAND TOTAL			410,000

64

During the life of this project, non-federal/recipient audits will be performed to determine whether the recipients have properly accounted for and used AID funds for the purposes intended in accordance with applicable laws and regulations. USAID will ensure that all commitments over $25,000 under this project are in the Mission's audit universe.

The Mission will schedule audits for those commitments over $25,000 and has ensured funds are available for audits in accordance to AID/W guidance dated March 31, 1992 on Audit Management and Resolution Program. Not all of the planned commitments over $25,000 under this project will require non-federal/recipient audits because of the nature of the activity (i.e., PSCs,). During the project, the Mission will make a determination of the commitments that require audit coverage. The Regional Inspector General for Audit will perform quality and compliance reviews of non-federal/recipient audits under this project and provide or arrange for additional audit coverage as requested by USAID, if deemed necessary.

D. Recurrent Costs

The project elements under this activity should not have recurrent cost implications for the GOE. The reason is that the majority of the technical assistance (representing 89% of the total project) needed to support the GOE in implementing policy reforms will probably not be maintained by the GOE upon completion of the project.

65

VII. Monitoring and Evaluation

A. Monitoring of Sector Policy Reform Program

1. Monitoring of Policy Measures

Achievement of policy measures is the mechanism for disbursement of dollar funds according to the schedule described in Chapter IV. The staff of the EAS will follow the progress on each measure through contacts with the relevant technical ministries, the Ministry of International Cooperation and the private sector and through newspapers. Both short-term and long-term consultants also will be good sources for monitoring progress. The Ministry of International Cooperation with the assistance of specially hired staff will coordinate with the relevant Ministries to provide reports on progress to USAID. In addition, the EAS staff with the assistance of TI staff, also will monitor indicators of impact to be able to determine the effects of individual policy measures and the overall program.

2. General Approach to Determining Impact

The purpose of the project is to support the implementation of the economic reform program that the GOE is carrying out with funding from other donors, particularly the World Bank (Structural Adjustment Loan) and the International Monetary Fund (Stand-by Agreement). The project also will advance one of USAID's three subgoals, namely, to increase economic growth. Achievement of this subgoal cannot be attributed solely to this program, particularly as the program will only serve to provide some of the necessary conditions for economic growth. The program will, however, impact rather directly on two strategic objectives: 1) increased macroeconomic stability and market pricing; and 2) increased private investment and trade. In both cases, of course, this program reinforces the IMF Stand-by and the World Bank SAL. Nevertheless, the monitoring activities of USAID will follow not only the achievement of the policy measures, but various impacts that these measures are likely to have, both on the strategic objectives and on other aspects of the mission strategy.

Given the duration of the program, which could be as little as 17 months from signing to achievement of the second year's policy measures, statistically significant changes in many variables during this period may not occur. The companion technical assistance project, which will help implement many of the policy reforms, will run for three years and complete monitoring of the program assistance will continue during this period. Furthermore, many of the indicators are the same as for the total mission program, and thus data will continue to be collected and analyzed.

66

The proposed indicators range from measuring the overall goal of economic growth to intermediate indicators such as investment and exports that are affected by reforms in two or more sectors to those that are directly linked to one or more policy measures. Achievement of a measure itself will not in most causes result in an immediate impact, but will only change the conditions so that impacts can occur. For example, removing the interest rate limitation on corporate bonds will make it possible and likely that corporate bonds will be issued, but this result is not guaranteed and some time interval will be necessary. Nevertheless, USAID will monitor the bond market in order to determine the impact on it because new bond issues are the expected impact of the policy measures. Bond issues in turn will facilitate new investment and eventually greater economic growth. Virtually all the policy measures are expected to affect economic growth through a similarly indirect and lagged process.

3. Crosscutting Impacts

The overall program of economic reform is expected to lead to higher sustained levels of economic growth. Therefore, per capita GDP will be monitored closely, as well as the components of economic output where it is often easier to attribute growth to specific economic policy reform measures. These impacts are likely to occur in the medium to long term, however, so other measures of impact are necessary. The most necessary factor that must change is the confidence of private sector investors, which in turn is a function of the factors that make up the investment climate. An index of producer/investor/consumer confidence does not currently exist in Egypt. The methodology for developing one is well-known and the expertise exists in Egypt to implement such surveys to measure it. USAID will work with the American Chamber of Commerce, the American University of Cairo Business School, the Ministry of Industries etc. to sell the idea of such an index. Funds available under the Technical Support for Sector Policy Reform Grant for monitoring of the Mission Program can be used for this purpose.

