

May 4, 1992

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FROM: NE/DP, Susan Merrill
SUBJECT: Egypt Strategy Review

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**PROGRAM STATEMENT
USAID/EGYPT**

The following Program Statement is presented in two parts. Part I is a summary of the status of general progress in key development sectors, including the economy; and of the continuing problems and constraints to development in those sectors. Part II is our strategy for addressing these problems and constraints.

I. SUMMARY OF PROGRESS AND CONTINUING CONSTRAINTS TO DEVELOPMENT

A. The Economy

The Egyptian economy is in a state of transition, evolving from over four decades of state intervention in allocating resources, to an environment in which free markets and prices will be allowed to operate and are the central determinants of growth.

For over thirty years, Egypt's centrally-planned economy has relied considerably on limited sources of external financing (Suez Canal tolls, remittances from workers abroad, oil exports, bilateral aid), and it has been subject to the uncertainty of international economic and political events. During the 1970s and early 1980s, the country enjoyed an annual growth rate of over seven percent, due primarily to favorable oil prices (oil is Egypt's primary export), remittances, and generous flows of economic assistance. However, such growth was short lived, as the economy stagnated in the mid-1980s with the fall in the price of oil, remittances, and other sources of external revenue.

With the decline in foreign exchange earnings, Egypt was unable to service its foreign debt. By 1989, debt service obligations were about 40 percent of total foreign exchange revenues. With the collapse of oil prices, the government initiated expansionary fiscal policies to maintain public sector outlays resulting in increasingly burdensome deficits and a rapidly worsening balance of payments, financed largely by foreign debt. By the late 1980s, Egypt had exhausted its international reserves and could no longer borrow its way to growth. Stagflation began to characterize the economy.

To correct these imbalances, Egypt negotiated a Stand-by arrangement with the IMF in 1987. The Stand-by's purpose was to

stabilize the economy through specific macro-economic interventions. Approximately six months later, the Stand-by was canceled because Egypt failed to adhere to the program. In 1988, Egypt tried again but was unable to conclude a second agreement with the IMF.

By 1990 the country faced a major crisis, with no apparent means of reducing a foreign debt which then totalled \$40 billion. Its trade and current account balances were in chronic deficit, inflation was high, and the budget deficit was growing to unmanageable proportions. Unable to service U.S. debt, Egypt flirted with violation of the Brooke Amendment, which would have required the termination of U.S. economic assistance.

Several events combined to rescue Egypt from the precipice and provide a new opportunity to pursue fundamental economic reform. The Gulf War, which initially looked as if it would further exacerbate Egypt's economic problems because of reduced foreign exchange revenues from all sources, actually brought significant benefits to Egypt through substantial debt relief and additional economic assistance.

Secondly, the demise of communism and the movement toward free market concepts in the world deprived Egypt of the socialist model that has been the basis of its economy since the Nasser regime. It also robbed Egypt of its natural trading partners in Eastern Europe with whom trade was often conducted on a barter basis.

Facing few alternatives, Egypt negotiated, and signed in May 1991, a new Stand-by Agreement with the IMF. The primary purpose of the IMF program is to restore macro-economic stability by reducing inflation, eliminating ceilings on interest rates, decontrolling the foreign exchange market, and reducing the budget deficit, now twenty percent of GDP.

To reduce the structural impediments to long term growth, Egypt signed a Structural Adjustment Loan (SAL) with the World Bank in October 1991. The SAL obligates the government, inter alia, to institute major reforms in the financial and trade sectors and to undertake a major privatization of the economy.

Egypt's performance in meeting the terms of the IMF Stand-by has been good. The Government has been much less successful in moving forward on the reforms called for in the SAL. Much more can be done in both programs. For example, further liberalization of interest rates and domestic tax reforms are required to generate the additional resources needed for investment and the reduction of the budget deficit. The Government must also reduce further the heavy subsidization of services such as water and power, and the subsidies which keep the public enterprise sector afloat. Although the Government has made some progress in this area in

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the context of USAID programs, a failure to remove subsidies will undermine macro-economic stability by exacerbating the budget deficit and by diverting badly needed investment resources away from the private sector. Removal of these subsidies is also necessary to free up the resources needed by the Government to operate and maintain AID-financed infrastructure, protecting these investments and sustaining their impact.

Problems remain in other major sectors of the economy. For example, the financial sector is key to mobilizing savings and investment capital, and for managing the nation's money supply. Egypt's public sector financial system is strained by the continued provision of credit to uneconomic public sector enterprises, crowding out private sector investment. Moreover, the system is weak institutionally, with few alternatives to the poorly run state banking apparatus. For example, there is no credible capital market in Egypt which can expand the financial base and mobilize resources for private investment.

Government policies are inequitable in their treatment of financial institutions and instruments. For example, bank deposits are tax exempt, whereas securities are subject to a number of taxes. Brokerage commissions, high by international standards, further discourage the development of capital markets. Restrictions on foreign banks operating in local currency deprive the banking system and money market of expertise and competition.

Policy and administrative restrictions on imports and exports to protect inefficient public sector industries stifle trade. Government controls in the sector removed competitive incentives to efficiency, inhibiting non traditional exports such as fruits, vegetables and light manufactures, and discouraging foreign investment.

Inefficient and unprofitable public sector enterprises dominate the business sector in Egypt, and absorb scarce capital needed to fuel private sector growth. As long as the public sector remains immune from market forces, the private sector will be on an unequal footing in the competition for resources. The Government has pledged to undertake massive privatization of the economy in conjunction with the SAL; however, progress has been slow and the Government has not yet created the conditions for equitable participation by the private sector.

It is too early to tell whether this third attempt at major economic reform will be successful. For the moment, it looks as if the political will to initiate reform has been mobilized; whether it can be sustained over the long haul is the question. The appropriate role for a foreign donor, such as USAID, is to encourage the Government to continue on the path of reform while providing it with the resources, both financial and technical, to plan and implement policy change.

B. Economic Infrastructure

Economists in the United States are unanimous in their view that economic infrastructure played an important role in the historical growth of the U.S. economy. They are equally unanimous in decrying the deterioration of that infrastructure and the implications this has for future growth. With the help of the United States over the past fifteen years, Egypt has made important progress in developing the infrastructure that is critical for economic growth. This includes major investments in power, telecommunications, irrigation, water and sanitation and transportation. In this respect, it could be argued that the completion of major infrastructure works in the later half of the 1980s, at about the same time that the Egyptian economy began to suffer reverses in externally generated growth, helped absorb the full impact of these reverses and contain the slide of GDP growth from sliding even lower.

Notwithstanding these additions to the nation's productive infrastructure base, problems remain. Inappropriate pricing policies and inadequate attention to operations and maintenance are causing infrastructure, constructed during the 1960's and early 1970's, to deteriorate rapidly and are jeopardizing even the newest facilities.

As the private sector grows it will come to depend on this infrastructure. If full benefits are to accrue to private sector development, the productive infrastructure base will have to be expanded, modernized and protected. This cannot occur if pricing policies and institutional arrangements continue to impede the efficient management, operation and maintenance of urban utilities and other infrastructure.

C. The Private Sector

An improved policy environment will create the basic conditions for a free market economy, private sector investment and growth. However, while policy reform (including reform of the laws which impede private sector investment) is a necessary condition to private sector growth, it not sufficient. There are other "second echelon" constraints to private sector participation in the economy which must also be dealt with. These are largely regulatory, technological and institutional in nature and include: limited access to international markets (as a source of technology, information and other factors that affect international competitiveness); deficient information collection and dissemination capabilities (particularly important as financial and export markets develop); inadequately trained managers; the public sector monopoly in research and development; and the unavailability of credit for small, labor intensive enterprises where employment potential is high.

Although currency devaluation and foreign exchange policy reform have increased export potential, further liberalization is necessary to remove administrative and tax barriers for the private sector to fully take advantage of these reforms. Furthermore, because Egyptian businessmen have been so isolated from world markets, they lack basic marketing skills, management methods, and an appreciation of quality standards.

Information is also critical if Egyptian exporters are to gain access to new markets. The undeveloped state of information systems is a problem which cuts across sectors and one that must be tackled if the economy is to become truly competitive. If financial markets are to develop, for example, transactions must be conducted with advanced technology customary in most world markets. In the public arena, policy makers require independently-researched data to advance the debate on economic reform and hopefully change entrenched attitudes.

Small and micro enterprises, heretofore largely neglected, can contribute to growth and help alleviate unemployment. As is the case in other developing countries, small entrepreneurs have very limited access to credit and expertise from the formal banking sector. Modeled on USAID's successful experience in small and micro enterprise lending, banking institutions must do more to assist small businessmen so that they are not forced to obtain loans from informal sources which charge exorbitant interest rates.

D. Agriculture

The state-run economy has also taken its toll on agriculture. Agriculture accounts for approximately seventeen percent of GDP but growth has been poor. For example, the value of production has grown at a minuscule .08 percent per year. Inappropriate pricing and marketing policies, and a large public sector role in the production and supply of agricultural inputs, are the main causes of poor performance.

There are also institutional and technological constraints to improved growth in agriculture. Institutional shortcomings are attributable to a legacy of statist guarantees of employment and a large government profile reaching untenable proportions. The bureaucracy is over-staffed and cumbersome and its overlapping responsibilities prevent effective management of programs and resources.

