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CLASSIFICATION

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PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. 263-K-619 2. COUNTRY Egypt 3. CATEGORY CASH TRANSFER 4. DATE JULY 1990
5. TO: Marshall D. Brown, Director USAID/Cairo		6. OYB CHANGE NO.
7. FROM: Frank Miller (A) AD/PDS		8. OYB INCREASE NONE TO BE TAKEN FROM: ECONOMIC SUPPORT FUND
9. APPROVAL REQUESTED FOR COMMITMENT OF: $115 million		10. APPROPRIATION –

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☒ GRANT	☐ INFORMAL ☒ FORMAL ☐ NONE	20 days (Disbursement)	N.A.

15. COMMODITIES FINANCED

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only: $115 million	U.S.: $115 million
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash:	Other:

18. SUMMARY DESCRIPTION

Cash transfer assistance is provided in recognition and support of Government of Egypt progress in implementing comprehensive economic reform. The Government's reform program is intended to transform Egypt from a centrally planned command economy to an economy based on free enterprise and reliance on market forces. The reforms supported by this Cash Transfer evidence progress towards this goal. The form of this assistance (as a Cash Transfer) is intended to provide immediate relief on urgent foreign exchange obligations of the government.

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19. CLEARANCES		DATE
REG/DP	PDS/E: PO'Farrell	July 1, 1990
REG/GC	AD/LEG: BMiller	7/1/90
A/EPC	(A) AD/FM: R. Bonnaffon	7/5/90
/EM		
/SER/COM		
A/PPE		

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE: [signature] DATE: July 5, 1990

TITLE: Mission Director

ACTION OFFICE ANDP-02
INFO ANEA-02 PPMF-01 PPPB-02 PPEA-01 ES-01 AMAD-01 ~~TELE-01~~
/011 A6 20/1158Z

INFO LOG-00 ADS-00 AID-00 INR-05 SS-00 CIAE-00 DINT-05
DODE-00 H-01 EXIM-06 NEA-00 NSCE-00 NSAE-00 COME-00
SSO-00 STRE-00 LAB-04 CTME-00 EAP-00 CIP-00 ITC-01
OPIC-08 CEA-01 DOTE-00 OMB-01 STR-18 INRE-00 AGRE-00
FRB-01 USIE-00 JUSE-00 SP-00 SNP-00 E-01 /051 W
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FM AMEMBASSY MANILA
TO TREASURYDEP WASHDC IMMEDIATE
SECSTATE WASHDC IMMEDIATE 5010
INFO AMEMBASSY ISLAMABAD

UNCLAS MANILA 25796

USADB

TREASURY FOR ALLEN E. CLAPP/OASIA

STATE FOR WGMA AGENCIES

AID FOR ANE/DP AND PPC/MFI

E.O. 12356:N/A
TAGS: EFIN, EAID, ADB, PK
SUBJECT: REPORT ON ADB BOARD MEETING - AUGUST 16, 1990

1. SUMMARY. THE ADB BOARD APPROVED IN ITS AUGUST 16TH MEETING A USD115.0 MILLION OCR LOAN TO PAKISTAN FOR THE THIRD TELECOMMUNICATIONS PROJECT. MEETING SUBSEQUENTLY IN EXECUTIVE SESSION THE BOARD APPROVED THE APPOINTMENT OF U.S. ALTERNATE DIRECTOR WILLIAM R. THOMSON AS VICE PRESIDENT OF THE BANK FOR OPERATIONS EFFECTIVE OCTOBER 1, 1990. END SUMMARY.