A more tangible measure of impact is private sector investment, or rather investment decisions. Although actual investment is not readily available without a delay, information on larger investment decisions is available from the General Authority for Investment and the General Office for Investment. Both these sources will be used as well as National Income Accounts and the banking system in order to have an up-to-date measure of investment decisions. The ratio of private sector to public sector investment will be followed closely as it is expected to shift quickly due to the policy of not expanding public sector companies or establishing new ones. Employment trends are likely to follow investment trends, but the effects will be muted. Some of the largest public sector companies as well as government agencies have done very little hiring over the last five years and are shrinking their work forces through attrition. A 1993 policy measure is likely to make this practice even more of an official policy. Thus it is likely that

61

growth in private sector employment will be offset in part by reductions in public sector employment. Privatization as it occurs probably also will result in employment losses, at least in the short run. Although the new private sector employment will be much more productive than the lost public sector employment, total employment in the formal sector may be slow to increase.

A number of other impacts are likely to be influenced by policy measures in more than one sector. They are discussed below in each individual sector, however, to make clear the connection with the individual policy measures. It is understood, of course, that many of the policy measures are related to each other in a complex web, and that the impacts will be influenced by more than just one or several policy measures.

4. <u>Impacts of Financial Sector Policy Measures</u>

The policy measures for the two years relate to the economic health of all banks, the participation of private and foreign banks, and the encouragement of the stock and bond markets through changes in laws, regulations, interest rate constraints and taxes. The purpose of the policy measures is to increase the rate of savings, mobilize more resources for investment and do it more efficiently. Implementation of the policy measures will provide the necessary conditions for these impacts to take place. The expected impacts USAID will follow include:

* The number of private and foreign banks and their share of deposits and loans.

* Total savings in banks and other financial institutions.

* Domestic savings as a percent of GDP.

* Number and size of bond issues.

* Number and value of new stock share offerings.

* Trading volume on the stock market.

USAID will also monitor the banking and financial sector, including such items as the money supply, credit, capital-asset ratios and so forth. These measures of economic stability and growth relate to the fiscal practices of the government as much as to the financial sector. While they are important for judging the success of the mission program, they are not as closely related to the Sector Policy Reform Program.

5. <u>Impacts of Fiscal Sector Policy Measures</u>

The fiscal sector is a shorthand way of describing the management of the government budget, particularly its revenues, expenditures and resulting fiscal surplus or deficit. The last item is critical for economic stability and growth through its effects on prices, savings and investment. The SPR Program will affect these items and USAID will track them. Other factors will also affect them and thus they are impacted only indirectly through the policy measures.

The USAID policy measures relate to improving the efficiency of the tax system, consolidating all income taxes, identifying taxpayers, and broadening the sales taxes. It also aims to improve control over expenditures by providing more information and by devising plans to limit spending on wages and subsidies. Therefore, the impacts that will be measured include:

* Income tax revenues and its share of total GOE revenues and GDP.

* The number of individual and corporate taxpayers.

* Sales tax revenues and its share of total GOE revenues and GDP.

* Total government expenditures as a share of GDP and the percentage of social and economic expenditures of the total.

* Subsidies as a share of GDP.

* Wages and salaries as a share of total expenditures.

6. <u>Impacts of Trade Sector Policy Measures</u>

The trade sector measures are designed to increase exports and imports by improving the efficiency of domestic production and by reducing the impediments to trade. The measures relate to removing the restraints on private sector exporters by easing restrictions on imported inputs and by improving the administration of the Egyptian customs system. Some of the impacts will flow directly from implementation of the policy measures, while others such as exports, will be less direct though still attributable to the policy measures. The balance of trade is not a target, but it will be tracked closely. The impacts to be monitored are:

* Number of exporters using the drawback system.

* Number of exporters using the temporary admission system.

* Value of imports previously banned.

* Private sector shares of imports and exports previously restricted to the public sector.

* Exports of goods and nonfactor services as a percent of GDP.

* Merchandise exports as a percent of GDP.

7. Impacts of the Domestic Enterprise Sector Policy Measures

The policy measures for the enterprise sector refer both to the privatization of public sector companies and to deregulation of the sector. The purpose is to promote more rapid growth of the enterprise sector, mainly through the privately owned sector. Privatization is expected to lead to greater efficiency, more investment and faster growth. It also will reduce the burden on the government budget both for new investment and subsidies to cover losses of state owned enterprises.

The ultimate goal of the policy measures is greater economic growth. In fact, the impacts of the policy reforms in the financial, fiscal and trade sectors on economic growth will be effected largely through the private enterprise sector. USAID will track the following impacts that can be attributed to policy reforms in the domestic enterprise sector, through some undoubtedly also will be due to reforms in the other sectors:

* Private sector output as a share of GDP.
* The private sector share of total investment.
* Manufacturing output and its share of GDP.
* Number of registered private companies.
* Number and value of companies privatized.
* The value of output in the spinning industry.

