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AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D. C. 20523

PROJECT PAPER
PAAD

EGYPT : 263-K-617
Cash Transfer

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pgs 25

CLASSIFICATION

AID 1120-1 PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. 263-K-617 2. COUNTRY Egypt 3. CATEGORY Cash Transfer 4. DATE July 1989
5. TO: Charles F. Weden, Director (Acting) USAID/Cairo		6. OYB CHANGE NO.
7. FROM: Vivikka Molldrem, AD/PDS		8. OYB INCREASE None TO BE TAKEN FROM: Economic Support Fund
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 115,000,000		10. APPROPRIATION —

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☐ GRANT	☐ INFORMAL ☐ FORMAL ☒ NONE	10 days (Disbursement)	N.A.

15. COMMODITIES FINANCED

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only	U.S.:
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash:	Other:

18. SUMMARY DESCRIPTION

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

As part of our continuing policy dialogue, far reaching economic consultations have been undertaken between the U.S. Mission and the GOE with special reference to macroeconomic reform, market liberalization, and deregulation.

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

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

BEST AVAILABLE COPY

19. CLEARANCES	DATE
PDS/E.(A), DDod	7/12/89
AD/FM (A), JBrody	7/11/89
LEG, KO'Donnell	7/12/89

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE — DATE 7/18/89

DIRECTOR (A), USAID/Cairo

TITLE

CLASSIFICATION:

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EGYPT: U.S. FY 1988 CASH TRANSFER

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Program Assistance Approval Document

FY 1988 Cash Transfer

I. ECONOMIC OVERVIEW AND ISSUES

The Egyptian economy was weak on many fronts when American economic aid was restored in December 1974. During the preceding ten-year period 1965-74, the economy grew in real terms by only three percent annually. Balance of payments problems were severe. They stemmed from war damage to the economy, a deterioration in the terms of trade, rising domestic demand and the burden of budget expenditures skewed toward subsidies and defense. However, the structural weaknesses in the system were temporarily obscured during the oil boom, 1975 to 1980. A surge in foreign exchange receipts from petroleum exports, earnings from the Suez Canal and workers' remittances substantially relieved the pressure on the balance of payments and the government budget. Led by rapidly rising domestic expenditures encouraged by expanded subsidies, Egypt's real economic growth soared to approximately eight percent annually during these years.

After 1981, the decline in oil prices negatively affected all of these sources of foreign exchange to varying degrees. Also, significant increases in per capita energy consumption resulted in a reduced petroleum supply for export. Government policies relating to management of industry and controls on agriculture resulted in uneconomic uses of imported as well as domestic inputs, further aggravating the balance of payments. Finally, inappropriate foreign exchange currency regulations and controls resulted in limiting the inflow of workers' remittances and private investment and has hampered the growth in exports. The sharp fall in petroleum prices during 1986 and their subsequent sluggishness has revealed and exacerbated the underlying structural weaknesses of the Egyptian economy and made more urgent the need for vigorous economic reforms.

The structural weaknesses of the economy are manifested through misallocations of resources in agriculture and industry; large budget deficits and severe balance of payments difficulties. Underlying these problems is the existence of substantial price distortions which reflect the extensive use of implicit and explicit subsidies and implicit taxation. In particular, the prices of foreign exchange, basic consumer goods, energy and capital are significantly lower than their economic prices. Cotton, an important export crop, is heavily taxed. The distortions in these fundamental prices have produced a sub-optimal pattern of imports and investment decisions in the production sectors. Furthermore, the maintenance of the subsidy system has led to administrative regulations which impede productivity. Improper pricing has given incorrect signals to almost all productive activity and to consumer demand and has caused an economic drain that is now hurting the very people the government wished to assist.

