UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

PUBLIC FINANCE ADMINSTRATION

(263-0209)

PROJECT PAPER AMENDMENT

NUMBER ONE

DATED SIGNED: 01/10/93

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: C (A = Add, C = Change, D = Delete)
Amendment Number: 1
DOCUMENT CODE: 3

2. COUNTRY/ENTITY: Egypt

3. PROJECT NUMBER: 263-0209

4. BUREAU/OFFICE: USAID/Cairo 03

5. PROJECT TITLE (maximum 40 characters): Public Finance Administration

6. PROJECT ASSISTANCE COMPLETION DATE (PACD)

MM	DD	YY
11	30	95

7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4)

A. Initial FY 88 B. Quarter C. Final FY 93

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

A. FUNDING SOURCE	FIRST FY 88			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	(6,236)	(665)	(6,901)	(26,770)	(30)	(26,800)
(Loan)	(-0-)	(-0-)	(-0-)	(-0-)	(-0-)	(-0-)
Other U.S. 1.						
Other U.S. 2.						
Host Country	-0-	1,618	1,618	-0-	4,026	4,026
Other Donor(s)						
TOTALS	6,236	2,283	8,519	26,770	4,056	30,826

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)	650			16,200	-0-	10,600	-0-	26,800	-0-
(2)									
(3)									
(4)									
TOTALS				16,200	-0-	10,600	-0-	26,800	-0-

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

11. SECONDARY PURPOSE CO

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

To improve the efficiency, equity, elasticity and neutrality of the tax system.

14. SCHEDULED EVALUATIONS

Interim MM 02 YY 92 | MM YY | Final MM 03 YY 95

15. SOURCE/ORIGIN OF GOODS AND SERVICES

☐ 000 ☐ 941 ☒ Local ☐ Other (Specify)

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

This amendment justifies continuation with phase II and an increased level of funding. I hereby concur with the proposed methods of implementation and financing under the project.

Concurrence: Douglas L. Franklin
Douglas Franklin, AD/FM

17. APPROVED BY

Signature

Title: Henry H. Bassford, Director

Date Signed: MM 01 DD 10 YY 93

18. DATE DOCUMENT RECEIV. IN AID/W, OR FOR AID/W DOC MENTS, DATE OF DISTRIBUT

MM DD YY

AID 1330-4 (8-79)

memorandum

ACTION MEMORANDUM TO THE DIRECTOR

DATE: December 17, 1992

FROM: (A)/PDS, Robert Jordan

THRU: (A)DDIR, Christopher Crowley

SUBJ: Approval of the Public Finance Administration Project Paper Amendment (263-0209)

PROBLEM:

Your signature is required approving the First Project Paper Amendment for the Public Finance Administration Project (263-0209). The purpose of this amendment is (1) to define the activities to be undertaken during Phase II of the Project and (2) to justify the proposed increase in the level of funding.

DISCUSSION:

The Project Paper Amendment was reviewed by the Project Review Committee on August 16, 1992 and October 27, 1992. An Executive Committee Meeting was held to review the subject Project Paper Amendment on November 5, 1992. The Project Paper Amendment has been modified to reflect the concerns expressed at the latter meeting as follows:

(1) The Log Frame has been reviewed and changes made to increase the measurability of the indicators.

(2) The Implementation Plan has been expanded to include specific benchmarks indicating progress in implementing the tax reforms.

(3) The role of the research units at the department level vis a vis that at the central ministerial level has been clarified.

(4) The economic analysis has been expanded to include citations from other country experience in support of the activities being undertaken in Egypt.

(5) The use of a contract to monitor commodities has been specifically included as an option in the section on implementation.

There are no pending issues and all necessary clearances have been obtained.

JUSTIFICATION:

Delegation of Authority No. 653 redelegates to the Mission Director the authority to amend project assistance authorizations without dollar limitation if (a) the amendment does not present significant policy issues; and (b) the amendment does not require the issuance of waivers which may only be approved in AID/W; and (c) the amendment does not result in total life of Project in excess of ten years. The section of Mission Order 5-4 entitled "Redelegation of Authority to the Deputy Director" redelegates this authority further to the Deputy Director, with the additional provision that the cumulative LOP funding does not exceed $30 million.

RECOMMENDATION:

That you sign the face sheet of the attached First Project Paper Amendment for the Public Finance Administration Project.

Clearance:
(A)AD/EAS, P.Mulligan PM
AD/LEG, T.Carter
AD/FM, D.Franklin

memorandum

DATE: October 28, 1992

FROM: EAS, Iman El Shayeb Iman Aly
A/AD/EAS, Paul Mulligan Paul F. Mulligan

SUBJ: Public Finance Administration (263-0209)

TO: A/OD/PDS/PS, Mary June

The attached Project Paper Amendment has been prepared by EAS and PDS/PS for review by the Executive Committee. The Project Committee met on Sunday, August 16, 1992 and again on Tuesday October 27, 1992 to review the document. The Project Committee and Officers named below have reviewed the document and agree with the format, analysis, and presentation. There are no concerns or issues which need discussion or resolution.

Project Committee	Clearance	Date
PDS/PS, Beth Cypser	BC	10/29/92
PDS/P, Mona El-Shafei	[illegible]	11/3/92
LEG, Peter Sullivan	[illegible]	10/29/92
FM/FA, Kazem Shawky	[illegible]	11/2/92
DIR/CS, Beth Paige	[illegible]	[illegible]
EAS, Mark Gellerson	[illegible]	10/29/92
Mission Environmental Officer	GRW	10/28/92

An Executive Committee Review has been tentatively scheduled for Thursday November 5, 1992 at 1:00 pm in the Large Ninth Floor Conference Room.

SECOND AMENDMENT TO THE PROJECT AUTHORIZATION

Name of Country: Arab Republic of Egypt

Name of Project: Public Finance Administration

Number of Project: 263-0209

1. Pursuant to Section 531 of the Foreign Assistance Act of 1961, as amended, the Public Finance Administration Project was authorized on November 27, 1987, and the authorization was amended on March 2, 1992. The authorization is hereby further amended as follows:

a. Paragraph 1 is amended by deleting the "sixteen million two hundred thousand United States Dollars ($16,200,000)" and replacing it with "twenty-six million eight hundred thousand United States Dollars ($26,800,000)."

b. Subparagraph 3.a. is amended in its entirety to read as follows:

"Source and Origin of Commodities, Nationality of Services

"Except as otherwise provided in the next succeeding paragraph, and except as A.I.D. may otherwise agree in writing, (i) commodities financed by A.I.D. under the project shall have their source and origin in the United States; (ii) the suppliers of commodities or services (other than ocean and air shipping) shall have the United States as their place of nationality; and (iii) ocean and air shipping financed by A.I.D. under the project shall be financed on flag vessels of the United States.

"Notwithstanding the foregoing, local procurement of the commodities and services enumerated in Section 18A1c of Handbook 1B, Chapter 18 (or any successor provision thereto) may be financed under the project to the extent provided in such section without source/origin or nationality waivers."

2. The authorization cited above remains in force except as hereby amended.

Henry H. Bassford
Director

Date

Clearances:

(A)AD/EAS, P.Mulligan PM
(A)AD/PDS, R.Jordan
AD/FM, D.Franklin DSF
(A)OP/PDS/PS, B.Cypser

DRAFTED:LEG:P.Sullivan:mf:(08/18/92):2PATH209

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ACRONYMS AND ABBREVIATIONS

APAU	Administration and Policy Analysis Unit
STD	Sales Tax Department of the Ministry of Finance
TD	Tax Department of the Ministry of Finance

I. EXECUTIVE SUMMARY

The Project Paper Amendment sets forth the scope of activities for Phase II of the Public Finance Administration Project. Phase I accomplished considerably more than was anticipated in the area policy and administration for sales and income taxes, but was less successful in the area of customs. Overall, the Project has been extremely successful to date. It is a Project which has been "in the right place at the right time" and has made major, substantive contributions to the implementation of significant tax reforms undertaken by the Government of Egypt as part of a massive macro-economic stabilization/structural adjustment program. Major accomplishments under Phase I of the Project include: the (unanticipated) introduction of the Sales Tax, development of sophisticated simulation models to show impacts of changes in taxation, and the completion of an exhaustive tax reform proposal presented in a report entitled "A Comprehensive Tax Reform Program for Egypt", which includes recommendations for reform of the income tax, indirect taxes, property taxes, and inheritance taxes; administrative reform requirements; and training needs. In 1991/92, its first year of application, the sales tax increased fiscal revenues by LE 3.0 billion.

However, a great deal remains to be done in Phase II, including the implementation of the general income tax and the extension of the sales tax to the wholesale and retail levels. Failure to carry out Phase II would likely mean that the GOE could not fulfill its commitments to the IMF and World Bank concerning fiscal sector reform and deficit reduction. The magnitude and importance of the tasks being undertaken in the Project, together with the experience gained from Phase I, fully justify continuation of Phase II. Continued support under the Project is critical to support the GOE as it carries out aspects of its economic reform program.

In this Project Paper Amendment, the Project goal and purpose have been clarified as being "to support the GOE's economic reform program", and "to improve the efficiency, equity, elasticity and neutrality of the tax system", respectively.

The rationale underlying the Project continues to be the need for major changes in the administration and structure of both direct and indirect taxes to bring about improvements in elasticity and revenue productivity, as well as in equity, neutrality, and efficiency. These changes are essential if the Egyptian tax system is to facilitate, rather than obstruct, significant and needed economic adjustments currently underway. The strategy to address these needs will continue to consist of a program that focuses on introducing a global income tax, expanding the role of the sales tax, and bringing about tax administrative reforms. The reform of customs will no longer be addressed directly by this Project. Certain aspects of customs and tariff policy reform will enter into the policy dialogue being undertaken by the Mission through the

Sector Policy Technical Support Project. Implementation of Phase II will require additional grant funds of $10.6 million, for a Life of Project total of $26.8 million.

II. PURPOSE OF THE AMENDMENT

The purpose of this Amendment is to define the activities to be undertaken during Phase II of the Project and to justify the proposed increase in the level of funding for the Public Finance Administration Project.

A. PROJECT GOAL, PURPOSE, AND OUTPUTS

The goal and the purpose of the Project have been modified slightly as follows. The goal, which was originally stated as being "to assist the MOF to link the public more equitably with the GOE's expenditure program," has been clarified as being "to support the GOE's economic reform program." The purpose has been broadened to include elasticity and neutrality, and now reads "to improve the efficiency, equity, elasticity, and neutrality of the tax system." Overall Project outputs also remain the same, and can be found in the Logical Framework included as Attachment B. Outputs for Phase II are discussed in Section III.B.

B. OVERALL PROJECT RATIONALE

1. Project Rationale

The original Project Paper highlighted a number of problems. The tax system had failed to keep pace with the growing economy and the demands placed on the system by a rapidly increasing population. As a result, GOE expenditures were largely financed from non-tax resources (such as donor assistance, oil revenues, Suez Canal revenues), which made Egypt's economy increasingly vulnerable to external forces. The tax system itself, having evolved over the decades through various ad hoc amendments, was seriously deficient in terms of its elasticity and revenue productivity, as well as on equity, neutrality, and efficiency grounds. The rationale underlying the Project is the need for major changes in the structure and administration of both direct and indirect taxes to bring about changes in these aspects. These changes are essential if the Egyptian tax system is to facilitate, rather than obstruct, significant and needed economic adjustments currently underway.

a. **Revenue Productivity** - A basic objective of tax reform in Egypt must be to increase the revenue yield to the central government, particularly from income taxes.

b. **Elasticity** - The very low responsiveness of tax revenues to economic growth, which has been a major contributor to the fiscal problems that plagued Egypt during the 1960s, must be improved as part of a sustained and effective program of deficit reduction.

c. **Equity** - An object of any tax reform should be to assure that the tax system is fair, imposing light taxes on the poor, treating those with equal incomes equally, and imposing a somewhat higher share of the tax burden on those with higher incomes. Equity also requires that those who owe taxes in fact pay them, an issue that is particularly relevant in Egypt. In the absence of consensus on this issue, an equal percentage tax liability on all, regardless of income, is a satisfactory outcome and often represents an improvement in equity over the existing situation in many countries.

d. **Neutrality** - Any tax system should interfere as little as possible with the decisions of businesses and individuals in response to market opportunities. In view of the large distortions in economic and financial decisions that result from the existing tax system in Egypt, this principle takes on particular importance as the country increases its reliance on market mechanisms to allocate resources and to promote economic growth.

e. **Efficiency** - Achievement of other tax reform objectives depends upon whether the tax is efficiently administered; that is, whether taxes are assessed quickly and accurately and are paid promptly when due. A key principle underlying the design of a reformed tax and administrative structure is the design of a simple tax structure that is easily understood by both the taxpayers and the tax administration. This would include eliminating duplicative taxes and burdensome methods of collection; removing many taxpayers from the tax rolls; and minimizing the need for filing of tax returns to the extent possible. Modernization of tax administration and the introduction of computerization must be an essential element of a comprehensive tax reform program, particularly in the case of income taxes.