Technological constraints affect the productivity of traditional farming methods, as well as post harvest practices. Farming is still characterized by a relatively low level of production technology and inefficient on-farm water management. Outdated and inefficient processing technology causes post harvest losses

of up to 20 percent.

In theory, the research system in Egypt should be tackling such problems. In practice, its impact has been weak. The diffusion of research agendas among competing agencies prevents the government research system from concentrating on the highest priorities. Furthermore, the agricultural research system is relatively isolated from outreach and extension mechanisms. Hence, technologies developed have little chance of reaching farmers.

Finally, there remains the problem of water and its relationship to cultivable land. Population growth and urbanization are rapidly devouring Egypt's scarce agricultural land. In response, the government is reclaiming desert land. Land reclaimed exerts pressure on limited irrigation water from the Nile River. There is little scope for groundwater exploitation; therefore, the Government and the private sector must continue to explore more efficient methods to manage existing water resources.

E. Social Sectors

As Egypt implements its economic reform program, reducing government expenditures to reduce the deficit will have short-run negative consequences for the funding of its social programs. Egypt has made impressive progress in addressing major health problems, reducing the population growth rate, and in educating its people. Egypt will have to find the resources needed to maintain and build on these past achievements, and to preserve overall social stability.

1. Population

Government programs in population, with substantial USAID support, have been successful in reducing fertility rates from approximately five births per woman in 1980 to just a little over four in 1988. There is an increasing trend in the use of birth control measures. Preliminary results from an Arab League survey indicate that almost 48 percent of Egyptian couples are currently using family planning methods, a figure that is nearly double the level recorded in 1980.

The population growth rate, though declining (from approximately 3 percent in 1985 to less than 2.5 percent in 1990) is still high and has obvious developmental consequences. The government is hard pressed to expand social services and create employment fast enough to absorb a growing labor force. Already one of the world's most densely populated countries, Egypt is becoming progressively more urbanized. The population density in urban Cairo surpasses that of Bangladesh, magnifying problems of overcrowding, poor sanitary conditions and inadequate housing. Egypt must continue to emphasize population programs to preserve

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current gains and reduce budgetary pressures caused by the need to provide social services to an expanding population.

Constraints to sustained progress in population include weak national institutions unable to formulate policies to reach their goals; inadequate supply of contraceptives (including advanced methods such as NORPLANT); and still nascent outreach capabilities involving the private sector, the media and NGOs.

2. Health

The Government, again supported by USAID, has made significant progress in combatting diseases which strike infants and children in Egypt. These programs have reduced infant mortality from 87/1000 in 1983 to 12/1000 in 1989 (including a reduction of infant deaths from diarrhea from 33 to 12/1000). Immunization coverage rates for six major childhood diseases increased to over 86 percent of children by 1990.

Despite these dramatic accomplishments, Egyptian children continue to die from preventable causes in great numbers. Acute respiratory infections (ARI), diarrhea, and complications of pregnancy are the top three killers of Egyptian children. ARI now accounts for 28 percent of infant deaths, diarrheal diseases comprise 27 percent and complications of pregnancy 13 percent. The maternal mortality rate remains high at 260/100,000.

Schistosomiasis continues to have a major impact on the Egyptian population. It affects the rural poor of all ages, but particularly school-aged children and young adults. Children in the Nile Delta region show particularly high rates of affliction. This disease significantly reduces productivity by an estimated half a billion dollars annually. Control measures, including chemical spraying of irrigation canals, are costly and potentially injurious to the environment. Hence, low cost preventive measures must be sought.

Government policies are skewed toward subsidized, curative services. This policy bias has reduced the funding available for more cost effective preventive care. The health bureaucracy remains bloated with a major share of the health budget allocated to the salaries of physician personnel. Meanwhile, the country faces a critical shortage of well-trained nurses--the most cost-effective care providers. Little has been done to advance private sector alternatives to the provision of health services, and there is minimal recovery of costs in the operation of government health facilities.

F. Environment

Egyptian policy makers have paid scant attention to the environmental consequences of their development decisions.

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Inappropriate policies, the absence of an effective environmental policy making body, inefficient technology, and a poorly educated populace are among the key constraints which have prevented environmentally sound development. The result has been alarming. Solid wastes litter the landscape and clog the waterways; clouds of industrial, vehicle, and dust pollution fill the air; and many canals, lakes and marine waters are heavily polluted. Adverse health effects are common. Damage to water and air quality is most acute.

The excessive use of subsidized fertilizer for agriculture, industrial waste, and raw sewage have seriously polluted water for drinking and irrigation. If unchecked, the economic effects of these practices could be devastating. For example, the contamination of agriculture drainage water could reduce cultivated acreage by 10 to 12 percent by the next century. The resulting loss in output could reach two percent of GDP or approximately \$700 million and could mean a loss of about 400,000 jobs in agriculture and supporting industries.

The air in Cairo and Alexandria is heavily polluted with uncontrolled emissions from industry and automobiles. Consequently, urban residents breathe air contaminated heavily with ozone, carbon monoxide and other pollutants and have a high incidence of respiratory disease. Air polluting industries located in residential areas place the population at added risk from exposure to toxic substances.

The Government has not made a concise statement of its policy objectives regarding the environment. It has passed a number of laws and decrees--ostensibly to protect the environment--but they lack coherence, are overlapping and have little or no impact because there is no enforcement authority. The government closely guards whatever information is collected on the state of the environment. Because of this, the public is generally unaware of the implications of a deteriorating environment. Advocacy groups (to the extent that they exist) are unable to bring real issues to the government's attention for action.

Recently, there has been some movement by the Government to bring the environment to the forefront of its development agenda. In connection with the World Bank SAL, Egypt has agreed to produce an Environmental Action Plan which integrates environmental issues into development decision-making. This plan is scheduled to be completed in May, 1992. Throughout the preparation of the plan, donors have encouraged the Government to address the fundamental policy, institutional, and technological constraints to progress in this area.

G. Political Reform

The changes in Eastern Europe, the Soviet Union and in other

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parts of the world are having a salutary effect on Egypt's political development as well as on its economy. In the broadest sense, these changes represent a "wake-up call" for the traditional power structure. There is some indication that the message is being heard.

While there is little tradition of pluralistic democratic development in Egypt, there has been a distinct liberalization of the political environment in recent years, highlighted by the existence of an argumentative and questioning legislature, a relatively independent judiciary, an active and often critical press, and increasing freedom of association.

The Government has also taken some steps in decentralizing development decision-making, primarily in connection with USAID's 10 year effort in local development. Nevertheless, true decentralization cannot occur unless local governments have the means to raise revenue and the authority to spend it in accordance with the priorities of the local community. This caused USAID to re-evaluate its assistance to local development and potentially explore more policy-oriented interventions to encourage fiscal decentralization.

Much remains to be done to guarantee broad participation of Egyptian citizens in the political and economic processes of Egyptian society. This is even more critical as Egypt embarks on a program of major economic reform. These reforms will not succeed if they do not appear to be equitable in their application. An open political system leads to more transparent decision-making and guarantees that the widest number of people can express their views, introducing an element of equity that might otherwise be missing.

The Government appears cautiously receptive to assistance in the development of democratic institutions, particularly with respect to the legislature and judiciary. Before any major efforts can begin however, USAID must learn more about the structure and function of the Egyptian government. Nevertheless, a door which had been closed is now slightly ajar and a prudent step through it now seems to be in order.

H. The Donors

The United States has long been the largest aid donor in Egypt, although successful implementation of the SAL is likely to attract substantial World Bank funding. Though their assistance is small compared to the U.S., other bilateral donors count Egypt among their most important recipients of assistance. With so many donors in the country, and with the Egyptian capacity to absorb and administer development projects is limited, it is important that the donors collaborate to explore issues of common concern; unite to press a common agenda with the Government; and

exchange information to avoid overlapping and redundant programs/projects. This collaboration takes place at several levels including a monthly donor coordination gathering co-chaired by UNDP and the Netherlands; donor sub-groups which discuss specific subjects such as the environment; a smaller group of donors (ie., the IMF, IBRD, UNDP and USAID) most directly concerned with economic reform; and frequent one-on-one consultations between donors.

The interests of other donors have been important in our decisions to disengage from certain development sectors. For example, the World Bank intends to support a program in basic education, including the construction of new schools. The Social Fund will incorporate many aspects of USAID's previous Local Development Project, including building local infrastructure. We will continue to encourage the donors to support those areas where assistance is warranted but where we have neither the financial nor staff resources to remain engaged.

II. PROGRAM STRATEGY

INTRODUCTION

The Mission's overall program goal in Egypt is the enhancement of Egypt's role as a model of stability, democracy, free markets and prosperity in the region. This goal recognizes the centrality of Egypt to the maintenance of peace and stability in the Middle East, and its potential to influence the development of more open political systems and economies in the region.

Recent events bear out our confidence that Egypt is poised to assume a greater leadership role in the Middle East. These include Egypt's major efforts to encourage and sustain broad Arab participation in the coalition against Iraq, the resumption of its leadership of the Arab League and its willingness to embark on an economic reform program which could have widespread repercussions throughout the region.