Recognizing the need for comprehensive structural reform, AID, the IMF, the World Bank, and other principal donors are actively engaged in a substantial policy dialogue with the GOE. The primary aim of the dialogue is to reduce price distortions and market interventions which cause a misallocation of scarce resource. During the past few years, the GOE has implemented a number of reform measures which have been advocated as part of this policy dialogue. In May 1987, the GOE initiated an economic reform program which led to an IMF standby agreement and Paris Club debt rescheduling. The reform program consisted of a partial unification of exchange rates into a new market-oriented rate within the banking system; increases in nominal interest rates and energy rates; lifting of many restrictions on agricultural production and trade; and increases in the price of a substantial number of consumer goods.

The May 1987 reforms were to be augmented by additional strengthening measures in November 1987. However, through the summer and into the fall of 1987, GOE fears of provoking popular reaction against the reform program caused the government to slow down its efforts. Key strengthening measures were not taken in November 1987, and interim

Standby targets were not achieved. In addition, the reform program, judged to be weak by the international community, did not attract needed additional resources — further exacerbating the government's problem of meeting Standby targets. The government and the IMF have, nevertheless, continued discussions on a new reform package which would support further, needed debt rescheduling.

The principal issue between the government and the IMF is the pace of reform. The great depth of the economic problem and the severity of the budgetary imbalance and structural distortions suggests that the government accelerate its implementation of reforms. A greater effort is necessary to produce measurable changes in the macroeconomic picture as well as to satisfy IMF requirements that the balance of payments become viable in the medium term (five years). Regarding the budgetary imbalance, government and IMF negotiators made substantial progress toward agreement during June 1989, and a number of revenue raising measures were forwarded to the People's Assembly for approval in late June and early July. In addition, as indicated in Section IV of this document, the government has also raised a number of administered prices to reduce the size of the subsidy burden and has continued to decontrol important elements of the economy.

These measures, taken together, while not sufficient to satisfy IMF criteria for a second standby, nevertheless, demonstrate a government commitment to economic reform and progress toward a market based economy.

II. U.S. OBJECTIVES

U.S. policy in Egypt seeks the establishment of a secure peace in the region. An essential determinant of this peace is a socially stable and economically developing Egypt. In the present circumstances, social stability and economic growth require Egypt to comprehensively reform the structure of her economy. With a rapidly growing population and a serious resource shortfall, a fundamental change in Egypt's economy is essential to avoid destabilizing shortages of key consumer goods and employment opportunities. This fundamental change must come about from a comprehensive change in the macroeconomic policies now in force.

The purpose of this cash transfer is to support satisfactory implementation of a new, market based policy framework which fosters the structural reorganization of the economy. The cash transfer provides immediately available foreign exchange resources to cushion the short-term deterioration in the standard of living of certain sections of the population by financing needed imports and by helping Egypt meet selected debt service obligations currently due or past due on commodity purchases. The fragile state of the Egyptian economy, which is presently highly dependent on foreign assistance, justifies and necessitates the exceptionally high level of present and proposed U.S. assistance to Egypt. The high potential for destabilizing dislocations associated with near term austerity as Egypt implements comprehensive structural reform, justifies the provision of cash transfer resources.

III. RECENT U.S. ASSISTANCE PROGRAM

The United States has committed economic assistance to Egypt totalling $14.0 billion from FY 1975 through FY 1988. Non-project assistance (including PL480) has totalled $8.1 billion. Project assistance for physical and social infrastructure and agriculture made up the remainder of this assistance, all of which is detailed in Table I. The FY 89 programming levels for the cash transfer, the Commodity Import Program and PL480 (Title I) are $ 115 million, $300 million and $170.1 million, respectively.

U.S. assistance seeks to help support Egyptian consumption, production and investment levels by providing a portion of the requisite foreign exchange. The imports needed for each of these purposes are substantial and cannot now be funded out of such market-determined sources of foreign exchange as petroleum exports, workers' remittances, tourism and Suez Canal revenues. Developing new and additional exports and import substitutes, and bringing consumer demand into balance with resource availabilities will be time consuming and difficult. During the process, sustaining the level of certain essential imports and productive activities requires continuing concessional balance of payments assistance.