Since the Project was first authorized, the need for fiscal sector reform has taken on added importance in the context of Egypt's on-going economic reform program. Specifically, 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 in-flows.

2. Strategy

The program of comprehensive tax reform for Egypt that has been designed under the Project aims to improve the distribution of tax burdens among Egyptian taxpayers, broaden the tax bases of income and sales taxes, reduce substantially income tax rates for individuals and businesses, and improve the overall elasticity of the revenue system. Such a comprehensive program will have major effects on Egyptian taxpayers and on the economy as a whole. In addition, the program has been constructed to maintain overall government revenues at the same time that the structure of the tax system is improved. The revised strategy for implementing this program contains the following elements based on evaluation of progress under Phase I and changes resulting from GOE fiscal reform.

a. **Introduction of Global Income Tax** - First and foremost is the introduction of a global income tax to replace the existing schedular system of income taxes. A global income tax is the centerpiece of the comprehensive tax reform program and the foundation for achieving all of the major objectives outlined above. The basic proposal is to replace the present complex, inequitable, and overlapping set of income tax rates by a single schedule of rates applicable to income from all sources. Income taxes are projected to account for 45% of tax revenues in FY 1992/93.

b. **Expansion of the Role of Sales Taxation** - The recent introduction of a broad-based sales tax at the manufacturing and import level has been a reform of paramount importance. The new tax, which is projected to account for 25% of tax revenues in FY 1992/93, provides a strong foundation on which future indirect tax reforms can build. In the years ahead, the role of the sales tax should be increased through expansion of the tax base to include more services and to include transactions at the wholesale and retail levels.

c. **Administrative reforms** - Structural and policy reform, to be fully successful, must be integrated with a broad range of administrative reforms and modernization efforts. The key to modernization of tax administration in Egypt is computerization. Computerization has been a major priority in implementing the sales tax, and an operational system is quickly being put in place. The longer-term program to modernize the administration of taxes will also create a need for organizational reform, which will provide an opportunity to more effectively use existing personnel.

C. PROGRESS DURING PHASE I AND JUSTIFICATION FOR CONTINUED SUPPORT

1. Progress During Phase I

The original Project Paper divided Project activities into the following four functional categories: Administration and Policy Analysis, Income Tax Administration, Customs Administration, and Excise Taxation. The original PP also envisioned a two stage process, consisting of Phase I which focused on analysis and design of a tax reform proposal and a Phase II which was to undertake the implementation of those reforms acceptable to the GOE. Generally speaking, by the end of Phase I, the Administration and Policy Analysis Component was to have produced a comprehensive policy reform agenda, while at the same time, the operational and procedural programs necessary to implement a tax reform package, if enacted, would have been pilot tested in the Income Tax Administration Component, the Customs Administration Component and the Excise Taxation Component. The field testing would have concentrated on standardization of processes, improved management information, and expanded training capacity.

During Phase I, outputs were further refined and focussed. External events significantly altered the original component activity mix and schedule. Under its Standby Agreement with the IMF, the GOE committed itself to implement a broad-based sales tax by mid-1991. Thus, rather than being limited to study and policy formulation as planned, much of Phase I was devoted to drafting legislation, training employees, preparing forms, and generally assisting the GOE implement the sales tax. Significant Project resources were contributed to this effort. Simulation models of the recommended administrative, operation, and procedural reforms had to be developed to assess the potential impact of the reforms. Nevertheless, a complete policy reform agenda was produced by the contractor as required prior to the end of Phase I.

The following outlines the major accomplishments realized under Phase I. Further detail is provided in Section II.C.2.

a. <u>**Policy and Administration Component**</u> - The accomplishments of this component are packaged as a final product in a report entitled "A Comprehensive Tax Reform Program for Egypt", and includes recommendations for income tax, indirect taxes, property taxes, inheritance taxes, administrative reform requirements, and training needs. These recommendations are accompanied by analyses, based on simulation models, of their impact on individual and corporate taxpayers, the public and private sector, and revenue levels. The report provided a conservative assessment of the likely net increase in revenues that would flow to the GOE from introduction of the comprehensive tax reform and modernization program. Following implementation of sales tax reform in 1991 which resulted in an increase in tax revenues of more than LE 3 billion, subsequent analysis has concluded that expansion of the sales tax to the retail level, as planned during Phase II, will add a further LE 1 billion, while efforts to improve the administration of sales tax could realistically be expected to increase this amount by at least another LE 0.5 billion, for a total increase in sales tax revenues of 4.5 billion. Income tax reform can be expected to produce substantial additional tax revenues for the GOE as well, as the tax base is expanded and compliance is improved. Although the amount of revenue increase from income tax reform and modernization is dependent upon the policies ultimately adopted by the GOE, an increase in income tax revenues of LE 1 to 2 billion in the first full year of implementation is likely.

b. **Excise Tax Component** - The most significant fiscal reform in Egypt for many decades was the introduction of the sales tax in May 1991. While a sales tax had been contemplated since 1978 and draft legislation had previously been prepared, the GOE had seriously underestimated the level of effort that remained in order to implement such a task, and the sales tax was not included in the original Project design. However, the GOE was committed under its Stand-By Arrangement with the IMF to implement a sales tax before the Summer of 1991. The Project contractor was approached to assist in the effort and its contract with AID was appropriately modified by, in effect, replacing a very modest level of effort anticipated to improve excise tax administration by a major effort in policy and administrative reform resulting in an implemented sales tax. The contractor accomplished all of the tasks required to implement a sales tax during Phase I. Sales tax revenues for the first year of the program were LE 3.0 billion, well above the projections initially forecast for the tax reform program.

This tax both broadened the base and simplified the rates of the pre-existing consumption duty. Although further expansion and changes in the sales tax and the accompanying excise taxes are desirable, this major reform of the indirect tax system should, over time, produce sufficient revenue to eliminate the archaic, complex and inefficient stamp duties and other miscellaneous taxes on various kinds of transactions. The new sales tax could also help to replace revenues from reductions in taxes on foreign trade. Such tax reductions are desirable over the longer term to lower the dependence on trade as a revenue source and to narrow the dispersion of taxes on trade in order to promote a more efficient allocation of resources.

c. **Income Tax Component** - The key accomplishment under this component was the set of recommendations defined in the "Comprehensive Tax Reform Program" document mentioned previously. Just as the introduction of a broad-based sales tax was the cornerstone of indirect tax reform, introduction of a global income tax is the cornerstone of direct tax reform. In keeping with major income tax reforms that have taken place around the world in the last decade, the Global Income Tax is characterized by a substantially broadened tax base and greatly reduced tax rates. The structure of the global tax, and the recommendations for how it is administered, however, have been tailored to the unique characteristics of the Egyptian economy.

Partly because resources and attention were diverted in the rush to implement the sales tax, some of the income tax work originally foreseen in the Project Paper for Phase I was slowed. However, by the end of Phase I, the foundation for the income tax reform had been established, with the need for reform clearly identified. Some initial steps in computerization had also been taken.

d. **Customs Tax Component** - During Phase I, a PASA team was brought to assist the Customs Department of the Ministry of Finance in: data collection and analysis, formulation of a policy reform agenda, and preparation of training and procurement plans. The team identified a variety of standard administrative reforms from which Egypt and the international trading community would benefit and completed an ADP proposal. However, it was not able to elicit significant support for these reforms from the GOE or formulate a comprehensive customs policy reform agenda.

2. Justification for Continued Support and Expected Accomplishments During Phase II

The Policy & Administration, Excise (Sales) Tax, and Income Tax components have been extremely successful to date. This conclusion is validated by both a recently-completed external evaluation and the comments of the Project's principal GOE counterpart, the Minister of Finance, who has described the contractor team as the best technical assistance team he has had the opportunity to work with. The contractor team, which provided technical assistance for these components, played a key role in supporting the 1991 implementation of the broad-based sales tax. The GOE did not have the in-house expertise to effectively design and implement the sales tax, yet its implementation was central to the GOE's efforts to fulfill its commitments to the IMF and World Bank by significantly reducing the size of the budget deficit. Essentially the same argument can be made with respect to the technical assistance team's role in supporting the implementation of a global income tax. The GOE is committed to implement such a tax within FY 1992-93, but does not have the expertise to do so on its own. Thus there is a continuing need for high quality technical assistance to support reform of Egypt's fiscal sector.

Termination of the National Tax Component at the present stage would be highly disruptive to the GOE's fiscal situation. The work is critical to helping the government meet its obligations under the economic reform program and it is highly improbable that the GOE could sustain the new sales tax or implement a revised income tax without the kinds of assistance envisioned for Phase II. Economic reform cannot succeed without proper implementation, and projects such as this are an important means of assuring that this occurs. USAID is at present the only donor doing serious work in implementation of tax reform.

It would be highly undesirable to abandon the government with a partially implemented sales tax and an income tax reform in its earliest stages. A great deal remains to be done in Phase II to extend the sales tax to the wholesale and retail level and to complete the administrative reforms and training programs that will be needed to enable the GOE to sustain the system on its own. Computerization needs to be enhanced at the central level and expanded to the district offices.

Similarly, work on the income tax is still at a relatively early stage, and much needs to be done to implement a global income tax once the GOE passes the requisite legislation. In addition to procedures, manuals, and forms, educational materials must be prepared for the public. Under computerization, applications for income tax administration must be completed and the computerized system must be expanded to all district offices.

There is still need for further policy analysis and for transferring the technology of tax policy analysis to the GOE. A number of income tax models are planned for completion during Phase II, the indirect tax models previously completed will be updated and revised, and training undertaken on the models. Establishing a tax research capability as originally envisioned for Phase I will be key to ensuring that the government will be able to sustain its new system when external support ends.

As mentioned above, the tax system should facilitate the economic adjustments underway, especially the reduction of the budget deficit through larger revenues. In addition, a reasonable tax system is a necessary condition for sustainable economic growth, particularly growth that depends on something more than agriculture and the informal sector. The overall reform program is removing many of the impediments to economic growth, but significant growth has not yet occurred and is unlikely until the private sector gains sufficient confidence to make investments in the new competitive environment. This new environment will include competition from imports and other domestic producers, plus the absence of price controls, quality restrictions and similar factors that made life comfortable in the past. Given this situation, an equitable, efficiently administered and predictable tax system is necessary in order to eliminate this source of uncertainty and risk. The recent imposition of the sales tax and the aggressive collection of individual and corporate taxes in the past two years have sensitized businessmen to the desire of the Government to collect revenues. Continued reform of the policies and administration of the sales, income, and customs taxes is necessary to insure that businessmen and other citizens understand that taxes are levied fairly on all groups in society. Furthermore, they need to realize that evasion is not necessary to remain competitive or to justify new investment.

Continuation of the project is required because much remains to be accomplished before the tax system can both facilitate and contribute to growth. The sales tax must be expanded to include wholesale and resale levels. A transition is necessary to convert the sales tax to the more complex, but economically superior, value added tax. Work on the income tax has begun, but the expenditures made so far would be wasted without continuation of it. While the income tax reforms may not produce the large increments in revenue that the sales tax did, they will be substantial. A significantly greater tax collection effort in 1991/92 resulted in an increase of income tax revenues of LE 4.2 billion, or 52% over the previous year. Institutional changes are necessary to maintain and increase this change. The growth in revenue may permit a reduction in rates, which is likely to be beneficial to economic growth. The increased revenues also will be beneficial because they will reduce the budget deficit, help control inflation, and allow the Government to provide essential infrastructure and social services.

III. ACTIVITIES UNDER THE PROJECT

A. ORIGINAL PROJECT DESIGN AND EVOLUTION

The original Project Paper divided Project activities into the following four categories: Administration and Policy Analysis, Income Tax Administration, Customs Administration, and Excise Taxation. The original PP also envisioned a two stage process consisting of a Phase I which focused on analysis and design of a tax reform proposal and a Phase II which was to undertake the implementation of those reforms acceptable to the GOE.

- The Administration and Policy Analysis Component was to provide a staff and coordinating role, with its activities centering on monitoring, research, analysis of priority non-technical issues, and the development of a central management information system.

- The Income Tax Administration Component was to act on various recommendations from the predecessor Tax Administration Project, as well as formulate recommendations in areas of functional taxation systems, legislation, data processing, and human resource development.

- The Excise Taxation Component was concerned with improved policy and administration and efficiency of excise tax processes and procedures.

- The Customs Administration Component was to provide recommendations on a customs policy reform agenda and to focus on improvements in the efficiency of customs operations as it relates to private sector operations.

All technical assistance under the Project, except that for customs, was provided through a competitively awarded contract to KPMG Peat Marwick. Phase I planned outputs were further clarified and focused during project implementation, and then documented through modifications to the contractor's scope of work. Simulation modeling of the reforms recommended by the contractors was added to the responsibilities carried out under the Administration and Policy Analysis Component. Generally speaking, computerization and training activities initially seen as primarily Phase II activities were moved ahead and begun in Phase I. The Project took sole responsibility for developing comprehensive computer systems for the introduction of the sales tax because there was no internal Sales Tax Department capacity in this area. With respect to income tax computerization, the original PP did not envision the breadth of computerization effort needed and the TA that was ultimately required. The cost of computer hardware and software to computerize most of the district offices was also not envisioned in the original PP, even though it is essential to successful computerization.

