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Interim Evaluation: Sector Policy Reform Program and Technical Support for Sector Policy Reform Project — Egypt

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ACRONYMS

AC	Affliated Companies
BTAP	Banking Technical Assistance Program
CBE	Central Bank of Egypt
CMA	Capital Markets Authority
DDSR	Debt/Debt Service Relief
EAP	USAID's Economic Analysis and Policy Directorate
EEC	European Economic Community
ERSAP	GOE's Economic Reform and Structural Adjustment Program
ESA	Employee Shareholder Association
FSN	Foreign Service National
FY	Fiscal Year
GATT	General Agreement on Tariffs and Trade
GCFCG	Gulf Crisis Financial Coordination Group
GDP	Gross Domestic Product
GIT	Global Income Tax
GNP	Gross National Product
GOE	Government of Egypt
GPP	Government Privatization Program
HC	Holding Company
HS	Harmonized System
IMF	International Monetary Fund
IDR	Intellectual Property Rights
MIC	GOE's Ministry of International Cooperation
NTB	Nontariff Barriers
PAAD	Program Assistance Approval Document
PE	Public Enterprise
PEO	Public Enterprise Office
PFAP	Public Finance Administration Project
POS	Point of Sale
SAL	World Bank Structural Adjustment Loan
SAMP	Structural Adjustment Monitoring Program
SDR	Special Drawing Rights
SOE	State-Owned Enterprise
SPR	USAID's Sector Policy Reform Program
TIN	Taxpayer Identification Number
TSSPR	Technical Support for Sector Policy Reform Project
UNDP	United Nations Development Programme
USAID	U.S. Agency for International Development
VAT	Value-Added Tax

LE = Egyptian Pounds (Livres Egyptiens)
Official rate, April 1994, LE 3.37 = US$1

SUMMARY OF MAIN FINDINGS AND RECOMMENDATIONS

FINDINGS

1. The Sector Policy Reform (SPR) Program has proved itself an effective substitute for the unconditioned cash transfers of the past two decades. It has succeeded in pushing forward the Government of Egypt's (GOE's) reform program while accommodating to the constraints imposed on policy lending by the special political circumstances of U.S. aid to Egypt. Despite the earmark and its implications for the credibility of conditionality, the GOE/World Bank/IMF program for reforms has been strengthened by the USAID backup, and USAID itself has become a more significant and effective partner in policy dialogue.

2. In the past decade, and especially the past three years, GOE has stabilized the economy and has made extraordinary progress toward economic liberalization and the reduction of distortionary economic policies. Following the wide-ranging reforms in agricultural policy that began in the mid-1980s, macroeconomic and broad sectoral reforms were introduced in 1991 with Bank-Fund support, under an Economic Reform and Structural Adjustment Program (ERSAP). Since 1991, exchange rates have been unified and exchange controls dismantled, real interest rates have become positive, the trade regime has become more open, and financial markets have been made more open and competitive. A beginning has been made in privatization.

3. USAID has contributed to this movement toward freer markets and increased efficiency of resource use. It was the chief sponsor, with GOE, of the agriculture sector reforms. Through the SPR it has provided support for ERSAP by reinforcing its conditionalities and complementing them by sponsoring new or related policy measures.

4. The SPR policy measures were generally well designed to meet the targets of the program. Compliance has been good though uneven. The most consistent compliance has been in the financial and fiscal areas. The biggest gap between commitments and performance has been in privatization. Compliance was cosmetic in some cases, notably privatization, where GOE invented a way to comply formally with ERSAP conditionality (by shifting state-owned enterprise (SOE) shares to so-called Employee Shareholder Associations) while leaving unaffected SOE control and introducing no management changes.

5. The SPR will have special priority in the post-debt relief years — in other words, after 1994. The promise of substantial Paris Club debt and debt service relief has been the main incentive for GOE adherence to the reform program. But this will be gone once the Bank and Fund certify compliance with ERSAP policy conditionalities, probably in a few months. An additional peril for policy reform is the comfortable budget and balance of payments posture of GOE. The temptation to pursue more expansionist, less prudent macroeconomic and sectoral policies will surely increase. The relative importance of USAID's SPR program will thus increase substantially, because it will be the only cash-backed multisectoral policy reform program.

6. Implementation of SPR has been extremely demanding. Conditionality could not be pushed so hard that it became "burdensome," given the large reform agenda that was already on the table. Nor could it be based entirely on the Bank-Fund policy matrix without risking the charge that the same reforms were being "paid for twice." Decision making is centralized, policy analysts few, the flow of information sluggish, and habits of open debate and policy dialogue embryonic. Some ministries are

uninterested, even hostile, to policy discussion with donors. Despite all this, and by dint of persistence and ingenuity, the Economic Analysis and Policy Directorate has succeeded in tracking compliance with the policy measures of SPR. In the process they have learned a great deal about the Egyptian economy and about obstacles to reform. And they have nudged the policy reform process forward.

7. Despite the generally good management of the program, the evaluation suggested several areas where modifications might increase effectiveness and impact.

- The policy measures are numerous (they number 20), and range widely over four economic areas or sectors. The program objective is not sufficiently clear or concrete, and specific subobjectives are not explicit. It is therefore not easy to see a unifying theme or vision that inspires the program.

- Monitoring has consisted mainly of a search for verification that policy measures have been complied with. This has been well done, and is essential; it is the basis for disbursement. But verification has become a laborious, auditor-like paper chase with uncertain links to broader policy concerns.

- The dialogue-enhancing potential of SPR was initially constrained by the practice of funneling all contacts with GOE through the Ministry of International Cooperation (MIC). Although this had advantages, it acted as a screen between USAID technical staff and the operating agencies. This is no longer a serious problem, because USAID staff now meet regularly with other agencies.

- Interactions between USAID and the Bank and Fund have been generally good but considerably less than optimal. Bank missions sometimes do little more than perfunctory briefings. When the ERSAP conditionality was being worked out, USAID was not informed until late in the day as to its content. It is difficult to get access to Bank and Fund reports that cover issues central to the effectiveness of USAID's SPR.

- The economists of the EAP directorate have had inadequate contacts with the Egyptian business community and with private sector players in general. This is no different from what happens in most USAID Missions, where private sector officers or trade and development project staff interact with the private sector, while economists worry mainly about public policy. Nevertheless, when the policy reform program is so directly aimed at liberating private energies, it is indispensable for the economic staff to be more involved with the business community and other private actors.

- Interoffice relations are cordial and collaborative, but USAID's size and organizational complexity has hindered internal collaboration on the SPR program. EAP staff are not always represented at meetings on SPR-relevant matters that other USAID units attend — with GOE officials, the World Bank, or other donors. The economists are not always adequately represented at high-level policy discussions. Other USAID offices were not in the past fully mobilized for preparation of policy measures.

- The potentials of the SPR's sister project, the Technical Support for Sector Policy Reform (TSSPR) Project, have been insufficiently exploited. Few studies have been financed, limited technical assistance provided. One reason is that GOE officials seem to prefer multilateral technical assistance in some policy areas. Another is that technical oversight of the TSSPR project has not fallen squarely within a well-defined jurisdiction within the EAP directorate.

RECOMMENDATIONS

1. A second SPR should follow the present project. In addition to greater effectiveness because of lessons learned from the present SPR, the next SPR will have greater significance because it will fill a policy lending void — the void created by the absence of a financially backed World Bank program and the disappearance of the incentive of Paris Club debt relief after 1994.

2. The new SPR (SPR II) should concentrate its policy measures on narrower, better-defined objectives. It should have one relatively simple major objective, such as: encouraging private sector supply response. Precise subobjectives should also be defined. Selection of policy measures could then be more finely targeted. All of this would make measure selection easier, monitoring simpler, and explanation of the program more comprehensible.

3. The Mission should continue to draw on the World Bank/IMF policy matrix for ideas about policy measures that are suitable for SPR II. This is efficient, because these measures are based on lengthy studies and analysis. It is efficient also because USAID can continue to reinforce and complement an existing structure of conditionality, much of which remains to be implemented. It is not "paying twice for the same reforms," especially because the World Bank will have no adjustment program other than its monitoring program (SAMP), which will have lost most of its bite because of the completion of the Paris Club's debt and debt service relief program.

4. In assessing policy measures proposed for inclusion in SPR II, the following questions should guide selection: Is the measure "strategic" — crucial to private sector growth or whatever overall objective is chosen? Is it technically uncontested? Is it monitorable? Is it credible and differentiated in terms of costs of noncompliance? Is there balance between the gains that will result from compliance and the risks and costs of noncompliance?

5. Given the uncertainties in present privatization policies compared with previous policy objectives, the GOE should prepare a new statement on privatization strategy and objectives.

6. A major procedural change should be made under SPR II. GOE should be asked to set up a tripartite Working Party on private sector development, consisting of GOE representatives, donors with policy programs, and private sector spokesmen. This Working Party would be an ongoing forum for consideration of policy issues like those in SPR II. It should be made up of middle- or high-level technical staff, should meet regularly, and should have a small budget for commissioning studies and policy analyses and perhaps a small secretariat. Its raison d'être would be the encouragement of in-depth technical discussion of policy issues in a noncontentious, problem-solving atmosphere.

7. The GOE should encourage USAID in its efforts to engage ministries other than MIC in more meaningful dialogue. The GOE should allow ministries other than MIC to approve the use of TSSPR money, which would encourage wider and deeper dialogue.

8. To help remedy the sparsity of policy analysis and policy analysis capacity that is widely noted as an obstacle to better-quality technical dialogue, USAID with TSSPR financing should help create small policy analysis units in key economic ministries. EAP staff have already made proposals along these lines. Nothing has come of them so far. Given the importance of the problem, another try would be worthwhile.

9. The monitoring process should in future consist much less of seeking documentary evidence of compliance with policy measures and much more in assessing real impacts of the specific measures and related obstacles to reform. The conditionality element in SPR should be more of an opening to dialogue and an opportunity for joint problem solving than an exercise in policy auditing. USAID should harness the TSSPR-sponsored small research grant project to this end, and create similar projects, such as a summer award program for joint research with U.S. graduate students around policy themes.

10. Monitoring of the traditional kind has to continue, of course. But USAID can make it easier — by including fewer, better-defined conditionalities, quantified where feasible, and by limiting the complexity of these conditions. USAID should also rely more on GOE provision of proof of compliance and less on its own seeking out such evidence; the corollary is that USAID has to be prepared to withhold disbursements until satisfactory evidence of compliance is provided. Responsibility for compliance monitoring should be transferred to the new monitoring unit at MIC, with EAP staff playing a collaborative and advisory role. USAID and MIC monitors should focus mainly on proximate or micro effects of policy changes, with impact assessments receiving major attention. Studies of macroeconomic effects — on aggregate growth, or on aggregate exports for example — should not be done; relevant inputs are too numerous, exogenous factors too important.

11. The policy impact studies should involve interviews of GOE implementing staff, private sector representatives, and other people and institutions affected by specific policy reforms. To determine reform effectiveness, shortcomings, need for additional reform or changed implementation procedures, and socioeconomic impacts.

12. The overall reform program in Egypt lacks transparency, in that little information is made available about it to the public, even the highly educated and politically aware public. USAID in its dialogue with GOE should express its concern on this matter. Government should be urged, for example, to publish the White Books that were supposed to be published giving details of each privatization transaction. To allow more general access to World Bank and some IMF studies, USAID should consider a policy measure allowing public distribution in Egypt of documents (such as many World Bank reports) that are publicly circulated outside of Egypt but not available, by GOE request, within the country.

13. Related to the previous recommendation, USAID should consider the inclusion of a PAAD covenant that commits GOE to provide USAID with all relevant IMF and World Bank documents. Truly confidential material is not at issue. It is rather the question of access to substantive studies like the recent Bank private sector regulatory system study and the IMF analysis of investment incentive issues — studies that are essential for the policy work of SPR.

14. USAID interactions with the World Bank, and to a lesser degree the IMF, should be intensified. Effort should be made to include USAID staff on bank study missions. USAID, as the major donor in Egypt, should also request more complete briefings and easier access to Bank staff.

15. EAP staff should intensify their efforts to establish contacts with the private sector, from small entrepreneurs to major industrialists, exporters and importers, service providers from lawyers and bankers to truckers and stevedores, and organized private groups from businessmen's associations to trade unions.

16. TSSPR should be reinvigorated and refocused. EAP management should consider the desirability of concentrating TSSPR efforts in three areas: encouraging studies that clarify and document constraints to private sector expansion; encouraging studies that increase understanding of the costs of nonreform and the benefits of reform; and attacking the problem of lack of policy analysis capacity, first by financing a study of the nature and dimensions of the problem, and later — if called for — financing the formation of policy analysis units within key economic ministries.

17. The SRP is a joint program, a cooperative effort of USAID and the GOE together. The findings of this evaluation bear on both partners, and most of recommendations require action on the part of each. It may nonetheless be convenient to set out separately here those recommendations that require mainly GOE action.

- The GOE should encourage USAID in its efforts to engage ministries other than MIC in more meaningful dialogue. To this end, the GOE should allow ministries other than MIC to approve the use of TSSPR money.

- The GOE should make adjustment policies and processes more transparent. The White Books on privatization transactions should be published without delay. The GOE should allow public distribution in-country of documents (such as many World Bank reports) that are publicly available outside of Egypt.

- The GOE should issue a new statement of its privatization strategy and objectives.

- The GOE should create a tripartite Working Group on private sector development (officials, donor representatives, private sector spokesmen).

- The GOE should create small policy analysis units in key economic agencies.

- The MIC monitoring unit should be given major responsibility for compliance monitoring, which should be its first priority. It should secondly provide analyses of the impact of adopted policy measures at the micro level. In its initial years it should not try to evaluate macroeconomic impacts of the overall reform program, which is difficult to do and less instructive than bounded impact studies.

The remaining recommendations require action by USAID alone or in tandem with the GOE.

SECTION ONE

INTRODUCTION

BACKGROUND TO THE SECTOR POLICY REFORM PROGRAM

The Government of Egypt (GOE) and the United States agreed to implement USAID's Sector Policy Reform Program (SPR) and the complementary Technical Support for Sector Policy Reform Project (TSSPR) in August 1992. SPR was designed to be a $400 million, two-year program, which would disburse up to $200 million per year in support of GOE implementation of agreed-to policy reforms in the financial, fiscal, trade, and enterprise sectors. TSSPR was designed to provide up to $10 million over three years to finance studies, short- and long-term technical assistance, and training in support of the policy reforms addressed under the SPR.

GOE's Ministry of International Cooperation (MIC) is USAID's official counterpart for both SPR and TSSPR, though USAID also interacts with other agencies (for example, the Ministries of Economy and Trade, Finance, and Agriculture; the Central Bank of Egypt; the Public Enterprise Office; and the Capital Market Authority) in implementing the program. USAID's Economic Analysis and Policy Directorate (EAP) is responsible for managing both SPR and TSSPR.

Purpose of SPR

The overall purpose of SPR is to complement and reinforce the government's Economic Reform and Structural Adjustment Program (ERSAP). Faced with an increasing and unsustainable external debt burden, rising fiscal and balance of payments deficits, slow growth, mounting unemployment, and declining living standards, GOE adopted its ERSAP in 1991, in cooperation with the International Monetary Fund (IMF) and the World Bank.

This comprehensive reform program was initially supported by an 18-month IMF Stand-by Agreement for SDR 278 million (approved by the Fund Board in May 1991) and by a complementary World Bank Structural Adjustment Loan (SAL) for $300 million (approved by the Bank in June 1991). The Stand-by and SAL were successfully completed in March 1993, but because of a favorable balance of payments situation (including Central Bank foreign exchange reserves of more than $15 billion), GOE decided not to make further draws from either facility.

Continued support to the government's ERSAP is being provided by a three-year SDR 400 million Extended Arrangement approved September 1993. The available financing is precautionary and not expected to be used. The World Bank also approved in September 1993 a three-year Structural Adjustment Monitoring Program (SAMP), which involves annual policy performance reviews but no financial support.

The Debt Relief Factor

The reform program was also supported by substantial debt/debt service relief (DDSR) from the international community. To mitigate the impact of the Gulf War and related Middle East crises on the Egyptian economy, the donor countries provided more than $4 billion in cash (mostly grant) assistance over FYs 1991 and 1992 under the umbrella of the Gulf Crisis Financial Coordination Group (GCFCG). The United States and regional creditors also canceled debt totalling $13 billion in late 1990. In addition, Paris Club creditors agreed in May 1991 to DDSR equivalent to $10 billion.

The significance of compliance with the Fund and Bank programs has been amplified by the DDSR provided by Paris Club creditors. Paris Club DDSR is linked to successful government performance under the IMF arrangements, which in turn require satisfactory performance under the World Bank's SAL and SAMP.

DDSR was designed to be provided in three phases. The first phase, which provided $3 billion DDSR (15 percent reduction in the present value debt service falling due), was implemented in July 1991 after the approval of the IMF Stand-by. The second phase, also $3 billion (15 percent of the present value of debt service), which was to have been implemented by December 31, 1992, was postponed until October 1993, following Fund approval of an Extended Arrangement in September 1993.

The final phase of DDSR, amounting to $4 billion (20 percent reduction), is scheduled by the Paris Club to take place by July 1994 and is conditional on satisfactory performance under the IMF Extended Arrangement, which is in turn conditional upon compliance with the World Bank's SAMP.

Although there has been generally satisfactory compliance with IMF-monitored macroeconomic policies, and with SAMP-monitored structural reform, performance in some areas, especially privatization and competitiveness-related actions, remains problematic and has threatened to force delay of the final Paris Club DDSR. On privatization, sales of state-owned enterprise (SOEs) are far short of targets. The World Bank has accepted alternative approaches (specifically, transfer of shares to employee associations) as satisfactory compliance.

In addition, the IMF and the government need to come to terms with the macroeconomic program for this year, including dealing with the need to increase export competitiveness through mutually consistent fiscal, credit, and exchange rate policies.

Once the Paris Club DDSR is completed, direct financial incentives to adhere to the Bank-Fund-supported reform program will no longer exist. The importance of compliance with the IMF and Bank programs will be limited to GOE's perception of the value of Bank/Fund issuance of a clean bill of policy health to the donor community and the private sector. Hence, the relative importance of USAID's SPR program should be expected to increase significantly in the future, because it will be the only financially supported multisectoral policy reform program.

EVALUATION OBJECTIVE AND METHODOLOGY

The objective of this evaluation is to assess the progress made to date under the SPR program and the accompanying TSSPR project, and to provide guidance concerning the contents, design, and implementation of both a proposed follow-on policy-based cash transfer program and the remainder of the TSSPR project. The evaluation assesses the appropriateness of the design of SPR and TSSPR, the

management of SPR and TSSPR by USAID and GOE, and the contribution of SPR and TSSPR to GOE's economic reform program. The evaluation also provides recommendations concerning a follow on policy based cash transfer program and complementary technical assistance.

The main part of the evaluation took place between March 20 and April 17, 1994; additional inquiry and analysis took place through early May. The evaluation team consisted of Elliot Berg (Team Leader), Richard Sines, and James Walker. The evaluators drew heavily on the ideas and experience of the USAID/Cairo staff, especially those in the Economic Analysis and Policy Directorate. The Trade and Investment Directorate provided invaluable help with private sector contacts. The extensive logistic underpinning provided by the Mission's friendly and efficient support staff greatly facilitated our work.

Measurement of the impact of SPR, as of all policy reform programs, is extremely difficult. The "counterfactual" issue is always present: no matter what the outcome from the adoption of a reform program like SPR, the results of continuing prereform policies might have been (probably would have been) worse. Time horizons are equally relevant: negative short-run impacts of reforms in a deeply distorted economy may make nonadjustment look better; but longer-term results will be more favorable to adjusters.

Difficulties in precise measurement of impacts are numerous. The program is recent — only two years old — and the overall reform effort (ERSAP) within which it is embedded is less than three years old. Even if adoption of all structural reforms had been complete at the time of the team's visit, this is too soon to see many results. And of course the structural adjustment measures have been only partially implemented.

Measurement by reference to ultimate or near-ultimate objectives (for example, increases in exports, private consumption, or per capita GDP) can yield interesting insights, but has serious limits. One is the brevity of the program. Another is that disentangling of policy impacts from other influences on short-term changes in economic performance, such as weather, wars, and world price fluctuations, requires multiple regression analysis using poor data and much institutional uncertainty. Such analyses rarely yield results that are robust enough to be credible. In any event there was not enough time in the present evaluation to do a quantitative analysis of this type.

Finally, quantitative assessment of a program like SPR requires overcoming the "attribution problem." Many actors contributed to the reform effort. Reform leaders within the government have played key roles in advocating, explaining, defending, and implementing the policy changes. On the external side, not only did the IMF and World Bank play major roles in addition to USAID, but the European Economic Community (EEC) and the Germans also contributed.

All this means that the evaluation has to be essentially qualitative, with all the limitations this entails in subjectivity and the uncertain generalizability of conclusions. Nonetheless, much can still be said. Positive impacts can be identified, as well as problems in implementation and ways to reduce them.

In this report we first set out main findings, then the recommendations that follow from them. The findings note the overall success of Egypt's reform program since 1991, and argue that USAID has contributed significantly to it. GOE compliance record is found to be generally good, with lags evident in only a few reforms areas. The anticipated completion in 1994 of the DDSR creates a special need for a follow-on policy program in the next several years. The strong and weak points of USAID's management of the program are then outlined.

In the ensuing recommendations we argue that the effectiveness of the SPR could be enhanced by giving it greater concentration and focus. Some general criteria for selection of new policy measures are put forward. Suggestions are made to widen the policy dialogue, the most important being a call for creation of a tripartite Working Party (government, private sector, some donors) that could be a forum for deeper, broader, noncontentious policy dialogue. Suggestions are also put forward to increase the future impact of TSSPR.

Evaluations of this kind always run the risk of appearing excessively critical. Evaluators seek out what is not going well while passing over those activities that are proceeding smoothly. It is worthwhile therefore to state our general conclusion at the outset: the SPR is a successful, effective project. In has succeeded in finding ways around the formidable constraint imposed on policy lending by the special political circumstances of U.S. aid to Egypt. Despite the earmark and its implications for the credibility of sanctions in case of weak GOE policy performance, the GOE/Bank-Fund program or reforms has been strengthened by the USAID backup, and USAID itself has become a more important and effective partner in policy dialogue.

