BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Administrator Agency For International Development

The U.S. Economic Assistance Program For Egypt Poses A Management Challenge For AID

The United States has provided Egypt with $7.3 billion in Economic Support Fund assistance since 1974. This high level of funding has been provided to help maintain peace and stability in the Middle East--the political objective of the program. A longer term supportive objective has been to help Egypt strengthen its economy. AID's progress toward this second objective has been limited by the program's political nature.

GAO recognizes that AID must work within the constraints of the Egypt program's political nature but believes certain actions can be taken to help determine how best to achieve economic development goals in view of the program's political objective. To do this, GAO believes that AID should (1) gain more in-depth knowledge of Egypt's development sectors and the economic policies that affect these sectors and (2) assess Egypt's development efforts undertaken in response to the provision of cash payments.

GAO/NSIAD-85-109
JULY 31, 1985

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B- 217660

The Honorable M. Peter McPherson
Administrator, Agency for
International Development

Dear Mr. McPherson:

This report discusses AID's progress in assisting the government of Egypt in developing its economy. We found that economic development progress has been somewhat limited by program conditions over which AID has little control, particularly the program's political nature. However, we believe that AID can take certain actions which should be valuable in supporting its continuing efforts to improve program effectiveness. For example, AID can gain important program knowledge through (1) more in-depth analyses of Egypt's development sectors and the policies that affect these sectors and (2) an assessment of the Egyptian development efforts undertaken in response to the provision of cash transfers by the United States.

The report contains recommendations to you on page 46. As you know, 31 U.S.C. §720 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Secretary of State; Director, Office of Management and Budget; and appropriate congressional committees.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE ADMINISTRATOR
AGENCY FOR INTERNATIONAL
DEVELOPMENT

THE U.S. ECONOMIC ASSISTANCE
PROGRAM FOR EGYPT POSES A
MANAGEMENT CHALLENGE FOR AID

D I G E S T

The United States has provided Egypt with $7.3 billion in Economic Support Fund (ESF) assistance since 1974. The United States uses ESF to promote political and economic stability in the areas where it has a special strategic interest. The Department of State takes a leadership role in policies pertaining to ESF programs, and the Agency for International Development (AID) is responsible for administering these programs.

The administration and the Congress have established a high level of ESF assistance for Egypt as one means to demonstrate U.S. commitment to broadening the base of the present Egyptian-Israeli peace agreement and bringing the principal parties of the Arab-Israel dispute into a peace settlement. This is the program's political and primary goal; however, it encompasses the longer term important and supportive goal of assisting Egypt in ensuring its own stability through economic development. Progress is being made toward the program's political goal, but achievement of the longer term economic goal has been more difficult, primarily because of the program's political nature.

GAO's review focused on management challenges that AID faces in establishing and implementing the ESF assistance program. Specifically, GAO sought to identify and assess the

--conditions and constraints of establishing and administering the ESF program and their effect on the progress made toward the program's longer term economic development goal and

--advantages and disadvantages of the current mode of providing the ESF assistance and the possible alternative ways of disbursing this assistance.

Tear Sheet

GAO/NSIAD-85-109
JULY 31, 1985

ESF PROGRAM IS LARGE AND DIFFUSE

The Egypt ESF program will amount to $815 million for fiscal year 1985, second in size only to the one for Israel. The levels of assistance are set high to help support the program's political objective. AID will use $515 million of the $815 million for a large portfolio of projects, $200 million to support imports of commodities and equipment, and $100 million for a direct cash transfer to support Egypt's budget. (See pp. 1, 2, 3, 7 and 8.)

AID officials described the program as large and diffuse, lacking consistent focus, and difficult to manage. This condition has resulted, in part, from the use of a large number of discrete development projects as the main means of annually obligating the large ESF package.

GAO noted that the AID mission in Cairo is under considerable pressure to identify and design projects which can absorb large amounts of annual funding and which provide visible evidence of the U.S. commitment to Egypt. (See pp. 12 and 13.)