The Mission believes that a comprehensive approach to the political and economic development of the country is necessary if Egypt is to achieve the status implied by our program goal. Thus, we have identified three program sub-goals which we believe are essential to this process: increased economic growth; enhanced human resource productivity and quality of life; and strengthened democratic systems, institutions and processes. The first two of these sub-goals are roughly consistent with program objectives presented in previous strategy documents. The third represents the addition of a new dimension to the USAID/Egypt program.

USAID'S development strategy will result in several changes in Mission programming. The first of these is a greater emphasis on

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economic policy reform through fast-disbursing policy-based programs and through projects; We will also increase our support for private sector development.

We will also place a greater emphasis on policy constraints in those sectors where we have made, and will continue to make, major investments. For example, we have made it clear to the Government that future assistance in the water/wastewater sector is contingent upon the adoption of appropriate cost recovery, administrative and other arrangements to ensure maintenance and sustainability of investments. We are taking a similar approach in the power, telecommunications and health sectors.

There is a new emphasis on the environment in Egypt. With the signing of the World Bank SAL, the development of an Environmental Master Plan, and the increasing interest of all donors in this area, USAID has an opportunity to bring its substantial resources to bear on major environmental concerns. We are already doing much to benefit the environment; however, we will seek to improve the coherence of our current approach and add some new, cost and staff efficient elements to the portfolio.

To capitalize on the major political changes that are taking place in the world, and the liberalization of the political environment that is occurring on a more modest scale in Egypt, the Mission believes the time is right support the development of institutions of democracy and governance. Our program in this area will be more fully developed following the completion of a separate strategy this summer.

Increasing pressures on scarce Agency staff and operating expense resources have required that the Mission look carefully at its program and determine where consolidation is possible. As a result, we have decided to phase-out of several staff-intensive program areas as current activities come to an end, and to streamline some large projects which have components which have been less successful than others. In the first category, we plan to end the Mission's successful involvement in Local Development and Basic Education at the completion of current project activities. We will also phase-out of Science and Technology as a separate sector, eliminating some project activities entirely, and reshaping others to support our new initiative in the Environment. In Agriculture, we are refocusing the National Agriculture Research Project (NARP) so that some less successful components can be dropped and the rest of the project be completed as scheduled.

There are several other cross-cutting features of our program that we will continue to emphasize. These include support for the role of Egyptian and American private voluntary agencies in the development process, and for training programs that benefit both public and private sector participants. It should go without

saying that all of our activities will maximize the procurement of U.S. produced commodities as required in Buy America legislation.

This program statement adopts the taxonomy developed in AID/W to describe the program in terms of program goals, sub-goals, strategic objectives and program outcomes. In this regard, we have had a successful collaboration with the Center for Development Information and Evaluation (CDIE) to develop appropriate objectives for the USAID/Egypt program. CDIE will continue to work with the Mission to develop the indicators we will use to measure progress against these objectives. For purposes of clarity in the narrative, we have not identified our proposed activities as Program Outcomes per se. These are more succinctly stated in the chart attached to this paper.

SUBGOAL I: INCREASED ECONOMIC GROWTH

The IMF stand-by agreement and the World Bank's SAL provide the basis for stabilization and transformation of the Egyptian economy. USAID has played a major role in negotiating policy change in Egypt prior to these two agreements. In addition, USAID and the Embassy played an important intermediary role between the Government on the one hand, and the IMF and the World Bank on the other in arriving at final agreement on the Standby and SAL.

USAID/Cairo's economic reform strategy will reinforce previous achievements in policy reform and support the IMF and World Bank with additional policy reform efforts in the areas of finance, trade, privatization and fiscal reform.

A. Economic Reform

The strategic objective for USAID/Cairo's economic reform program is increased macro-economic stability and market pricing. The Mission will undertake a two-pronged approach to achieve this objective. First, through an expanded cash transfer program, USAID will encourage the GOE to adopt and implement policy reforms in the fiscal, trade, financial sectors, and to privatize all but the most strategic state-owned enterprises. Second, we will encourage the GOE to further reduce subsidies for irrigation water, urban water, wastewater and power services and curative health care. This will permit the government to target limited subsidies, thereby reducing the deficit, while providing a safety net to the truly needy during this period of structural adjustment.

USAID's macro-economic policy reform program will concentrate on

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the fiscal and financial sectors to promote efficient allocation decisions, savings and external resource inflows. Egypt currently relies heavily on unstable external sources of revenue such as Suez Canal earnings and oil revenues. During the boom years of the 1970s and 1980s, Egypt neglected its internal sources of revenue leading to a weak tax base characterized by low revenue elasticity. Tax avoidance, tax holidays and the long lag time between assessment and collection complicate the picture. USAID will support the Ministry of Finance in its efforts to broaden the coverage of its sales tax and eventually transform it into a full value-added tax, introduce a global income tax, rationalize its customs duties on imports and modernize its tax administration system.

In order to accomplish this, USAID will provide technical assistance to help the Ministry of Finance develop potential tax reform scenarios and model the projected revenue impact of each reform. Once the GOE decides on a reform package, USAID will again provide technical assistance and commodities to modernize and automate the administrative systems needed to collect the taxes. These reforms are expected to broaden the tax base and generate additional annual tax revenues.

These reforms will play a key role in supplying the government with the resources it needs to reduce the budget deficit. At the same time, USAID will support the IMF's program to limit GOE expenditure growth.

As part of the Stand-by agreement with the IMF, Egypt began to reform the monetary system by liberalizing most interest rates and introducing a treasury bill market. Banks are now free to set their own interest rates which, after the first treasury bill auction in early 1991, stabilized at about 18 percent. Nevertheless, some distortions remain; for example, debt instruments still face a 7 percent interest rate ceiling.

As a result of past policies which set interest rates below market levels and rationed credit in favor of inefficient state-owned enterprises, Egypt's four principal banks are severely undercapitalized. This adversely affects the solvency as well as the stability of the financial system. Furthermore, inequitable tax treatment of financial instruments and institutions has hampered the development of capital markets.

Consequently, USAID's policy reform agenda will seek to remove these distortions in the financial sector by: improving credit allocation, eliminating barriers to capital markets formation, strengthening the financial structure of the banking system and increasing private sector participation in banking.

Specifically, USAID will encourage the GOE to submit legislation to remove government controls over interest rates and require

public sector lending institutions to lend at market interest rates to public and private sector borrowers alike. The GOE will be urged to pass and implement legislation which will provide equal tax treatment for interest and other forms of capital income. This legislation will also require commercial banks to reach a minimum ratio of capital to risk-weighted assets of six percent based on the Basle system. The GOE will also be encouraged to submit legislation to the Peoples Assembly to remove the present interest rate controls on corporate bonds and establish a private stock market. USAID will provide technical assistance in the preparation and implementation of these reforms.

The second major thrust of USAID's macro-economic strategy is to encourage market pricing and cost recovery in sectors such as irrigation, urban utilities and curative health care. Though the GOE is making good faith efforts to curb expenditures and thereby reduce its budget deficit, its long-standing practice of keeping the cost of living low through broad-based subsidies which are enjoyed equally by the rich and the poor, still permeates its planning. The GOE is increasingly aware that of the necessity to reduce these subsidies and target them to only the very poor. Moreover, economic pricing of curative health care, irrigation water, urban water and wastewater and electricity is essential if the government is to finance the operations and maintenance programs required to sustain infrastructure and improve service quality over the long term. USAID will continue to support policy change in these areas and it will provide the necessary technical assistance to enable the GOE to initiate or raise user charges in the aforementioned sectors by the mid-1990s.

B. Private Sector

A second strategic objective which will contribute to the Mission's subgoal of increasing economic growth is increased private investment and trade. Several of the key policy reforms which support macroeconomic stability also will serve to promote private investment and trade.

For many years, the GOE followed fiscal expansionary policies to sustain government expenditures for subsidies of essential consumer goods, production inputs, and the operation of state-owned enterprises. This led to increasing pressure on public sector financial institutions to allocate credit at below market rates to sustain these subsidies, effectively crowding out the private sector. Exchange rate policies also discriminated against private firms, especially those engaged in export activities. Foreign exchange was rationed, giving preference to public sector firms by applying lower rates to them. Fluctuations in the rates hampered non-traditional exports and created uncertainties in the financial and commodities markets. In 1991, the GOE adopted a policy of relatively free market

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exchange rates. USAID will continue to monitor the functioning of the foreign exchange market and its impact on trade and investment.

Distortions in money markets, including nominal ceilings on interest rates well below the rate of inflation and credit rationing to curb excess demand stifled the development of capital markets and yielded no real savings in the economy for investments. After credit was rationed in favor of the public enterprises, there was little left over for private investment. USAID-sponsored reforms in the financial sector will equalize access to credit between the public and private sectors and boost investment.

Investment policies which continue to constrain the private sector include an investment law which requires companies to distribute at least 10 percent of their profits to employees and reserves to the government the right to set production levels and prices. In addition, the application process itself is cumbersome. The approval process is not transparent and is perceived by private investors to be capricious. For instance, a Joint Stock Companies Law provides the basis for the formation of private companies but requires 51 percent Egyptian ownership, thereby limiting foreign investment in Egypt. USAID will provide technical assistance and sector support to help the GOE modify these investment laws by 1993.

As the GOE proceeds to implement tax and other fiscal reform measures which will narrow the budget deficit, USAID will work to eliminate distortions in the trade sector. The trade sector is a solid platform from which Egypt can grow, earn foreign exchange, service its debt and boost domestic sources of revenue.