SECTION TWO

FINDINGS

RECENT POLICY CHANGES HAVE BEEN REMARKABLE

In the past decade, and especially the past three years, Egypt has made extraordinary progress toward economic liberalization and the reduction of economic distortions.

Agricultural Reforms

Over the recent past, Egypt has undertaken a series of remarkable policy and regulatory reforms that have gone a long way toward liberalizing the agricultural sector.[1]

- Crop area allotments with delivery quotas at fixed procurement prices have been removed for all major crops except sugar cane.
- All agricultural producer prices, except for cotton and sugarcane, have been completely liberalized, and farmgate cotton prices raised; subsidies on fertilizers and pesticides have been significantly reduced and are expected to be completely phased out by 1995; and
- Private sector processing and marketing of agricultural products and private delivery of agricultural inputs are being encouraged; fertilizer distribution, a government monopoly a few years ago, is now more than 80 percent privatized. Restrictions on private sector rice processing and on intergovernorate transportation of milled rice have been liberalized. Import and export regulatory barriers are being reduced.

Macroeconomic and Sectoral Reforms

GOE's ERSAP initiated in 1991 a shift at the macroeconomic level. The subsequent policy changes resulted in a major transformation in the way the economy functions. Egypt moved from a centrally planned economy with key prices and activities controlled by government and a small, weak private sector to a more decentralized, more outward-oriented economy, with prices and markets much freer, and a private sector that is acknowledged to be the leading agent of growth. This is the fruit of the policy effort made by government over the last three years to achieve macroeconomic stability while embarking on a comprehensive structural adjustment program.

The reform program, however, remains uneven and partial. Although the stabilization components have been implemented with great speed and extraordinary success, structural reforms have come more slowly and imperfectly. In large part because the economy remains heavily controlled and regulated by the state, private sector investment, export growth, and overall economic activity have

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[1] See World Bank, *An Agricultural Strategy for Egypt*, December 1992, pp. 7-10 for a description of these reforms.

increased slowly or not at all. Rapid economic growth has not yet come. Poverty intensifies and unemployment continues to mount.

None of this detracts from the tremendous achievements that have been made in putting Egypt's policies right during the past three years. The centerpiece of the reform program has been a major front-loaded fiscal adjustment. The fiscal deficit has been dramatically reduced, from 17.2 percent of GDP in FY 1991 (ending June) to 4.7 percent in FY 1993 and a projected 2.6 percent in FY 1994. The reduced need for domestic financing of the deficit has facilitated monetary restraint and a reduction in inflation from 21 percent in 1991 to 7.4 percent in 1993 (annual rate ending January 1994).

Financial Sector Reform

Financial liberalization has also been significant. At the start of the reform program, GOE:

- Removed the ceiling on interest rates;
- Began phasing out the system of government controlled credit rationing;
- Initiated the use of treasury bill auctions to manage liquidity (thereby providing a market-determined reference interest rate to financial markets); and
- Dismantled foreign exchange controls and unified the exchange rate. This initially resulted in a 35 percent depreciation of the Egyptian pound, but the rate has remained stable since.

Financial liberalization has also supported reforms to strengthen the solvency and efficiency of the banking and security markets.

Trade Liberalization

The reform program has begun to move gradually away from inefficient import substitution policies and toward an outward-oriented trade regime. Trade liberalization has included three major components:

- Substantial reduction of nontariff barriers (NTBs), including the removal of most import bans and prior approvals;
- Reduction in tariffs (most tariff rates have been brought down from the 120-to-0-percent range to 70-to-5-percent range) and elimination of most tariff preferences; and
- Elimination of most export quotas and the upgrading of the drawback and temporary admission system for exports.

A gradual restructuring of the public enterprise (PE) sector has also been initiated. More than 70 percent of manufacturing production originates from 300 SOEs typically exercising state monopoly positions. The officially designated PE sector, which is the target of the government's privatization program, consists of 314 SOEs that employ 8 percent of the labor force and produce 10 percent of GDP. These SOEs were reorganized in 1992 into 17 diversified, financially autonomous holding companies

(HCs). These HCs have been cut off from fiscal budget subsidies and their access to subsidized credit is in principle severely restricted.

An Unfinished Agenda

The economy continues to be dominated by the state. Public expenditures still account for around 40 percent of total expenditure; the government and public enterprise sectors (including the governorates and the "economic authorities") produce more than 80 percent of GDP and employ the majority of the modern sector labor force. In leading sectors the state dominance remains pronounced; some 70 percent of manufacturing output, for example, is in state hands. Government controls, expressed in a dense network of regulations, remain omnipresent.

In spite of the substantial improvement in the policy environment, the overall policy framework is far from being private sector friendly. Businessmen's complaints range widely — from failure of government to release economic information in a timely manner to extensive monopoly pricing by public sector providers of key services, to excessive taxation and seemingly arbitrary imposition of fees and stamp taxes. They say government officials continue to regard them with suspicion, often with hostility.

Because credibility of the reforms is not yet established and because removal of government's heavy hand has only begun, the economic climate remains unconducive to the kind of private sector response that would generate strong increases in investment, exports, production, and employment.

In sum, the new orientation is still in its beginnings. The economy remains highly regulated, the climate still dirigiste. The changes are fragile, certainly reversible. But nobody would have predicted in the late 1980s that this shift in policy orientation would have taken place at all. Academic writers have been generally skeptical about the chances for reform.[2] The progress that has been made is not only promising for Egypt's future growth, but good news for economic reform in general.

SIGNIFICANT CONTRIBUTION OF USAID TO THIS POLICY TRANSFORMATION

USAID helped launch the reform process in the mid-1980s, via its sponsorship of agricultural policy reforms. USAID-financed studies in the 1980s provided necessary analytic background for ERSAP I sponsored by the World Bank and IMF in 1991. And the SPR program has helped sustain the impetus of the structural reform program embodied in ERSAP II (August 1993-December 1995).

Before 1991 a pure, unconditioned cash transfer arrangement prevailed. As is well-known, this type of resource transfer tends to be anti policy reform, in that it diminishes whatever hard budget constraint might exist in the recipient country, allowing governments to postpone the hard choices involved in adopting reforms.

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[2] See for example, Alan Richards, "The Political Economy of Dilatory Reform: Egypt in the 1980s," *World Development*, Vol. 19, # 12, 1991, pp. 1721-1730; and Raymond A. Hinnebusch, "The Politics of Economic Reform in Egypt," in *Third World Quarterly*, Vol. 14, #1, 1993, pp. 159-171.

SPR has allowed USAID to move away from this straight cash transfer arrangement and to introduce the concept that the flows involved are linked to improved policy performance. The special political circumstances that surround U.S. aid to Egypt, and other factors, admittedly limit the credibility of policy conditionality here.[3] But the change has shifted local perceptions and opened administrative doors.

SPR has given USAID access to the larger policy table, from which it had been excluded in the past. In agriculture, USAID was a major player from the start. It generated new information and ideas through a vigorous program of studies and policy analyses that could channel liberalization options to decision makers in the agricultural sector. Its technical assistance was welcomed and effective. But in the core economic ministries it was scarcely admitted that USAID had any role at all to play in matters of macroeconomic or general economic policy. According to personal accounts of the director and other USAID staff, it was a long, hard struggle to get key officials to simply acknowledge such a role. Now it is taken for granted that the USAID management is engaged in broad policy dialogue at high levels. This is the fruit, to a large degree, of SPR.

Similarly, at all levels, the existence of SPR — the need to understand policy contexts in order to invent and monitor suitable conditionality — has greatly increased policy awareness and knowledge, and has given Mission staff access to many officials in the economic ministries.

SPR has provided muscle and bone for the World Bank/IMF-sponsored ERSAP. The underlying principle or "theory" of SPR is that it would "reinforce" and "supplement" Bretton Woods policy reforms, and this it has done. SPR's considerable resources have a special economic as well as symbolic and political significance for the government. On a more concrete level, the fact that compliance with the specific policy measures incorporated in SPR I was good is an additional indicator of the program's effectiveness.

The EAP Directorate, which is responsible for management of SPR, has made major contributions to its effectiveness. The staff prepared the PAAD in-house and produced a perceptive and coherent document, based on sound economic judgement. In implementing the program they have demonstrated a fine sense of tactics and strategy. They have skillfully walked the thin line between the need to avoid "burdensome" new conditionality — in other words, additional to World Bank/IMF conditionalities — and the need to reinforce the existing program and insert needed supplementary measures.

The SPR policy measures adopted for 1992-1994 are the result. They are carefully crafted, and in many cases ingenious — simple, succinct, and well targeted to fit into the overall national reform program, the ERSAP.

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[3] Three factors constrain the credibility and effectiveness of the SPR. (a) The overall earmark reduces the likelihood of sanctions in case of nonperformance and hence the credibility of the conditionality. (b) USAID needs to steer a delicate course, avoiding too much additional conditionality — which the Egyptian authorities regard as "burdensome," given the large policy agenda agreed with the Bretton Woods institutions in ERSAP II — and the charge of paying twice for the same reforms. (c) It is difficult for USAID to find high-priority alternative uses for resources taken away from SPR because of noncompliance. This is due to the large project pipeline, the lack of staff available for design and implementation of new projects, and the anticipated slower progress in implementing other policy-based programs because they are entering policy terrain that is more resistant to reform.

GOOD PERFORMANCE ON SPR POLICY MEASURES

SPR is designed to support Egypt's economic reform by reinforcing and complementing the World Bank and IMF programs. It has done this largely by identifying intermediate or supplemental policy measures GOE should implement if to is to achieve the goals of the overall reform program. SPR places particular emphasis on extending the effects of policy reform to the private sector, reflecting the new consensus view among development scholars and practitioners that sustainable, broad-based economic growth is associated with a strong market-oriented policy posture — sound fiscal policies, a relatively open trade regime, an effective financial system, and a government role that is private sector friendly and restricted to strategic interventions only and limited direct control over production.

None of these conditions yet exists in Egypt. Hence, USAID's Sector Reform Program is designed to address constraints in the financial, fiscal, trade, and enterprise sectors. Reviews of the evolution of policy reforms in each of these sectors follow.

Annex A Tables A-1 and A-2 show the matrix of policy measures included in SPR. We will consider performance in each of the sectors as of the beginning of April 1994. SPR I runs for two fiscal years. The sector policy measures agreed to by GOE and USAID in August 1992 cover FY 1992-93, and those adopted in August 1993 cover FY 1993/1994.

Financial Measures

The Prereform Situation

Three decades of Egyptian socialism had led to a repressed, underdeveloped and inefficient financial system dominated by the public sector.[4] Even after President Sadat opened up the economy to the private sector in the early 1980s, the financial system remained chained by macroeconomic imbalances, foreign exchange controls, heavy government borrowing, a dominant public enterprise sector, distortional taxes, ubiquitous barriers to the entry of private financial institutions, interest rate ceilings, price and product controls, discretionary public sector credit rationing, and inadequate prudential regulation and supervision.[5]

Banking, like other sectors, favored allocation of resources to the public rather than to the private sector. Savings mobilization for investment was channeled through public sector financial institutions, including government-owned banks, insurance companies, and the social insurance system. In contrast with developed countries, financial intermediation was concentrated in a banking system dominated by

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[4] The financial system consists of the Central Bank of Egypt (CBE), responsible for controlling the banking system; specialized banks, including the National Investment Bank, National Bank for Development, Industrial Development Bank, and the Principal Bank for Development and Agricultural Credit; state commercial banks that dominate Egyptian banking through four state banks with more than 70 percent of all assets: the National Bank of Egypt, Banque du Caire, Bank of Alexandria, and Banque Misr; joint venture banks, each with an Egyptian majority share; private banks; insurance companies; pension funds; and the stock exchange.

[5] World Bank, September 20, 1993, p.1.

the four state commercial banks. Life insurance and private pension funds remained insignificant. The government monopolized the surpluses of the social insurance scheme, and the securities market was undeveloped. Real interest rates were negative.

Key financial institutions were insolvent. Supervision and regulation were weak. Loans were inadequately vetted. Other problems included deficient capital adequacy practices for banks, very high foreign currency exposure, excessively high loan limits for individual borrowers, little provisioning for doubtful loans, and widespread availability of overdraft facilities extended to delinquent public sector borrowers.[6]

Financial Sector Liberalization

General. GOE, under ERSAP, initiated its stabilization program simultaneously with financial liberalization. On the basis of success under similar situations in other countries, the reform program liberalized interest rate policies and the exchange rate, phased out administrative credit allocation, and introduced auctions of Treasury Bills to manage liquidity indirectly through a reference interest rate for the financial markets. The foreign exchange control system was dismantled and foreign exchange rates unified.

Egypt's current banking sector reform program, supported by the World Bank, IMF, U.S. and other donors, is described more fully in the 1993 World Bank study, *Financial Policy for Adjustment and Growth*. The overall banking reforms and resulting stabilization and financial sector improvements have been impressive: positive real interest rates, a new capital market law, and greater capital adequacy; removal of legal barriers to entry by private and foreign banks in basic financial activities; sounder regulations concerning liquid asset ratios; improvements in the system of loan classification; a reduction of loan limits to single borrowers; tighter limits on foreign currency exposure; and other reforms described below under SPR conditionality.

The process of financial liberalization was supported by additional reforms to strengthen the solvency and efficiency of the banking and securities markets, including recapitalization of public banks. The reforms significantly improved the system's efficiency; increased competition has brought more diverse services and lower banking fees.

The ERSAP strategy aims at mobilizing the donor community to provide financial support to the GOE reform program. The overall approach aims to develop more competitive market-oriented financial systems and to channel an increasing share of resources to the emerging private sector. Support for the private sector includes investment funds, promotion of venture capital institutions, and provision of lines of credit to appropriate financial institutions for on-lending to private firms. These activities are still embryonic. The newly established reforms have not yet been sufficient to activate the securities market, for example.

Substantial problems remain. Private and foreign investors are restricted from full participation in the insurance industry. Widespread market failure persists. Long-term credit for private investors is practically nonexistent. Credit to the rural areas continues to be dominated by the Principal Bank for

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[6] World Bank, 1991, p. 17.

Development and Agricultural Credit, a highly inefficient and overstaffed parastatal with an extensive network of 800 village banks and 4,300 agents. Banking liberalization continues to play only a minor role in rural finance, even though agriculture still contributes 20 percent of GDP and total exports, and about 36 percent of employment. More than 50 percent of the Egyptian population remains directly dependant on agriculture. Women are largely excluded from formal credit systems. Credit is also nonexistent in key specialized areas such as housing.

The overall structure of the banking industry, dominated by four large state banks, is not conducive to competitive finance. The financial system remains shallow and underdeveloped, failing to intermediate efficiently between savers and investors. Thus a need remains for introducing further competition into financial markets and for developing new financial institutions and instruments that more actively and efficiently lend to neglected sectors of the economy.

The reforms also aim to cut the government guarantees and subsidies that have allowed the public enterprise sector to rely on financial markets for capital during the past three decades. Banking sector reform is also critical it is own right and for supporting a successful and timely transition to a market-oriented economy.

USAID's FY 1993 Financial Policy Measures. The SPR financial conditions broadly complement World Bank and IMF financial conditionality by focusing on medium-term constraints identified in the World Bank's study, *Financial Policy for Adjustment and Growth*, Vol. I-III, 1993.

> **Condition Financial 1-FY 1993**: *GOE will complete a study of the financial sector, including banks, investment companies, mutual funds (if any), and insurance companies, and make recommendations to relax constraints that limit the efficient functioning of private financial institutions.*

This measure made technical sense. It was monitorable and credible, and supplemented the IMF/World Bank conditionality by adding the proposal that GOE put forward explicit recommendations based on the Bank report.

The USAID staff made a determined, but ultimately unsuccessful, effort in engaging CBE and CMA to make the recommendations. Finally, USAID sidestepped GOE's refusal to make any recommendations and allowed the condition to be met by accepting simple acknowledgment that GOE accepted the analysis in the World Bank report.

Early efforts to deal with the measure went stale because both CBE and CMA were reluctant to make recommendations, even if they were implementing them. In EAP's opinion, CMA and CBE were in agreement with recommendations suggested by USAID.

> **Condition Financial 2-FY 1993**: *GOE will complete the necessary steps to allow foreign banks to operate fully in the domestic banking system.*

This condition was strategic, because it made the banking system more competitive. It was easily monitored and credible. It was additional to existing IMF and World Bank conditionality, which did not focus on foreign institutions that operated in the Egyptian financial system.

This measure was satisfied. A new banking law (No. 37/1992) amended the banking and credit regulations. A foreign bank can now deal in local currency if it takes the form of a joint stock company

and registers under Companies Law 159, which requires at least three Egyptian shareholders. No minimum percentage share is mentioned in the law.

The achievement of this measure was confirmed by the IMF representative. Several businessmen and bankers indicated to the team that this constraint was removed and has already resulted in substantially greater competition and hence lower costs of some financial services. Several foreign banks now deal in Egyptian pounds and others have licenses to deal in foreign currencies.

Condition Financial 3-FY 1993: *GOE will pass and implement legislation providing equal tax treatment for interest and other forms of capital income.*

This benchmark was met. Under the new global income tax and the capital market regulations, dividends are no longer taxed — in other words, double taxation of profit income was ended. However, interest payments remain tax-free.

Condition Financial 4-FY 1993: *GOE will remove controls on interest rates for corporate bonds issued in accordance with the Securities Market Law.*

This measure was strategic. Interest rate controls constrained the development of the corporate bond market. This measure eventually could be extremely important for mobilizing funds and for directing investment funds to large investments with high payoffs, when the stock market is activated. It was not treated explicitly in any of the IMF or World Bank measures. The condition was easily monitored and credible.

This condition was met. It is incorporated into the new CMA Law No. 95/1992 as described below. The first corporate bond was floated on the market in early April, 1994.

Condition Financial 5-FY 1993: *GOE will insure that all commercial banks reach a capital/asset ratio of at least 5 percent.*

This condition was met, although there were problems with data for verification. Only a few banks representing a small share of banking activity failed to reach this capital/asset ratio. The first FY 1994 financial conditionality raised the capital/asset ratio to 8 percent. According to a letter from CBE dated 1 January 1994, only 5 banks representing 2.7 percent of banking activity have not reached the 8 percent target.

This condition was inadequately verified because the necessary data were not supplied by CBE. This prevented them from being well monitored. The USAID staff attempted to gather the necessary data, but did not succeed.

Condition Financial 6-FY 1993: *GOE will pass a Securities Market Law that provides the legal framework for a stock exchange and will issue the necessary regulations.*

This was met. Law No. 95/1992 enacted the capital market law. The enabling legislation was passed in 1993.

Capital market activity has not grown substantially since the enabling legislation. There are problems with both the legislation and the general investment climate that retard activation of the capital market. Solutions to these problems are needed to make the market function efficiently.[7]

Former Minister Makramala of MIC told USAID that GOE is committed to invigorating the capital market — the stock exchanges in both Cairo and Alexandria. The two have recently been linked by computer. However, the World Bank was not involved in the drafting or review of the law, and thus was not comfortable with them. For this reason, the World Bank indicated it would not be involved in the CMA or the stock exchange. This is very complex legislation, and probably wasn't very clear, as indicated by the score of alternative scenarios presented in the World Bank's financial policy report (1993, Chapter V, pp. 91-124), which indicates that the following tax measures continue to distort financial decisions in Egypt:

- Large tax subsidies to corporate investment;
- Tax penalties on noncorporate firms and smaller corporations;
- Tax subsidies to debt finance; and
- Favorable tax treatment of financial intermediaries — particularly pensions and insurance.

The FY 1994 SPR Financial Policy Measures. These maintain the same thrust as those of 1993.

Condition Financial 1-1994: *GOE will insure that all commercial banks reach a capital-asset ratio of at least 8 percent.*

This condition has been essentially met, although there are problems with its verifiability. (See Condition Financial 5-FY 1993 for a description of letter on which verification was based.)

The rationale for this strategic condition was to increase financial strength and soundness of Egyptian banks. As discussed in Condition Financial 5-FY 1993 above, adequate data were not provided to check this condition. USAID pointed out that virtually all the data required for calculation of capital asset ratios are already in the public domain in a variety of places. Most banks put out reports with the necessary information for verification. Balance sheets are published in newspapers, particularly when they present a favorable image for the bank. This lack of monitoring could be corrected in the future with better statistical synthesizing on the part of GOE.

Condition Financial 2-FY 1994: *GOE will remove controls on fees for banking services.*

This condition was met. Formal verification is still needed, however. Evidence is needed in the form of an already issued CBE circular to all banks effecting the end-1993 policy action under the IMF's Extended Arrangement.

The USAID rationale for the decontrol of service fees and charges was to increase competition among banks. Under the Extended Arrangement with the IMF, GOE committed itself by the end of 1993 to "liberalize bank fees and charges by setting a minimum at zero and maximum at an unconstraining level." The policy action to be implemented by end-1994, in this regard, is to "present to parliament a law removing maximum and minimum limits on fees and charges."

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[7] See Bentley (1993) and World Bank (September 20, 1993).

Alexandrian businessmen indicated to the team that the increased bank competition has greatly lowered banking fees of financial services that were formerly monopolized by the state banks. Some charges dropped by 50 percent. Others were removed entirely. These assertions were confirmed by other businessmen.

Condition Financial 3-FY 1994: *GOE will conduct a review of existing CBE supervisory regulations and procedures relating to off- and on-site bank examination and inspection, and produce a manual of revised procedures.*

This condition will probably be met. The Deputy Governor of CBE indicated to the team that this manual of revised procedures was being developed, but was not yet ready. GOE needs to present USAID with a manual of revised procedures. In addition, an explanatory memorandum should be attached illustrating how the off- and on-site supervision procedures are revised, how they are considered to be an improvement compared with the previous ones, and how they fit in the overall program for CBE strengthening within the Banking Technical Assistance Program (BTAP).[8]

As for on-site supervision, the Inspection Department is responsible. Since 1991, regulations for the classification of assets, provisioning, and suspension of interest, and the adoption of capital adequacy requirements have been promulgated. Although current examination practices are moving to better assessment of asset quality and bank solvency, because of lack of acceptable audit activities in some banks, examiners often perform time-consuming basic audit activities. Thus there is a need to review existing methodologies and techniques and recommend changes that will improve the effectiveness and timeliness of examination activities.