The modified Phase I work program also reflects the fact that the technical assistance contractor was drawn, early in the Project into a GOE crash program to implement a Sales Tax, a task that had not been included in the original Project design. The amended contract required support for: the analysis of the revenue and economic effects of the sales tax program; review of implementing legislation and Ministerial decrees; development of a comprehensive training program for the new Sales Tax Department; development of materials and plans for registering business; and design of the organizational structure of the new Sales Tax Department and its procedures for collection. The contractor was also required to take lead responsibility for developing a computerized sales tax processing system, in terms of hardware procurement, software development, and training.

B. ACTIVITIES UNDER THE PROJECT

1. Progress to Date

During actual implementation it became clear that policy could not easily be divorced from the relevant tax administration. In effect, the three major components related to taxes (Administration and Policy, Income Tax, and Excise Tax) have been combined. Therefore this document divides the Project activities into two overall components: National Tax Policy and Administration (consisting of income and sales taxes) and Customs Policy and Administration. For each of the components, the following sections describe progress to date under Phase I.

a. National Tax Policy and Administration Component - In the area of policy analysis, the following specific tasks were accomplished: completion of a tax reform policy agenda, including draft legislation; formulation of tax administration reform plans for the respective taxes, as well as implementation plans; completion of special studies of property and inheritance taxes and recommendations for reform; and development of at least twenty-seven special studies of various tax issues, in addition to the modelling efforts, which provide the analytic basis for the recommendations that were made in the final report.

The final product of this effort, entitled "A Comprehensive Tax Reform Program for Egypt," covers the income tax, indirect taxes, property taxes, inheritance taxes, administrative reform requirements and training needs. The reform agenda has as its objectives: increasing the revenue elasticity of the Egyptian tax system; improving the fairness of the tax system; eliminating many tax-induced distortions in the economy; simplification of the tax system; and modernizing the administration of the system. Major components of the reform package are a proposal for a unified Income Tax to replace a number of schedular income taxes, the substitution of a VAT-type sales tax to replace the various quantity-based consumption taxes, and the reform of the property and inheritance taxes to improve administration. If fully enacted and properly administered, the proposed reforms would result in improvements in both efficiency and equity. The new system would also be considerably more neutral in its effects on economic incentives than the present one, with its bias in favor of public over private sector borrowing and of debt over equity financing. The proposed tax reform would make the overall tax system simpler to administer and control. This, combined with computerization and training, will vastly increase the efficiency of tax collection. Already, the revenue effect of the Sales Tax, in its first year of implementation, was a net increase of over LE 3.0 billion.

With respect to the sales tax, the following specific tasks were accomplished: review and final preparation of the draft legislation; recommendations to assist in the implementation of assessment and collection of sales tax; development of computer software, including Arabic software, required to increase the capability to record, store and retrieve information; purchase and installation of required computer hardware; development of new forms and desktop publishing capacity to continue their production; development of the master taxpayer file and identification numbers; development of a sales tax model and utilization of it to analyze the effects of variations in different elements of the tax; and development and translation of a general sales tax guide for registered businesses and tax collectors.

With respect to income tax, the following specific tasks were accomplished: computerization of tax functions of the Tax Department; development of new initiatives to improve administration; preparation of recommendations for the creation of a taxpayer identification and tracking system; finalization of arrangements for field testing of ADP plans for the Tax Department functions at pilot offices; preparation of a draft of proposed policy and administrative reforms, although the final plan must depend on the nature of the law that the GOE actually adopts.

With respect to training, the following specific tasks were accomplished: training Sales Tax Department staff in the use of the computer hardware as well as in administration; training trainers; development of recommended steps for expanded management and technical training; training for computerization of the Tax Department; and design of a training plan for the Tax Department.

Phase I implementation of the National Tax Component cost considerably more than was anticipated in the Project Paper ($8.50

million vs. $4.45 million). This was primarily because of two factors: First, the significantly greater than planned (195%) usage of short term technical advisors. This reflects both the accelerated implementation of the general sales tax as well as the now-accepted view that high quality technical assistance relating to tax policy is more labor intensive than originally thought. Second, commodity procurement for Phase I of this component was over $1 million more than was planned for Phase I in the original Project Paper. This additional equipment was essential to equip the Sales Tax Department to cope with the changes required by the new tax.

b. Customs Policy and Administration Component - An external evaluation of Phase I of the Customs Component was recently performed. Results suggest that the PASA team was successful in identifying a variety of standard administrative reforms from which Egypt and the international trading community would benefit. These relate mostly to the adoption of various internationally accepted customs conventions dealing with tariff structure and classification, valuation, and general customs procedures. The PASA team also put together a proposal for a comprehensive automated data processing system which would facilitate the determination of customs duties and the analysis of customs-related data.

However, the team was not able to elicit significant support for these reforms from the GOE. More importantly, it was not able to formulate a comprehensive customs policy reform agenda which would contribute to the task of integrating Egyptian Customs into what is a rapidly evolving indirect tax system. As a result, Mission management did not extend the PASA agreement beyond the end of Phase I.

2. Activities Planned for Phase II of the Project

The activities planned for implementation during Phase II will support the implementation of the tax reforms identified and/or initiated during Phase I. Such reforms will focus on: broadening the base of the general sales tax to include wholesale and (possibly) retail levels, implementation of a global income tax, and on improving tax administration. Thus the assistance team will be involved in drafting of tax legislation, training, computerization, procurement, and general implementation support. Customs reform will not be included at this time because of lack of progress during Phase I and because of the failure to develop a collaborative working relationship with the implementing agency.

The original PP anticipated that a research unit would be established in the MOF during Phase I. Since this did not happen, it will need to be a key activity in Phase II, both for the Sales Tax and the Income Tax Departments. Rather than a single MOF research unit, research capability will also be installed and strengthened within each of the departments assisted under the

National Tax Component. The research units at the level of the Sales Tax Department and the Tax Department will focus on implementation level issues such as procedures and administration. The central level research unit, reporting to the Minister, will focus on policy level issues, legislative changes, and modeling to support these. Staff must become proficient in tax modeling, revenue forecasting, and in using the software developed for this Project to analyze future modification of tax rates and other elements of the tax system. Technology transfer will not be complete until these departmental units are operational and intellectually self-sufficient.

3. Major Phase II Outputs for the National Tax Component

- **A fully implemented global income tax.** This will be achieved through technical support to the Tax Department as it prepares for and implements the planned reform of the income tax and other taxes administered by the Tax Department. The Tax Department's ongoing tax administration operations will also be upgraded through technical assistance in administration and policy analysis.

- **The general sales tax fine tuned and broadened in coverage at least up to the wholesale level.** This will be achieved through technical support to the Sales Tax Department as it prepares for and implements the planned expansion of the sales tax to include additional services and the wholesale and retail trade sectors. Technical assistance will also be provided to the Sales Tax Department in administration and policy analysis on issues related to the efficient operation and administration of the existing sales tax.

- **A fully operational ADP system, together with appropriate software, in place for the Income Tax Department down through the main district offices.** This will include: finalization of a long-term system design and plan, development of expanded applications for the tax administration software currently being developed, and expansion of the computerized income tax system to the main district offices.

- **An expanded computerization of sales tax administration and ADP capability in place to support the sales tax processing system.** This will include: enhancement and fine tuning of the computer system at the central level, expansion of the computerized sales tax system to the District offices, preparation of additional management information reports, and formal and on-the-job computer training.

- **Comprehensive income and sales tax training programs developed**--including appropriate curriculum and equipment as funded by the Project.

- **The establishment of research and analysis capability** with fully trained staff in the Income and Sales Tax Departments.

- **Simulation model completion, updating and revision**, with model transfer and training.

4. <u>Planned Phase II Inputs for the National Tax Component</u>

US Long Term TA	324	PM
US Short Term TA	106	PM
Egyptian Professional Staff	408	PM
Egyptian Short Term TA	36	PM
US Training Assistance	48	PM
Commodities		

IV. SUMMARY ANALYSES

A. SUMMARY TECHNICAL ANALYSIS

During Spring of 1992, two evaluations were undertaken for the Project, as a pre-condition for continuing with Phase II.

The first of these evaluations entitled "Phase I Evaluation Report: Administration and Policy Analysis Component, Income Tax Administration Component and Local Finance Component" and dated February 26, 1992 made the following major recommendations: (1) The Mission should proceed to Phase II with the Sales Tax, Income Tax, and Policy Analysis components of the project and reinforce its efforts to ensure that a policy analysis unit is established in the Ministry of Finance. (2) If the Mission decides to proceed with further technical assistance in the customs component under Phase II of the project, it should seek to establish a delivery mechanism that will ensure free communication and coordination between those working on customs reform and those working on other areas of the revenue system. (3) Resource levels permitting, the Mission should proceed with work in local public finance in Phase II, but adjust its expectations regarding what it intends to achieve, aiming at more narrowly fiscal, rather than political-economic, objectives.

The second of these evaluations entitled "Phase I Evaluation Report: Customs Component" and dated March 3, 1992 had the following major conclusions: (1) Continuation of the project would be of benefit to Egypt because a modernized customs service based on a modernized law would bring benefits by way of efficiency and the ability to operate on a risk-based system of customs control. (2) Whether it should continue as originally planned is doubtful as the Customs Department has lost confidence in the PASA COP. If the project is to proceed, the MOF and the Customs Department must commit themselves unequivocally to giving it their full support, and appoint a liaison officer of senior rank to work with the implementation team appointed by USAID. (3) If further tenders were to be invited from private contractors the successful contractor would have the benefit of the PASA team's papers (presumably) but would almost certainly have to carry out his own evaluation of the requirements.

B. SUMMARY ADMINISTRATIVE ANALYSIS

The various tax departments constitute separate entities within the Ministry of Finance. Each reports to the Minister through its commissioner or undersecretary. The Sales Tax Department administers the newly instituted Sales Tax at the point of production and is also responsible for the administration of the remaining consumption taxes. A reorganization plan was approved by the Department and has been sent to the Central Agency for

Organization and Management for their concurrence. Computerization of the Sales Tax Department's activities has begun. The Tax Department administers all of the schedular income taxes, the general income tax, stamp duties and related levies, the inheritance tax, and other miscellaneous duties. As the structure of the tax law changes in a fundamental way, changes can also be expected in the Department's organizational structure. Computerization of income taxes is moving ahead slowly. Historically, the structures of both the Income Tax Department and the Sales Tax Department have included an office that carried out research; however, these units appeared to be geared to the legal issues. Expansion of the Departments' ability in the area of research to include the analysis of the economics of taxation should be undertaken. The Customs Administration is responsible for carrying out valuation and administering all tariffs, as well as administering the sales tax at point of import.

Overall policy direction and policy dialogue is the responsibility of a Project Policy Committee composed of the Minister and commissioners of the Income Tax Department, the Customs Administration, and the Sales Tax Department. A Steering Committee, consisting of operational counterparts as Project Liaison Officers in each functional area, did not function as planned and did not take on the necessary coordinating role. It was also found that the caliber and dedication of the individual serving as Project Liaison Officer was critical to ensuring the success of the various components. The Project Liaison Officer for Sales Tax has been in place and active since June 1990. A new Project Liaison Officer for Income Tax has been recently named. In the case of the Customs Component, an appropriate Project Liaison Officer has not been forthcoming. This, among other things, has hindered the implementation of that component.

C. SUMMARY ECONOMIC ANALYSIS

The GOE embarked upon a comprehensive economic reform program, which focuses on macroeconomic stabilization and medium term structural adjustment. The vital contribution which the Project makes to the overall reform program constitutes the principle economic justification for the Project. The Project provides direct assistance to the GOE for addressing a critical macroeconomic stabilization issue, the budget deficit, through the introduction of a limited general sales tax, as well as a global income tax. The Project also supports the GOE's efforts to introduce structural adjustments aimed at improving the economy's efficiency and competitiveness by reducing the extent of tax-induced distortions in the economy and permitting resources to be used where they are most productive.

D. SUMMARY FINANCIAL ANALYSIS

The Financial Analysis estimates funding requirements for the Project based on the implementation experience to date. It then compares these estimates with those provided in the original Project Paper and identifies the areas of where additional levels of input and or funds are required.

V. SUMMARY ILLUSTRATIVE FINANCIAL PLAN

A. USAID CONTRIBUTION

While the activities to be carried out in Phase II of the National Tax Component are largely the same as those established in the Project Paper, the projected cost of Phase II of this Component has increased from $6.2 million projected in the 1987 Project Paper to $17.85 million, requiring an additional $10.6 million. As in the case of Phase I, and as described in greater detail in Annex C, this is largely the result of: (1) greater than anticipated labor inputs and procurement, especially to implement the Sales Tax component, and (2) higher costs per person month in order to obtain the caliber of expertise required.