2. THE U.S. DIRECTOR SUPPORTED THE TELECOMMUNICATIONS PROJECT BECAUSE IT WOULD IMPROVE TELEPHONE SERVICE IN PAKISTAN. HE PRAISED THE DECISION TO CONVERT THE TELEPHONE DEPARTMENT INTO A CORPORATION BY 1992, LAYING THE GROUNDWORK FOR PLACING TELECOMMUNICATIONS SERVICE ON A BUSINESS BASIS AND LEADING TO EVENTUAL PRIVATIZATION. HE NOTED THAT T&T HAD GOOD FINANCIAL RECORD EARNING UPWARDS OF 25 PER CENT ON REVALUED ASSETS OVER THE LAST SEVERAL YEARS. HE APPLAUDED THE EFFORTS TO ALLOW THE PRIVATE SECTOR TO SUPPLY EQUIPMENT AND OPERATE PERIPHERAL SERVICES AND AGREED WITH THE PROPOSED USE OF THE PRIVATE SECTOR FOR INSTALLATION OF OUTSIDE PLANT. HE URGED THE PAKISTANI GOVERNMENT TO CORPORATIZE T&T AS SOON AS POSSIBLE AND TO BEGIN EFFORTS TO PRIVATIZE IT. HE ASKED STAFF
--
WHETHER THE CHANGE IN GOVERNMENT IN PAKISTAN WOULD AFFECT CORPORATIZATION OF T&T.

3. STAFF DID NOT EXPECT THAT THE CHANGE IN GOVERNMENT WOULD AFFECT THE CORPORATIZATION AGREED TO IN THE LOAN AGREEMENT.

4. OTHER DIRECTORS WERE SUPPORTIVE OF THE PROJECT WITHOUT MARKED CRITICISM.

5. MEETING IN EXECUTIVE SESSION, THE BOARD APPROVED THE RECOMMENDATION OF PRESIDENT TARUMIZU TO APPOINT [WIL]LIAM THOMSON AS VICE PRESIDENT OF THE BANK FOR [OPERA]TIONS EFFECTIVE OCTOBER 1, 1990. TARUMIZU'S

RECOMMENDATION WAS APPROVED UNANIMOUSLY.

THOMSON

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UNCLASSIFIED

UNITED STATES

AGENCY FOR INTERNATIONAL DEVELOPMENT

EGYPT: CASH TRANSFER (FY 1989 appropriation)

AID GRANT NO. 263-K-619

C

UNCLASSIFIED

EGYPT: U.S. FY 1989 CASH TRANSFER

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I. The Setting For U.S. Economic Assistance

The overall objective of U.S. economic assistance to Egypt is to foster economic and social development. Economic assistance is one of the key elements of broader U.S. support to facilitate and encourage the establishment of a permanent, comprehensive regional peace.

Egypt is a leader in the region and a strong advocate of regional peace. However, her ability to continue this role is influenced by domestic economic conditions. For the past few years, the economy has been very fragile as a result of a long period of subsidies, price distortions and government controls. The balance of payments and the government's budget are in substantial deficit. There is a very large external debt and related annual debt service payment. Real economic growth has essentially stopped. In addition, inflation and unemployment have eroded real incomes and introduced a source of potential social instability and discontent.

The highest priority of economic policy is to change the system from central management and control to a greater reliance on markets in order to achieve sustainable growth in real income and employment. To accomplish this economic transformation without a serious disruption in the social order, Egypt needs temporary relief from external debt service payments and a substantial infusion of external resources during the period of policy reform.

The Government of Egypt is now engaged in negotiations with the IMF for a second Standby arrangement. When the Standby is in place, Egypt will seek a Paris Club rescheduling of current debt service payments and arrearages. The Standby arrangement and Paris Club rescheduling are also expected to result in the reopening of some lines of international credit. In addition, the government is negotiating a Structural Adjustment Loan with the IBRD and hopes to complete the agreement as soon as the Standby arrangement is in place. The agreements with the IMF, Paris Club and IBRD will partly ease the government's resource problem. However, additional resources in the form of continued high levels of U.S. grant assistance are required during the period of economic adjustment.

U.S. economic assistance is provided to Egypt in the forms of project assistance, commodity import programs and as cash transfers. The provision of cash transfers has been agreed to by Congress in order to support significant economic reforms taken by the government. In May, 1990, the Government of Egypt made substantial progress in implementing reform measures, primarily to correct energy prices and reduce subsidies. The government also, since the last cash transfer in August 1989, made a number of other changes in policies related to exchange rate unification and liberalizing the operation of public sector industries. The release of this cash transfer is in recognition and support of these policy reform measures.