CONFLICTING VIEWS ON HOW BEST TO ACHIEVE THE PROGRAM'S POLITICAL AND ECONOMIC GOALS

Although the program's economic goal supports and is encompassed by the program's political goal, the methods for realizing the program's political goal and its longer term economic goal are not always the same and sometimes they conflict. That is, some actions taken to support the political purpose of the program may not be of optimal value in working toward the longer term economic development goal. There is continual questioning by Department of State, AID, and government of Egypt officials as to how these goals can be effectively achieved.

State Department officials emphasize the overriding priority of immediate political goals. AID officials see that the political purposes place priority on visible and short-term results and tend to discourage a more rapid pace toward economic reform because it may be politically destabilizing. Mission officials told GAO that AID, a development agency charged with the formulation and implementation of the

longer term economic development goal, must often subordinate this objective to the more immediate political goals. For example, at times AID has chosen projects because they provide visible evidence of U.S. political support and absorb large sums of funding. AID officials stated that while these projects provide some economic benefits, they may not have as high an economic development priority or value compared with other possible projects. (See pp. 9 to 13.)

U.S. and Egyptian officials differ on where to strike the balance between the program's goals and the best strategy for meeting these goals. According to Egyptian officials, Egypt welcomes U.S. assistance but questions whether it is being treated equally with Israel (which receives all U.S. assistance in the form of direct cash transfers) and whether the United States through its tight control of the assistance program is fully considering Egypt's own priorities for economic development. (See pp. 10 and 11.)

MIXED PROGRESS

AID can claim important discrete accomplishments from projects in areas such as agriculture, education, industry, electric power, water, and wastewater. However, it has been difficult for AID to influence the government of Egypt to quicken its pace in making economic policy reforms primarily because (1) AID lacks overall program funding leverage--the ability to withhold annual ESF funding--and (2) the government of Egypt is concerned that moving too quickly may be politically destabilizing. (See pp. 18 to 22.)

AID has tried to influence Egypt to make greater strides toward reforms but, since the ESF funds must be obligated during the fiscal year for which they are appropriated, it cannot withhold funds as a means of encouraging Egypt to change economic policy.

Egyptian officials recognize the need to reform policies which impede their efforts to develop and strengthen the economy but point to potential problems associated with such changes. For example, the government subsidizes many food items and electricity and water use rates are set too low to pay for operation

and maintenance costs. The subsidies have a major impact on the populace's income. The government of Egypt is concerned that making abrupt policy changes which affect prices and subsidies may be politically destabilizing; therefore, it is slowly attempting to reform these policies. The AID mission is helping to promote these reforms by discussing current policies with the Egyptians and the advantages of proposed reforms.

Notwithstanding the above constraints to policy reform, many AID officials and key government of Egypt officials agree that further in-depth development sector and economic policy analyses are needed to demonstrate the potential effect of reforming existing economic policies. (See pp. 22, 25, and 26.)

LARGE PROJECT PORTFOLIO MAKES PROGRAM MANAGEMENT DIFFICULT

Even though AID has established its largest mission in Cairo (funding for approximately 222 direct-hire U.S. and foreign national employees), AID officials told GAO that the large size of the project portfolio (77 projects in fiscal year 1984) has made it difficult for the mission to administer the program, challenged Egypt's ability to effectively absorb the large amounts of assistance, resulted in a large amount of obligated but undisbursed funds, and raised a question whether mission staffing levels are adequate. Specifically:

--The management and technical capacity of Egypt's development sectors to effectively absorb large quantities of project type assistance varies. This, according to AID officials, occasionally delays project implementation. In addition, requirements that Egypt provide matching funds for projects and finance the recurring costs of projects exacerbate Egypt's already large debt burden. Mission management believes that this situation may require the United States to consider providing more technical assistance to certain development sectors and funding recurring costs. (See pp. 28 and 29.)

--The program's high funding level, large portfolio of projects, implementation problems, and the full funding of projects in the year

they are first obligated has created a backlog or "pipeline" of funds obligated but not yet disbursed for Egypt's use. By the end of fiscal year 1982, this pipeline amounted to $2.7 billion. AID has recently succeeded in annually disbursing as much as has been obligated, reducing the pipeline to approximately $2.4 billion by the end of fiscal year 1984. However, since most of the assistance is in the form of projects and since projects normally take 3 to 5 or more years to complete, the pipeline is expected to remain relatively high. (See pp. 26 to 28.)