There is a consensus that the magnitude and importance of the task involved, together with the experience gained from Phase I, fully justify the increased expenditure on Phase II. Failure to adequately fund Phase II would likely mean that the GOE could not fulfill its commitments to the IMF and World Bank concerning fiscal sector reform and deficit reduction. In this context, the additional cost of Phase II is a good investment in a tax reform program that, when fully implemented, will generate additional tax revenues on the order of LE 5.5 billion per year, improve the efficiency of the tax system, and generally help the GOE stay on track with its economic reform program.

The current A.I.D. authorized level of the Project is $16.2 million. The Project is currently fully obligated at this level, with earmarks to date totalling $15.6 million. Table I outlines the actual expenditures to date under Phase I of the Project and projected expenditures for Phase II, for a total of $26.8 million. Contingency has been estimated at approximately 0.2% of Project costs and inflation at 5.0% for each remaining year of the Project.

Table II shows the present level of earmarks under the Project by line item and the expected commitments during the remainder of the Project. The methods of implementation and financing for the inputs under each activity remain the same as those indicated in the original Project Paper.

B. HOST COUNTRY CONTRIBUTION

The GOE contribution consists of in-kind contributions of the recurrent costs associated with the Project-related operations, including: facilities, office space, ADP maintenance, training logistics, and the MOF project counterparts. The USAID Project Officer will be working closely with staff of the Tax Department and the Sales Tax Department in order to establish a system for monitoring, verifying, and reporting on the GOE in-kind counterpart contributions to the Project.

C. EXPENDITURES AND COMMITMENTS

TABLE I

PROJECTED EXPENDITURES	Phase I Actuals	Phase II Projections	Project Total
NATIONAL TAX COMPONENT			
US Long Term TA	$3,367	$8,709	$12,076
US Short Term TA	$2,801	$2,841	$5,643
Egyptian Long Term TA	$283	$733	$1,016
Egyptian Short Term TA	$29	$65	$94
US Training Assistance	$75	$1,292	$1,367
Commodities	$837	$4,214	$5,051
Component Total	$7,393	$17,854	$25,247
CUSTOMS COMPONENT			
US Long Term TA	$875	$0	$875
US Short Term TA	$133	$0	$133
Egyptian Long Term TA	$11	$0	$11
Egyptian Short Term TA	$104	$0	$104
US Training Assistance	$11	$0	$11
Commodities	$35	$0	$35
Component Total	$1,169	$0	$1,169
Evaluation/Audit/Conferences	$23	$297	$320
Contingency	$0	$65	$65
TOTAL USAID CONTRIBUTION	$8,585	$18,215	$26,800
TOTAL GOE CONTRIBUTION			$4,026
PROJECT TOTAL			$30,826

TABLE II

PROJECTED EARMARKS	Earmarks as of 6/30/92	Projected Earmarks	Total Earmarks
Mobilization	$22	$0	$22
National Tax Component	$14,377	$10,848	$25,225
Customs Component	$1,169	$0	$1,169
Evaluation/Audit/Conferences	$23	$297	$320
Contingency	$0	$65	$65
TOTAL USAID CONTRIBUTION	$15,590	$11,210	$26,800

C. AUDITS

During the life of this Project, non-federal/recipient audits will be performed to determine whether the recipients have properly accounted for and used A.I.D. 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 ensure funds are available for audits (see budget line item in Table I) in accordance with AID/W guidance dated 3/31/92 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, NFAs). A non-federal audit of the technical assistance contractor's project financial records is currently being scheduled for early CY1993.

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 requested by USAID, if deemed necessary.

VI. IMPLEMENTATION

A. TECHNICAL ASSISTANCE PROCUREMENT PLAN

Under the Project, technical assistance for Phase I of the National Tax Component was initially obtained through a Direct Contract that was awarded competitively. The contract includes provisions which allow the contract to be extended up to five years; however, the scope of work only fully defines the work to be undertaken during Phase I. Therefore, the Office of Contracting Services determined that the five year option could not be exercised in this instance. Given the time constraints that came into play as a result of this determination, a Mission-issued sole source justification enabled a one-year extension of the initial contract for the initiation of Phase II activities. Given the importance of ensuring that the present momentum engendered by the present team is not lost, the Mission requested a waiver of competition from AID/W for the final two years of Phase II of this component. This waiver was approved by AID/W on 10/14/92. This approach supports AID's "Buy America" policy, since the technical assistance contract will be with a US firm.

Therefore, Phase II will require an extension of the Peat Marwick contract for technical assistance under the National Tax Component from 7/1/93 to 6/30/95. Preparations for negotiating the remaining two years will start as soon as the Project authorization amendment process is completed.

The following chart outlines the anticipated technical assistance levels of effort for each of the components, totalling 360 person months of US long term TA, 118 person months of US short term TA; 408 person months of Egyptian professional staff, and 36 person months of Egyptian short term TA.

TABLE III
TECHNICAL ASSISTANCE - LEVEL OF EFFORT (PM)

NATIONAL TAX COMPONENT (7/1/92 thru 6/30/95)	Year 1	Year 2	Year 3	TOTAL
Long Term US TA	—	—	—	—
Chief of Party: Senior Public Finance Advisor	12	12	12	36
Project Manager	12	12	12	36
Income Tax Administration				
Senior Income Tax Administrator	12	12	12	36
Income Tax Administrator	24	24	24	72
MIS Specialist	24	24	24	72
Sales Tax Administration				
Sales Tax Administrator	12	12	12	36
MIS Specialist	12	12	12	36
Training (Income & Sales)				
Training Advisor	12	12	12	36
SUBTOTAL Long Term US TA	120	120	120	360
Short Term US TA - Consultants & Home Office				
Policy analysis (Income & Sales)	10	11	7	28
Tax administration (Income & Sales)	13	10	7	30
Modeling (Income & Sales)	12	9	3	24
Computerization (Income & Sales)	8	8	8	24
Training (Income & Sales)	4	4	4	12
SUBTOTAL Short Term US TA	47	42	29	118
Long Term Egyptian Professional Staff				
Office Administrator	12	12	12	36
ADP Advisor	72	72	72	216
Tax Administration Specialist	12	24	24	60
Economist/Researcher	36	12	12	60
Expeditor/Procurement Specialist	12	12	12	36
SUBTOTAL Long Term Egyptian Staff	144	132	132	408
Short Term Egyptian TA				
Tax Administration Specialist	12	12	12	36

B. TRAINING PROCUREMENT PLAN

The training strategy developed during Phase I emphasizes in-country training, supported as required by opportunities for observational trips and/or international seminars/conferences. This developed in recognition of the following: participant training is relatively costly and therefore can support only limited numbers of individuals; participant training is likely to be constrained by English language capability of trainees, despite pre-departure language training; technical assistance under the

Project will be of limited duration, thereby making it imperative that a sound training capability be institutionalized within the implementing agencies to address their long term needs; and adequate in-country training is already available in some important technical areas, particularly in the area of computerization.

Training will be provided under Phase II through the mechanism of the technical assistance contract, which will include both long and short-term advisors to carry out the required training. The planned Level of Effort for these advisors is summarized in the preceding section. Updating of the Phase I training plans, appropriate selection methods, backstopping, and coordination will also be included in the scopes of work under the technical assistance contracts. The local costs of implementing these workshops and training seminars (e.g., per diem, transportation, etc.) will be the responsibility of the GOE, as part of their contribution to the Project.

If relevant opportunities for out of country training (such as international conferences, workshops, or consultation travel) are subsequently identified and included in the revised training plan, these may be funded under the Project on a case-by-case basis following approval by the USAID Project Officer.

C. COMMODITIES PROCUREMENT PLAN

The commodity procurement under Phase II primarily consists of computer equipment, as well as training aids and equipment, for the Sales Tax Department and the Tax Department. In addition, limited additional commodity support will be funded for the contractor, given the increase in team size during Phase II. The technical assistance contract will include the procurement of the commodities for both the implementing agencies and the contractor offices, either as a subcontract with a PSA or directly by the contractor but subject to limitations on overhead calculations. The following table provides the details of the commodities anticipated for procurement under the Project, indicating those that have been procured in Phase I and those planned for Phase II.

A procurement plan has been developed by the technical assistance contractor as part of the statement of work under the Phase I contract for the National Tax Component. Procurement for these institutional strengthening commodities will be carried out either by contractor staff or through a subcontracted Procurement Services Agent (PSA). For the purposes of this analysis, estimates of commodity requirements have been included on an illustrative basis for this component to reflect the recommendations put forth under Phase I.

TABLE IV COMMODITY REQUIREMENTS	Phase I	Phase II	TOTAL
COMPUTER SYSTEMS			
National Tax Component			
–Tax Department			
Single User 286 System	1	0	1
Single User 386 System	9	0	9
Multi User 386 System	1	0	1
Multi User 486 System	0	180	180
SUBTOTAL Tax Department	11	180	191
–Sales Tax Department			
Single User 386 System	8	0	8
Multi User 386 System	9	44	53
Single User 486 System	1	0	1
Multi User 486 System	1	0	1
SUBTOTAL Sales Tax Department	19	44	63
–Project Team			
Single User 286 System	11	0	11
Single User 386 System	2	4	6
Multi User 386 System	2	0	2
SUBTOTAL Project Team	15	4	19
Customs Component			
–Egyptian Customs Authority			
Single User 286 System	3	0	3
Single User 386 System	1	0	1
Multi User 386 System	0	0	0
Multi User 486 System	0	0	0
SUBTOTAL Customs Authority	4	0	4
PROJECT TOTAL: Computer Systems	49	228	277
PROJECT TOTAL: Computer User Units	90	1,260	1,350
VEHICLE			
National Tax Component			
–Tax Department	0	2	2
–Sales Tax Department	0	0	0
–Project Team	3	1	4
Customs Component			
–Egyptian Customs Authority	0	0	0
–Project Team	2	0	2
PROJECT TOTAL: Vehicles	5	3	8

End use monitoring of equipment procured by the Project has been and will continue to be undertaken by the Project Officer and the consultants during field trips to District Offices. The possibility and benefits of buying-in into the commodity monitoring contracts undertaken by other directorates in the Mission (e.g., HRDC or AGR), or in using them for models, will be examined, as the volume of commodities procured is expected to increase substantially during Phase II of the Project.

D. BUY AMERICA CONSIDERATIONS

With the exception of audit, the source of all inputs obtained with the additional $10.60 million authorized under the First Authorization Amendment will be "000" as all inputs will be provided through US contractors. Audit services will be obtained locally, but as these will be professional services contracts estimated not to exceed $250,000, they are exceptions in line with HB 1B Chapter 18A1c(4).

It is anticipated that the US TA contractors will spend approximately $1.94 million on residential rent, utilities, temporary lodging allowance, education allowance, local per diem, and salaries of local staff. As these are composed of commodities and services that are available only locally, local procurement of these items is eligible in accordance with HB 1B Chapter 18A1c(6).

E. IMPLEMENTATION SCHEDULE

SUBACTIVITY	WHO	FY 93 94 95 96 -- QUARTER -- 1234 1234 1234 1
General		
•PROAG Amendment Signed	USAID/MOF	
•Extend contract re TA for National Tax Component		
- Sole Source Waiver approved	USAID/MOF	
- Expanded SOW	USAID/MOF	
- PIO/T	USAID	
- Negotiate and execute amendment	USAID/Cons	
•Audit	CPA	
•Evaluation	IQC	
•PACD	USAID/MOF	
Sales Tax		
•TA on operations and administration	Cons	
•Expansion of Sales Tax	Cons/STD	
- Decree for expansion to the wholesale level	Cons/STD	
- Decree for expansion to the retail level	Cons/STD	
- Collection of sales taxes at wholesale level	Cons/STD	
- Collection of sales taxes at retail level	Cons/STD	
•Expansion of computer system to District Offices	Cons/STD	
•Development of training curriculum	Cons	
Income Tax		
•TA on operations and administration	Cons	
•Preparation and implementation of Income Tax reform	Cons/TD	
- Income tax legislation drafted	Cons/TD	
- Income tax legislation presented to People's Assembly	Cons/TD	
- Income tax legislation approved by People's Assembly	Cons/TD	
- Collection of income taxes under new system initiated	Cons/TD	
•Computer system design	Cons	
•Expansion of computer system to District Offices	Cons/TD	
•Development of training curriculum	Cons	

VII. ANNEXES

ANNEX A. REVISED LOGICAL FRAMEWORK

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Goal: To support the GOE's economic reform program.	Tax system reform supports budget deficit reduction: • Tax system generates adequate funds to keep budget deficit from expanding from its GOE FY91/92 level of GDP.	Analyses carried out by the APAU in conjunction with the consultants regarding: • Tax revenues as percentage of GDP • Tax revenue growth rate • Budget deficit as a percentage of GDP	1. GOE continues rationalization of expenditures under economic reform program, and is able to control the growth of government expenditures by keeping them equal to or less than the growth of GDP. 2. Data are made available by the MOF a timely manner.
	Tax system reform supports capital markets reform: • Stamp tax on securities repealed. • More neutral tax treatment of debt and equity. • Elimination of double taxation of corporate income.	Analysis of revised tax laws. Technical analysis by APAU in conjunction with the consultants.	
	Tax system reform supports privatization: • Tax holidays eliminated. • Tax base broadened. • Rates lowered.	Analysis of revised tax laws.	
	Tax system reform supports trade reform: • Refunds to exporters accelerated, reducing their financing burden. • Cascading of sales tax reduced through increased crediting of input taxes.	Structural analysis by APAU in conjunction with the consultants.	