B. Evaluation of Sector Policy Reform Program

This program epitomizes the complex relationship of monitoring and evaluation. The monitoring approach which proposes specific indicators for the Sector Policy Reform Program will also serve as an integral basis for evaluation. Decisions to disburse individual tranches will be based on assessments of GOE performance by EAS, working in conjunction with the technical assistance contractor and the counterpart agency, MIC. Based on its evaluation of specific indicators in the financial, fiscal, trade and privatization sectors, EAS will determine that individual tranche disbursements are warranted and make such a recommendation to the Mission director.

Due to the program assistance's limited time frame, its mid-term evaluation will be a formative evaluation with only limited emphasis upon impact. This evaluation, tentatively scheduled for January 1994, will provide relevant findings and recommendations which would be incorporated into any follow-on program and would also serve as an interim evaluation for the technical assistance

70

project. It should assess the performance of the GOE, the technical assistance contractor and USAID and each party's role in the management of individual tranche disbursements. The study will evaluate both the relevance and the quality of specific indicators employed to monitor sector progress. It will also judge whether appropriate mechanisms are being utilized to implement the program, while at the same time appraising the timeliness and pertinence of the technical support provided for the sector policy reform program.

A final evaluation of the technical support and the program assistance should be conducted in order to determine the degree to which the technical assistance contributed to meeting the strict policy conditionality and whether it brought about any other changes. While the final evaluation for the technical support project should be scheduled near the end of the technical support contract, the timing of the evaluation of the program assistance is more problematic. The nature of sector policy reform often results in delayed impacts with short term dislocations; therefore, the final evaluation of the economic impact of the policy reforms would not be meaningful until sufficient time has elapsed after reform implementation. The Mission, as a result of the uncertainties inherent in the sectoral approach, will determine the necessity and the timing of the program's final evaluation.

· 11'

ARAB REPUBLIC OF EGYPT
STRY OF INTERNATIONAL COOPERATION
ARTMENT FOR ECONOMIC COOPERATION
WITH U. S. A

ANNEX A

00575

July,29,1992

LEG DIRKS
DIRIEAS

Mr. Henry H.Bassford
Director
USAID/Cairo.

ACTION TO PDS FM
ACTION TAKEN ____ DUE DATE 8/12
DATE ____ INITIALS ____

Dear Mr. Bassford,

This is to request A.I.D. to authorize the Cash Transfer for Sector Policy Reform Program (263-k-626) for $ 200 million.

This amount will be used by the Government of Egypt to procure commodities from the U.S.or to pay U.S.debt.

Best regards.

Sincerely yours,

Dr. Hassan Selim
Administrator.

C&R USAID/CAIRO
1992 AUG -3 A 8:45

FAX : 3938187 - TELEX : 21722 - PHONE : 3913145 - 3910278 - 3908124 - 3905100 - 3905125
12

ANNEX B

ARAB REPUBLIC OF EGYPT
MINISTRY OF INTERNATIONAL COOPERATION
DEPARTMENT FOR ECONOMIC COOPERATION
WITH U. S. A

00574

July,29,1992

Mr. Henry H.Bassford
Director
USAID/Cairo

LEG
ACTION TO PDS FM
ACTION TAKEN NAN DUE DATE 8/12
DATE 8/4 INITIALS

Dear Mr. Bassford,

This is to request A.I.D. life of project funding of $ 10 million for the Technical Support for Sector Policy Reform Project (263 - 0233).

This project will assist the Government of Egypt to develop, carry out monitor and evaluate its economic reform program, specifically those sector policy reforms related to the A.I.D. Cash Transfer for Sector Policy Reform Program.

Best regards.

Sincerely yours,

Dr. Hassan Salim
Administrator.

1992 AUG -3 A 8:45
C&R USAID/CAIRO

13

FAX : 3938187 - TELEX : 21722 - PHONE : 3913145 - 3910278 - 3908124 - 3905100 - 3905125

ANNEX C

RECORD OF CATEGORICAL EXCLUSION

Project Location	:	Egypt
Project Title and Number	:	Cash Transfer for Sector Policy Reform Program (263-K626) Technical Support for Policy Reform Project (263-0233)
Funding	:	AID - $ 200 million (263-K626) AID - $ 10 million (263-0233)
Life of Project	:	3 Years, FY 1992 - FY 1995
Categorical Exclusion Determination Prepared by	:	Signature Glenn Rutanen-Whaley Glenn Rutanen-Whaley, PDS/PS Mission Environmental Officer Date: 7/21/92
Environmental Action Recommended	:	Categorical Exclusion
Mission Environmental Officer's Concurrence	:	Signature Glenn Rutanen-Whaley Glenn Rutanen-Whaley, PDS/PS Date: 7/21/92
Associate Mission Director's Concurrence	:	Signature [signature] Robert Jordan, (A)AD/PDS Date: 7/21/92
Decision of Environmental Coordinator, Bureau for the Near East	:	Approved: Gilbert S. Jackson Disapproved: ____________ Date: 7/21/92