II. Background and Recent Economic Developments

Egypt has had a centrally planned economy since the revolution in 1952. State control has been exercised through a large government bureaucracy and through state ownership or control of a majority of the productive assets. Prior to 1973, government policy promoted rapid industrialization and a strengthening of the military. Since 1973, the government has expended substantial resources to promote popular consumption and social welfare.

Between 1975 and 1980, Egypt's real economic growth soared to some 8% annually based on a surge in foreign exchange receipts. The principal sources of foreign exchange were petroleum exports, Suez Canal and tourism receipts, supplier credits, worker's remittances and foreign borrowing (See Table 1).

Table I
PRINCIPAL FOREIGN EXCHANGE RECEIPTS AND GOVERNMENT DEBT
(In $ billions)

	1975	1980	1984/85	1987/88	1988/89
Petroleum	0.4	2.9	2.9	1.7	1.1
Suez Canal	0.1	0.7	0.8	1.3	1.3
Tourism	0.4	0.8	0.8	1.6	2.0
Supplier Credits	0.4	0.8	0.9	1.2	0.8
Worker Remittances	0.4	4.0	3.5	3.4	3.5
Government Debt	---	20.0	36.4	43.1	45.8

Egypt's economic growth did not result from improvements in the economy's productivity or industrial comparative advantage. Between 1980 and 1984/85, when several important sources of external earnings stagnated or declined, real economic growth tapered off to an annual average of about 3%. In 1985/86 the economy experienced a more precipitous decline in petroleum earnings. The collapse of the world price of oil also restricted the demand for Egyptian labor in the oil producing states. Consequently, worker remittances also declined after 1984/85.

The large decline in earnings from petroleum and worker remittances occurred at a time when debt service payments were becoming an important outlay in the Balance of Payments (See Table II). The growth in the remaining traditional sources of foreign exchange earnings and non-traditional exports was not sufficient to compensate for the decline in petroleum related earnings and meet rising debt service payments. Also, no new sources of foreign exchange earnings emerged. Consequently, with imports continuing to rise at 20% per year from 1981/82 through 1984/85, the current account deficit remained high during this period at about $2.5 billion annually.

The deficit in the Balance of Payments Current Account was largely financed by government borrowing, which pushed Egypt's official external debt to $40 billion in 1986/87. By 1986, credit sources and donor flows could no longer finance the balance of payments deficit and the government began incurring arrearages in its debt service payments. With a bleak forecast for the balance of payments, slow growth in the economy, and creditor pressure for payments, the government, in 1986, began negotiations with the IMF on an economic structural adjustment program to be supported by a Standby arrangement and Paris Club debt rescheduling. At the same time, the government introduced a series of measures including trade restrictions to control demand for foreign exchange.

The scarcity of foreign exchange led the government to introduce severe restrictions on imports, resulting in a 20 percent decline in imports and a 50 percent decline in the current account deficit in 1986/87. In addition, after lengthy negotiations, the GOE reached an agreement with the IMF in April 1987. In May, several major economic reforms were introduced and a Paris Club rescheduling was expeditiously concluded.

While the first Standby and Paris Club rescheduling provided significant relief to the immediate balance of payments problems, the government's reform program was not adequate to reverse the deterioration in key economic indicators. After the initial improvement in the balance of payments because of the rescheduling, a rise in imports unmatched by new revenues brought on additional deficits in the current account and new arrearages on debts. Domestic revenue measures were also inadequate to bring the budget under control and the reliance on money creation to help finance the deficit sustained inflation. Real interest rates remained negative. Nominal energy prices averaged only 20 percent of the economic price. The foreign exchange regime remained restricted and contained multiple, overvalued rates. Severe controls remained on the private sector and significant inefficiencies remained in the public sector. Finally, implicit and explicit subsidies continued to fuel consumption and distort investment choices.