AID has made seven cash transfers totaling $926.9 million to the Government of Egypt (GOE) since September 1984. The FY86 and FY87 Foreign Aid Authorization Act conditioned the annual $115 million cash transfers on "the understanding that Egypt will undertake economic reforms or development activities which are additional to those which would be undertaken in the absence of the cash transfer." The U.S. FY88 Continuing Resolution legislation states that the FY88 cash transfer may be provided "... with the understanding that Egypt will undertake significant economic reforms which are additional to those which were undertaken in previous fiscal years, ...".

All cash transfer disbursements since September 1985 have supported far-reaching economic consultations. Since 1986, disbursements have been associated with the implementation of economic reform measures. The FY 86 Cash Transfer recognized a significant liberalization of import/export processes and a regularization of the customs regime. The FY 87 Cash Transfer encouraged the introduction of an array of fundamental reforms which led to an eighteen month IMF standby and Paris Club debt rescheduling. In keeping with the legislative requirement, the FY 1988 cash transfer supports the Egyptian Government's efforts to put in place a comprehensive economic reform program.

The distinguishing feature of the cash transfer assistance within the category of program aid is its facilitating role in the extensive policy dialogue between AID and the GOE. In that connection, AID carries on a Cabinet-level dialogue on macroeconomic policy reforms with the GOE. The policy dialogue has assisted the government to clarify the nature of many of the economy's problems and to consider alternative adjustment strategies. It has enabled AID to provide new ideas from technical experts and staff analysis, and in general, to create a more open environment for economic policy formulation.

IV. SATISFACTION OF LEGISLATIVE CRITERIA

The U.S. FY88 Continuing Resolution legislation states that the FY88 cash transfer may be provided "... with the understanding that Egypt will undertake significant economic reforms which are additional to those which were undertaken in previous fiscal years, ...". Since this PAAD refers to the FY88 cash transfer, the "previous fiscal years" relate to fiscal years culminating with (and including) FY87. This section catalogues and assesses the main economic reforms undertaken in FY88 and FY 89 which are additional to those taken prior to FY 88. The implementation of these measures provides the basis for the FY88 Cash Transfer. The primary justification for the release of the FY88 Cash Transfer is that these actions signify a GOE resolve toward greater reliance on market forces for economic decision-making in Egypt.

A. The reforms which support this Cash Transfer are as follows:

1. By March 1988, the remaining import transactions occurring at the overvalued commercial bank foreign exchange rate were shifted to a depreciated and more market oriented bank exchange rate — the new free bank market rate (FBMR) (see attached chart). The FBMR is set daily by a chamber of bank representatives — four from the public sector banks and four from private sector banks.

2. In August 1988, legal authority was established for all joint stock companies to issue bonds at a market rate of interest.

3. In a two step process during February and August 1988, retail fertilizer prices were raised by an average of 82 percent.

4. In March 1989, the average price of electricity was raised by 30 percent. A significant element of this action was that electricity prices to most industries, including public sector industries, rose by 66 percent. Prices were also increased for gasoline (May 1988) and other fuels (March 1989) by an average of 35 percent.

5. In May 1989, bank lending rates were raised by 2 percent and rates on savings accounts and certificates of deposit with maturities over six months were raised by 1/2 to 3 percent.

6. In July 1989, the exchange rate used to value imports for customs purposes is expected to be unified with the new bank exchange rate.

7. Throughout FY 88 and FY 89, subsidies on a wide range of consumer goods have been reduced. The most significant price increase which demonstrates the Government's commitment to reform was the 150 percent increase in the price of popularly consumed bread.

8. Throughout FY 88 and FY 89, the Government continued to improve the private sector investment climate in tourism through its program to contract out the management of public sector hotels to the private sector and through liberalized investment criteria. The Government has also sanctioned a significant expansion in access to important tourist locations by international air carriers and a private sector Egyptian air line. This action has ended the Government's monopoly in air service to these locations.