The USAID rationale for this condition is to improve CBE supervision, both off- and on-site. The production of a manual of revised procedure is the specific output. There is general agreement on the importance of this doable measure. It is monitorable and additional to IMF/World Bank conditionality.

Condition Financial 4-FY 1994: *GOE will develop policies and procedures that expedite branching for banks that meet the 8 percent capital-asset ratio requirement.*

This measure has essentially been achieved, but without the 8 percent capital-asset ratio requirement. CBE issued Circular No. 331 on July 15, 1993, which states its licensing policy for new bank branches. The circular states that applications for new branches are approved if the applying banks stick to CBE instructions regarding minimum capital adequacy ratio, classification and provisioning of banks' assets, limits on loans to any single customer, foreign currency exposure limits, and concentration of funds/investments abroad. In the circular, CBE will respond to or make a decision on applications within 90 days from the date it receives the application. In case of rejection, the concerned bank will be notified with the reasons. If the applying bank does not receive a response from CBE, the application is approved.

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[8] Regarding off-site supervision, the statistics and follow-up department at CBE is responsible for prudential off-site monitoring of the banking system. Prudential and statistical returns submitted by banks are reviewed by examiners. At present there is a need to improve the ability of the department to quickly compile information on debt, calculate key ratios, and compare performance against peers. There is an automation element on this in the BTAP. There is a need to review the existing returns and recommend modifications where appropriate so that information necessary to permit the calculation of ratios is forthcoming and a more sophisticated system is in place.

This measure was initially seen as a way to assure equal treatment between public and private banks in branching. Later it was developed in a form that guarantees that any bank, public or private, is given the opportunity to open a branch as soon as it has reached the 8 percent capital-asset ratio.

CBE indicated that the circular's language means that banks do not have to meet each and every criterion to get approval. The overall situation of a bank is considered, including its distance from the targets and the reason for the deviation. Banks whose applications are rejected are allowed to apply as soon as they reach the required ratios. CBE usually gives a decision within 30 days.

Condition Financial 5-FY 1994: *GOE will carry out a study to examine the feasibility of introducing new financial instruments in the financial sector.*

This condition will probably be met. The USAID's TI/FI Directorate is preparing scopes of work for this study. Once the scope of work is finalized, GOE would need to provide written approval for the study. CMA would probably be the implementing authority.

The rationale is to increase the awareness of GOE that new financial instruments are needed to develop the money and capital markets, and to lubricate the privatization process. The program is additional to IMF and World Bank conditionality. It is monitorable and an important part of the overall effort to develop the financial sector. Its strategic importance will be realized when the securities market is fully activated.

Condition Trade 7-FY 1994:[9] *GOE will develop a plan to permit foreign companies to participate fully in the insurance sector.*

This benchmark will probably not be met in FY 1994. A draft insurance law has been prepared that allows for foreign capital participation, up to 49 percent, in Egyptian insurance companies. However, this draft does not permit foreign control of insurance companies and it may limit foreign participation to certain sectors of the insurance market, such as the re-insurance market. A plan, as outlined in the language of the policy measure, is still needed. The passage of a law allowing full foreign participation in the sector would meet the spirit of this policy measure.

The rationale was to increase opportunities for the private sector in Egypt's economy and improve the efficiency of financial intermediation. If GOE would provide available data, this condition could be monitored. The measure is additional to IMF and World Bank conditionality. The condition is strategic because of its implications for developing financial intermediation in secondary financial markets.

Concluding Comments. In recognition of the fact that a well-developed financial sector is critical for improving the business climate and creating the right overall environment for private investment and growth, GOE has made exceptional advances in financial sector management and liberalization. Financial sector strengthening started but did not stop with Egypt's impressive up-front liberalization of interest and exchange rates. With the help of the IMF, World Bank, and USAID under SPR, GOE has established a steady process of financial reform that is making the Egyptian financial system more secure and competitive.

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[9] This trade sector measure is included here because it is essentially a financial sector issue.

The results are already striking: substantial cost reductions in banking fees and a widening of banking services to Egypt's private sector. Moreover, major steps are being taken to reinforce prudential management and regulations. Several joint-venture banks have been privatized.

The SPR program, through its financial policy component, is playing an important part in the overall financial development process. The SPR conditions draw on the World Bank's 1993 analytic study of the financial system and address important gaps in the IMF and World Bank conditionality.

Specific SPR financial measures effectively reinforce and supplement the IMF and World Bank programs — breaking down important barriers to entry by foreign banks, for example, and helping establish higher capital/asset ratios as a move toward providing more prudential management and regulation for weak banks in the system. Some SPR-induced financial changes should yield greater benefits with the activation of the capital market.

GOE performance in meeting SPR financial measures in FY 1993 and FY 1994 has been good overall, with some lapses. The latter can be attributable in part to the natural start-up costs associated with developing this new ambitious policy-oriented program. In some cases, the SPR condition was not technically met, like the capital/asset ratio measure in which a few banks did not comply. But laws were passed which strengthened bank operations. Thus the basic spirit and purpose of the condition was satisfied.

Enormous challenges remain for providing more complete and efficient financial services to the private sector. Innovative schemes are needed to help meet the scarcity of long-term credit, and all types of formal credit to micro-, small-, and medium-enterprises. Secondary financial markets, particularly insurance, could be developed. The securities market needs to be activated.

Many remaining financial problems, such as those associated with activating the securities market, can be directly or indirectly traced to Egypt's cumbersome and inconsistent legal and regulatory system, which was designed to serve a socialist economy that was not concerned with settling private commercial disputes. These key financial constraints are being addressed in new measures proposed for SPR II.

Fiscal Measures

The Prereform Situation

Prereform fiscal mismanagement, with excessive public sector expenditures and large fiscal deficits financed by domestic bank financing, produced mounting inflation and balance of payments deficits. Fiscal revenues were heavily dependent on the external sector, including Suez Canal and Petroleum Authority earnings and customs duties, and hence were relatively unstable. Tax revenues were relatively unresponsive to increases in income. Income taxes combined the undesirable features of high marginal rates with eroded tax bases. The latter was due to tax avoidance and evasion, widespread tax holidays, and the vulnerability of tax revenues to inflation caused by long lags between assessment and collection of taxes, and inadequate penalties applied to delayed tax payments.

In addition, customs receipts were limited by a trade regime that relied heavily on non-revenue-generating quantitative import restrictions and a tariff structure characterized by many specific tax rates and widespread tariff preferences and exemptions. The tax system was riddled with numerous tax stamps, excise taxes, and special purpose taxes.

The complex structure of income, property, and indirect taxes required high administrative costs (for the tax authorities, businesses, and individuals) and encouraged poor compliance. Indirect taxes, such as the development duty and the social solidarity tax, were levied on bases that overlap with those of other tax bases, thereby increasing marginal tax rates and compliance and administrative costs. In addition, the wide variation in tax rates introduced significant economic distortions, including capital-intensive import substitution at the expense of labor-intensive, export-oriented development. Moreover, the structure of the tax system did not provide any reasonable degree of tax equity.

GOE Reform Program (ERSAP)

Fiscal reform was initiated with the support of the IMF Stand-by and World Bank SAL in 1991 and USAID SPR in 1992. All parties recognized the critical importance of improved fiscal performance to financial stabilization and the reduction of economic distortions.

Rapid fiscal adjustment has been at the center of Egypt's reform program. The declining deficit has enabled GOE to shift from being a large net borrower from the domestic banking system, to a position where it has been able to make net repayments to the banking system equivalent to 3.5 per cent of GDP in FY 1992, 2.4 percent in FY 1993, and 1.6 percent in FY 1994. This has facilitated the reduction in the rate of expansion of total banking system credit that was required to contain inflation. It also shifted bank credit toward the private sector.

The successful reduction of the fiscal deficit has been achieved through a combination of expenditure reduction and revenue enhancement. Public expenditures have been reduced from 46.1 percent of GDP in FY 1991 to 39.5 percent in FY 1993 and are targeted to decline to 38.4 percent in FY 1994. This has been achieved primarily by reducing public sector investment from 16 percent of GDP in FY 1991 to 6.9 percent in FY 1994, while holding current expenditures within the range of 30-32 percent of GDP. Current expenditure shifts included significant cuts in subsidies, most importantly by raising energy prices and tightening control over the food supply authority (GASC).

These expenditure reductions were largely offset by increased public sector wages and greater domestic borrowing costs, the latter reflecting both higher interest rates and the cost of the large increase in treasury bills associated with sterilizing the considerable inflow of foreign exchange.

Total revenue has increased from 28.9 percent of GDP in FY 1991 to 34.8 percent in FY 1993 and a projected 35.8 percent in FY 1994. Central government nontax revenue, primarily Suez Canal and Petroleum Authority profits, accounted for more than one-third of the total revenue increase. Central government tax revenue growth has been responsible for generating most of the remaining revenue increase, or nearly two-thirds of the total revenue increase.

To generate these tax revenue increases, the government tax reform program included adoption in 1991 of a 10 percent sales tax at the import and manufacturing levels, which is planned to evolve into a full-blown valued added tax. GOE also increased tariffs, and plans to implement a global income tax and other tax reforms. USAID provided needed technical assistance to the Ministry of Finance's reform program through its Public Finance Administration Project (PFAP).

USAID's Fiscal Policy Measures

In this context, USAID's SPR policy conditionality in the fiscal sector concentrated on establishing specific tax policy benchmarks — the attainment that would assist GOE in meeting its broad fiscal sector commitments under the Stand-by and SAL.

Fiscal policy conditionality agreed to by GOE and USAID in August 1992 included four in FY 1993; three FY 1994 measures were agreed to in August 1993.

FY 1993 Fiscal Measure 1: *GOE will establish a system to generate and publish revenue and expenditure data on a quarterly basis with a lag of no more than two months.*

This measure was not met. It was designed to improve the availability of fiscal data to permit more informed decision making — in both the public and private sectors. USAID staff concluded that publication of these data would send an important signal to the private sector: that the government was moving strongly away from central planning and control to a free and open market economy.

However, in spite of repeated efforts by USAID to communicate the rationale for such information to the Minister of Finance, Minister of Cabinet Affairs, Minister for International Cooperation, and the First Undersecretary for U.S. Cooperation, the Ministry of Finance refused to publish the information. Although the ministry has offered to provide USAID with the data (the same data were being provided to the IMF), it regards the data as confidential and not for public consumption. This has been part of an overall policy of GOE to treat almost all economic policy information as confidential, including policy conditionality associated with the donor-supported reform programs.

Timely release of this particular set of data may not be strategically important or crucial for economic growth, but the overall governmental policy of treating economic policy information as confidential is a significant contributor to the lack of public ownership of the program as well as the lack of private sector response.

The measure, therefore, is properly regarded as strategically important to sustainable development. There is widespread misunderstanding and uncertainty about the direction and stability of reforms. Understanding and discussion within the private sector, the People's Assembly, and the government are effectively blocked, undermining broad support and effective implementation of the reform program and private sector response. Lack of information works strongly against the growth of local ownership of the reform program.

USAID was a pioneer in attempting to encourage GOE to adopt such a policy. The IMF and World Bank had not contested the government's policy and continue today to restrict access to their documents, including even to USAID. Hence, the government has had to face limited questioning of the technical soundness of its confidentiality policies.

Despite the potential importance of a broader informational reform, an acceptable policy reform alternative was not developed and USAID withheld $5 million from the cash transfer program. Although this may be seen as a credible cost for noncompliance with the limited reform measure originally called for, it would have been much more desirable if a broader policy conditionality could have been substituted and much more cost associated with possible noncompliance.

USAID should seriously consider raising the broader issue in the context of the future SPR program. The World Bank is proposing in its forthcoming report on private sector development in Egypt

that economic policy information be made available to the public for policy discussions. With support from several donors, meaningful progress on this front may yet be possible.

FY 1993 Fiscal Measure 2: *GOE will adopt a unitary taxpayer identification number.*

There was no similar benchmark under other donor reform programs. A unitary taxpayer identification number (TIN) which covered all taxpayer dealings with the government would allow the government to crosscheck via computer systems all taxpayer dealings with customs, sales, and income tax offices, and thus increase voluntary compliance with the tax laws. The technical soundness of the measure is well established and not contested, and its adoption would clearly complement the fiscal objectives of the IMF-supported fiscal reform program.

The TIN that was adopted by the Ministry of Finance was only applied to the income tax department. It replaced several taxpayer identity systems with a unique income tax department number for all tax-paying individuals, businesses and corporations, thereby facilitating computerization of the massive income tax roles. However, the sales and customs departments retained separate numbering systems. Given the ministry's focus on managing the new sales tax (with its own computerized numbering system), it was hard to get it to focus on overcoming bureaucratic and technical hurdles to adopting a truly unique TIN.

The income tax TIN was seen — quite reasonably — as significant progress and accepted by USAID as satisfactory compliance with the SPR conditionality. And there are expectations that eventually a unique TIN will evolve as computerization spreads. Both the ministry and the People's Assembly have expressed interest in eventually adopting a universal "cradle to grave" identification system. Implementation of the TIN has been effectively facilitated by the computerization program supported by USAID technical assistance within the Ministry of Finance

FY 1993 Fiscal Measure 3: *GOE will present to the People's Assembly a global personal income tax law.*

FY 1994 Fiscal Measure 3: *GOE will begin implementation of a Global Personal Income Tax that broadens the tax base and lowers marginal tax rates.*

As part of its commitment to the IMF, GOE initially agreed in April 1991 to implement a global income tax law (GIT) during FY 1993 (ending July 1993). The draft GIT law was submitted to the People's Assembly in June 1993. USAID's first performance measure reinforced the importance of this commitment and should be partially credited with this intermediate step having been taken.

USAID's second measure also reinforced a similar measure agreed to with the IMF[10] and incorporated into the Extended Arrangement in August 1993. SPR reinforcement was important since passage and implementation of the Global Income Tax (GIT) law had been delayed by over six months from original commitments with the IMF. It also added specificity to the GIT measures in terms of broadening the base and lowering the tax rates.

The People's Assembly passed a GIT law on December 31, 1993. The GIT, which is currently under implementation, lowers marginal tax rates from 80 to 48 percent (50 percent including the

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[10] IMF, Arab Republic of Egypt, Article IV Consultation, August 21, 1992, p. 11.

remaining special development and stamp taxes on income of 2 percent), reduces most taxes on wages to 20 percent, increases exemptions, and simplifies the rate structure.

The system has become more elastic — revenue growth is more responsive to income increases. It is now easier to administer — withholding of wage earnings and automatic high personal exemptions eliminate the need for most individuals to file tax returns. It is more equitable also — it reduces taxes on low-income groups while progressively taxing higher income groups. In addition, the elimination of double taxation of corporate dividends increases incentives for equity investment.

However, the GIT did not broaden the tax base. This is largely due to the failure to tax interest income, eliminate a variety of special exemptions and deductions, and adopt a 1 percent minimum turnover tax, all of which had been expected to increase revenue and improve the distributional equity of tax system. Furthermore, the law did not significantly reform the structure of noncompliance penalties and interest charges, which encourage poor and delayed taxpayer compliance. To compensate for the revenue shortfall, GOE introduced a nonuniform special fee on imports, thereby partially reversing recent tariff reductions.

Although the tax base has not been broadened as called for in the SPR measure, the GIT represents significant progress. There is general agreement that the new law represents a major improvement and modernization of Egypt's tax system. Therefore, USAID has reasonably determined that the SPR measure has been substantively satisfied.

FY 1993 Fiscal Measure 4: *GOE will broaden the coverage of general sales tax to include travel and telecommunication services.*

As part of its commitment to the IMF, GOE agreed in April 1991 to extend the coverage of the sales tax during FYs 1992 and 1993. USAID's policy measure, which was derived from recommendations made by USAID-financed consultants to the Ministry of Finance, added specificity to the general commitments made to the IMF. The sales tax was extended to telecommunications in early 1992, increasing sales tax revenues an estimated LE 150 million annually (0.6 percent of total government tax revenue). Travel service on airplanes, trains, and air conditioned buses were already subject to alternative taxes which are levied at a higher rate than the general sales tax and were not included in the sales tax extension. Hence, USAID judged the measure as satisfactorily completed.

FY 1994 Fiscal Measure 2: *GOE will take the actions necessary to prepare for the implementation of the general sales tax at the retail level.*

This is intended to be an intermediate step to extending the sales tax to the retail level and the conversion to a VAT with full crediting of input taxes by July 1995. It reinforces similar reform measures that were subsequently incorporated into the ERSAP II Policy Matrix in August 1993.

Although a wholesale level value added tax (VAT) was originally intended to be in place by July 1993, computerization and other administrative preparations have taken much longer than expected. The IMF reported in August 1993 that a new timetable for implementing the full VAT had been agreed to.[11] Intermediate steps in this process for FY 1994 included:

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[11] IMF Article IV, August 25, 1993, p. 15.

- In July 1993 GOE issued a decree to simplify the sales tax by combining items from the 20 percent and 30 percent categories into a 25 percent category and by expanding coverage to some services. GOE estimated that this will increase sales taxes by almost 8 percent.

- Coverage of the sales tax is to be further broadened to include additional services.

- GOE needs to officially announce the registration threshold (in terms of turnover) for the extension of the general sales tax to the retail level. In addition, there are a number of needed administrative steps, including restructuring the Sales Tax Department to accommodate the anticipated 10-fold expansion of businesses collecting sales taxes.

The IMF, USAID, and its consultants to the Ministry of Finance agree that the GOE sales tax program is on track. To assist GOE in meeting the SPR policy measure, USAID/EAP has prepared for GOE consideration a set of intermediate actions to be implemented this year. However, neither MIC nor the Ministry of Finance have yet to respond with an agreed-to set of actions, which then need to be implemented to satisfy the SPR policy measure.

The limited access to the Ministry of Finance decision makers in part explains this situation. The ministry is generally not receptive to donor interactions, with the exception of collaboration with USAID consultants and IMF and World Bank technical assistance. In addition, meaningful assistance from MIC is difficult, given the technical nature of the measure and its limited influence with the Ministry of Finance.

1993 Fiscal Measure 1: *GOE will prepare a time-phased plan to reduce the granting of tax holidays.*

The rationale for this measure is that tax holidays get GOE involved inappropriately in directing investment to particular sectors of the economy, cost GOE significant amounts of revenue and thereby work against lower marginal tax rates, and are judged ineffectual and unnecessary in many cases. USAID-financed consultants for the ministry estimate that if all tax holidays were eliminated, corporate taxes would increase by one-third and total taxes would increase nearly 5 percent (or LE 1.4 billion in FY 1992). If tax holidays currently in place were not renewed and new tax holidays were severely limited, USAID/EAP estimates that corporate taxes could be increased by LE 200 million annually within two years.

According to GOE's Letter of Intent requesting an IMF Extended Arrangement in August 1993, the renewal of tax holidays was ended as of July 1993. As part of the ERSAP II Policy Matrix, GOE agreed to allow the Fund to analyze the investment incentive system to make it more efficient and less costly in terms of lost taxes. A draft investment incentives study has been prepared and is currently under review by GOE. The Policy Matrix released in August 1993 calls for a draft law agreeable to the IMF to be presented to the People's Assembly by the end of June 1994.

Thus it would appear that USAID's policy measure calling for a time-phased plan has been largely met. However, although both USAID and the IMF are appropriately supporting this strategic policy objective, USAID has not had access to the IMF draft industrial incentives study and hence has not able to fully engage in policy discussions leading to the development of limits on tax holidays. GOE should be encouraged to release the document to concerned donors to facilitate meaningful discussions.

Conclusions

In summary, there has been remarkable success on the fiscal front. The deficit has been dramatically reduced, through both expenditure reduction and revenue enhancement. The tax system is more elastic, equitable, and easier to administer. GOE understands the importance of these measures to financial stability and accelerated development and is proud of its accomplishments. GOE ownership of fiscal reform is high and continued fiscally sound performance is probable.

The IMF, World Bank, and USAID have played reinforcing and complementary roles supporting GOE implementation of the fiscal program. The central role has been played by the IMF, in large part because of its importance to Paris Club debt relief. Although it is impossible to separate effects, it is clear that USAID, through a combination of complementary and reinforcing SPR conditions and technical assistance to the Ministry of Finance, has contributed significantly to the overall success of the fiscal reforms. This is so despite the fact that USAID effectiveness has been handicapped by limited opportunity for dialogue with the Ministry of Finance, apparently largely as a result of ministry indifference to donors in general. USAID also has been constrained in its dialogue by its lack of access to highly pertinent documents — for example the recent IMF study of investment incentives. If not remedied, this problem could significantly reduce the effectiveness of future USAID assistance to the ministry and SPR fiscal measures.

Although the most pressing fiscal reforms have already been made, tax reform should continue to remove the remaining constraints to private sector development. The most important remaining areas for future reform are:

- Implementation of the retail and wholesale VAT by July 1995 to generate revenue needed to further reduce the deficit and excessive customs tariffs.
- Rationalization of industrial incentives and free zones, including reducing tax holidays, to avoid inefficient investment and to facilitate reduction of corporate tax rates and elimination of the paid-in capital stamp tax of 1.2 percent annually.
- Increase of taxes on vehicle fuels (especially leaded gasoline) to raise additional revenue and reduce air pollution.
- Reform of tax noncompliance fines and interest charges and the practice of 100 percent tax audits to encourage voluntary compliance and to reduce tax administration costs and abuses.

Trade Liberalization Measures

The Prereform Situation

The import substitution industrialization strategy Egypt followed after 1961 included an array of highly protectionist nontariff barriers (NTBs) facing imports. In 1990, 53 percent of total agricultural and manufacturing output was protected by NTBs. NTBs to imports consisted of import bans (or licensing requirements), suspensions of letters of credit for certain imports, prior approval requirements for imports, quality control standards, and foreign exchange rationing (with priority access given to the public sector).