By the Spring of 1988, the economy's performance in meeting Standby targets was recognized as unsatisfactory. Moreover, without further adjustment measures and debt rescheduling, the government believed it would eventually be unable to provide a number of subsidies which have long been considered essential for social stability. Consequently, discussion of a stronger reform program to support a second Standby and debt rescheduling commenced with the IMF.

Unfortunately, after two years of intense discussions, the government and the IMF have not as yet reached agreement on the economic reform program needed to correct Egypt's economic problems. The fundamental issues preventing agreement are the size of the foreign exchange and interest rate corrections and the schedule for eliminating key price distortions and reducing the budget deficit to a manageable level. The government has consistently argued against the IMF's assessment of the size of the foreign exchange and interest rate corrections needed, and has pressed for a gradual approach for reducing subsidies. The IMF has held that a more rapid implementation is essential to correct the balance of payments and budget problems in the medium term. While the government has implemented a number of significant reforms during the summer of 1989 and in the Spring of 1990, these reforms were insufficient as the basis for the second Standby. However, recent discussions of the remaining policy issues suggest that the government is considering reforms which could lead to the conclusion of the second Standby and Paris Club rescheduling.

In mid-1989, the government began discussions with the World Bank for a Structural Adjustment Loan (SAL). The policy agenda for the SAL focuses on reforms in industrial policy, pricing and the trade regime and is complementary to the macroeconomic reform program under discussion with the IMF. In November 1989 and February 1990, significant progress was made in designing the reform program and setting its implementation schedule. The important elements of this agenda include; 1) the sale of non-strategic companies and assets owned by the public sector; 2) the transformation of the remaining public sector companies to a commercial basis of operation; 3) liberalizing investment laws to remove barriers to private sector investment; 4) significant reductions in subsidies in energy, transportation, pharmaceuticals, consumer goods and agricultural inputs; 5) significant improvement in the pricing of cotton and rice; 6) a reduced and tightly controlled government investment budget; 7) removal of trade restrictions; and 8) reform of the tariff structure.

III. U.S. Policy Dialogue

USAID has been conducting a comprehensive policy dialogue with the government since 1984. Our initial objective was to help the government obtain a clearer understanding of the extent of the distortions in the economy, particularly in the exchange rate, the budget, interest rates, energy prices and in the agricultural sector. To this end, USAID provided the government with policy analyses in each of these areas. A further objective was to persuade the government that it should seek the support and resources of the larger international donor community by developing its reform program with the help and support of the IMF and the World Bank.

With the signing of the first Standby, USAID moved the emphasis of its policy dialogue towards supply side measures. USAID's analysis had shown that the centralized and controlled nature of the Egyptian economy had confined the effects of the Standby reforms to a contraction in demand. Controls on business and investment prevented an adequate supply response to the new price signals which had been introduced. Without a growth in production, productivity and employment, further price reform and subsidy reduction would likely be increasingly more difficult to implement because of popular discontent over the reduction in real wages. Thus, in USAID's view, liberalizing the economy to encourage investment and growth was critically needed in order to compensate for the inevitable rise in prices as subsidies were removed.

Since 1984, $1,042 million have been provided to the government of Egypt as Cash Transfers. The provision of Cash Transfers has been closely associated with USAID's policy dialogue effort. Since 1986, Cash Transfers have been conditioned on the implementation of economic reforms. The FY 1986 Cash Transfer recognized a significant reform in the trade regime and customs tariffs. The FY 1987 Cash Transfer was supported by a wide range of reforms which led to the first Standby arrangement with the IMF and Paris Club rescheduling. The FY 1988 Cash Transfer was also supported by a wide range of reforms including improvements in the exchange rate, improved energy pricing and the opening of the tourist sector to significant private sector involvement.

IV. Justification for the Cash Transfer

This section catalogues and assesses the main economic reforms undertaken in FY 90 which are additional to those taken prior to FY 90. The implementation of these measures provides the basis for the FY 89 appropriated Cash Transfer. The primary justification for the release of the FY 89 appropriated Cash Transfer is that these actions evidence continuing GOE resolve to shift the economy from central control to a market basis.