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Purpose: To improve the efficiency, equity, elasticity and neutrality of the tax system.	Principal tax instruments conform to generally recognized standards in the following categories:	Surveys, evaluations, and analyses as follows:	1. Necessary policy, legal and administrative changes will be enacted in a timely manner. 2. The demand for greater tax revenues will be reduced by expenditure cuts and use of user fees where appropriate. 3. The GOE will continue its emphasis on the growth of the private sector. 4. MOF willingness and capability to seek and correct inefficiencies, inequities and distortions as they arise due to changes in the Egyptian economy. 5. Data is made available by MOF in a timely manner. 6. GOE continues to promote efficiency in its hiring policy.
	a. Efficiency of Tax Administration: • Average ratio of costs of collection to actual collections for the Tax Department (0.71 in GOE FY91/92) will decline by 5% or more from GOE FY91/92 to GOE FY94/95. • Average ratio of costs of collection to actual collections for the Sales Tax Department (0.30 in GOE FY91/92) will decline by 5% or more from GOE FY91/92 to GOE FY94/95. • Accelerated processing of income tax returns, resulting in a significant reduction in the backlog of cases from five years to less than 18 months. • Reorganization of Sales Tax Department to reduce variation in ratio of taxpayers to staff in district offices.	a. Efficiency: • MOF Monitoring & Evaluation System data in conjunction with consultant analyses	
	b. Equity: • Equal treatment of individuals and firms in equal circumstances. • Removal of low income households from tax system.	b. Equity: • Existence of revised income tax legislation • Analyses by APAU in conjunction with the consultants • Tax model simulations • Analysis of relevant tax laws	
	c. Elasticity: • Increase responsiveness of tax revenue to changes in tax base, i.e. increase combined elasticity of income and sales taxes to a level near to or exceeding unity.	c. Elasticity: • Analyses by APAU in conjunction with the consultants	
	d. Neutrality: • Eliminate special exclusions, deductions, and tax preferences in the income tax law. • Equalize tax rates across forms of business. • Standardize investment incentives across business.	d. Neutrality: • Structural analyses by APAU in conjunction with the consultants	

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Outputs: 1. Policy Reform resulting in an enacted body of legislation, policy statement and administrative procedures geared towards an efficient and equitable income and sales tax systems.	1. Revised tax laws, MOF decrees, operations procedures manuals, and administrative changes establishing: • A fully implemented global income tax. • A general sales tax that is extended beyond the manufacturing and importing level.	• USAID and MOF documentation on legislative, policy, and administrative changes. • GOE tax code. • Proposals made within GOE and to People's Assembly: • Reports by Tax Department and Sales Tax Department. • Analyses by the consultant. • Performance Monitoring System used for evaluation of the relevant efficiency and performance, identification of problems for analysis, and recommendations for improvements. • Adoption of a standard taxpayer identification number system.	1. Adequate GOE contribution as need. to implement changes on schedule. 2. Legislation necessary to change ta law can be processed through the Peopl Assembly. 3. No exogenous factors upset People' Assembly. 4. No exogenous factors upset procurement, TA and training schedule required to implement changes accordin to the project's design. 5. Trained staff is retained by MOF. 6. Research units established by MOF.
2. Comprehensive in-service training systems in each of the principal tax departments.	2. Adequate staff and facilities to train MOF employees. • Proper in-service training of all employees on new procedures within the schedule set for public implementation of the new procedures. • Adequate training courses to support the needs of tax administration and employee career development needs.	• Training records. • New course content. • Performance Monitoring System reports indicating that employees are following new procedures and that efficiency has improved. • Analysis by consultant.	
3. MISs functioning in each of the principal tax departments.	3. MISs capable of responding to analytical and organizational management needs and consisting of: • A fully operational ADP system for sales tax administration covering all district offices. • A fully operational ADP system for income tax administration down through the main district offices.	• MIS reports available on a timely basis. • Installation of computers and software at the Sales Tax district office level. • Statistics on Sales Tax staff trained in tax policy techniques. • Installation of computers and software at the Income Tax district office level. • Statistics on Income Tax staff trained in tax policy techniques.	
4. The establishment of research and analysis capability in the MOF.	4. Fully trained staff within the ministry producing requisite quality and quantity of research in the Minister's Office at the policy level and in both the Sales Tax and Tax departments.	• Studies. • Reports. • Computer generated analyses.	

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS			MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Inputs:					
	Original Authorization	First Amendment	Total		
Mobilization	$22	$0	$22		
National Tax Component	$14,500	$10,725	$25,225		
Customs Component	$1,169	$0	$1,169		
Evaluation/Audit/Conferences	$220	$100	$320		
Contingency	$289	($224)	$65		
Total	$16,200	$10,600	$26,800		

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ANNEX B. TECHNICAL ANALYSIS

During Spring of 1992, two evaluations were undertaken for the Project, as a pre-condition for continuing with Phase II. The first of these was undertaken by Roy Grohs of AID/NE/DP and was entitled "Phase I Evaluation Report: Administration and Policy Analysis Component, Income Tax Administration Component and Local Finance Component", dated February 26, 1992. The second was undertaken by Leonard Cairns, an independent consultant, and was entitled "Phase I Evaluation Report: Customs Component", dated March 3, 1992. A summary of the recommendations and conclusions of these two reports are presented below. The reports themselves can be found in Project files.

I. Executive Summary of "Phase I Evaluation Report: Administration and Policy Analysis Component, Income Tax Administration Component and Local Finance Component"

1. Summary

The Goal of this project is to provide technical assistance to the Ministry of Finance aimed at linking the public more equitably with the public expenditure. The Purpose of the project is to improve the efficiency of tax administration and equity in the incidence, assessment and collection of taxes.

The original project paper envisioned a two stage process wherein Phase I would have focused on analysis and design of a tax reform proposal with much of the implementation scheduled for a second Phase that was contingent upon performance in the first. Further, Phase I was divided into two components. One focused on customs administration and a second on income, excise and property taxes as well as administration and training.

The customs component was undertaken under a PASA with the U.S. Customs service. KPMG Peat Marwick won a competitive bid to work on the non-customs components. Through a later amendment, some work on local public finance was added to their contract. The present evaluation covers only the non-customs components of Phase I because the customs component is being evaluated separately.

External events altered the original project activity schedule. Under its Standby program with the IMF, the Government of Egypt had committed to implement a sales tax before mid-1991. Rather than being limited to study and evaluation, therefore, much of the effort of Phase I was in fact devoted to redrafting legislation, training employees, preparing forms, and generally gearing the GOE up to implement the sales tax.

Phase I ends on April 30, 1992. Rather late in that Phase, (in November of 1991), the Mission executed an additional buy-in to the Peat Marwick contract to finalize work on local public finance that had begun under another project, Local Development II (LD II).

By all accounts, Phase I work has gone extremely well. The sales tax was implemented on schedule and the Minister of Finance is extremely praiseworthy of the technical assistance that he received. Because of the crash program on the sales tax, some work on the income tax slipped and will need to be picked up in a second phase. Nevertheless, a major contractual commitment, to propose revisions in the income tax law, was accomplished. The Government was reviewing draft legislation at the time that this evaluation was conducted, with an eye toward possibly introducing and implementing a new global income tax by calendar year 1993. Meanwhile, the contractor is laying some of the administrative and technical foundations for implementing a global income tax, if one is legislated.

The key product of Phase I was a document prepared by the Contractor entitled, "A Comprehensive Tax Reform Program for Egypt." This report covers all elements of the present Egyptian tax system and recommends tax reforms that would improve equity in the tax system while also reducing adverse tax incentives on private sector production and consumer choices. It also details administrative reforms and training and computerization needs that would be required to implement and administer the system.

That report is an excellent piece of work. The contractor has drawn upon the services of some of the world's most renowned specialists in each of the areas of taxation and public finance and has compiled their individual recommendations into a draft tax reform proposal that is complete, cohesive, internally consistent and reflective of the best current thinking on the economics and administration of tax systems.

A great deal remains to be done in Phase II to "fine tune" the sales tax and to complete the administrative reforms and training programs that will be needed to enable the GOE to sustain the system on its own. Similarly, work on the income tax is still at a relatively early stage. Much needs to be done to implement a global income tax once the GOE passes the requisite legislation.

Work on local finance was more disappointing. The contractor met contractual obligations to produce three reports analyzing central-local fiscal relations and documenting the local fiscal system in Egypt, and was not the cause for the rather meager results achieved in this area. The reasons for that seem to lie in the facts that (a) the Mission's expectations did not coincide with those of the GOE on the merits of decentralizing the revenue system and (b) the Minister of Finance was not included on the special Committee that had been appointed by the GOE as a counterpart for this activity under LD II and continued as the counterpart under the Peat Marwick buy-in. A good deal of productive work can be done in local finance, but for the near term this would lie in the area of purely fiscal, rather than political-economic reforms. Before continuing in local finance, the Mission should identify what its objectives are in this area.

Customs evaluation lies outside the scope of this report. However, since customs represent more than half of the collections under the sales tax, further technical assistance in the former should be much more closely coordinated with the sales tax TA than was the case under Phase I.

2. Outline of Recommendations

(1) The Mission should proceed to Phase II with the Sales Tax, Income Tax, and Policy Analysis components of the project and reinforce its efforts to ensure that a policy analysis unit is established in the Ministry of Finance.

This should be the highest priority for Phase II. Indeed, if it can be assumed that the Contractor will continue to deliver the same quality of services in the second phase as the first, it would seem almost unconscionable to abandon this effort in midstream. To leave the GOE with a partially-implemented sales tax and only draft legislation for an income tax, or perhaps the momentum to adopt a global income tax without the capacity to implement it effectively, might in some way be worse than not having embarked on reform at all -- the old system, whatever its faults, had the merit that the GOE knew how to operate it.

(2) If the Mission decides to proceed with further technical assistance in the customs component under Phase II of the project, it should seek to establish a delivery mechanism that will ensure free communication and coordination between those working on customs reform and those working on other areas of the revenue system.

This would be a (close) second priority, since it would not leave a half-completed system behind, if abandoned. As noted later on, however, this is not to downplay the importance of additional work in customs administration and taxation. Since customs collections account for nearly half of the revenues under the present sales tax, it will be very important for the two systems to be harmonized.

(3) Resource levels permitting, the Mission should proceed with work in local public finance in Phase II, but adjust its expectations regarding what it intends to achieve, aiming at more narrowly fiscal, rather than political-economic, objectives.

This should be the third highest priority for Phase II. There is much important work to be done in "local" public finance, and as pointed out below, the effort is likely to "pay off" in additional revenues generated even with only administrative reforms. Moreover, given the massive amounts of private sector infrastructure and capital that may materialize if the structural adjustment program is successful, the present archaic property tax system will be ill-suited to the new economic environment that emerges. However, if some element must be abandoned in Phase II, this would appear to be the most likely candidate.

II. <u>Summary of "Phase I Evaluation Report: Customs Component"</u>

the purpose of the Component was to assist the Egyptian Customs Authority to improve the efficiency, equity and administration of the customs system.

Issue 1 - Performance of PASA Team. During Phase I, the PASA team was required to assist the Customs Department with the MOF with four main tasks: data collection and analysis, policy reform agenda, training, and preparation of a commodity procurement plan for the Project. The policy agenda program recommendations, consisting of items relating to the harmonized system of tariff nomenclature, the GATT valuation system, the Kyoto Convention, the Nairobi Convention, the Containers Convention, and the Transit Convention, meet the requirements for modernization of the Customs Department and would, in turn lead to a revision of Customs Law. The policies recommended by the PASA team to the Customs Department have been consistently sound and far-sighted, all in tune with contemporary developments. However, there are areas where more consultation with the other Component of the PFAP might usefully have taken place.

Issue 2 - USAID and MOF Management of the Component. The PASA's low-key approach supported by lengthy written recommendations may not have been the best approach for the Customs Department who were looking for a more active approach with some tangible indications of progress. A gap developed between the Customs Department and the PASA team which became a matter of increasing concerns as the head of the Customs Department lost confidence in the PASA approach. In fact, however, the PASA has made a large contribution to the effort in terms of analyzing the issues, but lack of response from the Customs Department and the PASA's unfamiliarity with the procurement rules have tended to neutralize it.