Import tariffs were also excessively high, ranging from 0.7 percent to 120 percent. Tariffs on manufactured consumer goods averaged 37.2 percent; on intermediate goods, 16.6 percent; and on capital goods, 17.7 percent. Most basic food imports paid 0.7 percent. Though 80 percent of total imports had tariffs under 15 percent, about 8 percent had tariffs of 65 percent or more (mostly alcohol, tobacco, autos, and luxury goods). The combination of tariffs and NTBs provided high and uneven effective protection to domestic producers. Egypt also had a system of export taxes and NTBs to exports (export licenses, quotas, prior approvals) and an overvalued exchange rate that implicitly taxed exports.

This import substitution strategy had well-known negative effects. Domestic consumers suffered because they have had to pay relatively high prices for low-quality domestically produced goods. Moreover, the overvalued exchange rate and the general lack of competition in the domestic economy made it difficult for Egyptian exports to compete in foreign markets. The inevitable pressures on the balance of payments led to administrative allocations of foreign exchange with all its disadvantages.

Trade Reforms under ERSAP

The Stand-by and SAL that embodied ERSAP I focused on liberalizing the exchange rate system, phasing out most NTBs, and reducing the level and dispersion of tariffs. The exchange rate was unified with the free market rate in November 1991 and allowed to depreciate about 35 percent relative to the U.S. dollar. It has since been stabilized through Central Bank interventions (which have prevented a nominal appreciation). The exchange system has thus become essentially free of restrictions: anybody can buy and sell foreign exchange from and to banks and foreign exchange dealers.

The production coverage of import bans was reduced from 37.2 percent of total agricultural and manufacturing output to 10.1 percent. GOE reduced the number of import prior approvals from 55 to 9. All suspensions of letters of credit were lifted. The number of tariff preferences was reduced from 90 to 29.

With the exception of a few items, the range of tariffs was reduced to 5-80 percent (short of the original objective of a 10-80 percent range). The duty drawback and temporary admission systems for exports were improved upon and the number of products subject to export restrictions was reduced to a few commodities.[12]

ESAP II trade liberalization has generally continued as agreed to under the Extended Agreement and SAMP. Import bans have been further reduced to 4.7 percent of agricultural and manufacturing output, with the remaining bans covering textile and clothing and poultry imports. Previously banned imports have been assigned tariff rates within the adopted tariff structure. The 9 remaining import prior approvals have been eliminated. Controls by the General Authority for Investment and the General Organization for Industrialization on imports of equipment have been abolished, as have import restrictions maintained by the Ministry of Military Production and the Industrial Monitoring Authority.[13]

GOE is also developing technical assistance procedures pertaining to antidumping and countervailing duty mechanisms with GATT technical assistance. The government has introduced the Harmonized System (HS) of commodity classification. In addition, GOE has also amended the quality

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[12] Government of Egypt, Letter of Development Policy, September 1993, p.6.

[13] Ibid., p. 7.

control system applying to imports to ensure that information on product coverage is published and unambiguous, and has harmonized fees imposed for inspection for foreign and domestic firms.[14]

GOE is also substantially reducing tariff rates. The maximum tariff was reduced from 80 percent to 70 percent in February 1994 and is scheduled to be further reduced to 60 percent by end-December 1994 and 50 percent by end-December 1995. Equivalent reductions of all other rates above 30 percent are also included. Capital goods are to be reduced to the 5 to 10 percent range. The remaining exceptions to maximum tariffs (mainly covering autos) are being phased out, except for alcoholic beverages. Tariff preferences have been abolished, with the exception of health and tourism and those covered under international treaties.

No tariff rates on imports were to be increased, except to remedy distortions in the tariff structure. However, concurrent with the tariff reduction in February 1994, the customs user fees were increased. Fees have been raised by 2 percent for imports with tariffs below 30 percent, and 5 percent for imports with tariffs above 30 percent. Although GOE has proposed to reduce the fees to a uniform 2 percent in July 1994 and eliminate them in July 1995, their introduction was prompted by the anticipated revenue shortfalls of the newly adopted General Income Tax.[15] The nonuniform fees may have also been designed to accommodate domestic producer pressures for increased tariff protection.

USAID Trade Policy Measures

Within this comprehensive trade liberalization program, USAID has focused its trade-related policy dialogue, conditionality and technical assistance largely on GOE policies and procedures which hinder private sector led export growth or constitute a bias in favor of the public sector. Seven SPR FY 1993 trade measures were agreed to August 1992 and an additional seven measures FY 1994 measures were adopted in August 1993.

FY 1993 Trade Measure 1: *GOE will eliminate the requirement that private sector exporters submit letters of guarantee under the temporary admission system.*

Letters of guarantee are letters from commercial banks guaranteeing payment of the cost of imported inputs and duties brought in under a temporary admission system. The way it worked in Egypt, bank charges and collateral requirements were a significant cost burden — 6 percent of the cost of imported inputs by some estimates.

There is no similar policy measure in the IMF/Bank programs. In February 1992, GOE issued Decree 42/1992 requiring that public sector exporters also submit letters of guarantee. USAID determined that this accomplished the objective of the SPR policy objective, which was to equalize the treatment of the public and private sectors. However, this did nothing to make Egyptian exporters more internationally competitive. The continued requirement of letters of guarantee continues to raise Egyptian exporters' costs.

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[14] World Bank and GOE, "ERSAP-II First Review Mission Aide Memoire," March 1994. The Bank determined that the changes made to the quality control system were satisfactory.

[15] Ibid. The Bank has argued for the full elimination of the fees by July 1995.

The private sector subsequently lobbied for and obtained issuance of a decree in January 1994 providing for the replacement of bank letters of guarantees by either firm guarantees (up to the limit of 80 percent of paid-in capital) or insurance to guarantee payment for the imported goods and duties if not reexported. While implementation of the decree was expected in May, excessive documentation faces firms trying to qualify for firm guarantees and insurance companies are not expected to provide the needed coverage. Hence, it remains to be seen whether this will adequately deal with the problem.

FY 1993 Trade Measure 2: *GOE will adopt procedures for prompt refunding under the drawback system.*

This measure added specificity to the benchmark set by the SAL, which required GOE to introduce measures to improve the drawback system. In early 1992 GOE adopted reforms aimed at speeding up the refund of duties paid on imported inputs used to produce Egyptian exports.

These reforms achieved their desired effect, as noted by the World Bank in its Aide Memoire for the first SAL supervision mission dated February 1992. Hence, USAID determined that the SPR measure had been satisfied. Notwithstanding these improvements, refunding delays under the drawback system apparently continued to be a problem, prompting the Minister of Finance to announce publicly in January 1994 that, effective immediately, reimbursement for all customs duties and sales taxes would be reimbursed immediately upon the re-export of imported inputs.[16]

FY 1993 Trade Measure 3: *GOE will initiate a study to review, evaluate, and recommend alternative options to the present mandatory public sector quality control regulations governing exports and imports.*

FY 1994 Trade Measure 6: *GOE will develop a time-phased plan to implement selected recommendations from the Quality Control Study.*

There are no similar policy measures under ERSAP I. However, the ERSAP II Policy Matrix includes a measure requiring GOE to adopt a program to harmonize the enforcement of quality control standards and fees (applying them equally to both imported and domestically-produced goods). The SPR study completed January 1994 has provided GOE, World Bank and USAID with a timely and in-depth understanding of the quality control problems and needed reforms, and hence is highly complementary, adding needed specificity.

The major finding of the study is that quality controls are significant barriers to trade, and that considerable overlap exists among government agencies involved in the formulation, implementation, and monitoring of quality control regulations. These lead to delays in the placement of goods on the market and to increased costs that must be borne by importers and exporters. Quality controls are one of the most important NTBs to trade currently remaining in Egypt. As recent newspaper stories attest (for example, the story about the poultry industry in the April 16, 1994 *Egyptian Mail*), they are readily and inappropriately utilized to protect domestic producers. Although it is impossible to quantify across the board, it clearly raises costs significantly. For example, the controls are estimated to increase perishable food costs by between 5 and 20 percent.

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[16] Montague Lord, et al., "Trade Policy and Customs Reforms in Egypt," Draft Report to USAID and GOE, January 30, 1994, p. 37.

The report recommends the establishment of a commission to review current health, safety, and quality regulations and the institutional structure of the regulatory agencies and to formulate reform legislation this year. The report recommends that standards and quality assurance should become the sole responsibility of a privatized Egyptian Organization for Standards and Quality Control, that the Ministry of Agriculture should have sole responsibility for food inspections, and that the Ministry of Health should be limited to the development of health standards and domestic health inspection issues. A number of immediate regulatory changes are recommended, including eliminating fat, protein, and fiber standards on food imports.

GOE has the report under review but has yet to develop an acceptable time-phased plan to implement its recommendations. Given the significance of this issue, GOE should move rapidly forward with the report's recommendations, including the formulation of reform legislation this year. This would send a strong signal to the private sector that the government is committed to streamlining regulatory regimes to support private sector development.

FY 1993 Trade Measure 4: *GOE will lower the coverage of import bans from 23 percent to 11 percent of domestic agricultural and manufacturing output. It will structure the reductions in a manner that does not discriminate against the private sector.*

FY 1994 Trade Measure 3: *GOE will reduce import ban coverage to 5 percent in such a way so as not to discriminate against the private sector.*

FY 1994 Trade Measure 1: *GOE will review all banning decrees issued by various Ministries or Government bodies so as to ensure that they are consistent with the official government policy on bans.*

The first two SPR import ban measures were designed to protect the private sector. The SAL required the reduction of bans from 23 percent to 11 percent and the SAMP called for further reduction to 5 percent. But neither agreement required equal treatment between the public and private sectors. The previous 1991 reduction of bans had subjected the private and agricultural sector to disproportionately large decreases in ban protection, while only minimally reducing bans for the public enterprises (mainly manufacturing). Hence, the World Bank had suggested that later reductions would necessarily have to focus on manufacturing and the public sector.[17]

The import bans were reduced in August 1992 to 10.3 percent and the reductions were proportionately larger for the public sector than for the private sector. The bans were further reduced to 4.8 percent in July 1993. Ban coverage for the private and public sectors was reduced by 56 percent and 53 percent, respectively.

Although this is viewed by the Mission as equal treatment of the public and private sector (satisfying the SPR measure), the remaining bans cover 7.2 percent of the public sector (dominated by textiles) and only 2.7 percent of the private sector. It is questionable whether a USAID interpretation of the measure to require continued proportionally larger public sector ban reductions would have been successful, given the vulnerability of the public textile sector to competitive imports.

The third SPR measure was added to the two previous banning measures to deal with the practice of ministries and governmental agencies imposing ad hoc import bans. The Trade Policy and Quality

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[17] World Bank, Egypt Structural Adjustment Report, 1991, p. 28.

Control Studies documented the extent of the problem. GOE needs to demonstrate that only those commodities on the official ban list are subject to bans by GOE entities.

FY 1993 Trade Measure 5: *GOE will initiate a study of the Egyptian customs system that will result in recommendations to improve the import tax system and administrative procedures.*

FY 1994 Trade Measure 5: *GOE will develop a time-phased plan to implement selected recommendations for he Trade/Customs Policy Study.*

There were no similar measures in ERSAP I, but ERSAP II does provide for a government review of tariff policy in 1995, with the objective of reducing maximum tariffs to below 50 percent after 1995. Hence, the SPR-sponsored study is complementary.

The resulting draft report, submitted in January 1994, lays out the broader trade policy issues facing the GOE as it moves forward with it trade reforms.[18] The study should be useful for the newly formed joint public-private High Commission on Exports and the Ministry of Economy and Foreign Trade. The study recommends:

- Conducting effective protection studies to estimate the impact of further liberalization on domestic industries;
- Limiting quality controls to health, sanitary, and religious requirements;
- Streamlining customs regulations and procedures, including creating a "one-stop shop"; and
- Strengthening export promotion mechanisms, including focusing on private sector export promotion institutional development.

These are important and useful recommendations providing general directions for further policy reform; however, further in-depth and detailed analyses with much more consultant time and technical ministries collaboration will be needed to develop more detailed and operationally useful recommendations. The GOE needs to develop a plan to begin implementing the study's recommendations, including identifying the more detailed studies that may be needed. These could be supported by USAID through TSSPR.

FY 1993 Trade Measure 6: *GOE will conduct a review that develops recommendations for the removal of regulations and laws that impede private sector participation in import and export industries currently dominated by the public sector companies.*

There is no similar measure in the Policy Matrices of ERSAP I and II. The SPR measure was satisfied when GOE amended its import and export regulations in 1991 and August 1992, so as to eliminate the special privileges previously granted to the public sector in this regard.

Before May 1991, the regulations governing trading activities discriminated against the private sector and provided many privileges to the Public Sector Trading Companies (PSTCs). The following are the major areas in which the PSTCs were granted a monopoly, monopsony, or any other form of privileged position:

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[18] Lord, ibid.

- The private sector was not allowed to engage in barter deals.

- The importation of the following commodities was restricted to the PSTCs: wheat, flour, unpacked tea, edible oil, fats, chemicals, fertilizers, pesticides, and seed potatoes.

- The importation of the following commodities was restricted to the PSTCs in competition with the beneficiary public sector companies — in other words, those producing or importing the traded goods: cotton, tobacco, coal, petroleum and its derivatives, arms and the production requirements for the armament industry.[19]

- Imports of reinforced steel from Yugoslavia were restricted to the PSTCs.

- Al-Gomhouriya Company for Drugs and Medical Supplies monopolized the importation of all the requirements of the health sector such as raw materials, chemicals, equipment, and the like, with the following exceptions: (1) imports by physicians and hospitals for private use, (2) drugs and other medical supplies approved by the Drug Imports Committee of the Ministry of Health, and (3) private sector imports of machinery and equipment (except those that were banned).

- Import of motor vehicles and their spare parts was restricted to the PSTCs.

- Exports of cotton, rice, and rice straw were monopolized by the PSTCs. Exports of petroleum and its derivatives — yarn, cement, and drugs — were restricted to the public sector companies producing these commodities.

- Private sector importers were required to pay 25 percent of the value of their imports upon requesting the L/C, and the remaining 75 percent when the L/C is issued.

The Export & Import Regulations of May 1991 and their amendments of August 1992 eliminated all the privileges previously granted to the PSTCs. There are no longer different regulations governing the private and the public sectors regarding trading activities. The new regulations deal with the two sectors as one entity and address the import activities of the two sectors as "importation for production or trading activities." A separate chapter in the Regulations deals with importation by Government entities (such as ministries and public authorities). One can conclude that, as far as the Export & Import Regulations are concerned, no bias now exists in favor of the public sector. However, the problem of conflicting laws and decrees issued by different ministries is a continuing issue.

FY 1993 Trade Measure 7: *GOE will permit the inclusion in the temporary admission system of firms that export part, but less than 100 percent, of their output.*

ERSAP I called for development of a government plan to improve temporary admissions for exports, but it did not specify needed reforms. The SPR measure thus added specificity for one of the needed reforms.

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[19] Exceptions to the above were three: (1) tobacco could be imported by the private sector for trade purposes; (2) the private sector exporters could import seed potatoes subject to the approval of the Agricultural Inspection on the quality and specifications of these potatoes; and (3) the private sector was allowed to import chemical fertilizers and pesticides except those required for field crops.

Under the Temporary Admission System (TAS), exporters are not required to pay custom duties and sales tax on their imported raw materials, provided that they submit a cash or bank guarantee equivalent in value to the required custom duties and sales tax, and that they export the finished products within one year from the importation of the raw materials. There was widespread confusion on the part of researchers and exporters as to who was eligible to use the TAS. A report by K. Stacey of the Peat Marwick group entitled "Survey of Custom Administration in Egypt" (January 1990) stated: "In order to qualify for the duty free concession, a manufacturer must export 100 percent of his production. Theoretically he could claim drawback on the exported product if he also sold on the local market, but he might find it difficult to prove his claims." The World Bank staff working on trade regulations in Egypt were also confused about this issue. In a report written in November 1991 by the World Bank, it was stated that "it is not clear whether one must be 100 percent exporter in order to qualify for temporary admission system."

After careful review of the laws and regulations governing the Drawback and TAS, and a series of meetings with the Head of the Drawback and TAS as well as with major exporters, USAID reached the conclusion that nothing in the law restricts the TAS to those who export 100 percent of their output. The reason for the confusion was that all the raw materials imported under the TAS must be reexported in the form of finished products. In practice, therefore, it was difficult for some exporters who export less than 100 percent of their output (and hence import raw materials for both their exported output and that sold locally) to use the TAS, because they have to be sure beforehand that all the materials they import through the system will be used in the production of exported goods. Some small exporters, therefore, refrained from using the TAS.

USAID started discussing this issue with the GOE in January 1992. This helped in clarifying the misunderstanding about the TAS among many exporters. A few months ago, the Chamber of Commerce was also informed of the true situation.

In mid-1992 GOE satisfied the SPR measure by issuing guidance making it clear that firms are not required to export 100 percent of their output in order to utilize the temporary admission system. However, they are required to export 100 percent of the inputs imported entering Egypt under the temporary admission system. This helped to clarify the confusion confronting exporters and increased their access to temporary admissions.

FY 1994 Trade Measure 2: *GOE will reduce the number of tariff preferences by one-half.*

This measure is aimed at increasing competitiveness. It was to be an intermediate step supporting the ERSAP I plan to reduce tariff preferences and thereby increase the degree of competition in the economy. A July 1993 Presidential Decree went beyond the requirements of this measure by reducing the number of tariff preferences from 29 to 2 items in July 1993. The remaining items are baby milk (which requires a license and is subject to 1 percent tariff) and pleasure boats imported by tourism companies, whose tariff was reduced from 80 to 40 percent. The Arab Petroleum Pipe Line Company also has a tariff preference on capital imports, with a tariff of 1 percent.

FY 1994 Trade Measure 4: *GOE will eliminate 5 of the 9 special conditions for imports.*

The "special conditions list," which contained nine commodities whose importation was permitted only under certain circumstances, was canceled by Presidential Decree in July 1993. Eight of these commodities were civilian in nature but could not be imported if they were produced by military factories. They included engines up to 125 hp, certain types of electric motors, radiators, and generators up to 700 KW. The ninth commodity was fuel and its derivatives, which could only be imported through

the Egyptian Petroleum Corporation. The SPR measure supplemented a similar ERSAP II policy condition to liberalize imports restricted by the Ministry of Military Production.

Conclusions

Egypt's trade regime has been significantly liberalized by ERSAP reforms supported by the IMF, World Bank, and USAID. Most significantly, the liberalization of the foreign exchange regime has provided the private sector with free access to foreign exchange needed for imports of capital and consumer goods. This has dramatically reduced governmental control over private sector investment and import decisions, thereby significantly improving economic efficiency and equity. The Central Bank is especially proud of Egypt's return to a free foreign exchange regime (after more than 30 years of controls and exchange shortages), the maintenance of exchange rate stability, and the accumulation of more than $16 billion in Central Bank reserves.

The reform program has also successfully dismantled most NTBs and replaced them with tariffs. The most constraining NTBs, including import and export bans and quotas, have been almost totally eliminated, leaving quality controls and complicated customs regulations and procedures as the most important remaining NTBs. The new tariff structure has been broadened to include imports previously protected by NTBs, rates have been significantly lowered, and tariff dispersion has been reduced. However, tariffs remain high by world standards, and highly protective of inefficient domestic producers.

Although these trade reforms have significantly enhanced the competitiveness of Egyptian exporters, overall export growth has been nil. However, some private sector nontraditional exports have increased significantly, especially apparel and fruits and vegetables.

The IMF and World Bank have clearly played the lead role in these trade reforms; however, USAID has significantly contributed with policy dialogue and conditionality supporting the broader trade program. Also, USAID was successful (with a few exceptions) in its support for a number of specific measures designed to overcome private sector barriers to imports and exports.

The SPR program has been effectively complemented by TSSPR-supported studies of trade policy and quality controls that significantly added to the understanding of pressing trade issues and needed policy reforms. USAID's active participation in trade reform has facilitated an increasingly collaborative relationship and dialogue with the Ministry of Economy and Foreign Trade that should lead to a further strengthening of ministry policy analysis and dialogue. This will be especially important in the future as the ministry's economic research unit provides staff support to the new High Commission on Exports.

Trade liberalization to date has been dramatic, but Egypt is far from the frontier of being an outward-oriented trade regime by world standards. The most important remaining areas for future reform include:

- Maintenance of a competitive real exchange rate; this is essential to provide incentives for export expansion. The real appreciation of the exchange rate since 1991 has largely undermined the benefits of the initial 35 percent depreciation.

- Continued reduction of tariff levels and dispersion; this is needed to increase competitive pressures on domestic industry to become more efficient, and to facilitate the needed real exchange rate depreciation.

- Elimination of unnecessary quality controls and burdensome customs regulations and procedures; this would significantly reduce transactions costs of trade.
- Privatization of export promotion agencies, to increase the effectiveness of efforts to overcome the years of inappropriate policies that hinder emerging exporters.
- Removal of public sector monopolies over strategic services, such as port services.

Enterprise Sector Measures

Eight enterprise-related policy measures are called for in the enterprise sector over the two years of the SPR program. Two refer to intellectual property issues, notably patent law and government organization in matters of patents and trademarks. Two concern liberalization of the textile industry. One measure covers price controls in the tourist sector. And three are aimed at accelerated privatization.

We consider the nonprivatization issues first, then privatization. The latter is discussed at greater length because it has become the focal point of debate and because issues of compliance have risen with special intensity.

Nonprivatization Measures

FY 1994 Condition Enterprise 1: *GOE will remove all price controls from hotels, restaurants and other businesses associated with tourism.*

This condition has apparently not been met. The Ministry of Tourism still influences prices charged by hotels and restaurants. A survey of price fixing and price controls in the tertiary sector of the economy will probably take place in the next few months and is expected to clarify the situation.

The Ministry of Tourism states that they eliminated any interference in hotel service pricing. However, they also indicated that pricing policies are completely left to the Tourism Chamber Union, which prices according to Egypt's competitive strength vis-a-vis other countries. This indicates that the ministry supervises price-setting for each hotel, and thus that there is in fact substantial government interference.

It's not clear how suitable this condition is. Competition takes place between levels of service — in other words, between expensive and less expensive hotels and restaurants. It also takes place between countries. So market forces constrain price fixers in this industry. But there may be problems here that are not readily apparent and that explain the rationale for this condition.