--The mission is having difficulty effectively managing the large portfolio of projects. Many AID headquarters and mission officials stated there has been insufficient project monitoring, evaluation, and analysis mainly because of insufficient staff. This has led to implementation problems, insufficient analyses of Egypt's development sectors and economic policies, and decisionmaking without the benefit of project evaluation. AID's Regional Inspector General, other evaluations (including AID's and those performed by others outside the government), and previous GAO work confirm these findings. These sources agree that this problem has been a factor in delaying program implementation and thus, the accomplishment of program goals. (See pp. 23 to 28.)

ALTERNATIVE NON-PROJECT PROGRAM APPROACHES

AID could use cash transfers, sector grants, and commodity imports as alternative modes for some of the project assistance. Such non-project modes normally require less mission staff and are faster disbursing, thus reducing the funding pipeline. However, non-project modes may allow AID less program control and accountability for development efforts than it believes is necessary.

GAO takes no position on which mode or combination of modes for distributing assistance to Egypt is most appropriate. GAO agrees with AID, however, that it is necessary to objectively and thoroughly assess the various modes to determine the best mix for accomplishing program goals in Egypt.

The United States provided about $102 million in economic assistance to Egypt in the form of a cash transfer in fiscal year 1984, $100 million in 1985, and is expected to provide $100 million in 1986. The government of Egypt signed agreements in 1984 and 1985 to use an equivalent amount of local currency to support its health and housing sectors. AID stated it will seek a similar economic development agreement for the fiscal year 1986 cash transfer. Thus, AID has some opportunity to assess Egypt's economic development response to the provision of cash transfers as a mode for distributing ESF. (See pp. 31 to 40.)

RECOMMENDATIONS

GAO recognizes that AID must work within the constraints of the Egypt program's political nature but believes certain actions can be taken to improve program results.

Thus, GAO recommends that the Administrator of AID direct the Near East Bureau and the AID mission to:

--Perform the necessary development sector and economic policy analyses to provide more in-depth knowledge of these areas to better assist Egypt in developing its economy, including making any necessary policy reforms.

--Assess the development efforts agreed to and undertaken by the government of Egypt in response to the provision of recently authorized cash transfers.

This information should prove useful to the Department of State and AID in determining the best way to achieve economic assistance goals for Egypt in the light of the program's political objectives.

AGENCY COMMENTS

The Department of State and AID provided GAO with official comments on a draft of this report. The report has been revised, where appropriate, to reflect their concerns and to describe important program changes and developments which occurred after the GAO field review in Egypt. The full text of their comments is contained in the appendixes.

In commenting on GAO's recommendation for further in-depth analyses of Egypt's development sectors and the policies that affect these sectors, AID stated that GAO might have overlooked studies which have already been done. GAO found that many of these studies were outdated, incomplete, or lacked sufficient detail. (See pp. 46 and 47.)

AID disagreed with aspects of GAO's proposal for AID to monitor the use of cash transfer payments to Egypt. AID stated that monitoring Egypt's use of cash transfer dollars would be extremely "difficult and impractical" because of the unrestricted nature of this use. AID also commented that even though the government of Egypt agreed to spend an equivalent amount of local currency for health and housing, AID could not ensure that this expenditure would be any larger than that government had already planned to spend in these sectors. GAO agrees it would be difficult to monitor the budget flow and use of an unrestricted cash transfer. This was not the intent of GAO's proposal. GAO believes that AID can assess the development efforts agreed to and undertaken by the government of Egypt in response to the provision of U.S. cash transfers. For example, AID can (1) monitor Egypt's adherence to the commitments it made in response to the cash transfers, (2) evaluate what can be accomplished through such commitments which include no agreement for the government of Egypt to take funding (or other) actions beyond those which may already be planned, (3) identify ways to strengthen these commitments, and (4) determine what development impact can realistically be expected from the provision of cash transfers to Egypt. GAO's recommendation was revised to clarify this point. (See pp. 47 and 48.)