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

1. Reduction of subsidies. The prices of flour, rice, macaroni, sugar, cigarettes, petroleum products, electricity and fertilizer were increased in a major package of subsidy reduction measures. (May 1990).

2. Movement toward exchange rate unification. In August 1989, the Central Bank exchange rate was devalued from \$1 = LE 0.70 to \$1 = LE 1.10. Furthermore, the recently approved GOE FY 91 budget incorporates a further devaluation of this rate to \$1 = LE 2.00. The GOE FY 91 budget becomes effective July 1, 1990.

3. Increased producer incentives. Producer price for cotton has been increased by about 30 percent and the import market for wheat has been opened up to the private sector.

4. Industrial liberalization. Price controls have been lifted on fifty six public sector produced products. (May 1990).

5. Trade liberalization. The list of banned imports was reduced by 60 customs categories (out of 270 categories).

B. Impact of the reforms.

1. The reduction of subsidies is clearly the boldest measure taken by the government this year. The subsidy reductions were primarily in widely consumed commodities which have been traditionally heavily subsidized. Also, the price changes were introduced essentially at the same time. The size of the price increases as well as the public nature of their change was an important departure from the government's previous approach to reducing subsidies. In the past, prices were raised with little publicity and often by altering the quality or size of the product.

   The revenue effect of the price changes is projected to be LE 2.5 billion (see Table III for detail). These measures, in the context of the recently approved FY 91/92 GOE budget, are expected to contribute to a reduction of the budget deficit equal to 2.5 percent of Gross Domestic Product (GDP). The total budget deficit is projected to be less than 10 percent of GDP.

2. The movement of the Central Bank exchange rate in August 1989 was not a significant economic reform measure. The devaluation was small and there was no adjustment of prices or the visibility of the subsidy on the budget. However, the movement of this rate did reflect the government's willingness to change a long held symbol of financial policy. Of more significance is the planned further devaluation of this rate which is reflected in the FY 91/92 budget which became effective on July 1, 1990. Consequently, the recently approved FY 91/92 budget which accommodates the further devaluation, makes the real subsidy to a number of strategic imports (e.g. wheat) more visible.

3. The government has argued that the rise in the price paid to cotton farmers improves the incentive for producing this crop. The 30 percent price increase will more than compensate for inflation. However, farmers continue to have a strong financial incentive to grow other major field crops -- wheat, clover, corn, rice -- instead of cotton. Cotton is still a heavily controlled and taxed crop in order to keep prices on inputs for inefficient state-controlled spinning mills low and to capture producer surpluses for the government. Furthermore, policy distortions in other areas of agriculture, particularly the continued favorable treatment of the livestock industry, have resulted in unusually high incentives to grow crops which compete with cotton.

   Permitting private sector wheat imports is a necessary prerequisite reform to the termination of the government's wheat import monopoly. However, the private sector has not, as yet, used its new ability to obtain import permits in a significant way. For this to happen, the private sector needs greater access to foreign exchange which would follow from expected reform of the foreign exchange system. Also, the private sector needs more time to assess the actual market for unsubsidized wheat before it commits substantial resources to import this commodity.

4. The decontrol of prices of a fifty six industrial products is the first stage in a process negotiated with the World Bank for the proposed Structural Adjustment Loan. The commodities whose prices were decontrolled consist of goods which are produced in a competitive environment and have low import protection. The World Bank estimates that the decontrolled commodities represent approximately 8 percent by value of industrial production. The importance of the price decontrol is that it removes one of the important bureaucratic constraints on the efficient operation of public sector industries. Also, when expected improvements in investment licensing are implemented, the private sector will have greater freedom to compete in the production of these goods since the freedom to set prices permits the private sector to correctly price quality differences vis-a-vis public industrial competitors. The implementation of this measure verifies that the government is implementing its program to shift the public sector to a market basis.

5. The items eliminated from the import banned list represent a small percent of imports. While not significant financially, the measure is further evidence of the government's willingness to reduce direct administrative controls on trade. In the past, the government has strongly held that techniques such as banning imports were a more efficient method of managing the allocation of scarce foreign exchange than reliance on market forces. The implementation of this measure reflects a change in government policy towards the market.