B. Impact of the Reforms

The eight measures noted above demonstrate a continued willingness by the government to correct prices, reduce subsidies and permit the operations of the economy to have greater exposure to market forces. At this time, because of the recent implementation of several of the key measures and because of critical time lags in the collection of data, no firm evidence is available on the impact of the reforms on the balance of payments, the budget deficit or economic growth. Thus, only rough projections and assessments can be presented on the measures' impacts. Furthermore, some time will be required on order to assess the behavioral effects these changes will have on consumption and investment — assuming these changes are sustained by further adjustments to correct for inflation. In terms of the specific measures, the impacts are assessed as follows.

1. The devaluation of the remaining import transactions occurring at the old accredited commercial bank rate to the new Free Bank Market rate (established in May 1987 as part of the program agreement for the IMF Standby) completed a promised Standby action three months ahead of schedule. At the time, this measure was important because it completed the equalization of the cost of foreign exchange for both public sector and private sector companies. The measure also introduced a more realistic price for foreign exchange to the public sector industries who were the primary beneficiaries of the old commercial bank rates.

   The benefits of this measure have been eroded somewhat because the rate setting chamber has devalued FBMR too slowly. In the latter part of CY 88 and into CY 89, the waiting time to purchase foreign exchange became too long for many private sector companies. These companies then turned to the private exchange system whose rate had been two to four percent more depreciated then the FBMR. In December 1988 the depreciation of the rate in the private exchange system became more severe so that by late March, 1989 the gap between the FBMR and the free market exchange rate reached fifteen percent.

   The Government then began devaluing the FBMR more rapidly and during June the gap between the FBMR and the free market exchange rate had been brought to approximately eleven percent.

   The importance of the elimination of the accredited bank rate transactions is that it has exposed imports, primarily public sector imports, to a clearly more appropriate price for foreign exchange than was the case previously. Furthermore, the government's recent devaluation suggests a government effort to close the gap between the FBMR and the free market rates and reestablish the positive features of this reform. When first introduced, the FBMR provided a strong stimulus to export. This stimulus should reemerge if the FBMR is depreciated to the free market level.

2. There has been no specific effect from legalizing the sale of bonds at market rates of interest because joint stock companies have not as yet floated bonds under the new legislation. The importance of this measure, however, is that it overturned the civil law's seven percent interest rate ceiling on this category of bonds. Joint stock companies now have the long sought after legal permission to sell bonds at market determined rates. Joint stock companies are likely to exercise this new right when further reform occurs in the structure of bank interest rates.

3. The fertilizer price increases raised the local price from about thirty percent to over forty percent of the world price. This was the first significant measure in five years to reduce fertilizer subsidies. Equally important, these price increases represent a first step toward moving fertilizer prices up so that the private sector may be allowed, in the future, to play a prominent role in the marketing of this agricultural input.

4. The increase in the price of fuel and electricity essentially kept up with inflation since the previous increase in May 1987, restoring the average electricity tariff to about 14 percent of its economic cost (long run marginal cost). The importance of the March 1989 tariff measure is that it significantly raised electricity prices to most industries (the rates for three large and uneconomic users were not raised), and the sixty six percent increase for industry exceeded the inflation rate for the same period (49 percent) and exposes most current industries and new industrial investments to a less

subsidized price structure. The revenue impact of this measure is projected to be LE 300 million during the next Egyptian budget year. The exemption of the three large users represents a loss of LE 25 million to the budget, but these firms have almost no technical capability to adjust their consumption. Their continued operation is mainly driven by employment and welfare considerations for those who work at the plants pending a decision to replace or redesign the plants' technology.

The relatively small rate increase to households in 1989, which brought the average increase down, represents a continuing desire by the government to minimize the price impacts of the reform on the lower income groups.

5. The increase in lending rates may result in small price increases in consumer goods because the largest portion of bank lending is for trade (inputs) finance. This measure is likely to have little impact on reallocating LE borrowing towards more efficient uses. Similarly, the increase in savings rates is not expected to measurably affect the continued dollarization of the economy. Short term deposit rates, including the key three month deposit rate, did not change. Longer term rates for deposits over six months rose by one half to two percent and a new seven year certificate of deposit was introduced at sixteen percent (three percent higher than the old rate on five year CD's). Few knowledgeable Egyptians invest in long term CD's because the annual rates are ten to thirty five percent below the expected yield on dollar deposits depending on one's expectations of inflation and devaluation.