FY 1994 Condition Enterprise 2: *GOE will present to the People's Assembly new legislation for patents that provides for both product and process patent protection for all types of technology, and increases the terms of protection to 20 years.*

FY 1994 Condition Enterprise 5: *GOE will conduct a study to examine the benefits of consolidating the patent, trademark, and industrial design offices under the authority of the ministry.*

Both conditions are monitorable, credible, and additional to IMF/World Bank conditionality. Strengthening intellectual property rights (IPR) is an important legal constraint to private sector development and foreign investment of high-tech industries.

Economic analysis has demonstrated that the social returns or benefits of innovation are high and in most cases far exceed the private returns, because of spillover effects. Environments that aid or condone IPR infringement discourage technological transfer and retard indigenous technology development.[20]

The first condition will probably be formally met, but probably not passed in a manner acceptable to the United States because the People's Assembly may invoke a General Agreement on Tariffs and Trade (GATT) loophole that would allow Egypt a 10-year grace period for pharmaceuticals. The People's Assembly may also make other modifications of the current draft patent law, making it unacceptable to the United States. However, the law has been prepared to replace Chapter One of Law 132 of 1949. The 20-year provision for patent protection is included (Article 10 of Chapter One of the draft). The draft law also includes the utility model, which provides for a weaker 7-year patent, which would encourage the adaptation of seminal technologies to local conditions.

The current draft law, or a modification, will probably be presented to the People's Assembly with the 20-year protection provision. Condition Enterprise 2/93 would be met with the submission of the draft by the Ministry of Scientific Research to the People's Assembly.

The rationale behind this measure is to bring Egypt into conformity with international guidelines. The U.S. State Department and Trade Representative's offices have examined the draft and are satisfied that it complies with international guidelines. Foreign firms should be more willing to locate or to expand their operations in Egypt, because they would be compensated for their costly investments in developing the patented technologies. Given Egypt's current weak enforcement and low penalties for violations, active enforcement and more costly penalties would be required for this condition to become truly strategic.

In addition to foreign investors owning intellectual property, Egyptian inventors would benefit relative to inventors in other parts of the world, because they would benefit fully from their efforts to invent or innovate. If passed and enforced, the law could encourage Egyptian joint-venture partnerships and subcontracting arrangement with overseas high-tech firms.

The rationale for the second condition is, like the first, to improve IPR protection to encourage indigenous innovation and invention and enable Egypt's fuller participation in the benefits of international trade and foreign investment. Legalizing the draft patent law represents only the first step toward developing IPR protection in Egypt. Organizational effectiveness also has to be strengthened.

Economies of scale and scope would be realized by placing administration of all types of intellectual property regulations within one authority. This condition has been met. A scope of work was prepared and sent to MIC on November 4, 1993, and was approved recently. The study is expected to begin in April 1994.

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[20] Studies in India and the Philippines, for example, reveal that in most cases fully patented inventions were contributed by local engineers with advanced graduate degrees from abroad. Failure to protect IPR not only discourages indigenous innovation but may contribute to brain drain.

The key requirement for making this condition strategic would be to strengthen the IPR enforcement and raise the penalties of noncompliance, particularly for patents. This would probably require strengthening the legal system along the lines recommended by Bentley(1994). It would also require specialized IPR training and administration. This SPR conditionality is credible and additional to IMF and World Bank conditionality. It has a reasonable chance of being implemented.

Privatization Measures

Prereform Situation. Since the extensive nationalizations 35 years ago, the Egyptian economy has been dominated by the state. This was not changed by the renewal of private sector activity that began in the mid-1970s. More than half of GDP, about two-thirds of nonagricultural GDP, and perhaps three quarters of formal sector manufacturing production is still generated in the public sector.

The large state-owned enterprise sector consists of three main groups of public enterprises. The "economic authorities" — the Suez Canal authority, Egyptair, the state petroleum and railway companies, and the utilities — power, water, telecommunications, and transport — comprise the biggest and most strategic group. The second consists of public sector financial institutions — principally the wholly-state-owned banks, joint venture banks, and insurance companies,

The roughly 400 nonfinancial PEs — those in industry, agribusiness and services — which GOE owns fully or in part, comprise the third group.[21] This set of PEs makes a relatively small contribution to national output and employment; it accounts for about 10 percent of GDP and employs some 8 percent of the labor force (1.1 million people). But it produces more than 70 percent of industrial output and includes many subsectors that are critical for economic development. Its estimated book value as of mid-1991 was LE 73 billion.

ERSAP I Reforms. The main target of GOE privatization program is this third group of enterprises. The program began under SAL I and ERSAP I. The focus was placed on policy changes and legal and institutional reforms. Many of the latter were embodied in Law 203 of 1991 — the granting of autonomy to SOE managers; the transformation of SOEs into joint stock companies; the removal of ministerial control by the creation of 27 (later 17) holding companies; the legalization of bankruptcy, liquidation and privatization; the hardening of budget constraints by phasing out access to budget subsidies and restricting state guarantees of PE bank loans. A new Minister for Public Sector Business Enterprise was appointed and a technical secretariat created — the Public Enterprise Office (PEO).

The divestiture dimension of the government privatization program (GPP) didn't really get under way until 1992; it was only in March of that year that the first two batches of Law 203 firms to be

[21] Actually, the target enterprises in the Government Privatization Program number 314. The reason for the discrepancy is unknown.

targeted for privatization were identified. (Some uncoordinated asset sales occurred before that date, but these were not substantial.)[22]

The first batch of privatization candidates, called the 1991-1992 batch, consisted of 20 entities — 7 100 percent state-owned, 7 assets of state-owned companies (including 3 hotels), and 6 blocs of shares in fully state-owned or joint venture companies. The second, or 1992-1993 batch, consisted of 7 SOEs, 6 segments of SOEs, and 12 share sales. The third (1993-1994) batch, announced in March 1993, consists of 37 whole companies and 3 assets of companies. (See Annex B for the list of companies and assets.)

ERSAP II. Under ERSAP II, GOE agreed to the following program.

- By end-December 1993:
  - Complete sales of the 22 assets/companies brought to the point of sale as of March 1993;
  - Bring to the point of sale (POS) 25 percent (LE 2.3 billion) and complete sales of 10 percent (LE 0.9 billion) of the book value of the companies included in the 1993-1994 privatization program.
- By end-June 1994:
  - Bring to POS the remaining 75 percent (LE 6.8 billion) and complete sale of additional 30 percent (LE 2.7 billion) of assets/SOEs of 1993-94 Privatization Program.
- By end-December 1994:
  - Complete sale of additional 30 percent (LE 2.7 billion) of the 1993-1994 program.
  - Bring to POS 50 percent (LE 5.5 billion) and complete sale of 20 percent (LE 2.2 billion) of the entities in the 1994-95 program.
- By end-June 1995:
  - Complete sale of remaining 30 percent (LE 2.7 billion) of the 1993-94 program.
  - Bring to POS the remaining 50 percent (LE 5.5 billion) and complete sale of additional 40 percent (LE 4.4 billion) of the 1994-95 program.

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[22] According to the IMF ("Recent Economic Developments", August 1993) in 1991, the Ministry of Agriculture sold 13 agricultural companies under the HC for Agricultural Development, for LE 200 mn. Additional public sector assets worth LE 50 m. were sold,leased or liquidated during the same year, and some 1300 small governorate-owned enterprises were sold for LE 31 mn.--an average of about LE 24,000 per transaction (US$ 7,000). From June 15, 1991 to Feb. 1992, local governorates sold 161 projects/assets worth LE 9 mn. In roughly the same period, the HC for agriculture sold agricultural land projects for LE 70 mn.and distributed land to young farmers and to poultry and cattle breeding projects for about LE 200 mn.

— Bring to POS 50 percent (LE 7.3 billion) and complete sale of 20 percent (LE 2.9 billion) of entities in the 1995-96 program. (The 1995-96 program should contain at least an additional 20 percent [LE 14.6 billion] of the total book value of the sector.

The SPR Measures

FY 1992/93 Enterprise Condition 2: *GOE will develop a national privatization plan.*

FY 1992/93 Enterprise Condition 3: *GOE will bring at least 5 public sector or joint venture enterprises worth at least LE 100 million to the point of sale. Point of sale includes a valuation, a reservation price and a formal offer of sale.*

FY 1993/94 Enterprise Condition 3.a: *GOE will privatize at least 10 public sector or joint venture enterprises worth at least LE 500 million.*

FY 1993/94 Enterprise Condition 3.b: *GOE will bring to the point of sale an additional 20 firms.*

The SPR measures on privatization reinforced these ERSAP/World Bank conditions and gave them specificity. The 1992/1993 Enterprise Sector measure #2, which asked GOE to develop a national privatization plan, restated a conditionality of SAL I, which was lagging.

The second 1992/1993 privatization-related SPR measure (#3) required that GOE bring at least 5 public sector or joint venture enterprises worth at least LE 100 million to the point of sale.

Performance. The USAID measures for 1992/1993 were satisfied. GOE had prepared a privatization program or plan for SAL 1 in 1991, though a more specific and up-to-date statement was needed. The PEO released in March 1993 a new and better-defined program setting out a schedule of planned privatizations of 87 companies/assets to be achieved by June 1993. The USAID measure calling for preparation of such a plan probably hastened its delivery.

The second 1992/1993 measure (bringing 5 enterprises to POS) was also satisfied. GOE was able to draw on the increasing output of the Public Enterprise Office, which had prepared for sale most of the first batch of 22 companies/assets by the spring of 1993. USAID-provided technical assistance (Bechtel) helped in valuations and preparation of company information memoranda.

The 1993/1994 enterprise measure #3, which specifies for the first time the actual sale of SOEs — 10 of them — in addition to calling for readying and offering for sale 20 more entities — is not satisfied as of April 1994. It is disconcerting to read in the correspondence that in November 1993 MIC responded to a USAID monitoring inquiry saying that this measure was satisfied. According to the PEO, said the MIC official, 20 companies had already been sold for more than LE 1 billion. Therefore, "This measure is now considered to be filled."

The USAID reply observed that not one of the 20 transactions listed in the PEO note involved transfer of majority ownership to private hands (though one or two sales were imminent). And it noted that measure 3.b required that the 20 enterprises to be brought to POS were supposed to be additional to those done in 1992/1993. Therefore, neither policy measure 3.a or 3.b had been satisfied,

However, it is likely that both measures will be met by mid-summer and conceivably even by June 1994, as is suggested by the status of sales and negotiations shown in Table 1 below.

One problem in assessing performance on privatization measures is the need to specify the point in the sales process at which the "sale" is said to have occurred. If the sale is not regarded as completed until money and title have changed hands and new owners are in possession of the firm, then this USAID measure will not be met for some time. It remains true that according to this definition, as of end-March 1994 not a single full privatization (sale of a going concern) from the government's program had yet taken place. However, if a completed sale is defined as the signing of a sales agreement or contract (which is the way the World Bank is defining it), and if account is taken of transactions that are in advanced stages of negotiation, then results are better and the outlook is more hopeful.

According to the recent (March 1994) World Bank ERSAP II review mission to PEO officials, five sales of going concerns have been or are likely to be concluded in coming weeks. (See Table 1.) Three more are in advanced stages of negotiation, with high probability of sale, and six are in earlier or more uncertain stages of negotiation. This suggests that the SRP target of 10 sales is within reach and likely to be met in the near future.[23] The recent wave of share allocations to Employee Associations is not included in this tally, though the World Bank counts them as meeting ERSAP II privatization targets.

The completion of at least 25 valuations of second and third batch companies,[24] the provision of new USAID and other donor technical assistance to Holding Companies and the aggressive offering or re-offering of companies, evidenced by ads in Cairo newspapers in recent weeks — all this suggests that the 1993/1994 Enterprise Sector measure #3.b is also likely to be achieved by this summer.

Although USAID's privatization-related policy measures may be satisfied, however, the ERSAP II conditionality is very far from being met. The First ERSAP II Review Mission (March 20 Aide Memoire) found a huge gap between agreed targets under the government privatization program (GPP) and actual results.

Table 2, which comes from the aide memoire, shows actual proceeds from sales amounting to LE 77 million, or about $20 million, which is less than 2.5 percent of the March 1994 target of a little under $1 billion (LE 3.2 billion). Actually, the story is even more dreary than this. The $20 million includes more than $10 million of asset sales that fall outside of the agreed-upon or "regular" program. In other words, only about $10 million of the targeted asset sales of nearly $ 1 billion were realized. And of the March 1994 point of sale target of $ 1.3 billion, only $48 million was realized, if Employee Shareholder Associations are excluded.

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[23] If these sales of going concerns fall short of the target, the partial privatizations (sales of parts of government share holdings) listed in Table 2 could be interpreted as equivalent actions. The definition of privatization is not explicit in the SPR documents.

[24] Valuations are estimates of the value of companies, usually derived in various ways: e.g., historical cost (book value), replacement cost, market value determined by calculating present value of discounted future earnings.) Twenty-three such valuations have been done, according to an article on privatization in *Business Monthly*, Journal of the American Chamber of Commerce in Egypt, Vol.10, # Feb.-March, 1994. The evaluation team was informed of others in the course of visits to Holding Companies.

TABLE 1
STATUS OF GOE PRIVATIZATION PROGRAM
AS OF MARCH 1994
(LE MILLION)[a]

COMPANY/ASSET & % PUBLIC OWNERSHIP	ASSET VALUE	VALUE OF SALES	STATUS
1. MISHROOB - 19%	15	15	SOLD[b] FEB, 1993
2. MISR CHEMICALS - 100%	206	25 (12%)	SOLD, 41% OF 1/3 SHARE CAPITAL INCREASE TO PRIVATE SECTOR, FEB 93.
3. EL NASR BOTTLING (COKE) - 100%	187	187	VIRTUALLY SOLD[a]
4. EGYPTIAN BOTTLING (PEPSI)-100%	108	108	VIRTUALLY SOLD[b]
5. EL NASR STEAM BOILER - 100%	56	56	VIRTUALLY SOLD[c]
6. MISR TOURIST VILLAGE CO. - 67%	18.8	14.4 (51%)	ADVANCED NEGOTIATIONS
7. ASHTI CO. - 67.2%	58	58	ADVANCED NEGOTIATIONS
8. CAIRO SHERATON - 100%	157	122	ADVANCED NEGOTIATIONS TO SELL 78%
9. UNITED HOUSING ESA/ESOP-(8.8%)	3	3	UNDER NEGOTIATION
10. EL SHAMS HOUSING (ESA/ESOP)-5%	10	10	UNDER NEGOTIATION
11. CAIRO.HOUSING ESA/ESOP - 10%	35	35	UNDER NEGOTIATION
12. ARAB ENGINEERING	35	35	UNDER NEGOTIATION
13. SHEPARD'S HOTEL	10.4	?	UNDER NEGOTIATION
14. EL NASR GLASS	140	?	UNDER NEGOTIATION

Table 1 - continued

COMPANY/ASSET & % PUBLIC OWNERSHIP	ASSET VALUE	VALUE OF SALES	STATUS
SALES OF SHARES:			
(A) COMMERCIAL INTERNATIONAL BANK	140	?	(ALL SOLD)
(B) EL MOHANDES BANK	?	602	
(C) EL MOHANDES INSURANCE CO.	?	0.2	
(D) EL TEMSAH FOR TOURIST PROJECTS.	?	0.05	
(E) SUEZ CEMENT	?	3.9	
	?	26.3	
16. LEASES:			
(a) CONSUMPTION GOODS & CLOTHING "SEDNAWI"			

a/ Sources : First ERSAP II Review Mission and Public Enterprise Office.
b/ Defined as signed agreement.
c/ Defined as all steps concluded but no agreement signed by both parties.

TABLE 2

GOVERNMENT PRIVATIZATION PROGRAM
CUMULATIVE TARGETS AND RESULTS ACHIEVED

(LE MILLION AND PERCENTAGES)

	END-DEC.93	EXPECTED END-MAR 94
A. SALES		
Targets		
1) 22 Transactions	1400	1400
2) 93/94 GPP	900	1800
Total (Cumulative)	2300	3200
Results a/		
1) 22 Transactions	[illegible]	40
2) 93/94 GPP	[illegible]	0
3) "Similar" Assets - GPP	30	30
4) "Other PE Sector" Assets	7	7
Total (Cumulative)	77	77
% of Sales Target Achieved	3%	2%
"Similar" Assets - Financial Sector	603	603
% of Sales Target Achieved if Financial Sector included.	30%	21%
"Advanced" Toward Sale But Not Sold b/	294	365
% of Sales Target if "Advanced" included	42%	33%
B. POINT OF SALE		
Target		
93/94 GPP	2300	4500
Total (Cumulative)	2300	4500
Results a/		
1) Employee Shareholder Associations	113	1595
2) Law 203 Companies	88	95
3) Law 230 Company Shares	66	66
Total (Cumulative)	267	1869
% of POS Target Achieved	12%	42%

a/ According to agreed definitions of sale and POS (See Annex IX to LDP).
b/ "Advanced" means no signed sales agreement and either a letter of intent or minutes of negotiation initialled or signed by both parties.

This extreme degree of nonperformance in so strategic a sector as privatization was the main reason the World Bank's Review Mission of March 1994 found GOE in noncompliance with ERSAP II. GOE response has been to speed up negotiations for the sale of enterprises and to create Employee Stockholders Associations — more than 100 of them at last count — to which shares in SOEs are being transferred.

During intensive consultations with the Bank in Washington in April, GOE claimed that these measures would satisfy the ERSAP II conditions. They won World Bank management over to their position. They did so on the basis of the achievements given in Tables 3 and 4.

Comparison of Tables 2 and 3 shows how this extraordinary shift in the World Bank position came about. For convenience, we put to one side the point of sale issue and look only at actual sales.

According to GOE's April 14 tabulation (Table 3), the Employee Shareholder Associations (ESAs) save the day. About 70 percent of completed sales consists of transfers to these associations, and about 83 percent of transactions close to completion. Three quarters of the sales of majority-owned companies consists of the transfer of 75 percent of shares in 11 construction companies to employees associations.

The sales target in ERSAP II for March 1994 was about $ 1 billion (LE 3.2 billion). GOE claims to have met this target by having completed sales of $ 740 million (LE 2.5 billion), and by having brought close to completion another $ 710 million (LE 2.4 billion) of state assets. But most (70-83 percent) of these sales or imminent sales consists of transfers to ESAs.

These transactions will have virtually no impact on management behavior. Shares that were held in the name of the HC are transferred to an account in the name of the ESA. The employees own the shares only so long as they continue working for the companies in question. The have no voting rights until majority ownership of the SOE is private, and the company is changed from a Law 203 company to a Law 159 company. The ESA can then sell shares on the stock exchange and purchase other shares or assets. Shares held by employees are not saleable. The equity implications of transferring ownership to ESAs are negative. Why should a few hundred thousand wage earners and managers be given ownership rights over the bulk of the nation's industrial assets?

In any case, the World Bank has accepted this shifting around of stock certificates as meeting the conditionality of ERSAP II. So from the Bank side at least, it appears that GOE has a green light for the final Paris Club debt rescheduling in June 1994. It remains for the IMF to give its approval.

Despite World Bank acceptance of this privatization as satisfactory adherence to its conditionality, the uncomfortable reality is that most of the objectives of the government privatization program have not been met.

There have been some positive changes. Ministerial control has been replaced by HC management of Affiliated Companies, and important steps have been taken toward readying enterprises for sale. Monopoly structures and controls have been reduced in a few sectors — notably in fertilizer distribution and agricultural marketing, banking, and some manufacturing. Price controls and import controls have injected competitive forces in some markets. The financial sector has become more open and competitive.

TABLE 3

PROGRESS IN ACHIEVING TARGETS
As of April 14, 1994
(LE million)

		Target	Results	
A.	Bring to the Point of Sale	4,500	6,265	
B.	Completed Sales	3,200		
	- First 22 Candidates		2,488	
	- Law 230 Company Shares		(233)	
	- Assets of Law 203 Companies		(33)	
	- Employee Shareholder Associations (ESAs)		(533)	
			(1,689)	*
C.	Close to Completion	n.a.		
	- First 22 Candidates		2,384	
	- ESA Schemes - CMA Approval		(379)	
	- ESA Schemes - remaining 65% of 11 Public Works Companies		(622)	*
			(1,383)	*
	Total (B+C)		4,872	*

TABLE 4

SALE OF MAJORITY-OWNED COMPANIES/ASSETS

i.	Completed	137	
ii.	Close to Completion		
	- ESAs - 11 Public Works Companies (75% ownership)	2,052	
		(1,596)	*
	- First 22 Candidates - Close to Completion	(379)	*
	- Law 230 Company - Majority Shareholding	(77)	
	Total Completed and Close to Completion (i + ii)	2,189	**

* Subject to Bank review.

** Compared with a commitment of LE2.2 billion (as per para.9)

But extremely modest numbers of divestiture to new owners and new managers have occurred. Improvements in internal efficiency of SOEs have not been given new impetus. Most of the structural obstacles to development that are produced by the oversized state enterprise sector remain almost as formidable as before the reform program began.

Indeed, the PE sector is larger now than before the ERSAP, because few SOEs are liquidated or sold and numerous new ones are formed, and restructuring investments have increased the capital base of existing enterprises.[25] Large volumes of national resources continue to be inefficiently absorbed by sheltered state enterprises. The PEs continue to have access to bank credit, whatever their creditworthiness; the budget constraint therefore remains soft. The playing field remains uneven, which discourages private sector expansion and faster economic growth.

At the same time, the privatization experience risks disturbing the policy dialogue. By the ingenious method of inventing Employee Shareholder Associations and hurriedly creating more than 100 of them, GOE is able to claim that it has met the targets and commitments of the ERSAP II. It was able also to get the World Bank to agree. But this compliance is merely in form, and not in substance. It is likely to have very few positive effects on economic efficiency and growth.

GOE, with or without the World Bank, will also have to work out a new privatization program. It is hard to see how it can without embarrassment continue to maintain that the target is still the quick divestiture of scores of SOEs as specified in the ERSAP II policy matrix and the Letter of Development Policy. That program seems to be dead in the water.

What Went Wrong?

Excessive Optimism. First of all, the timing as well as the scale were highly optimistic from the start. The ERSAP II calls for sale of $ 5 billion of state assets in two years — 25 percent of the 314 SOEs in the government's privatization program. The World Bank and GOE put this in stone in the Bank/Fund matrix and it was repeated in the Letter of Development Policy reproduced for the January 1994 Consultative Group meeting. And all this despite the fact that there had been no true divestiture (a trade sale, or sale of a going concern) since the reform program got under way in 1991.