V. Other U.S. Non-project Assistance

A. Commodity Import Program

Since the resumption of economic assistance to Egypt in 1975, $4.378 billion have been provided under the Commodity Import Programs. Currently, $200 million are provided annually to Egypt by legislative earmark for public sector and private sector CIPs. These CIPs help finance imports of needed raw materials and other commodities. Imports' finance is provided because the correction in the balance of payments cannot, in the long run, be absorbed solely by a contraction of imports. Such an event would result in a serious economic recession within Egypt, adversely effecting the consumption and employment of the lower income groups.

This year, the amount of resources Congressionally earmarked for CIP has been divided to provide $50 million to the public sector and $150 million to the private sector. This split follows from the government's increased emphasis on greater private sector involvement in the economy. During the past few years, and particularly last year, the government has eliminated its import monopoly on a number of important commodities including wheat and corn. In addition, the government has been attempting to change the policy environment to encourage greater private sector exports. The private sector has shown an interest in assuming the responsibility to import bulk agricultural commodities. However, in the tightly controlled foreign exchange market, the private sector has had difficulty in gaining access to hard currency. This year's allocation of CIP retains resources for high priority public sector imports and helps to relieve the private sector's foreign currency problems associated with their greater responsibility to import commodities which had been exclusively imported by the public sector.

B. PL-480 Title I, II and III

From FY 1975 through 1990, the U.S. financed $3.2 billion in PL480 Title I and III commodities. The FY90 program level is $153 million. The major portion of this assistance has been for wheat grain and flour. The U.S.-supplied wheat has been a critical element in meeting the demand for this basic foodstuff by the growing Egyptian population.

Title II grant obligations from FY 1975 through FY 1989 totaled $179 million and have been used to support feeding (including MCH) programs in Egypt.

These PL480 shipments complement CIP-financed shipments of corn, vegetable oil, tallow and of other consumer goods in helping provide a higher level of domestic consumption than Egypt's stringent balance of payments situation would otherwise permit. In addition, PL480 commodities directly support the consumption of low income Egyptians and, therefore, directly support the goal of stability.

VI. Impact on U.S. Balance of Payments

The immediate impact of the Cash Transfer on the U.S. balance of payments will be neutral. The grant will be spent entirely on debt service payments owed to or guaranteed by the U.S. Government and the purchase of U.S. goods (specifically wheat). It is unlikely that the Cash Transfer will result in any long term positive or negative effects on the U.S. balance of payments.

VII. Cash Transfer Implementation

A. Uses of Cash Transfer Proceeds

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

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

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

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

In negotiating the above uses, we noted that AID has a policy (STATE 325792 of October 20, 1987) that countries receiving cash transfer assistance use the proceeds for purposes (1) and (2) noted above (imports from the U.S. and debt service to the U.S.) in that order of preference. In this regard, the GOE has indicated its intention to use the cash transfer proceeds for items (1) and (2). USAID considers that any combination of these two uses - (1) or (2) - would be appropriate under the circumstances and that we need not require a specific justification for the combination which the GOE in fact chooses. Also, we believe the GOE should be encouraged to use cash transfer resources, within the parameters of the two specified eligible uses, for purposes which the GOE determines for itself are most effective and efficient. In sum, we believe the above-outlined arrangements concerning use of proceeds - arrangements which will permit the GOE to make its own choices within two categories of eligible uses - reflect a due appreciation for AID's policy preferences within the Egyptian context. Thus we do not plan to carry

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

the concept of an "order of preference" over into the Grant Agreement -- since to do so would raise, undesirably we believe, issues for still further negotiation, justification and documentation subsequent to Grant Agreement execution. Therefore, the Grant Agreement will not reflect any "order of preference" between the two specified eligible uses. However, should the GOE later wish to use cash transfer proceeds for other purposes, then AID would request the GOE to provide us with evidence that no pressing requirements exist under the two specified uses before AID would concur in alternative uses.