Egypt has historically pursued an import substitution strategy at the expense of export promotion. The government monopolized imports and introduced barter deals to direct exports toward financing the import of military hardware. Yet, high world prices for oil, tourism receipts, Suez Canal revenues, worker remittances and foreign aid could not prop up this strategy indefinitely. The government's failure to broaden and diversify the export base hit home in the 1980s when revenues from these other sources declined drastically.

Trade policies which employ import and export bans and restrictions to protect inefficient import substitution industries have stifled trade. Controls in the sector have also had damaging effects in removing competitive incentives to efficiency, retarding export development, promoting capital flight, and discouraging foreign investment and technology transfer. Corrective measures thus far have concentrated on reducing non-tariff barriers to import and exports and the reduction of import duties.

USAID will complement these initial reform efforts by providing technical assistance and sector support to the GOE to develop outward-looking, export-oriented trade policies. We will work together to modernize the systems by which Egyptian exporters gain access to imports; eliminate trade policies which hinder the ability of private sector firms to compete on an equal footing with public sector firms; reduce the coverage of import bans which prop up inefficient public enterprises from 23 to 11 percent of domestic manufacturing and agricultural output; eliminate state export and import monopolies; and harmonize the Egyptian system of customs duties with standard international classifications.

The proliferation of public enterprises in the Egyptian economy, combined with a regulatory environment which favors them, has severely constrained the growth of private enterprise. Simultaneously, surplus labor, inefficient production and management--in short, a lack of profitability-- has meant that real growth in output of public enterprises has been low. Only a vital, growing private sector can fuel Egypt's development in the 1990s and beyond. Privatization of public enterprises is essential to foster competitive markets for existing private firms and encourage new ones to enter the market. Privatization will support private investment by removing subsidies to former State-owned enterprises, forcing them compete fairly with private business.

USAID will support initiatives to develop the legal and administrative framework necessary for privatizing state-owned enterprises. USAID's strategy for privatization will supplement the policy conditions of the SAL by assisting the GOE to privatize selected enterprises in the tourism, industry, and agriculture sectors which it has identified in its economic reform program but which are not covered by the SAL. We will also provide technical assistance to help the GOE privatize its public enterprises such as: helping in the organization of the Public Enterprise Office (PEO); development of a strategy for privatization; working with recently established holding companies to identify candidates for privatization; valuation and restructuring of companies; and, assistance in actual divestiture. The government's goal is to privatize 15 enterprises with combined assets of at least 500 million Egyptian pounds by the end of 1993.

USAID also will assist the government to unify all business laws and replace the current system of licensing with a simple registration process by 1993. In support of these privatization activities, USAID will explore the possibility of providing sector assistance to enable the GOE to reduce surplus labor--a major obstacle to privatization.

A second generation of problems which hampers investment and

productivity includes lack of access to: appropriate technology, accurate market information, credit by small and micro businesses, and a dearth of well-trained private sector managers.

USAID's strategy will address each of these constraints to private enterprise growth and will build on current activities over the strategy period.

USAID assistance to the newly-created Export Development Center (EDC) will enable Egyptian exporters of fruits and vegetables and light manufacture (non-traditional exports) to take advantage of nearby markets in the Middle East and Europe. Working with this private entity, AID-financed technical assistance (including some provided by the International Executive Service Corps) will provide expertise in efficient production methods and in the formation of a data base that will assist the marketing of products. Since good information about markets is also crucial to exporters, USAID will work with the EDC to develop information systems for this purpose. The Mission also will support a newly-established private sector think tank, the Egyptian Center for Economic Studies, to provide objective, independent economic research and policy analysis to support a market economy.

Mission programs in support of the informal sector have been successful. USAID/Egypt plans to expand its support in this area until financial sector distortions that deny credit access to small and micro enterprise groups are removed. The potential of these groups in making the economy grow is significant, and as most small and micro businesses are labor intensive enterprises, they also have the potential of alleviating Egypt's unemployment problem.

As Egypt's market economy evolves, the need for private sector managers trained in modern management theory and practices will become acute. Both in-country and off-shore training will play a role in this area. USAID will support a management training program jointly sponsored by the government and the Egyptian Businessman's Association (EBA) to expose Egyptians to current management theory and practice. The Mission's Development Training Project will address other private sector training needs. For example, over 80 short-term training slots have been reserved for candidates from private sector companies spanning a range of enterprises, including small and micro enterprises.

Finally, the importance of infrastructure for private enterprise cannot be over-emphasized. Infrastructure today is barely adequate to support private business opportunities. As the transformation of the economy occurs and private investment (domestic/foreign) grows, infrastructure must be in place to meet increasing private sector needs. As the Mission plans future infrastructure initiatives, it will pay priority attention to targeting them toward areas in which there is potential for

private enterprise growth.

C. Agriculture

The third strategic objective--increased production, productivity and incomes in the agricultural sector--also contributes to the subgoal of increased growth in the economy. In order to achieve this objective, the government must reform its policy and institutional environment, develop and disseminate new technology for the production and processing of commodities, and improve the efficiency of water use.

By the 1980s, the economic impact of distorted policies prompted the GOE to embark with USAID on a comprehensive program of agricultural policy reform. However, if sector performance is to improve and add to the nation's supply of food and exports, further reform is required to remove remaining price controls for cotton and sugarcane, eliminate government control over the cropping pattern, and remove subsidies for livestock production.

USAID's current policy and institutional reform program is directed at liberalizing product and input markets and increasing private sector participation in agricultural processing and marketing activities. We will be adding some new reform measures in these areas to the ongoing Agricultural Production Credit Project and we will design a follow-on activity which will solidify and extend gains achieved to date.

Policy reform alone will not contribute to higher agricultural production and productivity without a reliable flow of modern technology. Egypt's unsophisticated marketing and processing capabilities limit the access of exporters to foreign markets and they result in post harvest losses of 20 percent or more for vegetables and other crops. USAID will assist Egypt's efforts to adapt and disseminate marketing and production technologies which are already in use elsewhere in the world.

Continued high population growth and the rapid pace of urbanization remove approximately 30,000 acres of fertile Delta land from agricultural production each year. As a result, the government has been forced to reclaim desert land for agriculture. Expansion into these new lands is constrained by the quantity and quality of water for irrigation. The Nile river is the primary source of irrigation, supplying 95 percent of Egypt's water. Given the finite nature of this water resource and the limited availability of groundwater, it is imperative that Egypt increase the efficiency of water use in agriculture and improve water quality.

USAID's current program in irrigation management finances major technology transfer investments (telemetry and communications, computer-based models, automated water management data bases, and

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high technology mapping capability). The program also emphasizes research and human resource development to improve management of Egypt's irrigation system and thereby increase efficiency of use and equity of water allocation. The Mission will design a follow-on program to augment current progress and will also focus on cost recovery.

USAID-funded research and technology transfer activities will continue to disseminate new methods and varieties for growing traditional cereal crops, but will increasingly emphasize higher value fruits and vegetables, cotton and crops suitable for cultivation in reclaimed desert lands. Finally, USAID will develop a new program activity to adapt and disseminate technologies to agribusiness to improve post-harvest handling, marketing and processing of commodities.

SUBGOAL II: ENHANCED HUMAN RESOURCE PRODUCTIVITY AND QUALITY OF LIFE

A. Social Sectors

The second major dimension of the USAID strategy, enhancing human resource productivity and quality of life of Egyptians, reinforces the first objective of increasing economic growth. In addition to policy-based programs to reform the overall structure of the economy, USAID will support programs in human resources development, infrastructure and the environment which will have a direct, and more immediate, impact on the quality of life of Egyptians.

1. Population

One of the major constraints to achieving economic growth and better quality of life for Egyptians is the rapid pace of population growth, which has more than doubled over the past thirty years to reach 56 million people. Hence, the Mission's strategic objective for the population sector is the increased level and effective use of modern contraceptive methods. If Egypt's fertility rate were to remain at the current level of 4.4 births per woman, the population would reach 92 million by the year 2013. Even now, Egypt is hard pressed to expand services, such as education, and employment opportunities fast enough to keep pace with population growth. Moreover, the population now places intense pressure on Egypt's limited land resources.

A major factor contributing to the high rate of population growth is a sharp decline in mortality rates since World War II without a commensurate decline in fertility. The key to reducing the rate of population growth is to reduce the fertility rate, that

is, the average number of children a woman bears by age 49 at current fertility levels. While there are a number of factors that influence fertility (maternal education, urban versus rural residence, age of marriage), the single most important is contraceptive use. Increasing contraceptive prevalence has been a major objective of USAID's assistance to Egypt since 1975.

With USAID assistance, family planning activities in Egypt have achieved notable success since the 1970s. The total fertility rate fell from an average of 5.2 births per woman in 1980 to 4.4 births in 1988 due in large part to an increase in the contraceptive prevalence rate (CPR) from 24 percent to 38 percent of married women of reproductive age. Preliminary results of the Central Agency for Public Mobilization and Statistics (CAPMAS) Maternal and Child Health Survey indicate that the CPR increased to almost 48 percent by the end of 1990, a doubling of the rate of contraceptive use in 10 years.