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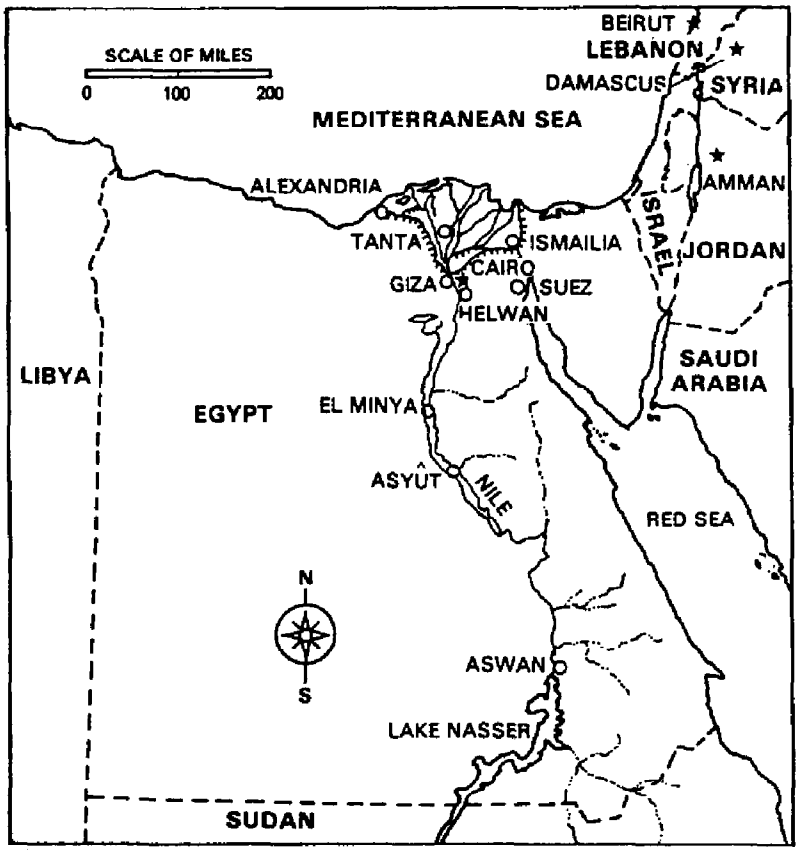
ABBREVIATIONS

AID	Agency for International Development
AID/W	AID/Washington headquarters
CDSS	Country Development Strategy Statement
CIP	Commodity Import Program
ESF	Economic Support Fund
GAO	General Accounting Office
GOE	Government of Egypt



Arab Republic of Egypt
Capital: Cairo (population about 10 million)
Population: 47.2 million (1984)
Land area: 386,100 SQ.M. (slightly larger than California, Nevada and Oregon combined)
Annual population growth rate: About 3.0%--three times the U.S. growth rate
Gross national product per person: $650 (1981)
Major agricultural products: cotton, wheat, corn
Industry: petroleum products, chemicals, fertilizer, textiles
Jobs: 50% in agriculture, 13% in industry
Major exports: petroleum, cotton
Major imports: food, particularly wheat, vegetable oil and sugar; industrial equipment and materials
Main trading partners: United States, Italy, West Germany

Source: AID

CHAPTER 1

INTRODUCTION

Between 1974 when it reestablished an assistance program to Egypt and the end of fiscal year 1984, the United States obligated over $9.7 billion in economic assistance to Egypt; most of this assistance, $7.3 billion,[1] has been in Economic Support Funds (ESF).[2] The United States provides ESF assistance to certain countries important to U.S. security and political interests; Egypt is one of these countries. The primary objective of this assistance to Egypt has been to help promote and maintain peace in the Middle East. A supportive, longer term objective which has evolved is to improve Egypt's economy.

This report examines the constraints to accomplishing the economic development objectives, the progress made in achieving economic development, and the advantages and disadvantages of alternative ways of providing ESF to Egypt.

EGYPT'S NEED FOR ECONOMIC ASSISTANCE

Between the revolution of 1952 and the October 1973 war with Israel, the Egyptian economy was transformed from an essentially free market economy with a strong private sector to an economy characterized by strong central control and public ownership. By 1973, the public sector controlled most production activities and financial institutions, a large portion of construction and transportation activities, and all foreign trade.