14

ANNEX D

Technical Support for Sector Policy Reform
Project 263-0233

CERTIFICATION PURSUANT TO GRAY AMENDMENT

gh the Gray Amendment does not apply to Economic Support which will finance this Project, it is USAID/Egypt policy to age the utilization of Gray Amendments firms and zations throughout the portfolio.

ector and Principal Officer of the Agency for International pment in Egypt, I certify that full consideration has been to the potential involvement of small and /or economically ocially disadvantaged enterprises, historically black es and universities and minority controlled private and ary organizations covered by the Gray Amendment.

ttached Project Paper discusses the efforts what will be aken in connection with the procurement plan to maximize the ipation of minority owned an small and disadvantaged izations. A t the time of each procurement action, every t will be made to encourage the participation of these izations and draw upon their knowledge and expertise.

Henry H. Bassford
Director

8/24/92
DATE

5C(2) - ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than the eligibility of a country to receive assistance. This section is divided into three parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fun resources. Part B includes criteria applicable only to Development Assistance resources. Part C includes criteria applicable only to Economic Support Funds.

N.B.: Part B has been omitted because it is inapplicable to this ESF-funded project.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE?

Yes, the Country Checklist is contained in the Project Paper for the International Executive Service Corps Project (No. 263-0229).

A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS

1. **Host Country Development Efforts** (FAA § 601(a)): Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

(a) Cash Transfer policy reform measures include specific reform measures related to the International Trade Sector which are designed to increase the flow of international trade between Egypt and the rest of the world. (b) Policy reform measures related to the Financial, Fiscal and Enterprise Sectors all are designed to foster private initiative and competition. (c) No perceptible impact. (d) Policy reform measures aimed at increasing private sector ownership in Egypt will discourage monopolistic governmental practices.

76

(e) Increased privatization, which is a focal point of the policy reform measures, will result in the need to make a profit which can only occur with improved technical efficiency in industry and commerce.(f) No perceptible impact.

2. **U.S. Private Trade and Investment** (FAA § 601(b)): Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S.participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Cash Transfer grant proceeds may be used by the GOE to purchase equipment and commodities of U.S. source and origin. It is expected that a significant amount of the grant proceeds will be used to purchase equipment and commodities from U.S. private sector sources, thus encouraging U.S. private trade abroad.

3. **Congressional Notification**

(a) **General requirement** (FY 1991 Appropriations Act § 523 and 591; FAA § 634A): If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified (unless the notification requirement has been waived because of substantial risk to human health or welfare)?

Congress has been notified in accordance with regular Agency practice.

(b) **Notice of new account obligation** (FY 1991 Appropriations Act § 514): If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular

N/A.

11

notification procedures?

(c) **Cash transfers and nonproject sector assistance** (FY 1991 Appropriations Act § 575(b)(3)): If funds are to be made available in the form of cash transfer or nonproject sector assistance, has the Congressional notice included a detailed description of how the funds will be used, with a discussion of U.S. interests to be served and a description of any economic policy reforms to be promoted?

Yes.

4. **Engineering and Financial Plans** (FAA § 611(a)): Prior to an obligation in excess of $500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

N/A.

5. **Legislative Action** (FAA § 611(a)(2)): If legislative action is required within recipient country, with respect to an obligation in excess of $500,000, what is the basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance?

The only legislative action required is customary ratification of the grant agreement by the People's Assembly. This has been obtained without difficulty in the past. Furthermore, the signed agreement is legally binding and effective without such ratification.

6. **Water Resources** (FAA § 611(b); FY 1991 Appropriations Act § 501): If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, _et seq._)? (See A.I.D. Handbook 3 for guidelines.)

N/A.

18

7. **Cash Transfer and Sector Assistance** (FY 1991 Appropriations Act § 575(b)): Will cash transfer or nonproject sector assistance be maintained in a separate account and not commingled with other funds (unless such requirements are waived by Congressional notice for nonproject sector assistance)?	Yes.
8. **Capital Assistance** (FAA § 611(e)): If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has the Mission Director certified and Regional Assistant Administrative taken into consideration and country's capability to maintain and utilize the project effectively?	N/A.
9. **Local Currencies**	
(a) **Recipient Contributions** (FAA § 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.	N/A.
(b) **U.S.-Owned Currency** (FAA § 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	N/A. Egypt is not at present declared an "excess" or "near excess" currency country.
(c) **Separate Account** (FY 1991 Appropriations Act § 575): If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies:	
(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that	(a) Yes. (b) Yes. (c) Yes.

- 79

government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account?

(2) Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the purposes of the DA or ESF chapters of the FAA (Depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government? Yes.

(3) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purpose? Yes.