Excessive optimism frequently characterizes privatization efforts, though perhaps rarely on so flamboyant a scale. Even in so likely a country as Taiwan, the government has been unable to transfer a single company into majority private hands since it began its ambitious divestiture program in 1989. It took years before Turkey's program yielded some sales. Tunisia's privatization program, often cited as a model, had resulted in sales of no more than 12 percent of public enterprise sector equity by 1992.

But Egypt should have been able to do much better than it did. Lack of buyers — or at least lack of capital for purchase of state assets — is not a major problem here as it sometimes is elsewhere.

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[25] Seven firms are listed in Appendix Table B-2 as PEs for which liquidation decisions have been taken. But of these, only one has actually been liquidated as of May 1994 — the Cairo Public Building and Prefabricated Housing Company. In the case of Eastern cotton, an HC Board decision to liquidate (taken on June 30, 1992) was not pursued because of worker protests. The remaining five construction companies enjoyed new business after the 1992 earthquake, and also, according to GOE representatives, increased their efficiency when faced with the threat of liquidation. They are still in business.

Donors were willing to finance many of the pre- and post-transaction costs, from valuation exercises to cushioning of disemployment effects. Many firms had a prenationalization life, and are being reprivatized, which is always easier to do than to privatize firms born in the public sector.

Four other reasons for slow progress can be identified, in addition to the "normal" overoptimism that typifies these programs.

- **Mistakes in conception.** The holding company idea has not proved productive.[26] It has so decentralized the management of the privatization process that coherence and transparency are at risk. Moreover, it creates managers of privatization who have strong interests in not privatizing. Finally, it allows cross-subsidization of money-losing firms by profitable ones within the HC, and also allows investments for restructuring to be made without proper screening. The result is maintenance (even expansion) of the size of the PE sector, and likely misallocation of investment resources.

  The World Bank has to be faulted for excessive zeal, inflexibility in the face of obvious difficulties or reluctance in compliance, and unwillingness to sanction noncompliance. The program was very big to begin with. And even in the face of accumulating evidence that sales were lagging badly, the targeting for new divestitures were never revised downward.

  Failure to find a proper role for the PEO was another misstep. The PEO was not mentioned in Law 203, though it is mentioned in the Letter of Development Policy as the implementing Agency. Legally, they were simply advisers to the Prime Minister. They had no formal access to the HCs. Attaching the PEO to the Prime Minister's Office compounded the problem. Not only was he inherently too busy to give it proper attention, but it left the PEO without a true bureaucratic home, a secure place in the administrative structure.

  It would have been better (though it may not have been possible) to create a single agency with responsibility for overseeing the privatization program, with the PEO as its technical arm. At the same time, the affiliated companies should have been made autonomous enterprises — the old ministerial holding-type organizations should have been killed and no HCs created to replace them. (One has to recognize though that this also may not have been politically feasible.)

- This is related to another error: an **unwillingness to face liquidation decisions early in the program**. Postponing them allowed the mix of profitable and unprofitable firms within HCs, which permits the continued financing and subsidization of nonviable enterprises by profits of healthy ones within the same HC.

- **Lack of ownership and political hesitancy.** Another source of failure is the lack of local ownership of the privatization program. This has two elements.

  — There is little evidence of real intellectual or ideological commitment to the privatization idea, little conviction that it is right for Egypt's economic growth and for Egyptian society.

[26] Of course there may have been no other options at the time, for political or bureaucratic reasons.

— Like the reform program as a whole, transparency is lacking. The details of bidding and pricing remain a mystery for the man in the street, even the educated or politically aware publics. "White Books" which, according to the Guidelines, are supposed to contain full information, have not yet appeared for any transaction.

Related to this is the hesitation of officials and political authorities to accept responsibility for sales. The Holding Company chairman is in the front line. He negotiates a sale. But he worries about selling too low. So he defends himself by insisting on the least impeachable of the range of valuations available (in other words, most often, book value in one of its variants).

He also shifts the decision upward as often as possible — to the responsible minister, then the Prime Minister. Each tries to deflect responsibility for the decision, which is politically dangerous. Many people cite the case of former Minister of Tourism Fouad Sultan, whose efforts to privatize hotels in the late 1980s led to strong attacks in the People's Assembly on the grounds that he was selling the family jewels. It ultimately cost him his job.

It's no wonder sales are few under these conditions. The political hesitation is often presented in terms of disemployment effects, but the problem is really one of ownership and commitment.

- **Soft budget constraint.** Related to much of what has been said, the budget constraint remains soft. Direct budget subsidies seem to have disappeared. But heavily indebted, uncreditworthy enterprises continue to receive sustenance, either from the profits of sister firms within the same HC, or from bank credit guaranteed by HC chairmen. Ironically, the proceeds of privatization sales also soften the budget constraint; they can go — and have gone — to finance restructuring of other affiliated companies within the privatizing HC. This happens without apparent vetting of these restructuring investments for soundness and priority.

- **Errors in implementation.** The awkward status of the PEO has been mentioned, and the allocation of privatization implementation responsibilities to an overburdened Prime Minister. Failure to fully use available technical assistance was a mistake: government never allowed the Bechtel people to do more than draft valuations, draft marketing plans, draft company memoranda. Government wanted to use local financial entities for this work.

  The adoption of an organizational structure that violates the lessons of experience was another: giving responsibility to one privatization agency would have been much more effective than allocating it to 17. The lost opportunity to decentralize more completely to the Affiliated Company has been mentioned.

  Finally, GOE failed to follow through on one of its promising initiatives: the attempt to give consulting firms and financial institutions responsibility for sale, on a success fee basis. Some 45 SOEs were packaged and offered for bid. This happened early in 1993. Bidders were to take on valuation, preparation of privatization plans and documents, marketing and actual sale — all on a success fee basis.

  The initiative failed. There was a strong response; some 40 firms (most of them in teamed bids) made proposals. But apparently none would work on a strict success fee basis. All submitted complicated fee structures, including up-front costs for valuation. No international

banker was willing to come without a substantial up-front fee. The proposed cost per transaction turned out to be high — $1 to $2 million in many cases. The HC Chairmen, who were responsible for the process, reacted strongly against these proposals, and rejected them. The initiative fizzled out, without resulting in any sales.

New Approaches and Measures

Given these circumstances, some different approaches and measures should be considered for inclusion in SPR II.

- It should be recognized that the privatization program as inscribed in the World Bank/IMF matrix is moribund and is unlikely to be revived soon in its present form. The World Bank has agreed to accept the hasty GOE redefinition of its privatization policy (giving shares to employee associations and to other entities, and otherwise selling shares) as meeting its conditionality. This reflects a necessary concession to reality: that in the next few years there will not be much privatization in the sense of sales of going concerns. It would be unwise therefore to insist on large numbers of classic divestitures in USAID's program. If 10 SOEs a year are meaningfully privatized in 1994-1996, that will be an achievement. There's no point in USAID risking confrontation on this issue when the World Bank has just run around it.

  Related to this point, the balance between deregulation or demonopolization and divestiture in the SPR should be strongly in the direction of deregulation. "Deconfinement" is the better term. Privatization strategy should give greater weight to regulatory reform, to removing obstacles to entry for private sector producers and service providers. In the long run this will be the most effective vehicle for privatizing the Egyptian economy.

- Public enterprise spending is at the same time constrained and unregulated. PEs can no longer make direct claims on the central government budget, and only limited claims on bank credit. But it appears that HC resources are being used to create new SOEs. Thus new firms are created almost every day, often with the help of foreign donors or credit suppliers, often also by HC investment of profits of affiliated companies (ACs). Even proceeds from sales of HC assets can be and presumably are being used for these purposes, as well as for sustaining money-losing firms within the HC.

  Just what to do about this is not clear. The provision common in many structural adjustment programs — that no new SOEs be formed — will not be accepted or would be generally flouted. Few ministers in Egypt or elsewhere are ready to reject investment financed by foreign grants or concessional loans. And under present institutional arrangements, government control over HC utilization of their resources is very loose. A requirement that all profits from AC operations go to the Treasury would be difficult to enforce and/or would induce uneconomic behavior by HC managers — for example, excessive investment in ACs that are profitable because of market power or special privileges. Requiring privatization proceeds to go to the Treasury would remove the one incentive HC managers have for privatization. The problem requires further study and reflection. SPR II might contain a measure calling for a study.

- Liquidation should be given greater weight. Some 50 firms have already been listed for liquidation (see Annex B, Table B-2). These are big money-losers, generally recognized to

be unviable. With the availability of resources for softening the political and social costs of disemployment, it should be easier to get Government to close these elephants down than to seek the sale of presumed family jewels.

- Government should be asked to produce a new policy statement on privatization. If it has abandoned the existing privatization plan (as expressed in ERSAP and the last Letter of Development Policy), it should say so. This would let donors know where they stand on this matter, and would be good politics beside. The capitulation of the World Bank on noncompliance with the present program makes this imperative.

- The strategy of turning over management of the divestiture process to private or semi-public financial institutions and consulting firms on a success fee basis should be revisited. This is the cheapest and most expeditious way to privatize going concerns. USAID should seek GOE sponsorship for a study — financed through TSSPR — last year's failed effort, combined with a review of experience in other countries with this approach to privatization.

- One of the policy measures should be for government to sponsor a study of nondivestiture and indirect methods of privatization — management contracts, leases, concession arrangements, contracting out of individual services, self-help schemes, and so on. The study could be a broader appraisal of the potential for private delivery of public services, including infrastructure services through private investment (Build-Own-Operate and related schemes).

General Conclusions on SPR Measures

The SPR policy measures were generally well designed to meet the targets of the program: reinforcement of GOE/IMF/World Bank ERSAP, and filling in ("complementing") gaps in the ERSAP. Best performance has been in fiscal and financial sector reform, worst in enterprise sector changes, and in privatization in particular.

In a number of cases the measure was complied with formally, but without fully contributing to broader reform objectives. The global income tax for example represents a substantial step forward, but the tax reform of which it is a part did not broaden the tax base, as was intended, nor was it revenue-positive. A slightly different example is in trade policy. The trade regime has become decidedly more liberalized. But tariffs continue to provide abundant protection to inefficient producers. And some of the intended benefits of reduced protection are being offset by new nontariff barriers, such as quality controls on imports. The privatization story speaks for itself.

Compliance then has been uneven, but good overall. Most of the SPR policy measures have been or are likely to be complied with.

CONTINUATION OF THE SPR OR AN EQUIVALENT WILL BE OF HIGH PRIORITY IN THE NEXT FEW YEARS

Policy change in Egypt has been induced by negative and positive incentives. The negative incentives were the prospects of continued macroeconomic instability and certain economic decline if GOE continued on its policy path of the 1980s. In the latter years of the decade annual budget deficits were soaring, monetary accommodation had pushed inflation above 20 percent a year, the heavy hand

of government was stifling economic initiative and the large state sector became an ever larger, increasingly inefficient absorber of national resources. It was not certain that Egypt's foreign partners, including the United States, would continue to finance an economy so distorted and wasteful, and so far off any visible growth path.

The positive incentive was continuation in aid flows, even at higher levels, if policy continued to move toward greater liberalization. Included in the aid package was a World Bank Structural Adjustment Loan and an IMF agreement. And there was a special incentive: substantial additional debt and debt service relief (DDSR) from the donor community,

As noted earlier, Paris Club DDSR is linked to successful GOE performance under the IMF arrangements, which in turn require satisfactory performance under the World Bank's SAL and SAMP. DDSR was designed to be provided in three phases. The first phase ($3 billion DDSR) was implemented in July 1991, the second (also for $3 billion) was approved in October 1993. The final phase ($4 billion) is scheduled by the Paris Club to take place by July 1994. It is however conditional on satisfactory performance under the IMF Extended Arrangement, which is in turn conditional upon compliance with the World Bank's SAMP.

Although there has been generally satisfactory compliance with IMF monitored macroeconomic policies, SAMP-monitored structural reform, especially privatization, appeared problematic and likely to force delay of the final Paris Club DDSR. But the successful conclusions of negotiations in Washington in mid-April now makes third tranche DDSR approval in June likely. One possible stumbling-block remains: the IMF and GOE need to come to terms on the macroeconomic program for the coming year, including dealing with the need to increase export competitiveness through mutually consistent fiscal, credit, and exchange rate policies.

Once the Paris Club DDSR is completed, the importance of compliance with the IMF and Bank programs will be limited to GOE's perception of their importance as certifiers of a sound policy reform framework to the donor community and the private sector. Hence, the relative importance of USAID's SPR program should be expected to increase significantly in the future, because it will be the only financially supported policy reform program.

One of the major inducements to reform, then, will disappear in 1994, (perhaps not until 1995, in case of a delay in IMF approval of third tranche debt relief). This increases the risk that the reform program will go off track. What makes the post-1994 period especially perilous for reform is that one of the major sticks will also be gone. The resource position of GOE can only be described as comfortable. External reserves are abundant, the budget is under control, inflation is low and declining. The aid pipeline is large. External and internal restraints are therefore loose. Government policy makers may feel that a little relaxation is in order, including looser fiscal and monetary policy — especially since the reform period has not been associated with renewed growth. With fewer and slimmer benefits and much less obvious costs, slippage prospects are certainly higher than they have been since the reform program began.

MANAGEMENT OF SPR I HAS BEEN GOOD BUT IMPROVEMENTS CAN BE MADE

The design and implementation of SPR has been extremely demanding. The constraints inherent in the project no doubt seemed stronger in 1991 and 1992 than they do now. GOE was reluctant, to say

the least, to see the straight cash transfer turned into a policy-based grant. No such arrangement existed for aid to Israel. And abundant conditionality already existed with the IMF's Standby and EFF and the Bank' SAL I and, later, the SAMP.

So the designers had to avoid additional conditionality that would be "burdensome." At the same time, the program had to have fresh elements; there was no point in "paying twice for the same reforms" as some observers saw it. Moreover, credibility had to be established — not easy, given the earmark and hence the low risk of sanctions for noncompliance.

Finally, the policy conditions of SPR had to be implemented in a bureaucratic and political structure where decision making authority is centralized, policy analysts few, information flow is sluggish and habits of policy dialogue with external partners other than the Bretton Woods institutions undeveloped.

The description of the policy measures and the analysis of compliance with them in the previous section have shown that USAID managers, notably in EAP, have succeeded in steering through most of the constraints and have implemented the program effectively. The underlying principles were straightforward: reinforce and complement GOE/IMF/World Bank ERSAP. The measures selected sought to broaden policy change by emphasizing neglected problems and framing reforms that were more specific and sometimes less ambitious than those in the ERSAP — intermediate targets.

Implementation has required persistence, imagination and considerable diplomacy. EAP staff has kept pressure on responsible GOE officials by frequent reminders to their main point of contact, the MIC, that evidence of compliance was required. The pressure is gentle but frequent, a useful complement to the World Bank's procedure; typically Bank supervision or review missions come for three intense weeks, then go home for four or six months, during which time monitoring of policy programs is mainly by remote control.

Despite the generally good EAP management of the program, the evaluation suggested a number of areas where modifications might increase effectiveness and impact.

Concentration and Focus in Policy Measures

SPR I contains 20 measures each year in four sectors — financial, fiscal, trade, and enterprise. The choice of sectors is understandable; these are key policy areas. The reasons for settling on 20 measures a year are not evident. It's a lot for systematic monitoring but substantially less than the number found in World Bank SALs around the world, and much less also than is found in the ERSAP II (World Bank/IMF) policy matrix.

Despite the choice of key sectors and a restricted number of measures in comparison with full blown adjustment program, the program lacks a well-defined expression of what it is seeking to achieve. The reform measures are all worthwhile, and all aim in some sense at broad-based economic growth. But it is difficult to perceive a unifying theme or vision that animates the program. Proximate objectives also are thinly-defined, which also contributes to the problem of coherence. Selection of specific policy measures is also made difficult in the absence of a clearer statement of more immediate objectives.

It would be desirable therefore to set out narrower and more concrete objectives for the SPR. This is already being done in the preparatory work for a second SPR. It should give a clearer vision of

the program's purpose, greatly facilitate the selection of policy measures and make for more convincing presentation of the program to GOE and others.

Balance Between Monitoring and Dialogue

Monitoring for compliance has been good. Interviews and review of the program's files make it clear that EAP staff have attacked the monitoring problem with great ingenuity and persistence. They spend considerable time requesting documentary evidence that the policy measures have been complied with. This means chasing down decrees, seeking provisions in laws or executive regulations, checking data, confirming general statements made by officials about implementation of specific reforms.

The verification pursuit has yielded satisfactory evidence of compliance in most cases. But it has become a frequently frustrating, often absorbing task that sometimes takes on the appearance of a paper chase with uncertain links to broader policy concerns.

Partly this is due to the difficulty of monitoring conditions that are sometimes imprecise. "Process" conditions that call for "improving" or "preparing" something or "developing procedures" to do something are frequent sources of monitoring problems.

But the way program monitoring has evolved, procedures are also laborious: letters are sent to the responsible officials in the MIC, who forward them to relevant technical ministries. Often the technical ministry concerned sends back a perfunctory reply, saying the measure has been or is being complied with. The USAID officer sends another letter asking for documentary evidence — most often an implementing decree or law. Sometimes the reply states that the measure has been achieved when it evidently has not, as in a recent exchange of correspondence on privatization achievements.

Hard confirmation of compliance on the policy measures is of course necessary; after all,it governs disbursements. But the compliance checking seems to have become all-absorbing, leaving too little scope for genuine dialogue about and analysis of the broader, deeper policy questions that surround the reform measures. The potential for using monitoring as an instruments for the initiation of true dialogue, an opening for the exchange of ideas about problems and possible solutions has been underexploited.

Also, monitoring has not entailed sufficient on-the-ground assessments to determine if the reforms have been implemented as intended, whether unintended effects or residual problems may remain, and probable actual and anticipated impacts. The effectiveness of these reforms should be assessed to determine if identified constraints to private sector investment, production, exports, and imports have, in reality, been removed by the GOE reform actions and what related or residual problems may require further GOE reform action. The significance of the reforms, in terms of probable microeconomic impacts on business exports, imports, investment, costs, revenue, employment and earnings, should also be estimated to the extent feasible.

MIC Connection

The dialogue-augmenting potential of SPR was formerly restrained by the practice of funnelling contacts with GOE through the Ministry of International Cooperation. The link to MIC had advantages for the SPR and USAID; its leadership has been very influential in matters of economic policy making, so working through the ministry opened channels to high-level decision makers.

But the relationship was constraining too. To some extent, MIC acted as a screen between USAID technical staff and the technical ministries and other operating agencies with which close relationships might have developed otherwise. This issue is no longer significant. Access to technical ministries is no longer impeded by MIC coordination.

Interactions with World Bank and IMF

Interactions between the World Bank, IMF, and USAID on the policy reforms have been generally good but clearly less than optimal. The USAID director has frequent (at least monthly) meetings with the resident representatives of the Fund and Bank. These provide for fruitful exchanges of views and collaboration on policy issues. USAID economists have frequent discussions with the Bank economist and to a lesser extent the Fund resident representative on economic performance issues. USAID program officers also attend monthly donor coordination meetings with opportunities to exchange views on their respective programs.

However, the exchanges on the development of policy objectives and measures are not fully collaborative. IMF and World Bank mission may be in country for several weeks without substantive contact with USAID technical staff other than to provide exit briefs (which may not even include the most relevant staff — the economists). For example, the World Bank has just completed a three week SAMP monitoring mission, including 15 professional staff, with no discussions with USAID other than an all-donor briefing attended by the USAID program office.

Also, the joint IMF/Bank policy matrices for the ERSAP I and II were independently developed by their staff, and only then shared on exit briefings with USAID. In contrast, USAID economists have been much more collaborative, openly soliciting IMF/Bank staff views to ensure that USAID SPR measures significantly complement and support the overall reform program.

Although Mission staff openly share technical policy analyses supported by USAID, the World Bank and IMF staff all too often do not or cannot provide full access to their reports. The Bank and Fund respect the right of GOE to prohibit access to their draft documents and confidential memoranda on policy performance, and GOE is intent on treating many of these documents as highly confidential.

Copies may be leaked, read but not removed from their offices, or the USAID director may persuade the relevant GOE minister to release the document. But lack of open access to documents often preclude USAID technical staff involvement in meaningful policy dialogue. For example, the World Bank restricted access to the recent Aide Memoire of the ERSAP Review Mission and to the Bank's draft Private Sector Development Report. The IMF did not share its draft Investment Incentives Study. In all of these cases, USAID has a real need-to-know if it is to effectively monitor SPR I, develop SPR II, and discuss the issues with GOE.

Interaction with Private Sector

The loosening of constraints on private sector activity is the central theme of the SRP. EAP staff show much awareness of the issues involved; the PAAD shows great sensitivity to them, and the staff recognizes that the private sector is a source of basic information about impacts of reform measures and also a provider of needed insights into obstacles to Egyptian growth.

However, actual EAP contacts with the Egyptian business community have been limited. Partly this is a result of internal USAID division of labor. As in most missions, economists tend to deal with broad macroeconomic issues and with government policy makers, while private sector officers deal with local private sector representatives. In Cairo it is the Trade and Investment Office that operates in the private sphere. EAP staff have sought out and relied on the Trade and Investment Office for information about and contacts with the private sector, but this has not been sufficient. There is no substitute for continuous and broad-based personal contacts to find out what is really happening in the Egyptian private sector.

The EAP correspondence and files reveal few discussions with local business firms, especially those of medium and small size. They show few discussions with exporters, small or large. Evidence of first-hand, on-the-ground information gathering is slim. Foreign business contacts seem to be few.

It is worth noting that such outreach by staff economists to private sector actors is not common in any USAID mission. It's what private sector officers or related staff do. Nonetheless, when the policy reform program is so directly aimed at liberating private energies, it is indispensable for economists to be more engaged. It would give EAP staff greater credibility in dealing effectively with GOE as an advocate of an improved business environment. And it would allow richer analysis of the degree of compliance and market impact of individual reform measures.