Issue 3 - Progress in Improving Customs Laws and Policies. If the Component proceeds in accordance with the standard reforms recommended by the PASA team, extensive changes will be required in Article 22 (value for duty), Article 50 (examination of goods), Article 102 (drawback), and Article 114 (fixed-fee penalties and revision and consolidation of the remainder will be necessary in due course. Data relating to customs duty should be available for fiscal planning at an early stage for the timely review of rates of duty, import prohibitions and restrictions and licensing requirements. Drawback should be further examined from a broad economic and policy perspective, and compared with temporary importation. The Harmonized System is recommended for adoption.

Issue 4 - Standardized Administrative Policies and Operating Procedures. The Customs Department has a structure that deals with the daily tasks of a customs service but it is largely founded on the assessment of tariff rate and value by customs officers. If the Customs Department is modernized, importers will be responsible for making a complete declaration of their goods, including tariff category, rate of duty and transaction value. The scale of examination of goods will be reduced and a different structure will be necessary.

Issue 5 - Training. The PASA team has produced a sound Comprehensive Training Plan which was designed in consultation with the Project Officer. It provides a sensible plan for dealing with the extensive changes expected in Phase II and later, progressing from changes in the law to the design of staff instructions and training courses that will meet the situation as it develops.

Issue 6 - PASA Efforts in ADP and MIS. A longer term strategy is needed to give the Customs Department a second opinion with respect to the advice presented by the current contractor.

Issue 7 - Conclusions.

(1) Continuation of the project would be of benefit to Egypt because a modernized customs service based on a modernized law would bring benefits by way of efficiency and the ability to operate on a risk-based system of customs control.

(2) Whether it should continue as originally planned is doubtful as the Customs Department has lost confidence in the PASA COP. If the project is to proceed the MOF and the Customs Department must commit themselves unequivocally to giving it their full support, and appoint a liaison officer of senior rank to work with the implementation team appointed by USAID.

(3) If further tenders were to be invited from private contractors the successful contractor would have the benefit of the PASA team's papers (presumably) but would almost certainly have to carry out his own evaluation of the requirements. This would lead to more reports and the chairman of the Customs Department has had enough of those.

To staff such changes would require a project manager of considerable stature to drive the project at a healthy speed, and probably a customs expert of wide experience on a permanent basis. In addition, experts would be needed for the implementation phases of the innovations and assist with the design of relevant training courses.

(4) Consideration should be given to the provision of a laboratory for use in connection with HS liability determinations.

(5) Consideration should be given to enhancing the Customs Department Headquarters communications facilities with fax, telex, and desk-top publishing facilities.

(6) Consideration should be given to the provision of library facilities for both the training center and ADP section.

(7) The use of a microfiche system at the Alexandria Filing Project should be reconsidered.

(8) The use of seals for securing overland cargo to avoid using customs officers to oversee the transit movement should be followed up.

(9) Commercial interest should be kept abreast of changes that affect trade.

ANNEX C. ADMINISTRATIVE ANALYSIS

I. ORGANIZATION OF THE IMPLEMENTING AGENCY

The various tax departments (income, customs, sales, and real estate) constitute separate entities within the Ministry of Finance. Each reports to the Minister through its commissioner or undersecretary. The taxation side of the Ministry is large, employing over 50,000 individuals. Responsibility to assess and collect the principal taxes is generally decentralized in branch offices or at ports of entry. Chart I shows the overall organizational structure of the Ministry.

Prior to the Project, the present tax departments had grown physically and geographically without commensurate changes in management structures, communication systems, and management information systems. Key technical and management issues related to weaknesses in the flow of information, standardization of procedures, internal monitoring and controls, and delegation of authority. The Project is assisting in correcting these weaknesses through policy changes, administrative reform, and computerization.

A. Sales Tax Department

The Sales Tax Department administers the newly instituted Sales Tax at the point of production (presently accounting for approximately 50 percent of the total sales tax collected). The Sales Tax Department will of course continue to administer this tax when it is expanded to the wholesale and retail levels. The Sales Tax Department is also responsible for the administration of the remaining consumption taxes. The Department organization is divided into five major operational sectors under the Commissioner's office, each headed by an Undersecretary. Within the Office of the Commissioner itself, there are seven staff support operations. Chart II lays out the organization of the Sales Tax Department. Most of the actual tax collection and compliance operations are carried out through the approximately forty six district offices spread across nine regions. The Department has approximately 4,000 employees, of whom about 2,300 are tax agents (maamours) and the remainder are support staff.

When the Project started, this department was the Consumption Tax Department. During implementation, when it became clear that the recommendations regarding the adoption of a General Sales Tax were to be implemented, the Consumption Tax Department was renamed to be the Sales Tax Department. Last year, the Project TA Team prepared a reorganization plan that was discussed with the Department officials. After being approved, the Department sent the plan to the Central Agency for Organization and Management for their

CHART I
Ministry of Finance

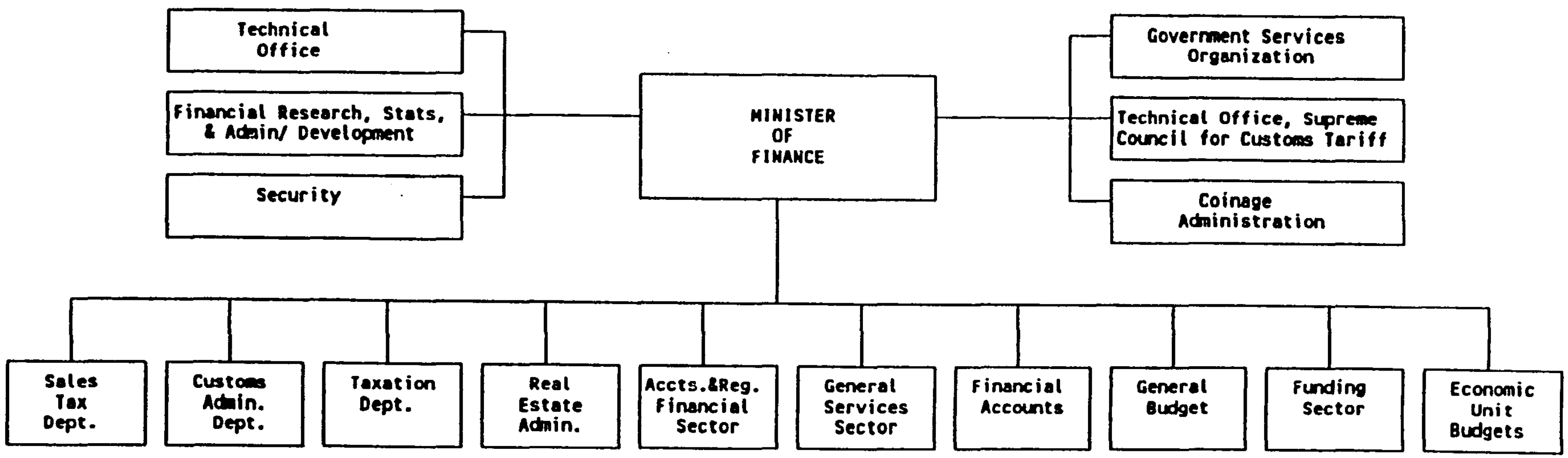
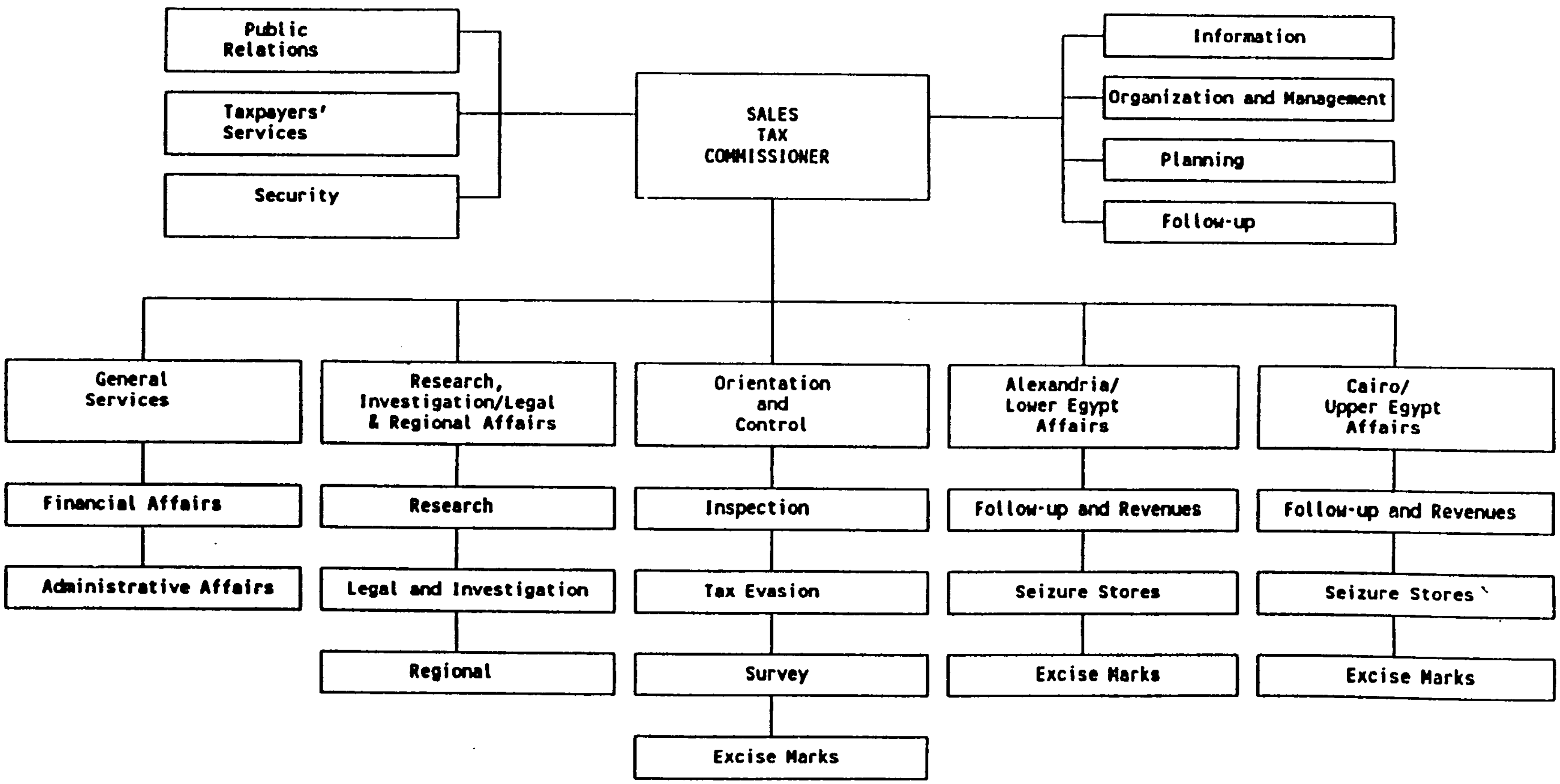


CHART II
Sales Tax Department



concurrence. Until now, the Department is still awaiting their response.

Under the Project, computerization of the Department's activities has begun. The major elements of the computerized sales tax processing system are now operational in the eight regional offices and the head office of the Sales Tax Department. Prior to this effort, the Department had literally no computer capacity. The new system has quickly demonstrated its contribution to improved taxpayer compliance and improved Department efficiency.