(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government? Yes.

10. **Trade Restrictions**

(a) **Surplus Commodities** (FY 1991 Appropriations Act § 521(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.s. producers of the same, similar or competing commodity? N/A.

(b) **Textiles (Lautenberg Amendment)** (FY 1991 Appropriations No.

Act § 521(c)): Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

11. **Tropical Forests** (FY 1991 Appropriations Act § 533(c)(3)): Will funds be used for any program, project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas? — No.

12. **PVO Assistance** — N/A.

(a) **Auditing and registration** (FY 1991 Appropriations Act § 537): If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?

(b) **Funding sources** (FY 1991 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for — N/A.

41

international activities from sources other than the United States Government?

13. **Project Agreement Documentation** (State Authorization § 139 (as interpreted by conference report)): Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).

Case-Zablocki Act reporting procedures will be followed with respect to this Program.

14. **Women in Development** (FY 1991 Appropriations Act, Title II, under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased?

N/A.

15. **Regional and Multilateral Assistance** (FAA § 209): Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

No.

16. **Abortions** (FY 1991 Appropriations Act, Title II, under heading "Population, DA," and § 525):

(a) Will assistance be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

No.

82

(b) Will any funds be used to lobby for abortion?	**No.**
17. Cooperatives (FAA § 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life?	**No.**
18. U.S.-Owned Foreign Currencies	
(a) **Use of currencies** (FAA §§ 612(b), 636(h)); FY 1991 Appropriations Act §§ 507, the 509): Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.	N/A.
(b) **Release of currencies** (FAA § 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	N/A. Egypt is not at present declared an "excess" or "near excess" currency country.
19. **Procurement**	
(a) **Small business** (FAA § 602(a)): Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?	Yes.
(b) **U.S. procurement** (FAA § 604(a)): Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him?	Yes. Grant Proceeds can be utilized only to procure commodities and equipment of U.S. source and origin.
(c) **Marine insurance** (FAA § 604(d)): If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine	Egypt does not so discriminate.

93

risk with such a company?

(d) **Non-U.S. agricultural procurement** (FAA § 604(e)): If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

N/A.

(e) **Construction or engineering services** (FAA § 604(g)): Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)

N/A.

(f) **Cargo preference shipping** (FAA § 603)): Is the shipping excluded from compliance with the requirement in § 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates?

N/A. Cash Transfer Grant proceeds can be used to finance shipping fees only if shipping of commodities or equipment is done on privately owned U.S. flag carriers.

(g) **Technical assistance** (FAA § 621(a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract extent practicable?

N/A.

Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?Yes, to both questions.

(h) **U.S. air carriers** (International Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such services is available?
Yes.

Yes. Cash Transfer Grant Proceeds can be used to finance shipping fees only if shipping of commodities or equipment is done on privately owned U.S. air carriers.

(i) **Termination for convenience of U.S. Government** (FY 1991 Appropriations Act § 504): If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

N/A.

(j) **Consulting services** (FY 1991 Appropriations Act § 524): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?

N/A.

(k) **Metric conversion** (Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 § 2, and as implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements grants and other business-related activities, except to the extent that such use is impractical or is likely to cause

N/A.

95

significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

20. **Competitive Selection Procedures** (FAA § 601(e)): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes.

21. **Construction**

(a) **Capital project** (FAA § 601(d)): If capital (e.g., construction) project, will U.S. engineering and professional services be used? — N/A.

(b) **Construction contract** (FAA § 611(c)): If contracts for construction are to be financed will they be let on a competitive basis to maximum extent practicable? — N/A.

(c) **Large projects,** Congressional approval (FAA § 620(k)): If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the Congressional Presentation), or does assistance have the express — N/A.

96

approval of Congress?

22. **U.S. Audit Rights** (FAA § 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? — N/A.

23. **Communist Assistance** (FAA § 620(h)): Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — Yes.

24. **Narcotics**

(a) **Cash reimbursements** (FAA § 483): Will arrangements preclude use of financing to make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated? — N/A.

(b) **Assistance to narcotics traffickers** (FAA § 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have reason to believe have either: (1) been convicted of a violation of any low or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been an illicit trafficker in, or otherwise involved in the illicit trafficking of, and such controlled substance? — N/A.

25. **Expropriation and Land Reform** (FAA § 620(g)): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate — Yes.

foreign nationals in accordance with a land reform program certified by the President?

26. **Police and Prisons** (FAA § 660): **Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?** — Yes.

27. **CIA Activities** (FAA § 662): Will assistance preclude use of financing for CIA activities? — Yes.

28. **Motor Vehicles** (FAA § 636(i)): Will assistance preclude use of financing for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? — Yes.

29. **Military Personnel** (FY 1991 Appropriations Act § 503): Will assistance preclude use of financing to pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? — Yes.