Despite these achievements and the existence of a general policy framework which supports family planning, even further reductions in fertility rates are possible. However, the government still constrains the expansion of family planning services, prevents private sector entry into contraceptive manufacturing, and impedes cost recovery. The Mission will work with the government to reduce these obstacles.

The primary technological constraints to increasing the CPR are lack of access to more longer term clinical methods, such as injectables and NORPLANT, and lack of local manufacturing capability for inter-uterine devices (IUDs).

USAID and the GOE will work together to increase contraceptive prevalence from 48 percent in 1992 to 53 percent in 1997, and to increase use effectiveness from 81 percent in 1992 to 91 percent in 1997. This is expected to help the GOE achieve its goal of reducing the fertility rate from its current level of 4.4 births per woman to 3.5 by 1997.

In order for the GOE to achieve these targets, couples must have access to information and services which will enable them to select an effective method, use it correctly and continue use. Studies show that three in five women of childbearing age want no more children. More than half of their husbands also desire no more children. These data suggest that, given access to information on family planning and high quality services, couples would use contraception.

In response to such findings, USAID will work with the State Information Service to develop a national communication strategy, intensify family planning television campaigns, and give priority to information-education-communication activities.

Supporting these efforts, USAID will also assist the Ministry of Health (MOH) to upgrade the content and methodology of physician and nurse training courses, train more than 10,000 service providers at the national and governorate levels, institutionalize its counseling course and strengthen its outreach capabilities. The Mission will provide IUDs, NORPLANT and condoms to the public sector, thereby increasing the number of couple years of protection from 4.0 million in 1992 to 5.0 million in 1997.

According to the 1988 Demographic Health Survey, the private commercial sector provides approximately 70 percent of family planning services in Egypt. Mission strategy cannot overlook a service provider of this importance. Moreover, since this sector sustains its own activities by charging customers for goods and services, it requires only limited assistance in information, education and communications and training of private sector service providers, including more than 4000 pharmacists. The Mission will focus its support to the private, not-for-profit sector on the Egypt Family Planning Association, which is the major private voluntary service provider.

To help overcome institutional weaknesses which have an impact on outreach programs, USAID will provide technical assistance to develop the capability of the National Population Council, as well as governorate level offices, to plan, coordinate and report on family planning activities at the national and local levels.

USAID will assist four other implementing agencies under the current Population/Family Planning II and its successor project to improve their management capacity. For example, technical assistance and financial resources will be geared toward assisting the MOH to produce, distribute and implement an operations manual; improve its contraceptives tracking system; and produce timely, comprehensive annual plans. USAID will assist the NPC to produce and distribute a strategic plan for population and family planning in Egypt based on service data, research and national policy.

2. Health

The fifth strategic objective is to improve maternal and child health.

During the late 1970s and early 1980s USAID worked with the GOE to increase access of the rural and urban poor to health services to reduce the high infant mortality rate. Since access alone was not sufficient to improved health, USAID and the GOE embarked on a program to introduce cost-effective technologies such as oral rehydration therapy (ORT) into more than 3600 outpatient clinics nationwide. Working with United Nations agencies such as UNICEF and WHO, the GOE and USAID implemented extensive public

awareness campaigns, trained health workers, and improved ORT and immunization services.

These efforts led to dramatic increases in coverage for ORT and immunizations. As a result, the infant mortality rate dropped from 87 deaths per 1000 live births in 1983 to 43/1000 in 1991.

Despite these accomplishments, Egyptian children continue to die from preventable causes, such as acute respiratory infections (ARI), diarrhea and complications of pregnancy. The maternal mortality rate also remains high at 260/100,000.

Other communicable diseases still afflict the population in large numbers. In 1990, there were almost 600 recorded cases of polio. Between 50 to 80 percent of the Egyptian population show signs of previous hepatitis B infection and 4 to 10 percent are chronic carriers. As many as 25 million Egyptians are at risk of contracting schistosomiasis while 9 million (many of them children) are already infected.

The principal constraints to improved maternal and child health are inappropriate policies which have weakened the institutional delivery of preventive services. For example, by attempting to subsidize curative health care for the entire population, the Ministry of Health allocates much of its budget for this purpose at the expense of funding cost-effective preventive services which have the most impact on reducing maternal and child mortality.

Personnel policies reinforce this bias by promoting an excess of physicians (who command the lion's share of the MOH personnel budget) and a dearth of nurses. The physician dominance of the health sector, combined with the almost exclusively curative nature of medical education, results in a predominance of high-technology, curative approaches to health care rather than the low-technology, more cost-effective measures recommended by the WHO and many donors.

In order to improve maternal and child health, USAID and the GOE have adopted a three-pronged approach. First, USAID will provide technical assistance, commodities and train at least 80 percent of the Ministry's health workers to maintain the traditional program of immunization against six major childhood diseases, at coverage rates above 80 percent. USAID will subsequently evaluate the feasibility of assisting the GOE to reach its goal of raising coverage rates to 90 percent by 1997. Moreover, through mass campaigns to vaccinate pregnant women against tetanus, USAID and the GOE hope to raise coverage rates to 70 percent by 1995. USAID will also sponsor the introduction of hepatitis B vaccine into the immunization program through technical assistance, training and the financing of an initial

two-year supply of the vaccine with the objective of immunizing 80 percent of the target population by 1995. In efforts to reduce the incidence of communicable diseases, the Mission will continue research activities to discover a schistosomiasis vaccine.

The second part of USAID's approach to reducing child mortality is to introduce a national program for the detection and treatment of acute respiratory illness in the MOH and private sectors such that 80 percent of primary health care physicians, nurses and technical staff recognize the symptoms of severe ARI, and 60 percent of physicians prescribe approved drug therapy.

The success of any program to combat ARI hinges on placing more responsibility on the mother as first-line care giver. Hence, USAID will help the MOH and the private sector develop a media-based educational campaign for mothers, teaching them to recognize signs of serious ARI cases and seek treatment.

Finally, in order to reduce both maternal and infant mortality due to complications of pregnancy, USAID will provide technical assistance, commodities and training such that 80 percent of MOH primary health care facilities provide improved prenatal, delivery and post-partum services. The objective is to encourage 60 percent of women to seek prenatal care; ensure that 70 percent of deliveries are attended by a trained traditional birth attendant, nurse or physician; make 70 percent of women aware of the benefits of spacing their children and encourage 80 percent of mothers to breastfeed their babies for at least four to six months.

In order to accomplish these objectives, USAID will assist the GOE to introduce preventive concepts into its pre-service and in-service physician training curricula. USAID will also launch a major effort to reform curricula and improve training for secondary technical and baccalaureate nurses.

If these programs are successful, they should help to GOE to achieve its goal of reducing the infant mortality rate to 37/1000, the child mortality rate to 5/1000 and the maternal mortality rate to 200/100,000 by 1997.

B. Public Utilities

The sixth strategic objective, which falls under Sub-goal II, is increased access to, and efficiency and reliability of, public utilities in urban target areas.

Egypt's 56 million people live almost entirely on the 4 percent of arable land that comprises the Nile Valley and Delta, constituting a population density nearly double that of Bangladesh. Density in Cairo, for example, averages 29,000

inhabitants per square kilometer and may range as high as 116,000 persons per square kilometer, one of the highest population concentrations in the world. Population density and growth in other large Egyptian urban areas, such as Alexandria, the Provincial Cities of Beni-Suef, Fayoum and Minia, and the Canal Cities of Port Said, Ismailia and Sues, is also very high. The Government has tried to deal with the strain this growth in population has put on urban infrastructure by heavily investing in alternative growth poles in new cities.

Historically, urban infrastructure programs have constituted a large percentage of USAID assistance to Egypt. Major investments include: \$1.956 billion in water and wastewater; \$1.336 billion in electric power; and \$282 million in telecommunications. Since 1975, urban infrastructure has accounted for \$3.56 billion in obligations or approximately 45 percent of the Mission's entire project budget.

In spite of these efforts, a full complement of reliable and technically efficient public utility services are not yet available to a large portion of the urban population in Egypt. Existing public utility infrastructure has deteriorated and new construction has not kept pace with rapid population growth in Egypt's large urban areas. Sewer flooding and water shortages are no longer prevalent in Cairo and flooding in Alexandria and in several of the Provincial Cities has been alleviated due largely to USAID's past and current efforts. Further expansion and improvement of urban public utility infrastructure, especially wastewater and some water facilities in large urban areas, is essential to improve the quality of life and productivity of the Egyptian population. However, the amount of future assistance in these sectors hinges on the GOE's willingness to reform policies, particularly those relating to cost recovery and operations and maintenance.

1. Water/Wastewater

The importance of potable water and sanitary drainage to the Egyptian economy and the quality of life cannot be overstated. The Nile is the source of 80 percent of Egyptian drinking water and it is to the Nile that the wastewater effluent eventually drains. Approximately 25% of the population have no source of treated water and 70 percent do not have access to sewerage collection systems. Pollutants in this closed system have significant environmental impact. The Mission's Environmental Strategy identifies degradation of water quality and inadequate disposal of untreated wastewater as major environmental threats.

USAID has provided nearly \$ 2 billion over the past 14 years to help people have better access to potable water and to have

sewerage removed from the streets. By 1995, eight cities with a combined population of 17 million, or roughly one out of every three Egyptians, will have received improved water and wastewater services through current USAID-funded activities. USAID has focused this assistance in urban centers of production and commercial growth, where water and sewerage problems are more visible and where larger numbers of people can benefit.