At the time of the October 1973 War, after 25 years of intermittent war and a decade of public control, Egypt's economy was approaching the brink of disaster. Its economic and social infrastructure had deteriorated badly and population and consumption outpaced domestic productivity. Egypt could no longer pay its debts, and prospects for external economic assistance from any source were bleak.

Following the signing of the Sinai Accord with Israel in 1974, Egypt again started receiving assistance from the United

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[1] $2.3 billion of the total has funded food aid under Public Law 480, and approximately $0.1 billion has funded local currency programs--using U.S. dollars to purchase local currency to support projects.

[2] Economic Support Funds were formerly designated as security supporting assistance. The International Security Assistance Act of 1978 (Public Law 95-384, Sept. 26, 1978) replaced security supporting assistance by establishing an Economic Support Fund.

States and other Western countries,[3] and under the leadership of President Sadat, started to pursue a course of peace and economic development. President Mubarak has continued this course.

Egypt is economically stronger today than it was in 1973. However, much of the recent growth in the economy has resulted from such outside factors as growth in foreign exchange due to earnings from petroleum sales, remittances from Egyptians working abroad, tourism, and Suez Canal revenues. In contrast, important development sectors such as industry and agriculture have experienced relatively little recent growth in Egypt. This unbalanced growth is traceable, in part, to the pricing controls and consumer subsidies that Egypt established in the 1950's and 1960's to help narrow the gap between the rich and poor. These policies, which pervade much of the economy and sometimes act as disincentives to industrial and agricultural growth, are costly for the government of Egypt (GOE) to maintain.

In 1984, Egypt received approximately $528 million in economic assistance from international agencies, with the World Bank contributing about $458 million of this sum, and approximately $1.3 billion in bilateral economic assistance, with the United States by far the leading bilateral donor, contributing over $1 billion annually.[4]

U.S. ASSISTANCE

When Israel and Egypt signed the Sinai Accord in 1974, the United States renewed diplomatic relations with Egypt and began providing it with substantial economic assistance. The overriding objective of this assistance is to demonstrate U.S. commitment to broadening the base of the present Egyptian-Israeli peace agreement and bringing all the principal parties of the Arab-Israel dispute into a peace settlement. This is referred to as the political goal, which is primary, but it encompasses the longer term important supportive goal of assisting Egypt in ensuring its own stability through economic growth.

The United States has used Economic Support Funds as the main source of economic assistance to Egypt. The Foreign Assistance Act of 1961, as amended, stipulates that the intent of ESF is to provide economic assistance to certain countries important to U.S. security and political interests. The Department of State generally determines the political and security justifications for extending ESF monies and recommends the funding levels

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[3]Between 1974 and 1979 Arab countries also provided substantial assistance to Egypt. Arab assistance dropped sharply starting in 1979 and 1980 because of disagreement with Egypt over its stance on the peace process in the Middle East.

[4]The latest data available from the Agency for International Development for bilateral assistance was for fiscal year 1983. The United States continued to provide over $1 billion to Egypt in fiscal years 1984 and 1985.

necessary to satisfy political and security objectives. This responsibility is fulfilled in cooperation with the Agency for International Development (AID), which administers the program.

According to the State Department, the magnitude of U.S. assistance to Egypt helps to demonstrate U.S. evenhandedness in the Middle East. Proponents argue that any diminishment in U.S. aid would convey a negative signal that would adversely affect U.S. political objectives. The minimum level of aid for Egypt is set in the annual congressional authorization and appropriation process[5] and the resulting continuance and modification of the Foreign Assistance Act. The Congress has often increased the amount requested by the State Department and AID. For instance, AID requested $750 million for Egypt for fiscal year 1985 but the Congress increased this to $815 million.

ESF can be distributed to recipient countries in the form of "program" assistance or "project" assistance or a mix of the two.

--Program assistance consists of recipient-country budget support through commodity import assistance, direct cash transfers, and/or grants to support specific development sectors, such as agriculture and industry.

--Project assistance is tied directly to specific projects, such as the construction of a health care center or a textile plant.