30. **Payment of U.N. Assessments** (FY 1991 Appropriations Act § 505): Will assistance preclude use of financing to pay U.N. assessments, arrearage or dues? — Yes.

31. **Multilateral Organization Lending** (FY 1991 Appropriations Act § 506): Will assistance preclude use of financing to carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? — Yes.

32. **Export of Nuclear Resources** (FY 1991 Appropriations Act § 510): Will assistance — Yes.

preclude use of financing to finance the export of nuclear equipment, fuel, or technology?

33. **Repression of Population (FY 1991 Appropriations Act § 511): Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population** of such country to contrary to the Universal Declaration of Human Rights?

Yes.

34. **Publicity or Propaganda** (FY 1991 Appropriations Act § 516): Will assistance be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress?

No.

35. **Marine Insurance** (FY 1991 Appropriations Act § 563): Will any A.I.D. contract and solicitation, and subcontract entered into under such contract include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate?

Yes.

36. **Exchange for Prohibited Act** (FY 1991 Appropriations Act § 569): Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employees, expressly prohibited by a provision of United

No.

States law?

N.B.: PART B OF THE ASSISTANCE CHECKLIST, WHICH IS APPLICABLE TO DEVELOPMENT ASSISTANCE ONLY, HAS BEEN OMITTED BECAUSE IT IS INAPPLICABLE TO THIS ESF-FUNDED PROJECT.

C. CRITERIA APPLICABLE TO ECONOMIC SUPPORT FUNDS ONLY

1. **Economic and Political Stability** (FAA § 531(a)): Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?	Yes, to both questions.
2. **Military Purposes** (FAA § 531(e)): Will this assistance be used for military or paramilitary purposes?	No.
3. **Commodity Grants/Separate Accounts** (FAA § 609): If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? (For FY 1991, this provision is superseded by the separate account requirements of FY 1991 Appropriations Act § 575(a). See § 575(a)(5).)	N/A.
4. **Generation and Use of Local Currencies** (FAA § 531(d)): Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? (For FY 1991, this provision is superseded by the separate account requirements of FY 1991 Appropriations Act § 575(a).	N/A.

91

See § 575(a)(5).)

5. **Cash Transfer Requirements (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund," and § 575(b)): If assistance is in the form of a cash transfer:**

(a) **Separate account:** Are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds?

Yes.

(b) **Local currencies:** Will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account, and has A.I.D. entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of A.I.D. and that government to monitor and account for deposits and disbursements?

Yes.

(c) **U.S. Government use of local currencies:** Will all such local currencies also be used in accordance with FAA § 609, which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available?

Yes.

(d) **Congressional notice:** Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that

Yes.

aV

will be served by the assistance,
and, as appropriate the economic
policy reforms that will be
promoted by the cash transfer
assistance?

93

5C(2) - ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than the eligibility of a country to receive assistance. This section is divided into three parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fun resources. Part B includes criteria applicable only to Development Assistance resources. Part C includes criteria applicable only to Economic Support Funds.

N.B.: Part B has been omitted because it is inapplicable to this ESF-funded project.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE?

Yes, the Country Checklist is contained in the Project Paper for the International Executive Service Corps Project (No. 263-0229).

A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS

1. **Host Country Development Efforts** (FAA § 601(a)): Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

(a) The project will provide financing for technical assistance to assist the GOE in achieving its economic reform program related to the Cash Transfer for Sector Policy Reform. The economic reform program includes specific measures related to the International Trade Sector which are designed to increase the flow of international trade between Egypt and the rest of the world. (b) Policy reform measures related to the Financial, Fiscal and Enterprise Sectors all are designed to foster private initiative and competition. (c) No perceptible impact. (d) Policy reform measures aimed at increasing private sector ownership in Egypt will discourage monopolistic governmental practices. (e) Increased privatization, which is a focal point of the policy reform measures, will result in the need to make a profit which can only occur with improved technical efficiency in industry and commerce. (f) No perceptible impact.

2. **U.S. Private Trade and Investment** (FAA § 601(b)): Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S.participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Cash Transfer grant proceeds, which will be disbursed upon the GOE implementing certain economic policy reform measures, may be used by the GOE to purchase equipment and commodities of U.S. source and origin. It is expected that a significant amount of the grant proceeds will be used to purchase equipment and commodities from U.S. private sector sources, thus encouraging U.S. private trade abroad. The Technical Support for Policy Reform Project will assist the GOE in implementing the required economic policy reform measures.

3. **Congressional Notification**

(a) **General requirement** (FY 1991 Appropriations Act § 523 and 591; FAA § 634A): If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to

Congress has been notified in accordance with regular Agency practice.

Congress, has Congress been properly notified (unless the notification requirement has been waived because of substantial risk to human health or welfare)?