Despite these achievements, the needs of the system remain substantial. USAID assessed these needs in 1991 in collaboration with the World Bank. The conclusion is that simply to maintain present levels of service, rehabilitate or replace deteriorated facilities, and to operate and maintain systems properly will require nearly \$600 million per year. This does not take into account increased population growth in urban centers, which could cause system costs to rise to \$1.1 billion/yr.

Current investments in the sector are threatened by chronic underfunding and by the weaknesses of the entities which are responsible for operations, management and maintenance of water and wastewater facilities. The central government inflexibly controls funding in a process which is not responsive to local needs. Utilities which have the responsibility for providing these services have little control over their financial and organizational circumstances. They retain no revenues; they have no voice in setting tariffs or rate structures; and they are overstaffed by an underpaid workforce.

The last National Water Tariff schedule set in 1987 called for a doubling of rates to all categories of consumers with the target of covering 100 percent of O&M costs for water and 50 % of O&M costs for wastewater by 1992. However, because the schedule was not indexed for inflation, anticipated real gains for meeting cost recovery have long been eroded. Even though subsequent Prime Ministerial decrees have authorized the governorates to increase tariffs at rates substantially higher than the schedule, governors and local popular councils have been reluctant to implement the decrees. This is likely to remain the case until these localities get the authority to retain, as well as raise revenues. In addition, the real costs of operation and maintenance are unknown making it difficult for decisionmakers at all levels to implement an effective tariff policy.

Institutionally, national policy setting bodies in this sector are weak. Organizational authority and responsibility is dispersed among numerous public entities at both the national and local levels. Difficulties in coordination among these bodies is often encountered. Since central government controls inhibit the autonomy of local water and wastewater organizations, the managers of these facilities make few decisions. Subsidies are a disincentive to efficient operations. Finally, the training of the engineers and technicians to run the systems has been

inadequate. A USAID-funded training needs assessment concluded that 24,000 people with these skills will have to be trained in the next 10 years.

USAID's objective in this area is to increased number of water and wastewater facilities in urban areas. The sine qua non for additional assistance will be policy and institutional reform in the water and wastewater sectors. Although we have been active in cost recovery discussions for the past several years, much more progress must be made to ensure the sustainability of current investments. We are also providing financial support and technical assistance for organizational reform efforts, but much more progress is required here also.

The general outline of the reform agenda which we will pursue in connection with any new assistance includes: 1) reorganization of utilities into regulated modern municipal utilities with the appropriate authority and skills; 2) existence of 100 percent O&M cost recovery plans to be implemented as mutually agreed; 3) reform of personnel systems and operators certification programs; and 4) tariffs raised and regulated by a public, but non-governmental body. USAID will provide technical assistance and training in support of this agenda.

In general, the USAID strategy will shift its emphasis from water to wastewater. Because of substantial donor assistance for water projects in the 1980s, and because Egypt is now undertaking major water facility construction projects on its own, water coverage is far more extensive than sewerage and there is less of a need for donor assistance. An exception to this is in the some of the provincial and secondary cities which require water treatment plants which exceed the capabilities of local contractors.

Conversely, the wastewater establishment relies almost completely on donor assistance for expansion of the large collection networks, rehabilitation of pump stations and construction of treatment facilities. Technically, construction for collection, treatment and disposal of sewerage is considerably more complicated than treatment and distribution of water. Egyptian contractors have developed little experience in large scale wastewater technologies therefore the need for assistance in this area remains substantial.

Consistent with this strategy, and contingent upon serious government efforts at reform in these sectors, USAID plans to develop a new generation of water and wastewater activities, with emphasis on the latter. In this regard, we will consider supporting follow-on wastewater projects in Cairo and Alexandria. We will also consider a combined water/wastewater program in several of Egypt's "secondary" cities.

2. Electric Power

The Egyptian electric power system serves nearly 11 million customers concentrated in Cairo, Alexandria, the Delta, and along the Suez Canal and the Nile River. Electric energy comes from generating facilities which are installed at strategic locations in the Nile Valley, the Delta and the Suez Canal and which are integrated by a complex network of transmission lines. Areas outside the reach of the power system are supplied from gas turbines and diesel driven generators. These facilities are state-owned and are the responsibility of the Ministry of Electricity and Energy (MEE) and five operational and executive authorities. The Egyptian Electricity Authority (EEA) is responsible for the planning of the bulk power supply that includes generation and transmission at high voltages.

Egypt's 157 generating units have a combined capacity of nearly 12,000 MW which should be enough, along with currently planned additional capacity, to meet customer demands until the year 2001. USAID has played a major role in developing this capacity, providing nearly \$1.6 billion since 1977. This includes support for: 1) power system planning, construction, operation and maintenance, and utility arrangement; 2) expansion and rehabilitation of 4800 megawatts (MW) of generating facilities; 3) rehabilitation of transmission facilities; 4) rehabilitation and expansion of distribution systems; and 5) establishment of computer centers to monitor, supervise and direct the operation of the bulk power supply network and the network serving Alexandria. The major focus of future USAID support to the sector will be the improved performance of existing electric generation and distribution facilities.

While generating facilities and transmission and distribution networks are adequate to meet current customer demand, the electric power sector faces a number of constraints which, if uncorrected, will increasingly impede the sector's overall efficiency. Broadly, these constraints involve: policies related to economic pricing of electric energy; institutional issues relating to training of middle management staff; transmission and distribution networks; and technical issues involving imbalanced allocation of financing to generation; energy losses; and lack of facilities to manage regional systems.

Government subsidies to the sector have kept electric energy prices far below economic prices and, as a result, customers have no incentive to control consumption, and industry utilizes obsolete and inefficient processes. In recent years, the government has implemented a series of price increases (reaching nearly 60 percent of long range marginal cost of producing electricity) in connection with USAID's support to the sector. However, tariffs remain well below economic prices. USAID has financed a comprehensive electricity pricing study that provides

the foundation and methodology for energy pricing in the future. Based on this study, Egypt is required, under the World Bank's SAL, to achieve long-run marginal cost pricing of electricity in 1995. USAID's support in this sector will continue to be linked to negotiated incremental achievements of this objective.

USAID will also support a Policy Reform and Institutional Assessment to look at the legal and financial impediments to increased efficiency, system reliability, cost savings and revenue generation. This assessment will recommend a time-phased plan for improvements in financial performance, changes in policies and regulations, tariff structures, and tariff collection.

Institutionally, the development of middle management within the Ministry of Electricity and Energy has not kept pace with the evolution of the utility system. Managers at this level have had little or no exposure to effective management techniques or the management functions of utilities operations. This will have long term implications for the overall management of the system. USAID is now supporting an Executive Management Development Program for senior management in the Ministry of Electricity. To further enhance the government's capacity for utility management, USAID will finance an assessment of longer-term management development goals and help design and finance a program which will meet these goals.

Among the technical constraints to sector efficiency is the unbalanced financing of system facilities which has favored the development of generation capacity at the expense of transmission and distribution. With responsibility for these functions divided between two different authorities, this bifurcated planning and financing has resulted in nearly 70 percent of total sector funding allocated to generation, with the rest going to the other functions. In a well planned system, allocations to these two elements should be roughly equal. USAID programs will seek to address this imbalance through increasing emphasis on transmission and distribution in the system.

Energy losses on the transmission and distribution system are 65 percent to 70 percent higher than is reasonably acceptable. The Egyptian Distribution Authority (EDA), with USAID support, is studying the causes of high energy losses and will be developing a nationwide program to reduce losses to reasonable levels. After this study is completed, USAID will determine the appropriate assistance to assist the EDA reduce losses in the system. USAID currently plans to finance new transmission substations in Alexandria and Cairo to relieve facilities that will be overloaded in the next few years. This will reduce the losses that are caused by such overloads. USAID will also support energy efficiency improvements through rehabilitation of generation capacity at thermal power facilities and at some

utilizing gas turbines.

The National Energy Control Center is responsible for the reliable operation of the 500 kilovolt (KV) transmission system. While there is one regional control center currently in existence, and another in development, there is no centralized control of the electrical networks serving various other operating zones. Effective management requires the collection and presentation of data on system performance that alerts center management to undesirable trends or abnormal conditions. USAID will finance the construction of a Regional Control Center which will collect and display operating data for the Cairo Zone. The EEA Control Center will utilize the information to more effectively manage the operation of this complex network. This will contribute to reduced losses and enhanced quality of service.

3. Telecommunications

A modern, efficient telecommunications network is a crucial component of the economic infrastructure. Adequate telecommunications services enhance the efficiency of private sector firms, government services, and agricultural producers. Telephones greatly improve the dissemination of market information, which allows market participants to respond rapidly to demand and price conditions. These benefits contribute to an environment supportive of investment, job creation, and economic growth.

An assessment of the telecommunications sector in 1978 identified the need for a twenty year, \$20 billion program to rehabilitate and modernize the telecommunications network. Thus far, \$2 billion has been invested in the sector, falling considerably short of the declared objective. Underinvestment is the single greatest factor constraining the development of the telecommunications network.