The importance of this reform is that it is the first upward adjustment of bank deposit rates since 1982. Coupled with the deregulation of interest on joint stock company bonds, it suggests a government willingness to deal with an important issue which it has been avoiding for a long time. (See Annex B for the current interest rate structure).

6. The unification of the customs valuation rate with the new FBMR is a further step to unify the foreign exchange rate. However, this is primarily an important revenue measure because it links the customs duty to the LE price of imports. Consequently, the revenue collected from customs duties will rise in direct proportion to the devaluation of the currency. The revenue impact of this measure is expected to be at least 300 million, and possibly as much as LE 1.0 billion, during Egypt's 1989/90 budget year.

7. See Annex A for a detailed list of various price and revenue measures and their approximate revenue impacts.

8. The deregulation of the tourism industry is the most important example of government divesture of responsibilities and a monopoly position. The reforms in the tourism sector have produced a strong positive investment climate in the sector and improved efficiency in existing facilities. There is a dramatic and visible private sector construction boom in the principal tourist areas and occupancy rates of existing facilities are at an all time high. In terms of the balance of payments, the growth in tourism has had a significant positive impact earning $ 1.8 billion in FY 88 and projected to earn $ 2.0 billion in FY 89.

   The deregulation of the tourism sector and its strong and measurable benefits is the model which USAID is urging the government in our policy dialogue to apply to other sectors of the economy -- particularly to industry.

V. IMPLEMENTATION

A. Uses of Cash Transfer Proceeds

Grant proceeds may be used by the Government of Egypt (GOE) for any or all of the following purposes determined by the GOE to be necessary for balance of payments purposes:

(1) Financing the import of capital goods, raw materials and other goods and related services deemed essential by the GOE. The source and origin will be AID Geographic Code 000 unless otherwise requested by the Government and agreed to by AID.

(2) Servicing of U.S. Government or U.S. Government guaranteed debt* except FMS and other military or "ineligible" debt. "Ineligible" debt refers to debt arising from, for example, police related equipment or other items considered by AID to be inappropriate for AID financing. (A Grant Agreement covenant will prohibit such "ineligible" expenditures.)

(3) Other purposes or uses as subsequently agreed between the parties (e.g., payment of non-U.S. debt or non-U.S. guaranteed debt or procurement of commodities from non-U.S. source/origin).

In negotiating the above uses, we noted that AID has a policy (STATE 355792 of October 20, 1987) that countries receiving cash transfer assistance use the proceeds for purposes (1) and (2) noted above (imports from the U.S. and debt service to the U.S.) in that order of preference. In this regard, the GOE has indicated its intention to use the cash transfer proceeds for items (1) and (2). USAID considers that any combination of these two uses - (1) or (2) - would be appropriate under the circumstances and that we need not require a specific justification for the combination which the GOE in fact chooses.* Also, we believe the GOE should be encouraged to use cash transfer resources, within the parameters of the two specified eligible uses, for purposes which the GOE determines for itself are most effective and efficient. In sum, we believe the above-outlined arrangements concerning use of proceeds -

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* The AID/W policy guidance does not explicitly equate debt guaranteed by the USG with debt owed to the USG. However, the policy purposes seem very similar and we are, in fact, equating the two for this purpose.

arrangements which will permit the GOE to make its own choices within two categories of eligible uses - reflect a due appreciation for AID's policy preferences within the Egyptian context. Thus we do not plan to carry the concept of an "order of preference" over into the Grant Agreement -- since to do so would raise, undesirably we believe, issues for still further negotiation, justification and documentation subsequent to Grant Agreement execution. Therefore, the Grant Agreement will not reflect any "order of preference" between the two specified eligible uses. However, should the GOE later wish to use cash transfer proceeds for other purposes, then AID would request the GOE to provide us with evidence that no pressing requirements exist under the two specified uses before AID would concur in alternative uses.