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

USAID has been informally advised by the authorities of the Central Bank of Egypt that this Cash Transfer is expected to be used primarily to pay current and past due payments on GSM-102 and PL480 debt.

B. Special Account for Cash Transfer Dollars.

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

This account will be used solely for the receipt of FY 89 appropriated cash transfer assistance from AID. The proceeds will not be co-mingled with other funds from any other source. Should any interest be earned on such account, such interest will be treated as though it were grant proceeds received under the terms of the cash transfer agreement. Any required redposits (from hypothetical misuse of funds) will be similarly treated.

The FY1990 Appropriation Act added further elaboration of separate account requirements for cash transfers. AID issued guidance for the financial management of dollar separate accounts in STATE 194322 (June 17, 1990). Although this Cash Transfer will be funded with FY 1989 ESF appropriations, the FY 1990 statutory provisions and AID guidance have been reviewed so that the implementation arrangements for this program will be in conformance.

C. Monitoring and Audit

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

The grant agreement and implementation letters will contain provisions for accounting, reporting and monitoring of the grant proceeds in conformance with dollar special account guidance issued in State 194322 dated 6/15/90. Specifically in regard to this guidance and the need to assure the capability of the implementing agency (GOE Central Bank) to adequately manage the special non-comingled account, the Mission has reached a positive determination. This judgment is based on the Bank's excellent management of last year's cash transfer special account, the fact that this authorization is for a very similar/identical program, and, the fact that Regional Inspector General/Cairo conducted an assessment of last year's special account transactions with no adverse findings on the bank's management. The capability of the implementing agency is therefore, reasonably assured.

D. Local Currency

FAA Section 531 (d) requires that, as to Commodity Import Programs and "other program assistance," AID funding be used, "to the maximum extent feasible," to generate local currencies for support of AID funded Basic Human Needs activities.

AID/W has indicated that, as a matter of policy, deposit arrangements apply to Cash Transfer generations (see 89 STATE 185485.) "Generations" occur for this purpose when commodities are imported using Cash Transfer funds; and "generations" are computed (as under Commodity Import Program arrangements) on the basis of the highest official exchange rate (LE per dollar) available to importers for any transaction. Therefore, to the extent that local currency is generated under the Cash Transfer Agreement, deposits will be required. AID/W has confirmed that such deposits may be co-mingled with the already existing Special Account established and maintained under CIP documentation (89 STATE 185485). Thus, Cash Transfer related local currency will be programmed and expenditures monitored according to the same procedures currently used for the CIP Special Account. It should be noted that the GOE has followed a practice of maintaining a separate account for local currency generated under each CIP program (and for the FY88 Cash Transfer). However, these accounts collectively comprise the Special Account governed by the 1980 Memorandum of Understanding regarding Special Account. Programming and monitoring by AID is carried out with reference to the aggregate Special Account, as contemplated by 89 STATE 185485.

The grant agreement will not require local currency deposits for Cash Transfer dollars used to pay eligible debt service payments. The reason for this is that such deposits would require the government to create new local currency, given the current budget deficit situation. Requiring the government to print new money introduces inflationary pressure. The inflation arises because the payment of external debt does not bring new, real resources to Egypt to satisfy the local demand generated by the spending of the new money deposited in the local currency account. For the next several years, a principal macroeconomic goal will be to find ways by which the government can reduce the rate of monetary expansion. Forgoing local currency deposits when the cash transfer dollars pay eligible debt service supports this macroeconomic objective.

VIII. Beneficiaries

As the FY 1989 CDSS stated, over the long run, a comprehensive reform program will benefit the poor by stimulating employment opportunities as the economic situation improves. The reforms which have been made to date, however, are short of what is needed to stimulate the economy. In fact, the immediate effects of the reforms noted above are primarily to increase prices and consequently reduce demand, without a commensurate increase in investment or employment. These reforms will, therefore, have the effect of reducing real incomes. The GOE is aware of this and has tried to minimize this effect on the most vulnerable groups. For example, the electricity tariff increases were targeted primarily at industrial users, leaving small residential consumers with much lower proportional increases.