Since 1978, USAID supported the expansion of telecommunications in Egypt, providing \$345 million. This includes support for: 1) equipment to replace obsolete motor driven rotary telephone switching systems in Cairo and Alexandria with electronically controlled switching systems, increasing their capacity from 127,000 lines to 295,000 lines; 2) equipment and materials to expand and rehabilitate associated outside plant cable networks; and 3) the expansion of two existing exchanges by 24,000 lines and the installation of state-of-the-art digital switching systems for three new exchanges with a capacity of 74,000 lines.

While the Egyptian telecommunication network has expanded rapidly over the last decade, the sector remains strained and underdeveloped. Currently there are 2.15 million telephone lines

in Egypt serving a population of more than 56 million people, a telephone line density of nearly four telephone lines for every one hundred (4/100) Egyptians. The official waiting list for new telephone service is 1.2 million, of which Cairo and Alexandria account for more than half. Egypt's large population, combined with its high annual growth rate, means that the government phone company, ARENTO, must install an additional 45,000 lines per year just to maintain the current telephone line density. An additional 300,000 lines per year are required if the government is to achieve its goal of increasing the national density to 10/100 population by the year 2002.

USAID's strategy in the telecommunications sector is to support government objectives which are to: (1) extend telecommunication services; (2) replace overburdened switching equipment which relies on outmoded technology; (3) reduce service interruptions due to network problems through more responsive maintenance; (4) improve call completion rates; and (5) to train ARENTO employees in the planning, operation, maintenance, and repair of the equipment provided under the project.

The Egyptian telecommunications network currently faces a number of constraints which, if uncorrected, will impede the network's overall efficiency. Broadly, these constraints involve policies related to economic pricing of telecommunication services, institutional issues relating to the development of technical staff, and technical issues caused by equipment which originates from several different countries.

With respect to pricing policy, the cost of domestic telephone service is not covered by domestic service charges. As a result, ARENTO depends on revenue generation from connection fees and high international tariffs. Connection fees bear no relationship to actual connection costs and are established in many instances to regulate application for telephone service. USAID will finance a series of studies and assessments of the telecommunications sector to improve market pricing and cost recovery and define constraints to the efficient operation of the ARENTO. The study will recommend reforms which, if implemented, will enable the telecommunications sector to operate on a commercial basis.

Incompatible system equipment causes inefficient call routing and constrains the operations of the national network. For example, there are twelve different types of switching equipment in the network each with different transmission standards. USAID will finance network standardization, expansion and modernization, and the development of facilities that will improve the management of the national network. Specifically USAID will finance: service to over 500,000 households and businesses currently without access to telephones, increasing telephone density to ten per hundred Egyptians; replacement of approximately 175,000 lines of

obsolete crossbar equipment and temporary switching equipment; and training for ARENTO staff to improve existing skills and gain new expertise in planning, operating, and maintaining Egypt's national network.

USAID also will finance a centralized operations and maintenance control center that will identify system problems, generate status reports, and dispatch alarms in the event of service interruptions. The center would provide the ARENTO with information to diagnose problems within exchanges, in the transmission system, and in the distribution system. In addition, USAID will finance a Network Operations Center which will provide surveillance, analysis and control for local and toll traffic within the network.

C. Environment

The Mission's seventh strategic objective--enhanced protection of Egypt's freshwater and air resources--is also aimed at improving the quality of life of Egyptian citizens.

Serious environmental degradation constrains not only Egypt's economic development, but the health and livelihood of its citizens. Available evidence suggests that environmental damage to Egypt's water resources is most serious, followed by air, coastal and marine, and land resources.

Unfortunately, there is currently no strong public pressure for the GOE to formulate and implement policies to protect the environment. Moreover, the Egyptian Environmental Affairs Agency, the entity charged with environmental regulation, lacks the authority, budget, staff and technical resources to fulfill its mandate. Egyptian industries employ outdated and wasteful technology whose by products are injurious to the environment. Upgrading this technology will be a long and expensive process and one which is not likely to occur in the current, controlled economy. Until the policy environment is more favorable, the Mission is reluctant to initiate a major, discrete project in the environment. However, we will integrate a new environmental dimension into several current and planned projects in areas where we are already having substantial environmental impact, such as water/wastewater, agriculture and energy.

Other elements of the Mission's policy reform agenda indirectly benefit the environment. Reducing subsidies on inputs like fertilizers and pesticides, a feature of our Agricultural Production Credit Project, will have a positive environmental impact on land and water resources. Moreover, our support for irrigation cost recovery and irrigation improvement activities contributes substantially to the conservation of Egypt's water resources.

The Mission will also seek to upgrade the environmental policy analysis capability of selected line ministries by implementing prototype policy studies as part of its irrigation, agriculture, energy and water/wastewater portfolios.

USAID will continue its outreach to private sector firms through the industrial energy conservation project. Also in the private sector, USAID will encourage proposals for pollution prevention and environmental protection activities, and environmental awareness programs as part of its PVO grant program.

Finally, the Mission will seek to improve environmental awareness by fostering the free flow of information among Egyptian agencies, international organizations, PVOs, private firms and the academic community. Working through existing information systems such as the Egyptian National Science and Technology Information Network, the Mission will support efforts to establish permanent repositories of environmental data so that they are available for critical analysis and review by the entire spectrum of investigators.

USAID's technology transfer activities in sectors such as water/wastewater, energy, industrial energy conservation and irrigation will all have a positive impact on the quality of the environment in Egypt.

SUBGOAL III: STRENGTHENING OF SELECTED DEMOCRATIC SYSTEMS, INSTITUTIONS AND PROCESSES

As a new initiative, the USAID mission has begun a governance and judicial strengthening program to support the liberalization of Egyptian society and the reinforcement of the economic reform process. The program will enhance government accountability and improve management of the key representative and legislative components of government. It will strengthen the effectiveness of representative government, information systems and media institutions that are essential for responsive and accountable government. The program will also strengthen key judicial systems at national and/or local levels, improve judicial management and support for the autonomous rights of individuals. At local government levels, the program will enhance the role of elected local councils in decision-making and the relationships of these councils with the national parliament and other representative bodies of government.

The Mission has initiated a dialogue with senior representatives of key legislative, judicial and local government institutions to determine their interest in strengthening the representative elements of government, and in judicial reform. Initial discussions have been favorable, and the mission is now preparing

three sector assessments which will identify other areas for potential support. The sector assessments include: 1) a Political Economy Assessment of the economic and political reform process, with opportunities for strengthening the reform process; 2) an assessment of governance institutions consisting of an analysis of representative institutions and the media at the national and local levels 3) a legal/judicial reform assessment.

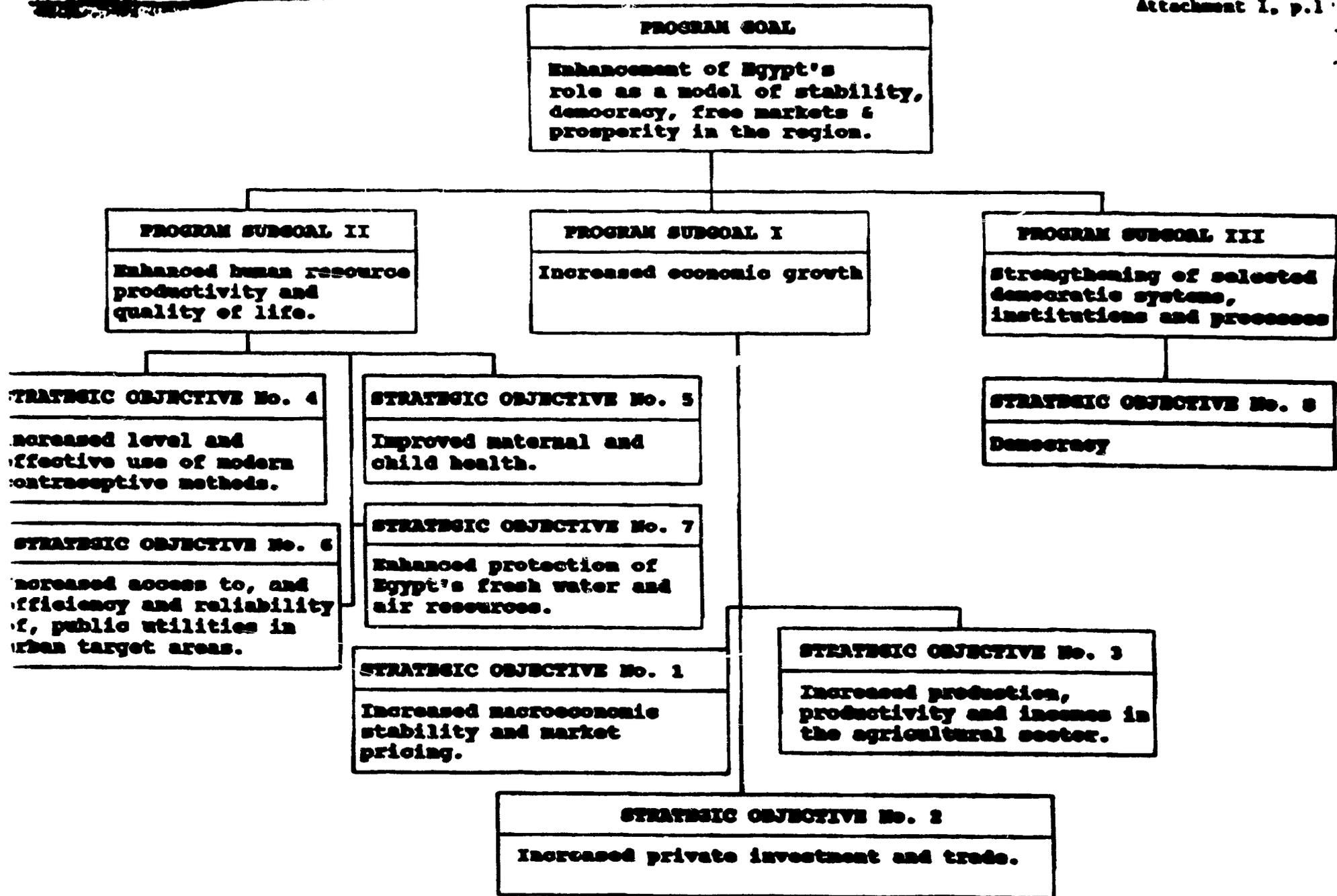
Following the completion of the sector assessments, the mission will develop a Democracy Initiatives Strategy which is expected to be completed in June 1992. The strategy will define a strategic objective for political development, identify the key areas for program intervention, and establish the major performance management objectives for the governance and judicial strengthening program.