Also, we note from the AID/W cash transfer policy guidance (STATE 325792) that any use of cash transfer proceeds to service debt owed to any institution (U.S. or otherwise) is permissible only where a showing can be made that such debt service requirement "is a significant barrier to growth and development". In the case of Egypt, the critical element is that continuation by the GOE of debt service payments to U.S. and other official creditors is necessary to maintain sufficient creditworthiness to gain access to new loans and grants from those creditors. Such loans and grants are, in turn, required to finance a major portion of the foreign exchange and investment expenditures needed to facilitate a resumption of economic growth.

B. Special Account for Cash Transfer Dollars.

A provision of the FY 89 Appropriations Act specifies that countries receiving cash transfer assistance establish a separate account for the dollar assistance. Policy guidance on ESF Cash Transfer Assistance in Handbook 1 offers further guidance on interpreting this provision. Accordingly, the following procedures apply to the establishment of this account for Egypt:

This account will be used solely for the receipt of cash transfer assistance from AID. The proceeds will not be co-mingled with other funds from any other source. Should any interest be earned on such account, such interest will be treated as though it were grant proceeds received under the terms of the cash transfer agreement. Any required redeposits (from hypothetical misuse of funds) will be similarly treated.

C. Monitoring and Audit

Egypt will advise AID in writing quarterly of disbursement of the uses to which such grant proceeds have been put. The accounting books and records will be available for inspection by USAID for a period of two years following the disbursement of the cash transfer. Evidence of uses would include letters of credit for imports, cancelled documents of loan indebtedness, and the like.

The grant agreement will contain provisions for accounting, reporting and monitoring of the grant proceeds. The grant agreement will provide for the right of audit and retention of records for three years after the date of last deposit, deposits to include interest earned on the account.

D. Local Currency

FAA Section 531 (d) requires that, as to Commodity Import Programs and "other program assistance," AID funding be used, "to the maximum extent feasible," to generate local currencies for support of AID funded Basic Human Needs activities. AID/W has confirmed that, as a matter of policy and perhaps of law also, deposit arrangements apply to Cash Transfer generations (see STATE 185485.) "Generations" occur for this purpose when commodities are imported using Cash Transfer funds; and "generations" are computed (as under Commodity Import Program arrangements) on the basis of the highest official exchange rate (LE per dollar) available to importers for any transaction. Therefore, to the extent that local currency is generated under the Cash Transfer Agreement, deposits will be required. AID/W has confirmed that such deposits may be co-mingled with the already exisiting Special Account established and maintained under CIP documentation (STATE 185485). Thus, Cash Transfer related local currency will be programmed and expenditures monitored according to the same procedures currently used for the CIP Special Account.

VI. Beneficiaries

As the FY 1989 CDSS stated, over the long run, a comprehensive reform program will benefit the poor by stimulating employment opportunities as the economic situation improves. The reforms which have been made to date, however, are short of what is needed to stimulate the economy. In fact, with the exception of liberalization in the tourism sector, the immediate effects of the other reforms noted above are primarily to increase prices and consequently reduce demand, without a commensurate increase in investment or employment. These reforms will, therefore, have the effect of reducing real incomes. The GOE is aware of this and has tried to minimize this effect on the most vulnerable groups. For example, the electricity tariff increases were targeted primarily at industrial users, leaving small residential consumers with much lower proportional increases. Major fertilizer increases were timed to take place after many of the price controls on agricultural crops had been removed, so that increased farm income was available to make the fertilizer increases affordable.

Nevertheless, the immediate effect of these reforms is to reduce incomes, particularly for low and middle income urban Egyptians, and for Upper Egyptians. With reduced incomes, more poor Egyptians will be forced into the labor market, particularly women and children. Employment possibilities for these groups in the formal production sector will be very limited, so most will go into low productivity, low pay jobs in the service sector. While women entering the labor force under the current economic conditions will generally be poorly paid in low productivity jobs, their entry reduces an important social barrier — i.e., the custom of seclusion of women — which is unlikely to be raised again when the economy improves and productivity (and income) rise.