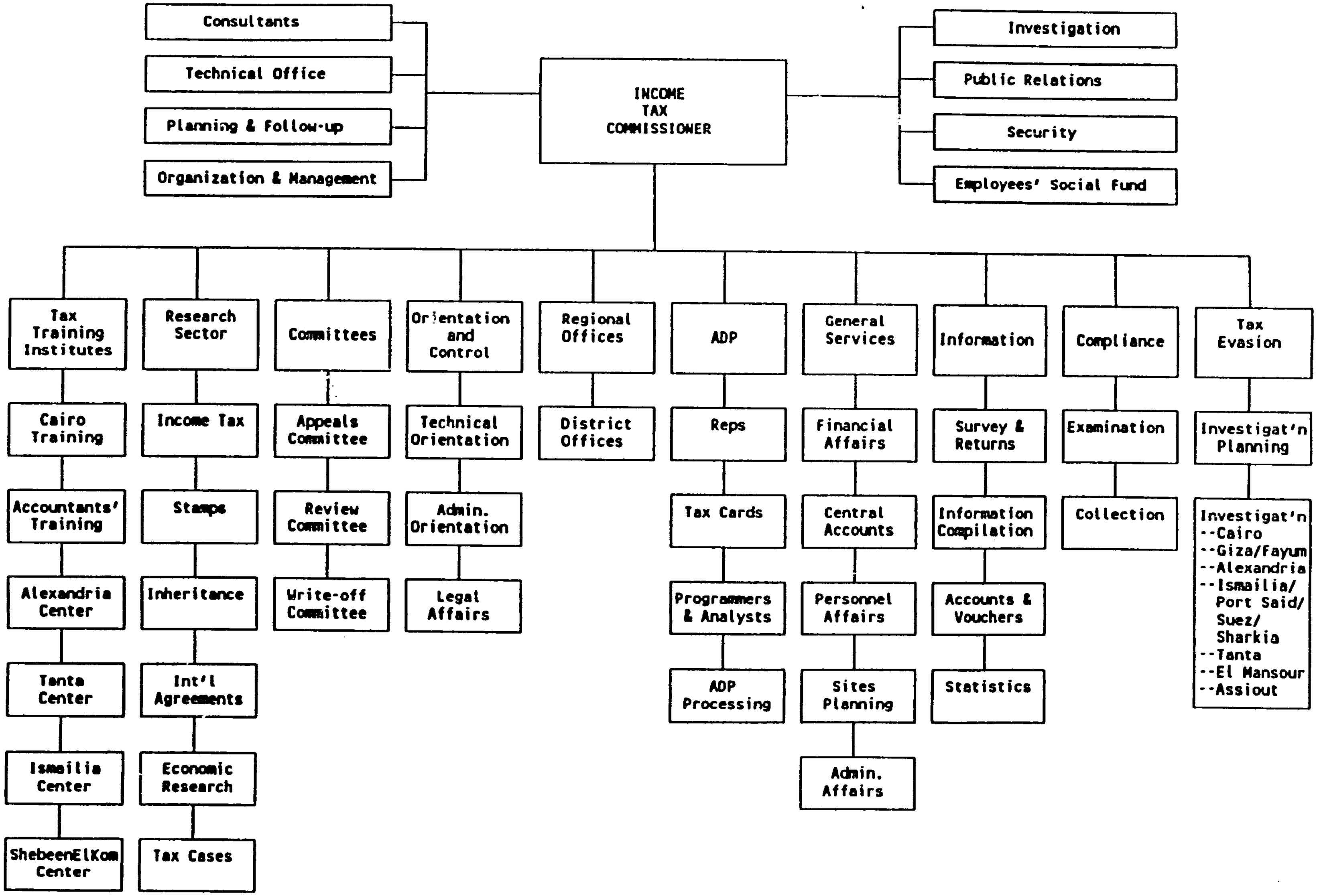
B. Tax Department

The Tax Department administers all of the schedular income taxes, the general income tax, stamp duties and related levies, the inheritance tax, and other miscellaneous duties. The Department organization includes ten major operational sectors under the Commissioner's office, each headed by an Undersecretary. Within the Office of the Commissioner itself, there are six staff support operations, as well as twelve or so consultants. Most of the actual tax assessment, collection, and compliance operations, with some notable exceptions, are carried out through the approximately one hundred and seventy district offices spread across twenty seven regions. Until recently, regional and district office operations were under control of the Compliance Sector. By decree issued earlier this year, direct control of all field operations was transferred to the Commissioner's Officer. Chart III lays out the organization of the Income Tax Department. The Department has approximately 22,000 employees, of whom about 12,000 are tax agents (maamours) and the remainder are support staff.

The current Tax Department organization is greatly influenced by the structure of the existing tax system, the existence of a highly non-compliant taxpayer population, and a labor-intensive mode of operations. As the structure of the tax law changes in a fundamental way, associated changes, also of a fundamental nature, should be made in the Department's organizational structure. The following would result in shifts in workload and a freeing up of resources for more productive roles: elimination of stamp duties and related levies; proposed large increase in family burden exception amount would reduce the taxpayer rolls; an expansion of withholding at source and increased voluntary compliance will reduce the number of audits required; and computerization will consolidate processing and accounting functions. In addition the greater use of presumptive taxation methods will require specialized personnel. Also, in support of taxpayer efforts to comply voluntarily with the new tax system, a higher priority would be given to taxpayer education.

Although computerization of income taxes is critical to the long-term success of income tax reform in Egypt, it is moving ahead

CHART III
Tax Department



slowly. The fact that the Tax Department already has an ADP Office has ironically slowed the progress relative to the Sales Tax Department. However, operating computer systems have been installed in approximately thirty district offices and initial releases of the major elements of the income tax processing system have been completed.

C. Research and Analysis Units

In a country the size of Egypt, and where the bureaucratic boundaries between the major tax departments are not easily crossed, a strong argument can be made for having separate units in each of the departments, with a smaller unit in the Minister's office that has access to the results of these separate departments. Historically, the structures of both the Income Tax Department and the Sales Tax Department have included an office that carried out research. However, these units appeared to be geared to the legal issues that arise in the enactment and implementation of taxation. The Project is undertaking the expansion of the Departments' ability in the area of research to include the analysis of the economics of taxation through the establishment of an Economic and Tax Analysis unit in each Department. Each Economic and Tax Analysis unit would report to the Minister and/or the respective Commissioner directly. The units' responsibilities would include reporting on how well the tax system is working; estimating future tax collections using analytic models; analyzing the impacts of alternative tax polices; monitoring collections as part of an early warning system; and identifying future issues.

In addition, the Project's technical assistance is recommending the creation of a similar, though smaller, unit designed to respond directly to the Minister. This Financial Analysis Unit would provide him with a broad overview of tax policy issues and the economy in general. It would analyze a wider range of issues that are of importance to him, by drawing on existing resources throughout the Ministry, particularly those of the Tax Department and the Sales Tax Department.

D. Customs Administration

The Customs Department is responsible for carrying out valuation and administering all tariffs, as well as administering the sales tax at point of import (currently amounting to approximately 50 percent of the sales tax collected). The Department organization is divided into nine major operational sectors under the Commissioner's office, five of which function as part of a central directorate and four of which are operational geographic zones. Each is headed by an Undersecretary. Within the Office of the Commissioner itself, there are nine staff support operations.

Chart IV lays out the organization of the Customs Department. The Department has approximately 17,000 employees.

On the operational side, computerization is relatively advanced under the existing customs administration. However, greater coordination needs to be in place with regards to statistics compilation and analytical capabilities.

E. Coordination and Computerization

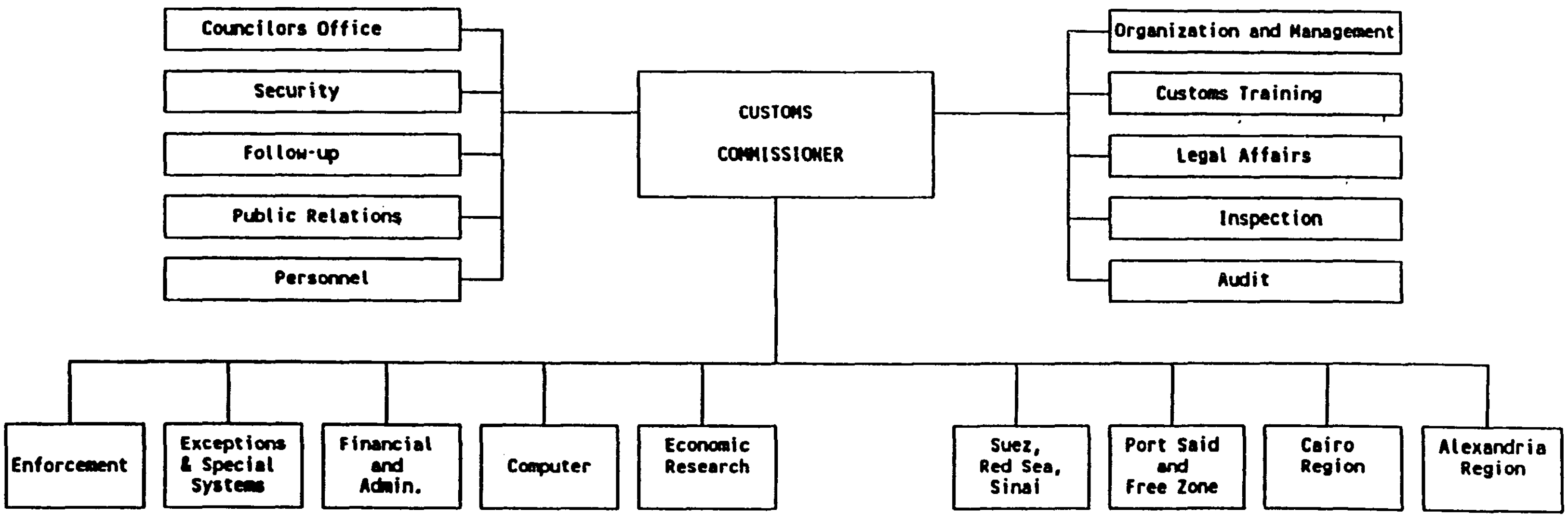
Each of the three major revenue departments of the MOF (Tax, Sales Tax, and Customs) maintains an independent data processing operation. Although the departments serve a taxpayer universe that has a significant degree of commonality, each department uses its own taxpayer identification system, and maintains its own separate data base of taxpayer information. There is virtually no ADP coordination between the technical or managerial staffs of the three departments. In addition, there is currently no link between the operations of the Tax Department and the Sales Tax Department, despite the overlap of taxpayer populations and the closely related work of the two departments.

II. PROJECT ADMINISTRATION

Overall policy direction and policy dialogue is the responsibility of a Project Policy Committee composed of the Minister and commissioners of the Income Tax Department, the Customs Department, and the Sales Tax Department. The original Project plan calls for the Commissioners and the Minister to name operational counterparts as Project Liaison Officers in each functional area, in order to form a Project Steering committee. The Steering Committee was to meet regularly and make decisions regarding administrative and financial matters, and to monitor project performance. During implementation of Phase I, the Steering Committee did not function as planned and did not take on the necessary coordinating role. This role was taken on by the Project Officer and the contractor in the case of the Income and Sales Tax components, and by the Minister himself with respect to the overall Project. Where the Customs component was concerned, this limited level and timeliness of interaction was exacerbated by the PASA Team's limited area of expertise.

At the component level, it was found that the caliber and dedication of the individual serving as Project Liaison Officer was critical to ensuring the success of the various components. The Project Liaison Officer named for the Sales Tax Department was instrumental in ensuring exceptional coordination among the various players in order to facilitate implementation of the recommended programs. The Project Liaison Officer for Sales Tax has been in place and active since June 1990. A new Project Liaison Officer

CHART IV
Customs Department



for Income Tax has been recently named. Based on experience with the Sales Tax Department, the role of this counterpart is extremely important in terms of the being the intermediary between the contractors on the one hand and the staff of the department on the other. The Project Officer is confident that this new appointment will make a substantial contribution to the implementation of the recommended Income Tax reform.

In the case of the Customs Component, an appropriate Project Liaison Officer has not been forthcoming. This has hindered the implementation of that component. Progress under the component was also limited by the PASA Team's lack of experience in reforming customs laws and policies, as well as other technical areas. The PASA Team was not able to show expertise or provide assistance in needed areas, such as assisting the Customs Department in the Sales Tax implementation. In addition, misunderstandings concerning the PASA scope of work, the PASA Team's difficulty in getting information from the Department, and the lack of a focal point within the Department that was willing to "champion" the recommended changes can also be viewed as contributing to the lack of progress under this component. Therefore, although the Commissioner of the Customs Department has accepted those recommendations provided by the PASA team which coincide with his own views, nothing has materialized in terms of implementation. The mid-term evaluation has confirmed the merit of these recommendations within the context of customs administration; however, there is the appearance that the value of the recommendations is not recognized by the implementing agency. The Project is viewed as a source of additional commodities, with little thought being given to how they will be utilized within the context of a broader policy and administration reform for the Customs Department.

ANNEX D. ECONOMIC ANALYSIS

In 1991, the GOE embarked upon a comprehensive economic reform program. This program focuses on macroeconomic stabilization and medium term structural adjustment--both of which are necessary if Egypt is to achieve higher sustained growth in per capita income. The Public Finance Administration Project is designed to support both aspects of the reform program. The vital contribution which the Project makes to the overall reform program--as elaborated upon below--constitutes the principle economic justification for the Project.

The GOE's reform program consists of stabilization and adjustment measures. With respect to macroeconomic stabilization, the critical need was to reduce the relative size of the budget deficit, which was as high as 20 percent of GDP in 1990. The Project provides direct assistance to the GOE for addressing this issue. During Phase I, Project funded-technical assistance supported the introduction of a limited general sales tax. This tax accounted for approximately LE 3.0 billion in additional revenues during FY 92. During Phase II, Project-funded technical assistance will support not only the broadening of the general sales tax, but also the introduction of a global income tax. Full implementation of the complete set of tax reforms described above will yield estimated additional annual revenues of about LE 5.5 billion -- thus making an important contribution to economic stabilization through reduction of the budget deficit.

The Project also supports the GOE's efforts to introduce structural adjustments aimed at improving the economy's efficiency and competitiveness. Specifically, the general sales tax and the global income tax have been designed--primarily with the help of Project-funded technical assistance--so as to reduce the extent of tax-induced distortions in the economy and permit resources to be used where they are most productive. Moreover, the Project has supported efforts to make the tax system easier to administer--thereby conserving on scarce administrative resources.