Program development will occur in two phases. An Interim Program will begin after the sector assessments and strategy development activities have been completed. It will consist of short range activities in support of the overall strategy. Interim program activities may include training and technical support for judicial legal institutions, support for non-governmental organizations (NGOs) and legislative and representative institutions. The interim program will allow the Mission to proceed with high profile but complementary political development activities in support of overall program objectives in a relatively short time.

The second phase of program development will also begin as soon as the Democratic Initiatives Strategy is completed and will consist of the development of three or more projects in support of legislative institutions, media, representative local government and legal/judicial reform. Project design will begin immediately following the completion of the sector assessments and the strategy. The first major project could be authorized in FY 93.

Staffing Considerations

The Mission will address this issue in the final draft of the strategy.



PROGRAM GOAL
 Enhancement of Egypt's role as a model of stability, democracy, free markets & prosperity in the region

PROGRAM SUBGOAL 1
 Increased economic growth

STRATEGIC OBJECTIVE No. 1
 Increased macro-economic stability and market pricing
 Budget deficit as pct. of GDP.
 Domestic monetary/credit expansion.
 Real interest rates.
 Public expenditures relation to GDP inflation.
 Stability in international reserves.
 Index of market pricing.
 Real effective exchange rate.

PROGRAM OUTCOME No. 1.1	PROGRAM OUTCOME No. 1.2
Adoption and implementation of policy reforms in trade, fiscal, financial and business sectors.	Improved market pricing and cost recovery in sectors/services of USAID emphasis.
Policy score card based on benchmarks.	Pct. of O&M costs recovered for: Water systems. Sewerage systems. Electrical generation and distribution systems. Telephone systems. Pct. of O&M costs recovered in targeted health care facilities. Pct. of beds in targeted hospitals occupied by paying patients. Pct. of curative health care costs recovered. Pct. of O&M and capital costs recovered for irrigation.

DRAFT STRATEGIC PLAN

PROGRAM GOAL

Enhancement of Egypt's
role as a model of stability,
democracy, free markets &
prosperity in the region

PROGRAM SUBGOAL 1

Increased economic growth

STRATEGIC OBJECTIVE NO. 2

Increased private investment and trade

Foreign exchange earned by exports.
Private investment as pct of total investment
(domestic/foreign).
Growth rate of total investment.
Number of registered private companies.
Employment (female & male).
Level of foreign banking activities.

PROGRAM OUTCOME No. 2.1

Adoption and implementation
of policy reforms in trade,
fiscal, finance and business
sectors; privatization.

Policy score card based on benchmarks.
No. of state-owned enterprises sold.
Valuation of state-owned enterprises sold.

PROGRAM OUTCOME No. 2.2

Increased access to U.S. technology and expertise

No. of U.S. - Egyptian trade links (Agency
distributors agreements).
No. of CIP users.
No. of IESC clients.

Attach

PROGRAM OUTCOME No. 2.3
Establishment & strengthening of institutions and information systems for promoting investment and exports

Names of specific institutions and their related products and services (by categories)
Volume (traded) companies on the stock exchange list
Institution performance (No. of members organizations or magnitude of service delivery)
New kinds of financial instruments (by category)

PROGRAM OUTCOME No. 2.4
Increased coverage and sustainability of SME services

No. & pct. of SMEs receiving loans from SME development programs and commercial banks (at positive real interest rates)
Lending charge as pct. of cost of service in AID programs

PROGRAM OUTCOME No. 2.5
Power, telecommunications and water provided to enable the growth of private industry and commerce in urban areas

Total urban infrastructure capital expenditures (water, sewerage, power, and telecommunications) provided to targeted industrial areas
Pct. of total urban infrastructure capital expenditures (water, sewerage, power, and telecommunications) in areas targeted for industrial and commercial growth

PROGRAM GOAL

Enhancement of Egypt's role as a model of stability, democracy, free markets & progress in the region

PROGRAM SUBGOAL 2

Increased economic growth

STRATEGIC OBJECTIVE No. 3

Increased production, productivity and incomes in the agricultural sector

Agricultural production growth rate
Pct. agriculture as a share of GDP
Growth rate in all-factor agricultural productivity
Growth rate of per capita income from agriculture

PROGRAM OUTCOME No.3.1	PROGRAM OUTCOME No. 3.2	PROGRAM OUTCOME No. 3.3
Liberalized product and input markets and increased private sector share of agricultural processing and marketing.	Improved technologies developed and adopted for the production, processing, and marketing of agricultural commodities.	Increased efficiency of land & water use for agriculture.
No. of policies reformed (by type).	No. of improved production, processing & marketing technologies developed.	Value of agricultural production divided by quantity of land in production.
Pct. of production and marketing of agricultural inputs by the private sector.	Pct. of farms adopting improved technologies	Quantity of water (m ³) in agriculture divided by value of agricultural production.
Pct. of post-harvest agricultural processing and marketing by the private sector.	No. of non-farm firms adopting improved technologies.	Total quantity of water (m ³) in agriculture divided by quantity of land in production.

PROGRAM SUBGOAL
 Enhanced human resource productivity
 and quality of life

STRATEGIC OBJECTIVE No. 5
 Improved Maternal and Child Health

Infant mortality rate.
 Under five mortality rate.
 Maternal mortality rate.
 Polio incidence.
 Neonatal tetanus incidence.
 Hepatitis B carriage rates.

PROGRAM OUTCOME No. 5.1	Program Outcome No. 5.2	Program Outcome No. 5.3	Program Outcome No. 5.4
Improved Case Management of Acute Respiratory Infections (ARI).	Increased access to clean water and sewerage systems in urban areas.	Increased immunization coverage.	Improved access to perinatal care.
Percent of facilities correctly using ARI diagnostic and treatment protocol. Percent of lower respiratory tract infections correctly treated. Percent of mothers aware of signs of ARI and seeking treatment.	Percent increase in urban water coverage. Percent increase in urban sewerage coverage.	Percent of women immunized with tetanus toxoid. Immunization coverage rates for seven vaccine-preventable childhood diseases.	Percent of births attended by trained midwife, nurse, or physician. Percent of women receiving prenatal care.

PROGRAM GOAL

Enhancement of Egypt's role as a model of stability, democracy, free markets & prosperity in the region

PROGRAM SUBGOAL 2

Enhanced human resource productivity and quality of life.

STRATEGIC OBJECTIVE No. 4

Increased level and effective use of modern modern contraceptive methods.

Contraceptive prevalence rate (CPR)
Use effectiveness rate.

PROGRAM OUTCOME No. 4.1	PROGRAM OUTCOME No. 4.2	PROGRAM OUTCOME NO. 4.3
Increased family planning service volume and improved service quality.	Improved information for policy makers.	Improved management capacity in implementing agencies
No. of trained physicians, specialists, pharmacists, and service providers.	Number of policy-based assessments completed and disseminated.	Implementing agency annual plans approved which reflect government-level input.
Contraceptive years of protection.	National and governorate-level policy conferences held and proceedings disseminated.	Refined management information system in place.

PROGRAM SUBGOAL

Enhanced human resource productivity and quality of life

STRATEGIC OBJECTIVE No. 6

Increased access to, and efficiency and reliability of public utilities in urban target areas

Percent increase in water and sewer connections.
 Output of electricity available to consumers (MWH generated-MWH lost).
 Percent increase in telephone connections.
 Water Wastage.
 Number of water line breaks.
 Telephone call completion rate.
 Electricity fault rate per 100 km of lines.
 Number of floods from sewer line failures.

PROGRAM OUTCOME No. 6.1	PROGRAM OUTCOME No. 6.2	PROGRAM OUTCOME No. 6.3	PROGRAM OUTCOME No. 6.4
Increased number and capacity of telephone exchanges.	Improved performance of existing electric generation and distribution facilities.	Increased number of water and wastewater facilities.	Enhanced OOE management capacity.
No. and capacity of exchanges installed.	Km. of lines renovated. No. of generation units rehabilitated or replaced. No. of distribution centers installed.	No. of water facilities built. No. of wastewater facilities built.	No. of O&M personnel trained. No. of control centers installed. No. of organizations with cost accounting systems. No. of organizations with preventive maintenance programs.

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