Informal studies show that when income is reduced, poor families tend to spend less on school expenditures, and girls are probably affected first. Anecdotal information also suggests that petty crime increases as people look for ways to cope with declining income.

The bright spot is tourism. Liberalization in the tourism sector has already resulted in substantial investment in tourism facilities and an increase in tourist visits. These translate very directly into new jobs in construction, services, and sales.

The cash transfer will help to eliminate some of the negative impacts of the current economic decline by providing badly needed foreign exchange resources for commodity imports and debt payment. Further, the cash transfer affords USAID a voice in policy discussions with the GOE to advise on the needed direction of reform to lead a sustainable, growing economy where incomes and employment will increase. Though the immediate impacts of the current set of reforms have been negative on Egyptian incomes, failure to undertake the reforms would ultimately lead to greater income and employment declines, without the promise of an eventual upturn in the economy.

VII. RECOMMENDATION

The Project Committee recommends that, at this time, a $115 million cash transfer to the Government of Egypt (GOE) be approved and authorized. Obligation of funds (through execution of a Grant Agreement) would take place upon satisfactory outcome of the Congressional Notification procedure and receipt of an OMB funds apportionment.

VIII. AUTHORITY

Under Delegation of Authority No. 653, the Egypt Mission Director may approve and authorize non-project assistance following consultation with AID/W; such has taken place through the months. Also, per STATE 193671, the Acting Director has (for the period July-September 1989) been delegated all Director's authorities as contained in DOA No. 653.

DOC., APPROVAL. July 18, 1989

ANNEX A: Revenue Measures for Selected GOE-Supplied Goods and Services

During the period October 1987 to June 1989 the following revenue measures were implemented:

- The price of rationed cooking oil was increased by 36%. Expected new revenues are LE 19 million per year.
- On average, rationed sugar prices increased from P.T. 10/kg to P.T. 20/kg. This price change results in approximately LE 56 million increase in annual revenues.
- Popular bread experienced a 150% price increase. Popular bread produced by both public and private bakeries is under government price control. As of July 1989, 90% of both private sector production (50% of total bread production) and public sector production is now sold at P.T. 5. By the end of July 1989, the government plans to cancel the P.T. 2 bread completely. We estimate the revenue impact from reducing bread subsidy to be LE 640 million approximately.
- Price of small-sized bottles of Pepsi and Coke increased from P.T. 10 per bottle to P.T. 15 per bottle. Annual revenue impact of this price increase is approximately LE 135 million.
- Cigarette prices were raised by 20% in May 1988 and by an average of 18% in June 1989. Total revenue impact is expected to amount to LE 600 million per year from FY 90.
- Newspaper prices increased by 33%. This was estimated to increase revenues by about LE 3 million.

- School fees were increased by 50%. This should increase revenues by approximately LE 53 million.

- Domestic telephone calls were shifted to a 6-minute unit charge. This is estimated to increase annual revenue by LE 32 million.

- Telephone installation fees were increased by LE 100 (flat rate). This price increase is estimated to increase revenues by LE 15 million.

- First and second class railroad ticket prices were increased by 80% while third class ticket prices were increased by 50%. This price increase is expected to raise revenues by LE 55 million in CY 1989.

- In May 1988, regular gasoline prices were increased by 40% while premium gasoline prices were increased by 33%. Price increases yielded an additional revenue of LE 350 million in FY 88/89.

- Other petroleum product prices were raised in March 1989 and electricity tariffs were raised by an average of 30 percent, resulting in an annual revenue yield of LE 450 million.

- Cement prices were increased by approximately 53%, resulting in an annual LE 200 million additional revenue.

- Publicly produced rebar prices were increased by 52% approximately (from LE 388 to LE 590 per ton). This price increase is expected to increase revenues by LE 60 million, approximately.