Intra-USAID Collaboration

Interoffice relations are generally good, but USAID's size and bureaucratic complexity hinder internal collaboration on the SPR program. A number of problems have emerged.

Meetings with the IMF, World Bank, GOE and private sector are often held separately by different units and representatives — the director alone or with one or two associates in some cases, the technical staffs in economics, investment and trade, agriculture, and the program office in other cases. The substance and spirit of these meetings is not always transmitted to nonparticipating individuals and units.

The issue is perhaps particularly pertinent for the economists. Brief memoranda of conversation or debriefings are often inadequate substitutes for their participation in policy-relevant meetings. These meetings involve in-depth policy discussions that bear strongly on the technical side of SPR. More effort is needed to include the relevant technical staff (especially economists) in these general meetings where possible or to provide detailed debriefings.

In the initial phases of SPR, the economists did not always fully and substantively involve other offices in the development of earlier draft SPR policy measures. For example, another office reports that in the past they were only advised to provide proposed SPR measures within twenty-four hours via E-mail to EAP.

In recent months, this problem has been pinpointed by the EAP staff as requiring new attention. As a result, informal discussions have expanded, and inter-office sector committees have been created to develop SPR II measures, and this is generating much more intensive interchange of ideas. The committees have produced useful statements of rationales for proposed new policy measures, among other outputs.

These new avenues for interaction, however, have not yet produced many in-depth analyses of the issues. Some reasons for this are evident. Staff time is sparse, given multiple responsibilities. Perspectives vary a great deal making it harder to reach consensus on technical issues.

All of this presents some problems for decision making. Proposed policy measures, with the issues analysis that underlies them, are typically presented at a meeting of the director and senior staff. They are discussed at this meeting and the director tends to make decisions about inclusion or exclusion of particular measures. But because of the heavy workloads and intermittent intra-office collaboration, in-depth technical rationales are seldom on the table to give technical direction to the process. Decisions are largely based only on discussions at the meeting.

The director then formally presents USAID's proposed policy measures to the Minister of International Cooperation, at meetings where the agenda is usually crowded and where background technical analyses are rarely part of the dialogue. While economists have often been present at these meetings, they apparently have played a limited role in the decision-making process, which is demonstrated by dialogue between the director and minister.

If these discussions in the future are to focus more on the policy issues and less on performance measures, as the evaluation team believes they should, the economists should play a more central role in the decision meetings, which should be structured so as to allow more technical discussion.

Staff in other technical offices express the opinion that the economists have not fully exploited their technical capacities, in-depth knowledge and varied contacts with outsiders. While this may have limited substantive interactions in the past, the arrival of a new chief economist and another senior manager/economist with cross-office responsibilities has facilitated much more fruitful inter-office cooperation and dialogue.

Technical Support for SPR Project

TSSPR's potentials have been insufficiently exploited. This SPR sister project is a valuable resource. It provides $10 million over a three-year period for financing reform-related studies and technical assistance.

TSSPR has not been much used. As of April 1994, expenditures amounted to less than $3 million. Three studies had been financed. The bulk of spending was for financing of Bechtel-provided technical assistance for privatization. The MIC monitoring unit is to be financed from these resources, but disbursement is badly lagging on this subproject. Only a few additional studies are ready for implementation.

USAID staff have put forward some interesting, innovative, and promising proposals to GOE: among them, technical assistance in planning and budgeting within the Ministry of Finance; a trade policy planning unit within the Ministry of Economy; a proposal for a small research grants program to finance Egyptian academics for policy-related studies. Most have been rejected. The small grants proposal is accepted but implementation lags badly. Even the project for creation of the monitoring unit within MIC is well behind schedule.

Some of the reasons for this patchy utilization of TSSPR are clear. One important factor is the frequent reluctance of GOE officials to take bilateral, perhaps especially US technical assistance. Thus a proposed study of debt problems within the public sector was allocated to the EEC after USAID

proposed it, but was never carried out. The IMF was asked to study budget problems and the USAID proposal was never taken up.

In addition, TSSPR seems to have been something of an organizational orphan, not falling squarely within a well-defined jurisdiction within EAP. Responsibility for technical oversight has moved between different EAP staff members.

Conclusions on Program Management

The EAP managers of SRP have handled well most of the many challenges presented by the SPR. They wrote a perceptive PAAD, based the policy measures on sound economic analysis and have successfully managed the implementation process so as to nudge the reform process forward without running into the many possible pitfalls. Moreover, the recently arrived director of EAP is giving vigorous attention to removing revealed problem areas.

Implementation of the program has in fact revealed some areas where improvements can increase effectiveness and impact. These have been reviewed in this section: a tendency toward too much dispersion of policy measures and perhaps too many measures, coupled with a too broad definition of objectives; some crowding out of dialogue because of preoccupation with verification of compliance; a too-narrow channeling of contacts with GOE through the MIC; restricted contacts with the Bretton Woods institutions and with the Egyptian private sector; and the underutilization of TSSPR.

SECTION THREE

RECOMMENDATIONS

1. Introduce a Second SPR, as Is Now Planned

SPR I has worked well and much experience has been gained in designing and implementing a conditioned cash transfer program in the special political context that defines the U.S.-GOE aid relationship. There is potential for greater effectiveness in a second program, building on the lessons of experience — in particular, by opening up a broader and deeper dialogue with GOE and other economic players.

Moreover, SPR will have a special importance in the next two years. The absence of a financially backed World Bank program and the disappearance of the incentive of Paris Club debt relief create a policy lending void that SPR II can help fill. Another way to put it is that SPR II is needed to fill the post-debt-relief gap in cash-backed policy dialogue.

2. Concentrate Measures on Narrower, Better-defined Objectives

In our view, the program should have one, relatively simple major objective. The linked themes that run through almost all the reform measures are private sector development and deconfinement through regulatory reform. Making the market economy work better is a related theme. It's hard to put this into some shorthand set of phrases that would capture its essence; many possibilities such as broad-based growth have become so hackneyed one hesitates to use them. One possibility is: Encouraging private sector supply response. Another is: Faster growth through private sector development. Not terribly sexy, but illustrative. Mission staff have other, probably better ideas.

Shorthand presentation aside, the point is to determine one relatively circumscribed central objective for the program, and then to define subobjectives and policy measures appropriately. In each sector, the question becomes: What are the major problems or constraints in meeting the overall objective of private sector growth and what kinds of measures best address them?

In the financial sector, for example, three major subobjectives might be: making the financial system more efficient and diverse through greater competition, readying the capital market for the increase in flotation of shares anticipated as a result of government's shift in privatization policy away from trade sales (sales of going concerns as a whole), and increasing the supply (and reducing cost) of financial services for small and medium-sized enterprises.

In the enterprise sector, to take another example, the objectives might be: to demonopolize provision of services that are strategic with respect to export growth — for example, port facilities and related services; to prevent continuing and uncontrolled expansion of public enterprises; or to spur divestiture and to encourage consideration of nondivestiture forms of privatization.

If the subobjectives are carefully defined and bounded, it would make the task of selection of new policy measures easier, because they would have to be explicitly linked to the stated objectives. And it would encourage greater focus, perhaps by reduction in the number and range of policy measures. This would facilitate coherent presentation and closer and more intensive monitoring by the (to-be-created)

MIC evaluation unit, and by USAID staff or others. It would make monitoring and assessing impact much easier in general.

3. In Selecting New Policy Measures, Use the Following General Approaches and Criteria

USAID staff have been drafting new measures for a possible second policy program (SPR II). The evaluation team discussed with them, informally and formally, the draft measures under consideration, as well as general approaches and priorities for a second SPR. Because the measures are still at a draft stage, and still being redefined and revised, it would be inappropriate for us to formally discuss them here. What we can do is address some general issues about approaches to and criteria for selection of policy measures, and put before the Mission a few suggestions on specific measures that emerged from our visits and discussions.

It should be noted that at the end of each of the sectoral reviews of SPR I measures in Section Two, priority areas of need for policy attention or specific measures are suggested for mission consideration.

The Mission Should Continue to Be Inspired by the World Bank/IMF (August 1993) Policy Matrix

This contains an abundant set of policy conditions, most of them based on intensive studies and reflecting a broad knowledge of sectoral problems and institutional conditions. This potpourri of policy conditionality extends to mid-1996, and it is of course strongly market- and private sector-oriented. Both in time frame and in policy orientation it is a source of conditionality ideas from which it is highly suitable for USAID to draw.

Some people worry that USAID will be "paying twice for the same reforms" if it draws on some policy measures set out in the Bank/Fund matrix. But this is a misguided notion. USAID's policy lending is intended to reinforce and supplement policy conditionality. It supports policy conditionalities that are of special importance, or general reforms that are urged by the Bank or Fund but not yet adopted.

Even if GOE were to have operative Bank or Fund programs (SALs or Fund agreements that were being drawn upon), the "paying twice" idea would be wrong. But in fact there will be no regular SAL or normal Fund agreements in the next few years. USAID will be the only donor with money backing up policy reform programs.[27] There will therefore be only one payer for reforms, though Egypt will of course draw intangible ("image") benefits from continued adherence to the reform program.

In any case, in the future as in the past, USAID measures will be modified and adapted taking account of changing circumstances and new information. And, also as in the past, GOE and USAID staff will have identified wholly new priority measures to be included in the SPR. So the SPR would never simply replicate the Bank/Fund program. The main point is that there need be no hesitation about drawing on that body of conditionality.

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[27] The EEC also has some policy loans, but much smaller than USAID's.

Concentration and Focus

As indicated earlier, it would make the program more comprehensible and give it coherence if measures were integrated around one (relatively) concrete theme, such as encouraging private sector supply response. Measures should then be directly linked to subobjectives.

Specific Selection Criteria

In assessing a proposed measure, the following questions should be asked:

- **Is it "strategic"?** — in other words, aimed at key constraints or bottlenecks to private sector growth, or more generally, crucial for the attainment of the specified objective and subobjectives?

- **Is it technically uncontested?** Measures that recommend adoption of policies or institutional changes that do not enjoy consensus among experts should not be adopted without clear justification. For example, many writers now state that after a reasonable reduction in levels and dispersion of tariffs, trade liberalization measures should tread softly in reducing protection and concentrate more on export promotion. In Egypt, import liberalization has thus far received the main attention, export promotion relatively little.

- **Is it monitorable?** Process conditions ("improve" this, "undertake" or "develop" that) require special care in specifying acceptable measures of satisfactory performance. Precise wording is essential. Quantified measures are most easily monitorable and therefore desirable, but they can be confining and increase risks of nonperformance. Monitorability also means that the number and complexity of measures and their sectoral diversity should not exceed the staff capacity of the monitoring agency.

- **Is it credible and differentiated in terms of costs of noncompliance?** The authorities tend to regard each measure as being worth the same in terms of disbursements for performance or nondisbursement for nonperformance; they seem to believe that authorizing a study is equal in performance weighting to privatizing 10 enterprises. Some indication should be given that this is not the case, if incentives to reform are to be right.

- **Is there reasonable balance in each measure between potential benefits arising from adoption of the measure and the risks and costs of nonperformance?**. There's no point in including a measure that has high probability of being ignored unless it promises to bring great gains in policy improvement. Careful consideration should be given to the costs incurred by introducing measures that are especially contentious: more generally contentious dialogue, and, in the case of noncompliance, the costs to USAID and GOE of reallocating nondisbursed SPR money.

4. Widen the Policy Dialogue

Conditioned policy loans or grants can accelerate policy reform in various ways. The money can induce governments to introduce or speed up a policy or institutional change they don't like or believe in; later, seeing its benefits, they may come to internalize or "own" it. This is said to have happened in

Egypt. But it does not seem to occur very often — judging from high rates of noncompliance and backsliding in reform programs.

More durable reform can come via the process of policy lending itself. One way this can happen is if local authorities share in the elaboration of the policy program and explain it to politically aware publics. The reforming government is then likely to own the program, apply it, and stick to it.

Also, in the process of developing a reform program, it is possible that the parties can jointly explore problems and find new solutions. Or minds may be changed: disbelievers in the efficacy of market-oriented policies may come to see their virtues and power; foreign reformers may gain new insight into market failures and institutional constraints and learn what will and won't work in local environments.

Neither of these process-related paths to durable policy reform has been much travelled in the worldwide reform episodes of the past 15 years. And they have not been travelled in Egypt. Neither the World Bank/IMF-sponsored ERSAP, nor the USAID SPR has involved much Egyptian participation in their elaboration, nor — at least in the SPR — has there been much joint problem-solving or mind-changing. In short, ownership and dialogue lack.

All the concerned parties are aware of this and deplore it. But it is not easy to change. Decision making is highly centralized, local policy analysts are few, information flows very sluggishly through the system, the political environment and traditional practices and attitudes are not conducive to open debate.

What to do? All proposed remedies have flaws and uncertainties. But some small steps may be possible.

- In the preparation of SPR II, *USAID should continue and intensify its consultations and discussions with concerned technical ministries.*

- A procedural condition should be made part of SPR II. *GOE should establish a tripartite Working Group on private sector development*, consisting of GOE representatives, donors (World Bank, USAID, other donors with policy loans) and private sector spokesmen. It could be called a Task Force, but this carries the unwanted implication of a fixed term and a specified objective.

  The Working Group would become an ongoing forum for consideration of policy issues of the kind raised in ERSAP and the SPR. It should be made up of higher level technical staff — first undersecretaries or department directors. It would become the principal forum for policy debate, a vehicle for deepened dialogue, and for joint efforts to clarify the nature of policy obstacles to private sector growth and suggest possible solutions. It should not be a forum for discussion of compliance or noncompliance on conditionalities; this is inevitably contentious and prevents the emergence of an atmosphere of collaborative problem solving.

  The Working Group would meet regularly — perhaps monthly. It should be given a small budget for studies and commissioning of policy papers, and perhaps a one-person secretariat. It could decide to break into smaller subgroups for more intense consideration of specific issues or subsectoral questions.

The most likely bureaucratic home for such a group seems to be the Ministry of Public Sector Business, Environment and Administrative Reform. Minister Abeid has expressed interest in setting up Task Forces of various kinds for wider exchanges of views between the private sector and GOE. Our proposal, or some variant of it, might fit into that initiative.

- One of the obstacles to dialogue and to the growth of local ownership of reform is the sparsity of economic policy analysis and analysts within GOE. This was a recurring theme in our discussions with officials and with other donors. Solutions are not obvious. USAID has tried. The EAP offered in 1993 to finance a trade policy unit within the Ministry of Economy. No positive response has come forward.

  The issue is so important that another, perhaps broader effort should be made. The idea would be to *help create small policy analysis units in key economic ministries* — trade policy, tax policy, or industrial policy for example. Similar units might be proposed (if they do not now exist) in major spending ministries like Education and Health. Special training programs in policy analysis could be set up, perhaps some short-term study abroad financed. This is a set of activities to which TSSPR should give attention.

- MIC has acknowledged that direct and deeper USAID contacts with technical ministries are desirable, with MIC serving as a facilitator and coordinating body. This would be made easier if the GOE allowed other ministries to approve the use of TSSPR money.

- *The monitoring process should in future consist much less of seeking documentary evidence of compliance with policy measures and much more in assessing real impacts.* With the creation of the TSSPR-financed monitoring unit in MIC this problem may greatly diminish. That unit is in excellent position to uncover the evidence needed to prove compliance. USAID staff should be freed up to investigate market and institutional impacts of related sets of policy changes.

  Monitoring of the traditional kind has to continue, of course. But USAID can make it easier — by including fewer, better-defined conditionalities, quantified where feasible, and by limiting the complexity of these conditions. USAID should also rely more on GOE provision of proof of compliance and less on its own seeking out such evidence; the corollary is that USAID has to be prepared to withhold disbursements until satisfactory evidence of compliance is provided. Responsibility for compliance monitoring should be transferred to the new monitoring unit at MIC, with EAP staff playing a collaborative and advisory role. USAID and MIC monitors should focus mainly on proximate or micro effects of policy changes, with impact assessments receiving major attention. Studies of macroeconomic effects — on aggregate growth, or on aggregate exports, for example — should not be done; relevant inputs are too numerous, exogenous factors too important.

  The policy impact studies should involve interviews of GOE implementing staff, private sector representatives, and other people and institutions affected by specific policy reforms to determine implementation effectiveness, shortcomings, need for additional reforms or changed implementation procedures, and socioeconomic impacts.

  Surveys of firms should also be conducted using questionnaires to determine business managers' perceptions as to reform effectiveness and impacts on firm investment, production, exports, imports, costs, revenue, employment, earnings, and so forth. The questions should be developed for each specific reform item. To the extent feasible, the questionnaires should

be grouped so that multiple reforms can be covered by the same questionnaire. The questionnaires could have objective, subjective, and open-ended questions on effectiveness and potential impacts. Surveying relatively small samples of firms (for example, 100) from a judgmental sample that allows for diversity as to size of firms, sector, and geographical location, domestic and foreign ownership, and so forth, could provide meaningful data and insights.

The impact studies or assessments of each of the individual reforms could include quantitative analyses of the survey's objective questions, qualitative analyses of the subjective/open-ended questions, qualitative analyses of GOE and private sector institutional interviews, related economic data, and so forth. The assessments should discuss implementation success, shortcomings, needed additional reform actions, and potential impacts. Potential impacts should be extrapolated to the extent feasible to estimate the universe of firms potentially affected, and probable impacts in terms of export earnings, imports, revenues, costs, employment, and earnings.

USAID can harness the newly created small grants research facility for this purpose. TSSPR funds could also be made available to finance U.S. graduate students for *summer research on impacts of the reform program*, this research to be done in partnership with an Egyptian graduate student or junior faculty member.

- *Significant TSSPR funding should be set aside for these and other kinds of USAID-implemented technical studies related to SPR*, without need to formally clear such studies with MIC.

- *Lack of transparency in the reform program and lack of public information about it are major threats to its sustainability and should be addressed in SPR II.* We were repeatedly struck by how little is known about the specifics of the program even among university professors teaching courses about the Egyptian economy and its development. The public education program provided for in the privatization grant should help by increasing public information about that sensitive part of the reform agenda. But GOE has to help. The White Books on the details of every transaction are essential. None have yet appeared, for the transactions that have come to the point of agreement.

  More generally, documentation and statistics remain hard to access. The abundant material in the background papers for the Consultative Group meeting in Paris in January of this year allow people in France or England to know more about the Egyptian reform program than any professor in Cairo. *USAID should consider a policy measure requiring public distribution in Egypt of documents (such as many of those put out by the IBRD) that are publicly circulated outside of Egypt.*

5. Strengthen Relationships with the World Bank and IMF

With the decline in the importance of IMF/Bank leverage after the Paris Club final debt relief, the relative importance of USAID SPR policy-based cash transfer will significantly increase. Although IMF and World Bank influence should be expected to remain significant, USAID will need to shoulder more of the responsibility for supporting ERSAP II, including more participation in policy analyses and dialogue. To do this properly will require greater access by USAID to IMF and World Bank reports (including drafts) and memoranda on policy issues relevant to ERSAP II.

Mission management should raise this matter with the relevant GOE ministers and *consider the inclusion of a PAAD covenant that commits GOE to provide USAID with all relevant IMF and World Bank documents*. Truly confidential material is not at issue. What is at issue is access to substantive studies and reports that are available in Washington and distributed to GOE, but are kept from donors in Cairo. Although this is primarily a GOE matter, the World Bank and IMF are implicated. They should be encouraged to review their information access policies and to support a broader sharing of relevant information.

The USAID director and economists are also encouraged to discuss with the Fund and Bank local staff the possibilities of *more involvement of USAID staff with Fund/Bank monitoring and technical study missions*. Greater USAID emphasis on policy studies under TSSPR and more external contacts and policy dialogue would also tend to increase USAID's knowledge base, and thereby promote more meaningful two-way interactions with Fund and Bank staff. It may also be useful for USAID/Washington to discuss the possibilities for fuller collaboration and information-sharing with the Fund and Bank.

However, continued and growing close working relations in Cairo are expected to be more important. Implementation of the evaluation team's proposal to establish a tripartite policy analysis and dialogue Working Group or task force, including representatives from the Bank, Fund, and USAID along with GOE and private sector, should facilitate more fruitful interactions.

6. Spend More Time Talking to The Private Sector

EAP staff, including Foreign Service Nationals (FSNs), should intensify their efforts to establish contacts with a wide spectrum of the business community — manufacturers large and small, importers and exporters, service providers from lawyers and bankers to truckers and stevedores, microenterprise owners, and others. Periodic meetings with business groups like the Alexandria Businessmen's Association can provide information indispensable for identifying new policy conditionality and assessing the evolution and impact of policy changes. Wage-earner representatives should not be ignored.

7. Reinvigorate TSSPR

The TSSPR has a broad mandate and has produced several studies and financed a variety of other activities. The flexibility and openness of TSSPR, the possibility it offers to finance innovative programs like the small grants program and to respond to new opportunities, are highly desirable features that should be retained. But some sharper focus in its objectives would be helpful. *The Mission might consider focussing the main TSSPR effort on three activities.*

The first is to continue to *finance studies that illuminate problems, particularly constraints on private sector expansion*. This is to feed the dialogue and possibly generate new conditionalities for the future.

The second is to *expand the number of studies, and the study programs, aimed at understanding the impact of policy reform*. These should be focussed not on economy-wide effects but on proximate impacts: for example, how have government and private actors responded to tariff reductions; how have exports responded to attempted simplification of export procedures; how have new companies responded to changes in company law.

They would be mostly survey-type studies of the rapid reconnaissance variety. Data analyses to measure first round or proximate impacts should also be possible. Several program possibilities for enlarging the stream of this kind of empirical or policy research were mentioned in the previous recommendation — for example, small grant awards to Egyptian academics and summer awards to U.S. graduate students.

Finally, *TSSPR should help address the problem of scarce policy analysis capacity* signalled earlier. Probably the best way to start would be to undertake a study of the existing situation in policy analysis: is any done, where, by whom, how good is it, does anybody read it, and so on. Accompanying this should be a descriptive piece on the policy-making process in Egypt.[28] The objective of the study would be to determine the need for and feasibility of creating or strengthening policy analysis units inside or outside GOE, and to recommend locations for such units.