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

Informal studies show that when income is reduced, poor families tend to spend less on school expenditures, and girls are probably affected first.

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

The government is, however, preparing to implement a significant liberalization of investment procedures, a privatization of government businesses and a restructuring of inefficient public sector industries. These programs are expected to improve the investment climate and create new jobs and income.

IX. RECOMMENDATION

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

X. AUTHORITY

Under Delegation of Authority No. 653, the Egypt Mission Director may approve and authorize non-project assistance following consultation with AID/W; such has taken place through the months.

DOC., CT90 July 1, 1990

Table II

EGYPT: BALANCE OF PAYMENTS
(in millions of current dollars)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89
CURRENT ACCOUNT						
Exports	4350	4185	3406	2831	3368	2546
Petroleum	2957	2891	2215	1470	1657	1066
Other of which:	1393	1294	1191	1361	1711	1480
Agriculture	663	554	475	467	498	372
Other	730	740	716	894	1213	1108
Imports	-10738	-10516	-9256	-7952	-9838	-10079
Trade balance	-6388	-6331	-5850	-5121	-6470	-7533
Services Receipts	4188	4178	4073	4837	5493	6416
Shipping	521	606	574	508	446	531
Suez Canal dues	974	897	1028	1148	1268	1307
Tourism	825	850	800	1200	1600	2021
Investment Income *	1079	1044	914	790	1000	1000
Other	789	781	757	1191	1179	1559
Services Payments	-4103	-4308	-4410	-4756	-5300	-5592
Interest **	-2555	-2486	-2342	-2749	-3100	-3400
Other	-1548	-1822	-2068	-2007	-2200	-2192
Services Balance	85	-130	-337	81	193	824
Worker Remittances	3930	3497	2973	3012	3386	3530
Current Account Balance	-2373	-2964	-3214	-2028	-2891	-3179
Official Transfers				974	698	710
Current A/C Balance				-1054	-2193	-2469

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* IMF Estimates

**These figures refer to interest obligations.
Actual payments, however, amounted to $1.29 million, $1.094 million, $0.785 million and $1.016 million in the period 1985/86 - 88/89.

Table III

Revenue Impact of GOE 1990 Price and Budget Measures

	Base Revenue or Quantity Affected	1990 Price Increase to mid-May	Additional Planned Increase	Gross Revenue Impact (million)	Net GOE Revenue Impact * (million)
1. Electricity	LE 1,425	+38% (EEA est)		LE 542 (EEA est)	LE 460 (EEA est)
2. Fuels (excluding sales to EEA)	LE 2,032	+45% (USAID est)		LE 920 (USAID est)	LE 800
Subtotal, Energy				LE 1462	LE 1260?
3. MOS Supply Commodities	(USAID ests)				
- Flour, bread					
baladi	3.51mmt		?		
shami	1.62mmt		?		
- Flour, other					
82 percent	0.31mmt	+100%		LE 116	
72 percent	0.20mmt	+120%		60	
bakery	0.20mmt		?		
lux bakery	0.10mmt	+57%		41	
- Macaroni	0.05mmt	+54%		21	
				LE 238	LE 200?
- Frz fish/meat			?		
- Tea subsidy	LE 98 mil		cancel?		
- Rice, rationed		+38%		LE 50! (USAID est)	LE 50 (USAID est)
- nonrationed		+50%			
- Sugar, rationed		+50%			
nonrationed			+65%e		
4. State Enterprise Prices					
- cigarettes	LE 2,000	+13-20%		LE 400 (GOE est)	none (USAID est?)
- medicines		+20%			
- coop eggs		+67%			
- phosphate fertilizer, 12/89		+93%		LE 75 (USAID est)	LE 25 (USAID est)
Subtotal, Non-Energy				LE 1034	LE 300?
Grand Total				LE 2496	LE 1560

* After allowance for prospective increases from 1989/90 to 1990/91 in the LE costs of inputs (e.g., imports, fuel, rice procurement) and other production costs (labor, etc.).

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