- Price of popular cloth was increased from P.T. 17.5 per meter in 1987 to P.T. 80.5 in 1988.

- Insurance premiums were doubled.

- Water tariffs were increased by 25% approximately.

- Price of tomato paste was doubled.

ANNEX B: Deposit and Lending Rates for Banks

Table 1. EGYPT: INTEREST RATE STRUCTURE, ON DEPOSITS
(% per Annum)

Effective Date	April 1980	June 1980	January 1981 *	July 1982	May 1987	May 1989
0 - 6 days	0.0	0.0	0.0	0.0	0.0	0.0
7 - 14 days	4.5	4.5	5.0	5.0	5.0	5.0
15 - 30 days	5.5	5.5	6.0	6.0	6.0	6.0
1 - 3 months	6.5	6.5	7.5	7.5	7.5	7.5
3 - 6 months	7.0	7.5	8.5	8.5	8.5	8.5
6 - 12 months	7.5	8.0	9.0	9.5	9.5	10.0
1 - 2 years	8.0	9.0	9.5	11.0	11.0	12.0
2 - 3 years	8.5	9.5	10.5	12.0	12.0	13.0
3 - 5 years	9.0	10.0	11.0	12.5	12.5	14.0
5 - 7 years	9.5	10.5	11.5	13.0	13.0	15.0
> 7 years	.	.	.	.	.	16.0
Saving Deposits	7.0	8.0	8.5	10.0	10.0	11.0
Investment Certificates	10.0	11.0	12.0	13.25	13.25	16.25

Note: As of January 1989, the maturity distribution of LE deposits at commercial banks was as follows--less than 30 days, 50%; from 1 to 3 months, 7%; from 3 - 6 months, 8%; from 6 to 12 months, 10%; more than one year plus saving deposits, 25%. Commercial banks account for more than three-fourths of all LE-denominated demand and time deposits at Egyptian banks.

* Interest rates on deposits for 6 months and less than one year was raised from 9% to 9.5% and for one year to less than 2 years from 9.5% to 10.0% as from August 1, 1981.

[illegible], Inge Loeffl
5/19/[illegible]

Table 2. EGYPT: INTEREST RATE STRUCTURE, ON LENDING

(% per Annum)

Effective Date	April 1980	June 1980	January 1981	July 1982 *	May 1987	May 1989
Discount Rate	10.0	11.0	12.0	13.0	13.0	13.0
Interest Rate Minima and Maxima on Lending to:						
1. Agriculture & Industry						
< 1 year	11 - 13	12 - 14	13 - 15	- 13	11 - 13	13 - 15
1 - 2 years	11 - 13	12 - 14	13 - 15	- 13	12 - 14	14 - 16
> 2 years	11 - 13	12 - 14	13 - 15	- 13	13 - 15	15 - 17
2. Services **						
< 1 year	11 - 13	12 - 14	13 - 15	13 - 15	13 - 15	15 - 17
1 - 2 years	11 - 13	12 - 14	13 - 15	13 - 15	14 - 16	16 - 18
> 2 years	11 - 13	12 - 14	13 - 15	13 - 15	15 - 17	17 - 19
3. Trade						
< 1 year	11 - 13	12 - 14	13 - 15	16 -	16 -	18 -
1 - 2 years	11 - 13	12 - 14	13 - 15	16 -	17 -	18 -
> 2 years	11 - 13	12 - 14	13 - 15	16 -	18 -	18 -

* A minimum rate of 11% was set for interest rate on loans granted to agriculture and industry as from December 1, 1983.

** These rates were fixed on loans and advances granted for the household sector as from May 1, 1987.

PRE/E, Ingi Lotfi
5/19/89

STATUTORY CHECKLIST

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA? — YES / N/A

b. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? — N/A

c. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities? — NO

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? — N/A

e. FY 1989 Appropriations Act. If assistance is in the form of a cash transfer: (a) are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account to be used in accordance with FAA Section 609 (which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. — Yes.

Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available)? N/A

(c) has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance? YES.