8. Take Further Actions (GOE)

The SRP is a joint program, a cooperative effort of USAID and the GOE together. The findings of this evaluation bear on both partners, and most of the recommendations require action on the part of each. It may nonetheless be convenient to set out separately here those recommendations that require mainly GOE action.

- The GOE should encourage USAID in its efforts to engage ministries other than MIC in more meaningful dialogue. To this end, the GOE should allow ministries other than MIC to approve the use of TSSPR money.

- The GOE should make adjustment policies and processes more transparent. The White Books on privatization transactions should be published without delay. The GOE should allow public distribution in-country of documents (such as many World Bank reports) that are publicly available outside of Egypt.

- The GOE should issue a new statement of its privatization objectives and strategy.

- The GOE should create a tripartite Working Group on private sector development (officials, donor representatives, private sector spokesmen).

- The GOE should create small policy analysis units in key economic agencies.

- The MIC monitoring unit should be given major responsibility for compliance monitoring, which should be its first priority. It should secondly provide analyses of the impact of adopted policy measures at the micro level. In its initial years it should not try to evaluate macroeconomic impacts of the overall reform program, which is difficult to do and less instructive than bounded impact studies.

The remaining recommendations require action by USAID alone or in tandem with the GOE.

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[28] This may be unnecessary; the structure of the situation may be well-enough understood already.

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ANNEX A

TABLES A-1 AND A-2, 1992 AND 1993 POLICY MEASURES

TABLE A-1

1992 POLICY MEASURES

Financial	Fiscal	Trade	Enterprise
1. GOE will complete a study of the financial sector (including banks, investment companies, mutual funds (if any), insurance companies, etc.) and make recommendations to relax constraints which limit the efficient functioning of private financial institutions.	1. GOE will establish a system to generate and publish revenue and expenditure data on a quarterly basis with a lag of no more than two months.	1. GOE will eliminate the requirement that private sector exporters submit letters of guarantee under the temporary admission system.	1. GOE will undertake a study of: the social and economic costs and benefits of opening the cotton spinning industry to private investment and market pricing of inputs and outputs; and the most appropriate means of accomplishing this opening.
2. GOE will complete the necessary steps to allow foreign banks to operate fully in the domestic banking system.	2. GOE will adopt a unitary taxpayer identification number.	2. GOE will adopt procedures for prompt refunding under the drawback system.	2. GOE will develop a national privatization plan.
3. GOE will pass and implement legislation providing equal tax treatment for interest and other forms of capital income.	3. GOE will present to the People's Assembly a Global Personal Income Tax Law.	3. GOE will initiate a study to review, evaluate, and recommend alternative options to the present mandatory public sector quality control regulations governing exports and imports.	3. GOE will bring at least five public sector or joint venture enterprises worth at least LE 100 million to the point of sale. Point of sale includes a valuation, a reservation price and a formal offer of sale.

Table A-1 — continued

Financial	Fiscal	Trade	Enterprise
4. GOE will remove controls on interest rates for corporate bonds issued in accordance with the Securities Market Law.	4. GOE will broaden the coverage of the general sales tax to include travel and telecommunication services.	4. GOE will lower the coverage of import bans from 23 percent to 11 percent of domestic agricultural and manufacturing output. It will structure the reductions in a manner that does not discriminate against the private sector.	
5. GOE will ensure that all commercial banks reach a capital/asset ratio of at least 5 percent		5. GOE will initiate a study of the Egyptian customs system which will result in recommendations to improve the import tax system and administrative procedures.	
6. GOE will pass a Securities Market Law which provides the legal framework for a stock exchange and issue the necessary regulations.		6. GOE will conduct a review which develops recommendations for the removal of regulations and laws that impede private sector participation in import and export industries currently dominated by public sector companies.	
		7. GOE will permit the inclusion in the temporary admission system of firms that export part, but less than 100 percent, of their output.	

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TABLE A-2

1993 POLICY MEASURES

Financial Sector	Fiscal	Trade Sector	Enterprise Sector
1. GOE will ensure that all commercial banks reach a capital/asset ratio of at least 8 percent.	1. GOE will prepare a time-phased plan to reduce the granting of tax holidays.	1. GOE will review all banning decrees issued by various ministries or other government bodies to ensure that they are all consistent with the official government policy on bans.	1. GOE will remove all price controls from hotels, restaurants and all other business associated with tourism.
2. GOE will remove controls on fees for banking services.	2. GOE will take the actions necessary to prepare for the implementation of the general sales tax at the retail level.	2. GOE will reduce the number of tariff preferences by one-half.	2. GOE will present to the People's Assembly new legislation for patents which provides for both product and process patent protection for all types of technology, and increases the terms of protection to 20 years.
3. GOE will conduct a review of existing Central Bank of Egypt supervisory regulations and procedures relating to off- and on-site bank examination and inspection, and produce a manual of revised procedures.	3. GOE will begin implementation of a Global Personal Income Tax (GIT) which broadens the tax base and lowers marginal tax rates.	3. GOE will reduce import ban coverage to 5 percent so as not to discriminate against the private sector.	3a. GOE will privatize at least 10 public sector or joint venture enterprises worth at least LE 500 million. 3b. GOE will bring to the point of sale an additional 20 firms.
4. GOE will develop policies and procedures which expedite branching for banks which meet the 8 percent capital asset ratio requirement.		4. GOE will eliminate 5 of the 9 special conditions for imports (which severely restrict the import of petroleum products or civilian goods domestically produced by military factories).	4. GOE will develop a time-phased plan to implement selected recommendations from the Textile Sector Liberalization Study.

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Table A-2 — continued

Financial Sector	Fiscal	Trade Sector	Enterprise Sector
5. GOE will carry out a study to examine the feasibility of introducing new financial instruments in the financial sector.		5. GOE will develop a time-phased plan to implement selected recommendations from the Trade/Customs Policy Study.	5. GOE will conduct a study to examine the benefits of consolidating the patent, trademark and industrial design offices under the authority of one ministry.
		6. GOE will develop a time-phased plan to implement selected recommendations from the Quality Control Study.	
		7. GOE will develop a plan to permit foreign companies to participate fully in the insurance sector.	

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ANNEX B

PRIVATIZATION TABLES

B'

TABLE B-1

PE SCHEDULED FOR PRIVATIZATION

PE Name	Total Assets (L.E. 000's)	Number of Labor
FIRST BATCH 1991-1992		
A. Law 203 Companies 100% State Ownership		
Misr Free Shops Co.	177,045	1,181
Egyptian Vineyards Co.	103,666	1,908
El Nasr Bottling Co.	186,849	5,759
Egyptian Bottling Co.	107,625	4,151
El Nasr Glass and Crystal Co.	140,154	6,876
Misr Studio and Film Production Co.	11,463	611
El Nasr Steam Boiler Manufacturing Co.	56,144	1,022
B. Assets of Law 203 Companies		
Cairo Sheraton Hotel	156,474	NA
Aswan Oberoi Hotel	16,630	NA
Sheraton Boat M/S Anni		
Sheraton Boat M/S Hopt	51,356	NA
Sheraton Boat M/S Aton		
Shepheards Hotel	10,640	NA
C. Shares in Law 203 Companies		
Porcelain Dinner-Ware and Utility Ware 66.4%	66,488	3,159
D. Shares in Law 159 Companies		
Misr Touristic Vil. Co. 66.7%	18,785	NA
E. Shares in Law 230 Companies		
Suez Cement Co. 38.5%	245,240	NA
Chloride Egypt 38%	20,713	NA
Ashti Co. 67.2%	57,871	NA
Egypt Narden International 49%	2,033	NA
TOTALS	1,429,176	24,667
SECOND BATCH 1992-1993		
A. Law 203 Companies 100% State Ownership		
Kafr El Zayat Insecticides & Chemicals Co.	69,725	746

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TABLE B-1 — Continued

PE Name	Total Assets (L.E. 000's)	Number of Labor
The Nile General Auto Repairs Co.	119,458	
Arab Office Engineering Consultancy & Designs	35,062	748
Paints & Chemical Industries Co.	188,980	1,778
Alexandria Co. for Pharm. & Chem. Industries	101,802	1,088
El Nasr Engineering & Refrig. Co. (KOLDAIR)	88,042	2,195
Egyptian Ship Build. & Repairs Co.	68,985	2,288
Agricultural Mechanization Co.	26,132	
B. Assets of Law 203 Companies		
Alamine Hotel	NA	
Palestine Hotel	NA	
Consumption Goods & Cloth (SEDNAWI)	NA	5,981
Consumption Goods & Cloth (CICUREL)	NA	
Fashion Ware Home (HANNAUX ALEX)	NA	2,648
Fashion Ware Home (CHEMLA)	NA	
C. Shares in Law 203 Companies		
El Nasr Clothing & Textile Co. (KABO) 78.1%	121,345	5,660
Egyptian Food Co. (BISCO MISR) 99.4%	92,232	4,343
Egyptian Supplies & Marine Works Co. 99.3%	39,301	1,345
United Housing Co. 8.9%	3,493	202
El Nasr Electronics & Eng. Co. (PHILIPS)	42,700	3,861
D. Shares in Law 230 Companies		
Egyp. Int'l Pharmac. Co. (EPICO) 59.5%	86,271	
Egyp. German Elec. Products Co. 95.3%	70,965	
Schindler Egypt 48.9%	54,766	
Egyp. German Dyes Co. 24%	5,796	

TABLE B-1 — Continued

PE Name	Total Assets (L.E. 000's)	Number of Labor
Misr Carbonated Beverages (MISROB) 19%	14,983	
Arabian Ceramic Co. (ARACMCO) 38%	31,046	
Sinai Diving Club 43.3%	9,522	
TOTALS	1,270,606	32,883
THIRD BATCH 1992-1993		
I. Law 203 Companies		
A. Industrial Sector		
El Nasr Factory for Refractories & Ceramics (SORNAGA)	96,114	1,769
Egyptian Cooper Factory Co.	306,935	6,902
Industrial Gases Co.	53,274	1,599
Abuqir Fertilizers & Chemical Industries	1,270,312	2,479
Delta Spin. & Weav. Co.	193,351	6,469
Uniarab Spinning & Weaving	418,108	7,364
Dakahlia Spinning & Weaving	280,604	8,714
Damietta Spinning & Weaving	177,198	4,970
Alexandria Spinning & Weaving	171,757	4,355
Extracted Oils Co.	211,457	2,712
Tanta Oil & Soap Co.	159,607	4,936
Kaha	134,232	4,122
Cairo Oil & Soap Co.	106,304	2,611
Alexandria Confectionaires & Chocolate Co.	94,698	3,807
Egyptian Starch, Yeast & Detergents Co.	87,238	1,799
Edfina Co. for Preserved Foods	154,071	4,489
Al Ahram for Beverages Co.	162,812	2,661
Egyptian Light Transport Manufacturing Co.	299,119	3,024

TABLE B-1 — Continued

PE Name	Total Assets (L.E. 000's)	Number of Labor
Springs & Transport Needs Manufacturing Co.	38,374	715
Misr Engineering & Tool Co. (MICAR)	46,032	1,609
Egyptian Co. for Refractories	274,870	3,509
B. Health Sector		
Medical Packing Co.	75,453	1,911
Arab Drug Co. (ADCO)	74,583	1,497
C. Cement Sector		
El Amreya Cement Co.	827,447	1,533
Tourah Portland Cement Co.	1,058,012	3,460
Helwan Portland Cement Co.	1,335,209	4,020
D. Foreign Trade Sector		
Misr Car Trading Co.	68,629	1,330
E. Domestic Trade & Distribution Sector		
Egyptian Co. for Wholesale Trade	228,655	2,463
Egyptian Co. for Fish Marketing	55,519	2,996
Egyptian Co. for Packing, Dist. & Foodstuff	541,894	2,486
F. Housing Sector		
Development & Popular Houses Co.	179,573	1,089
G. Transport Sector		
United Arab Stevedaring Co.	129,503	6,048
Alexandria Containers Handling Co.	107,315	1,080
Port Said Containers Handling Co.	95,363	3,200
Damietta Containers Handling Co.	66,477	668
Egyptian General Warehouses	88,652	2,178
Misr Hotels Co.	110,873	2,738
H. Industrial Sector		
Delta Ind. Co. (IDEAL) (Almaza Plant)	76,158	7,947

TABLE B-1 — Continued

PE Name	Total Assets (L.E. 000's)	Number of Labor
I. Tourism Sector		
Egyptian Hotels (CISSEL)	1,149	163
J. Retail Trade Sector		
Consumption Goods & Clothes Co. (SEDNAWI Branch)	9,857,222	5,981
TOTALS	19,714,153	133,403

Source: "Labor Policy Issues in Privatization," Integrated Development Consultants, BECHTEL/PID, November 1993.

TABLE B-2

PE FOR WHICH LIQUIDATION DECISIONS HAVE BEEN TAKEN

PE Name	Total Assets	Number of Labor	Comments
1 Eastern Cotton Co.	737,671	1,113	Board decision of HC taken on June 30, 1992
2 The Nile General Co. for Bridges	24,016	895	For companies 2 through 6, the Board of Directors of the parent holding company recommended liquidation on July 7, 1992.
3 The Nile General Co. for Construction	29,203	1,000	
4 General Arab Co. for Contracting	51,244	1,705	
5 Alexandria General Co. for Contracting	19,701	712	
6 General Contrac. Co. for Sanitary Install.	12,220	412	
7 Cairo Co. Public Build. & Prefab. Houses	54,823	2,068	G.A. agreed to liquidate on June 15, 1993
TOTALS	928,878	7,905	

TABLE B-3

PE WHICH LOST MORE THAN 50 PERCENT OF ISSUED CAPITAL

PE Name	Total Assets	Number of Labor
Misr Helwan Spin. & Weav. Co.	309,966	12,963
National Spin. & Weav. Co.	165,128	6,041
Middle Egypt Spin. & Weav. Co.	148,845	6,397
Nasr for Spin., Weav. & Knitting Co.	96,160	4,423
Cairo Silk Textiles Co.	83,111	3,890
Alexandria Metal Products	85,144	1,947
Cairo Metal Products	65,291	2,951
El Nasr Co. for Television & Electronics	269,471	2,702
Egyptian Fero Alloys	256,166	2,240
Alexandria Shipyard	316,800	5,129
General Egyptian Irrigation Workshops Co.	53,604	1,935
Misr Dairies & Food Co.	149,850	5,433
High Dam Co. for Civil Works	58,737	1,412
Egyp. Irrigation, Drainage & Civil Construction	38,972	650
The Egyptian Wood Working Co. (WOODCO)	34,459	34,459
The General Co. for Batteries	40,274	1,443
Egyp. Co. for Electric Instruments (SHAHER)	128,051	3,083
Egyptian Co. for Chemical Trading	80,318	2,058
ElNile Co. for General Engineering	61,875	1,275
Egyptian Co. for Metalic Cons. (METALCO)	94,432	3,791
Erection & Industrial Services Co.	65,408	1,669
El Nasr Co. for Rubber Products	63,899	2,060
San El Hagar Agr. Co.	61,978	680
ElGomhoria General Contracting Co.	79,137	1,360
ElWady General Co. for Contracting	57,331	873
Prefabricated Houses Co.	51.366	1,118
Nile for Reinforced Concrete Co. (SPECO)	122,698	3,721
Arab General Co. for Foundation (VIBRO)	55,309	2,142
ElSaeed General Co. for Contracting	44,444	1,930
Egyptian Contracting Co. (EL ABD)	123,243	2,019
Red Sea General Co. for Contracting	25,511	594

TABLE B-3 — Continued

The Canal General Co. for Contracting	41,779	792
ElNasr for Civil Works Co.	61,020	1,831
Sand Bricks Co.	164,701	3,215
ElNasr Hardboard Co. (FARASCOUR)	14,954	448
General Co. for Mineral Wealth	147,618	1,766
Egyp. Gypsum. Marble & Quarries Co. (GYMCO)	233,552	2,025
Port Said Spin. & Weav. Co.	60,771	60,771
El Wady Cotton Ginning Co.	34,627	1,018
Arab Cotton Ginning Co.	38,088	1,190
Al Kahira Cotton Co.	377,910	816
The Cotton Trading & Export Co.	255,394	842
Alexandria Commercial Co.	297,100	801
TOTALS	5,014,492	197,903

The first 16 companies are included in the 1992/1993 restructuring program.

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ANNEX C

SCOPE OF WORK

SCOPE OF WORK

EVALUATION OF SECTOR POLICY REFORM PROGRAM AND TECHNICAL SUPPORT FOR SECTOR POLICY REFORM PROJECT

I. Objective

The objective of this evaluation is to assess the progress made to date under the Sector Policy Reform Program (SPR) and the accompanying Technical Support for Sector Policy Reform Project (TSSPR), and to provide guidance concerning the contents, design and implementation of both a follow-on cash-based policy reform program and the remainder of the TSSPR Project. Specifically, the evaluation should: 1) assess the appropriateness of the design for SPR and TSSPR; the management of SPR and TSSPR by USAID and the GOE; and the contribution of SPR and TSSPR to the GOE's economic reform program; and 2) make recommendations concerning future policy-related program and technical assistance activities.

II. Background

In August 1992, the Governments of Egypt (GOE) and the United States agreed to implement USAID's Sector Policy Reform Program and the Technical Support for Sector Policy Reform Project. The former is a $400 million, two year program which disburses up to $200 million each year in return for GOE implementation of agreed-to policy reforms in the financial, fiscal, trade, and enterprise sectors. TSSPR provides up to $10 million over three years to finance studies, short and long term technical assistance, and training in support of the policy reforms addressed under the SPR. SPR was designed by USAID to complement and re-enforce the economic reform program which the GOE agreed to in 1991 with the World Bank (via a Structural Adjustment Loan) and the IMF (via a Stand-By Agreement). While the Ministry of International Cooperation in the GOE is USAID's official counterpart for both SPR and TSSPR, USAID has had extensive interaction with a variety of other ministries (Economy and Trade, Finance, Agriculture) and organizations (Central Bank of Egypt, Public Enterprise Office, and the Capital Markets Authority).

The first year of the SPR has recently been completed. The GOE successfully ~~completed~~ 19 of the 20 policy measures included in the program (see Annex A); and, USAID disbursed $195 million out of a possible $200 million. Moreover, a new set of policy measures covering the four sector dealt with in the SPR was agreed to by the U.S. and GOE (see Annex B). Concerning TSSPR, a number of activities are either underway or have been completed. For example, a study of liberalizing the textile sector has been

finished, while studies concerning trade policy reform, the impact of price liberalization, and reform of the GOE's system of import and export quality controls are underway.

The program/project evaluation which is the subject of this scope of work will take place approximately half way through the second and last year of the current SPR. Consequently, and as explained in greater detail below, the evaluation will examine the design of SPR/TSSPR and their implementation to date, but will focus to a significant extent on recommendations for the policy measures and technical assistance activities to be included in a follow-on policy-based program. That is, the results, findings, and recommendations of the evaluation are expected to play a key role in the design and implementation of a successor cash-based policy reform program.

III. Statement of Work

During the course of this evaluation the consultants will:

1. Meet with relevant USAID and GOE officials, and review relevant documents, to obtain a clearer understanding of: the GOE's economic reform program, the World Bank and IMF stabilization and adjustment programs, the objectives of SPR and TSSPR as well as the design process and implementation procedures.

2. Review the policy measures included in the first and second year of the SPR. This review should address the following: the justification for selecting the four sectors (financial, fiscal, trade, and enterprise) covered by the SPR; the importance of the policy measures negotiated with the GOE for the 1992/93 and 1993/94 programs; and the relationship between the SPR policy measures and the policy reforms included in the IMF and World Bank programs.

3. Review the internal USAID management of the SPR and TSSPR. This should include an assessment of: the management of both activities within the Economic Analysis and Policy Directorate (EAP); the effectiveness of coordination between EAP and other involved USAID Directorates such as Agriculture (AGR) and Trade and Investment (TI); and the effectiveness of the coordination between SPR/TSSPR and the remainder of the Mission's policy-related portfolio.

4. Assess the effectiveness and adequacy of the counterpart role played by the Ministry of International Cooperation within the GOE. Assess the extent and usefulness of SPR-related cooperation between USAID and other ministries or organizations within the GOE.

5. Assess the effectiveness of coordination between USAID and the IMF and World Bank relating to SPR and TSSPR.

6. Assess the quality, timeliness, and utility of the studies, technical assistance, or training funded by TSSPR.

7. Assess the adequacy of the procedures used to monitor and document GOE policy reform performance under the SPR.

8. Assess the current economic situation in Egypt; identify sectors and issues requiring further policy reforms; identify supporting technical assistance needs; develop options for policy reform measures and technical assistance activities.

9. To the extent practical, estimate the economic costs and benefits of various policy reform measures and technical assistance activities to date and of options for the future.

10. In light of (1)-(9) above, provide guidance and recommendations concerning the design and implementation of a follow on cash-based policy reform program and technical assistance activities. These recommendations should deal with: the sectoral focus of any follow-on program; specific policy measures to be addressed--with options presented where appropriate and assessed in terms of their relative economic costs and benefits; USAID/GOE implementation and management of the program; the monitoring of GOE policy reform performance; techniques for assessing the impact of policy reforms accomplished under the program; the selection and design of related technical assistance activities with, as practical, expected net benefits; and the relation of the follow-on program with the on-going World Bank and IMF programs.

IV. Deliverables

The contractor shall be responsible for carrying out the assessment and assuring delivery to USAID of the final report and other interim documents as described below. Three copies of a work plan for the evaluation and an outline of the final evaluation report shall be presented by the consultant to USAID at the beginning of the second week in country. A draft final report shall be presented by the consultant by the end of the fourth week in country. This report will be circulated for comments, and those comments will be incorporated--as judged appropriate--by the consultant in the final report, which shall be submitted within two weeks of receiving USAID and GOE comments.

V. Relationships and Responsibilities

The EAP Directorate within USAID/Cairo will provide overall supervision and guidance for the evaluation team. Significant inputs may also come for the AGR and TI Directorates. The evaluation team will also need to work closely with GOE officials in the Ministry of International Cooperation, the Ministry of Economy, the Ministry of Finance, the Central Bank of Egypt, the Public Enterprise Office, and elsewhere so as to obtain their views concerning progress to date under SPR and TSSPR and important policy issues that need to be addressed under a follow-on policy reform program.

VI. Level of Effort and Timing