(b) **Notice of new account obligation** (FY 1991 Appropriations Act § 514): If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular notification procedures?

N/A.

(c) **Cash transfers and nonproject sector assistance** (FY 1991 Appropriations Act § 575(b)(3)): If funds are to be made available in the form of cash transfer or nonproject sector assistance, has the Congressional notice included a detailed description of how the funds will be used, with a discussion of U.S. interests to be served and a description of any economic policy reforms to be promoted?

N/A.

4. **Engineering and Financial Plans** (FAA § 611(a)): Prior to an obligation in excess of $500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

Yes.

5. **Legislative Action** (FAA § 611(a)(2)): If legislative action is required within recipient country, with respect to an obligation in excess of $500,000, what is the basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of the

The only legislative action required is customary ratification of the grant agreement by the People's Assembly. This has been obtained without difficulty in the past. Furtherfmore, the signed agreement is

a\b

purpose of the assistance?

legally binding and effective without such ratification.

6. **Water Resources (FAA § 611(b); FY 1991 Appropriations Act § 501): If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, <u>et seq.</u>)? (See A.I.D. Handbook 3 for guidelines.)**

N/A.

7. **Cash Transfer and Sector Assistance** (FY 1991 Appropriations Act § 575(b)): Will cash transfer or nonproject sector assistance be maintained in a separate account and not commingled with other funds (unless such requirements are waived by Congressional notice for nonproject sector assistance)?

N/A.

8. **Capital Assistance** (FAA § 611(e)): If project is capital assistance (<u>e.g.</u>, construction), and total U.S. assistance for it will exceed $1 million, has the Mission Director certified and Regional Assistant Administrative taken into consideration and country's capability to maintain and utilize the project effectively?

N/A.

9. **Local Currencies**

(a) **Recipient Contributions** (FAA § 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

The GOE has agreed to provide any funds in addition to the Grant necessary to carry out the Project effectively and in a timely manner. U.S.-owned Egyptian currency is not available specifically for this Project.

91

(b) **U.S.-Owned Currency** (FAA § 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	No.
(c) **Separate Account** (FY 1991 Appropriations Act § 575): If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies:	There will be no local currency generations within the meaning of § 575.
(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account?	N/A.
(2) Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the purposes of the DA or ESF chapters of the FAA (Depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government?	N/A.
(3) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purpose?	N/A.
(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government?	N/A.

10. **Trade Restrictions**

(a) **Surplus Commodities** (FY 1991 Appropriations Act § 521(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.s. producers of the same, similar or competing commodity?	N/A.
(b) **Textiles (Lautenberg Amendment)** (FY 1991 Appropriations Act § 521(c)): Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?	No.
11. **Tropical Forests** (FY 1991 Appropriations Act § 533(c)(3)): Will funds be used for any program, project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas?	No.
12. **PVO Assistance**	N/A.

(a) **Auditing and registration** (FY 1991 Appropriations Act § 537): If

cfl

assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?

(b) **Funding sources** (FY 1991 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government?	N/A.
13. **Project Agreement Documentation** (State Authorization § 139 (as interpreted by conference report)): Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).	Case-Zablocki Act reporting procedures will be followed with respect to this project.
14. **Women in Development** (FY 1991 Appropriations Act, Title II, under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased?	N/A.
15. **Regional and Multilateral Assistance** (FAA § 209): Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided?	No.

Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

16. **Abortions** (FY 1991 Appropriations Act, Title II, under heading "Population, DA," and § 525):

(a) Will assistance be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?	No.
(b) Will any funds be used to lobby for abortion?	No.
17. **Cooperatives** (FAA § 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life?	No.

18. **U.S.-Owned Foreign Currencies**

(a) **Use of currencies** (FAA §§ 612(b), 636(h)); FY 1991 Appropriations Act §§ 507, the 509): Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.	U.S.-owned Egyptian currency is not available specifically for this Project.
(b) **Release of currencies** (FAA § 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	Egypt is not at present declared an "excess" or "near excess" currency country.

19. **Procurement**

(a) **Small business** (FAA § 602(a)): Are there arrangements to permit U.S. small business to	Yes.

participate equitably in the furnishing of commodities and services financed?

(b) **U.S. procurement** (FAA § 604(a)): Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him?

Yes. Procurement will be from the U.S. and Egypt.

(c) **Marine insurance** (FAA § 604(d)): If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

Egypt does not so discriminate.

(d) **Non-U.S. agricultural procurement** (FAA § 604(e)): If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

N/A.

(e) **Construction or engineering services** (FAA § 604(g)): Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)

N/A.