There is a growing body of evidence supporting the view that tax system reform can lead to significantly improved economic performance. For example, in the two years following comprehensive income tax reform in Jamaica investment in fixed capital jumped 36 percent and 27 percent respectively, thereby reversing the stagnation of the previous 10 years. The results of the comprehensive tax reform implemented in Indonesia in the early 1980s (which was similar in many ways to the reform program recommended in Egypt by the project-financed consultants) also support the view that such reform can contribute to significantly improved economic performance. Indonesia was virtually alone among large oil-exporting countries in being able to sustain at least modest real GDP growth during the mid 1980s despite sustained lower oil prices. This was due inter alia to revenue results of tax reform (the ratio of non-oil taxes to GDP increased by 50 percent) as well as to reduced tax administration costs, improved taxpayer compliance, and the lower efficiency costs associated with simpler tax laws and more uniform tax rates.

All in all, the Project plays a key role in supporting GOE fiscal sector reform. Such reform, in turn, is central to the GOE's economic restructuring program and thus to efforts to attain a higher rate of sustained economic growth. In this context, and keeping in mind the superior performance of the Project to date, the economic justification of the Project is clear and compelling.

ANNEX E. FINANCIAL ANALYSIS

AID's inputs to the Project consist of technical assistance, training, commodities, audit, and evaluation. Following are cost estimates for each of the above inputs.

1. Technical Assistance

In order to estimate funding requirements for the technical assistance level of effort called for in Phase II of the Project, an analysis of expenditures under the current contract was undertaken. For budgeting purposes, standard costs were developed for a person-month of resident US long terms TA labor, a person-month of US short-term TA labor, and a person-month of Egyptian professional staff or short term TA, under a long-term contractor. On the basis of the existing contract, these standard costs were then "loaded" with a multiplier of 1.9 in order to fully identify the cost of a person-month of TA. The loaded standard costs therefore also include a proportional amount of other direct costs (e.g., communications, expendable supplies, secretarial/translator services, local travel, etc.) and indirect costs (e.g., overhead, G&A) that support the provision of the technical assistance. An inflation rate of 5.0% was used over the three year contract period. These standard costs are presented in Standard Cost Worksheets 1, 2, and 3 below.

STANDARD COST: LT US TA WORKSHEET 1

Long-term contract with U.S. citizen for Personal Services working under a long-term contractor.
Contract period: 1 year

	Year 1	Year 2	Year 3	TOTAL
FX COSTS				
Average Annual Salary per Consultant *	$72,305	$75,920	$79,716	$227,942
Post Differential (15%)	$10,846	$11,388	$11,957	$34,191
Fringe *	$26,552	$27,880	$29,274	$83,705
	$109,703	$115,188	$120,948	$345,839
International Travel/Per Diem/Excess Baggage **	$6,330	$0	$6,979	$13,309
Physical/Inoculations **	$1,200	$0	$0	$1,200
R&R (RT) **	$5,400	$5,670	$0	$11,070
POV Shipment	$6,500	$0	$7,166	$13,666
HHE Storage (8,000 lb @ $0.48)	$3,840	$4,032	$4,234	$12,106
Air & Surface HHE Shipment (600 lb @ $3.65 + 7200 lb @ $2.13)	$17,526	$0	$19,322	$36,848
	$40,796	$9,702	$37,701	$88,199
SUBTOTAL FX COSTS	$150,499	$124,890	$158,649	$434,038
LC COSTS				
Residential Rent and Utilities	$15,460	$16,233	$17,045	$48,738
Temporary Lodging Allowance **	$4,500	$0	$0	$4,500
Education Allowance **	$11,710	$9,146	$9,603	$30,458
				$0
SUBTOTAL LC COSTS	$31,670	$25,379	$26,647	$83,696
TOTAL COSTS PER YEAR	$182,169	$150,269	$185,296	$517,734
TOTAL w/MULTIPLIER (1.9) ***	$340,470	$280,849	$346,314	$967,632
TOTAL COSTS PER MONTH w/MULTIPLIER	$28,372	$23,404	$28,859	
AVERAGE MONTHLY COST				$26,879

* Assumes 11 months employment; Fringe includes holiday/vacation pay, SUI, FUI, health care benefits.
** Assumes an average of three dependents: spouse and one child.
***Multiplier includes Other Direct Costs, Overhead, and G&A

STANDARD COST: ST US TA — WORKSHEET 2

Short-term contract with U.S. citizen for Personal Services working under a long-term contractor.
Contract period: 1.5 months

	Year 1	Year 2	Year 3	
FX COSTS				
Average Salary/Consultant for Contract Period	$12,256	$12,869	$13,512	
Fringe (16% average)	$1,961	$2,059	$2,162	
International Travel (1 RT)	$3,550	$3,728	$3,914	
FX SUBTOTAL	$17,767	$18,655	$19,588	
LC COSTS				
Per Diem (21 days in-country)	$2,877	$3,021	$3,172	
LC SUBTOTAL	$2,877	$3,021	$3,172	
TOTAL COSTS PER CONTRACT PERIOD	$20,644	$21,676	$22,760	
TOTAL w/MULTIPLIER (1.9) *	$38,583	$40,512	$42,538	
TOTAL COSTS PER MONTH w/MULTIPLIER	$25,722	$27,008	$28,358	
AVERAGE MONTHLY COSTS				$27,029

* Multiplier includes Other Direct Costs, Overhead, and G&A

STANDARD COST: LT & ST EGYPTIAN TA — WORKSHEET 3

Long or short term contract with Egyptian citizen for Personal Services working under a long-term contractor.
Contract period: 1 month

	Year 1	Year 2	Year 3	
LC COSTS				
Average Monthly Salary per Consultant/Staff	$764	$803	$843	
Fringe (12%)	$89	$193	$202	
SUBTOTAL	$853	$995	$1,045	
TOTAL w/MULTIPLIER (1.9) *	$1,595	$1,860	$1,953	
AVERAGE MONTHLY COSTS				$1,803

* Multiplier includes Other Direct Costs, Overhead, and G&A

The original Project Paper's financial projections were based on levels of effort and cost estimates that actual implementation has found to be unrealistic. Worksheet 4 below compares the level of effort identified in the original Project Paper with a revised level of effort that reflects the labor intensive nature of the required technical assistance, particularly the significantly greater usage of short term TA. Worksheet 5 then compares the average cost of a person month of TA developed in the three previous worksheets, with the average cost assumed in the original Project Paper. These differences reflect the recognition of the high caliber expertise required, both in terms of specialties and depth of experience.

LEVEL OF TECHNICAL ASSISTANCE REQUIREMENTS (PM) — WORKSHEET 4

	Original PP Estimates			Revised Estimates			
	Phase I	Phase II	TOTAL	Actuals Phase I	Estimates Phase II	TOTAL	Difference
NATIONAL TAX COMPONENT							
US Long Term TA	148.0	201.0	349.0	153.0	324.0	477.0	37%
US Short Term TA	42.0	51.0	93.0	168.0	106.0	274.0	195%
Egyptian Long Term TA	15.0	20.0	35.0	61.5	408.0	469.5	1241%
Egyptian Short Term TA	101.0	135.0	236.0	37.5	36.0	73.5	-69%
US Training Assistance	27.5	28.5	56.0	5.0	48.0	53.0	-5%
Component Total	333.5	435.5	769.0	425.0	922.0	1,347.0	75%
CUSTOMS COMPONENT							
US Long Term TA	54.0	78.0	132.0	56.0	0.0	56.0	-58%
US Short Term TA	9.0	18.0	27.0	9.0	0.0	9.0	-67%
Egyptian Long Term TA	0.0	0.0	0.0	106.0	0.0	106.0	N/A
Egyptian Short Term TA	19.0	51.0	70.0	29.0	0.0	29.0	-59%
US Training Assistance	6.0	12.0	18.0	0.8	0.0	0.8	-96%
Component Total	88.0	159.0	247.0	200.8	0.0	200.8	-19%

TECHNICAL ASSISTANCE COST ESTIMATES PER PERSON MONTH OF TA ($ 000) — WORKSHEET 5

	Original PP Estimates	Revised Estimates Phase I Actual	Revised Estimates Phase II Estimates	Average Difference
NATIONAL TAX COMPONENT				
US Long Term TA	$18.9	$22.8	$26.9	31%
US Short Term TA	$10.0	$17.3	$27.0	122%
Egyptian Long Term TA	$2.0	$0.9	$1.8	-32%
Egyptian Short Term TA	$2.0	$0.8	$1.8	-35%
US Training Assistance	$10.0	$15.6	$26.9	113%
CUSTOMS COMPONENT				
US Long Term TA	$16.7	$15.6	N/A	-7%
US Short Term TA	$10.0	$14.7	N/A	47%
Egyptian Long Term TA	$0.0	$1.0	N/A	N/A
Egyptian Short Term TA	$1.3	$0.4	N/A	-69%
US Training Assistance	$10.0	$15.0	N/A	50%

Worksheet 6 uses the revised estimates for cost of technical assistance and level of effort to compute the Phase II costs of technical assistance.

PROJECTED EXPENDITURES FOR PHASE II TA ($000)				WORKSHEET 6
NATIONAL TAX COMPONENT	Year 1	Year 2	Year 3	TOTAL
US Long Term TA	$3,064	$2,528	$3,117	$8,709
US Short Term TA	$1,106	$1,026	$709	$2,841
Egyptian Long Term TA	$230	$246	$258	$733
Egyptian Short Term TA	$19	$22	$23	$65
US Training Assistance	$443	$389	$460	$1,292
Commodities	$1,833	$2,381	$0	$4,214
Component Total	$6,696	$6,591	$4,567	$17,854

2. Commodities

The majority of the commodity procurement primarily consists of computer hardware and software for installation in the Sales Tax Department and the Tax Department, training aids and equipment, and a limited number of vehicles. Worksheet 7 illustrates the original commodity needs as identified in the original Project Paper, and compares these with the recommended level of commodities developed over the course of implementation. The Worksheet also compares the cost estimates that were valid at the time of original Project design to those that are applicable now, including transportation and contingency.

COMMODITY REQUIREMENTS REVISIONS — **WORKSHEET 7**

ORIGINAL PP ESTIMATES (both Phase I & II)	Tax	Sales	Customs	Team	Cost/Unit	Total
COMPUTERS: Original						
--Single User System, 1MG RAM, 20MG HardDisk, 800KB DiskDrive Hard Disk; 800 KB DiskDrive	200	-	2	1	$3.0	$609
--Single User System, 1MG RAM, 2 800KB Disk Drives	392	-	12	3	$4.0	$1,628
--Dot Matrix Printer, 120 character capability	178	-	8	2	$0.5	$94
--Laser Printer, high resolution	140	-	-	-	$1.0	$140
Original Total Computers	592	0	14	4		$2,471
Original Total Computer User Units	592	0	14	4		
VEHICLES: Original	1	1	1	1	$15.0	$60
						======
TOTAL COMMODITIES: Original						$2,531

REVISED PP AMENDMENT ESTIMATES (by Phase)	PHASE I					PHASE II					
	Tax	Sales	Customs	Team	Costs	Tax	Sales	Customs	Team	Cost/Unit	Total
COMPUTERS: Revised											
--Single User 286 System, peripherals & SW	1	-	3	11		-	-	-	-	$4.0	$0
--Single User 386 System, peripherals & SW	9	8	1	2		-	-	-	4	$6.0	$24
--Multi User 80/386 & components & SW	1	9	0	2		-	44	0	-	$13.8	$607
4 Terminals/system; stabilizer;											$0
--Single User 486 System & peripherals	-	1	-	-		-	-	-	-	$6.3	$0
--Multi User 80/486 & components & SW 6 Terminals/system; stabilizer;	0	1	0	-		180	-	0	-	$15.6	$2,815
Revised Total Computer Systems	11	19	4	15		180	44	0	4		$3,446
Revised Total Computer User Units	14	51	4	21		1080	176	0	4		
VEHICLES: Revised --5 passenger utility vehicle; 4 wheel drive; 4 cylinder; gasoline engine; spare parts	0	0	2	3		2	0	0	1	$22.5	$68
TRAINING COMMODITIES --aids and equipment, e.g., overhead projectors, screens, boards, closed circuit TV, VCRs, training computers, etc.	-	-	-	-		$300	$400	-	-		$700
TOTAL COMMODITIES: Revised (by Phase)					$872						$4,214
											======
TOTAL COMMODITIES: Revised Estimates for both Phase I & II											$5,086

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ANNEX F. ENVIRONMENTAL CONCERNS

The original Project Paper identified the Project as qualifying for a categorical exclusion under AID Environmental Procedures set forth in 22 CFR 216.2 (c)(2)(i). The regulations state that these procedures apply to all new projects, programs or activities authorized or approved by AID and to substantive amendments or extensions of ongoing projects, programs, or activities. As the purpose of this current action is to increase funding to carry out the activities included in the original Project design, this amendment does not constitute a substantive change from an environmental impact perspective. As such, no additional procedures need to be applied.