(f) **Cargo preference shipping** (FAA § 603)): Is the shipping excluded

No. 50/50 shipping rules will apply to this

from compliance with the requirement in § 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates?	project.
(g) **Technical assistance** (FAA § 621(a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract extent practicable? Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?Yes, to both questions.	Yes.
(h) **U.S. air carriers** (International Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such services is available?	Yes.
(i) **Termination for convenience of U.S. Government** (FY 1991 Appropriations Act § 504): If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?	Yes.
(j) **Consulting services** (FY 1991 Appropriations Act § 524): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109,	Yes.

103

are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?

(k) **Metric conversion** (Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 § 2, and as implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements grants and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage? — Yes.

20. **Competitive Selection Procedures** (FAA § 601(e)): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes.

21. **Construction**

(a) **Capital project** (FAA § 601(d)): If capital (e.g., construction) project, will U.S. engineering and professional services be used? — N/A.

(b) **Construction contract** (FAA § 611(c)): If contracts for construction are to be financed will they be let on a competitive basis to maximum extent practicable? — N/A.

(c) **Large projects,** Congressional approval (FAA § 620(k)): If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the Congressional Presentation), or does assistance have the express approval of Congress? — N/A.

22. **U.S. Audit Rights** (FAA § 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? — N/A.

23. **Communist Assistance** (FAA § 620(h)): Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — Yes.

24. **Narcotics**

(a) **Cash reimbursements** (FAA § 483): Will arrangements preclude use of financing to make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated? — N/A.

(b) **Assistance to narcotics traffickers** (FAA § 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have — Yes.

105

reason to believe have either: (1) been convicted of a violation of any low or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been an illicit trafficker in, or otherwise involved in the illicit trafficking of, and such controlled substance?

25. **Expropriation and Land Reform** (FAA § 620(g)): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President? — Yes.

26. **Police and Prisons** (FAA § 660): Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? — Yes.

27. **CIA Activities** (FAA § 662): Will assistance preclude use of financing for CIA activities? — Yes.

28. **Motor Vehicles** (FAA § 636(i)): Will assistance preclude use of financing for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? — Yes.

29. **Military Personnel** (FY 1991 Appropriations Act § 503): Will assistance preclude use of financing to pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? — Yes.

30. **Payment of U.N. Assessments** (FY 1991 Appropriations — Yes.

Act § 505): Will assistance preclude use of financing to pay U.N. assessments, arrearage or dues?

31. **Multilateral Organization Lending** (FY 1991 Appropriations Act § 506): Will assistance preclude use of financing to carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? — Yes.

32. **Export of Nuclear Resources** (FY 1991 Appropriations Act § 510): Will assistance preclude use of financing to finance the export of nuclear equipment, fuel, or technology? — Yes.

33. **Repression of Population** (FY 1991 Appropriations Act § 511): Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country to contrary to the Universal Declaration of Human Rights? — Yes.

34. **Publicity or Propaganda** (FY 1991 Appropriations Act § 516): Will assistance be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress? — No.

35. **Marine Insurance** (FY 1991 Appropriations Act § 563): Will any A.I.D. contract and solicitation, and subcontract entered into under such contract include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for — Yes.

107

marine insurance when such insurance is necessary or appropriate?

36. **Exchange for Prohibited Act** (FY 1991 Appropriations Act § 569): Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employees, expressly prohibited by a provision of United States law? — No.

1 0 6

N.B.: PART B OF THE ASSISTANCE CHECKLIST, WHICH IS APPLICABLE TO DEVELOPMENT ASSISTANCE ONLY, HAS BEEN OMITTED BECAUSE IT IS INAPPLICABLE TO THIS ESF-FUNDED PROJECT.

C. CRITERIA APPLICABLE TO ECONOMIC SUPPORT FUNDS ONLY

1. **Economic and Political Stability** (FAA § 531(a)): Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?	Yes, to both questions.
2. **Military Purposes** (FAA § 531(e)): Will this assistance be used for military or paramilitary purposes?	No.
3. **Commodity Grants/Separate Accounts** (FAA § 609): If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? (For FY 1991, this provision is superseded by the separate account requirements of FY 1991 Appropriations Act § 575(a). See § 575(a)(5).)	N/A.
4. **Generation and Use of Local Currencies** (FAA § 531(d)): Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? (For FY 1991, this provision is superseded by the separate account requirements of FY 1991 Appropriations Act § 575(a).	N/A.

109

See § 575(a)(5).)

5. **Cash Transfer Requirements** (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund," and § 575(b)): If assistance is in the form of a cash transfer:

(a) **Separate account:** Are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? N/A.

(b) **Local currencies:** Will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account, and has A.I.D. entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of A.I.D. and that government to monitor and account for deposits and disbursements? N/A.

(c) **U.S. Government use of local currencies:** Will all such local currencies also be used in accordance with FAA § 609, which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available? N/A.

(d) **Congressional notice:** Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that N/A.

will be served by the assistance, and, as appropriate the economic policy reforms that will be promoted by the cash transfer assistance?

\\\\\\