From 1976 through fiscal year 1984, the ESF assistance package remained at approximately $750 million a year--with approximately $300 million for the Commodity Import Program (CIP) to purchase commodities and capital equipment and $450 million for a large portfolio of projects.[6] In fiscal year 1984, approximately $102 million of the previously obligated ESF funding was reobligated as a cash transfer to Egypt.[7] For fiscal year 1985, the United States increased ESF for Egypt to $815 million--approximately $515 million for development projects, $200 million for CIP, and $100 million for a cash transfer. It is legislatively required that this $815 million appropriated for Egypt be obligated.

AID's field mission in Cairo obligates and otherwise administers the ESF assistance. The mission, AID's largest, is

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[5]AID can seek deferral or rescission of funding under the Budget Impoundment Act of 1974 if it believes that the funding will not be spent effectively by a recipient government.

[6]Between 1979-82, an additional $300 million was obligated to Egypt as a peace dividend derived from the Camp David accord, and in 1981 ESF funding was changed to all grant funding.

[7]In fiscal year 1984, a total of $103 million was reobligated from past ESF obligations to Egypt.

supported by AID's Near East Bureau in Washington. During the recent 10-year effort to help Egypt develop its economy, the AID mission has administered the investment of billions of U.S. dollars in Egypt's development sectors and has helped to implement many projects in these sectors.

The United States has obligated approximately $4.1 billion for development projects and $3.1 billion for the Commodity Import Program since the start of the program through fiscal year 1984. The following table shows funding by major area of assistance since the start of the program.

U.S. Economic Assistance to Egypt
for Major Sectors of Assistance
from 1974 through September 30, 1984

Assistance sector	Obligated (millions)
Project assistance:	
Infrastructure (electric power, water and waste-water, telecommunications)	$2,189.2
Public industry	431.0
Agriculture and irrigation	293.1
Social services (health, education, population)	414.5
Decentralization (project to decentralize development decision making and implementation)	432.2
Finance and investment projects	130.6
Science and technology	78.9
Other projects (feasibility studies and small projects)	109.9
Non-project assistance:	
CIP	3,119.8
Cash transfers	101.9
Total	$ 7,301.1

PRIOR GAO REPORTS

Some of our reports on AID's Egypt program cited many of the issues and subissues discussed in this report. For example:

--Our September 1977 report, Egypt's Capacity to Absorb and Use Economic Assistance Effectively (ID-77-33), stated that the high levels of U.S. aid to Egypt were based on political objectives and not on economic development goals. U.S. policymakers believed that Egypt

might not have the capacity to absorb increases in project type aid and that the impact of this aid would depend on Egypt's willingness to undertake economic reform.

--Our May 1979 report, Meeting U.S. Political Objectives Through Economic Aid in the Middle East and Southern Africa (ID-79-23), concluded that the assistance program had built-in constraints. For example, high assistance levels set for political reasons can strain the abilities of the countries to effectively absorb the extensive project assistance. In addition, U.S. officials are sensitive about having large U.S. staffs working in some countries. This pressure to limit staff size strains field mission ability to monitor assistance programs.

--Our March 1981 report, U.S. Assistance to Egyptian Agriculture: Slow Progress After Five Years (ID-81-19), stated that the size of the Egyptian program had magnified implementation problems and delays, monitoring of project activities was inadequate, and AID's efforts to promote policy reform had yielded limited results.

--Our July 1984 report, Direct Contracting By The Agency For International Development Can Be Better Managed (NSIAD-84-108), questioned whether project officers, because of their heavy workloads, are able to adequately monitor projects and contracts.

OBJECTIVES, SCOPE, AND METHODOLOGY

In this review, we sought to put into perspective the management challenges that the AID mission faces in establishing and administering the ESF assistance program for Egypt. Specifically, we sought to identify and assess the

--conditions and constraints of establishing and operating this assistance program and their effect on the progress that AID has made toward the program's longer term important and supportive economic development goal and

--advantages and disadvantages of the current mode of providing ESF assistance to Egypt and the possible alternative ways of disbursing this assistance.

Much of our work concentrated on identifying the effect of the program's large size and primarily political objective on AID's efforts to help Egypt develop its economy.

We performed audit work at AID's headquarters in Washington (AID/W) and mission in Cairo. We interviewed cognizant officials at the Departments of State, and Treasury, the World Bank, and the International Monetary Fund in Washington, D.C. and officials at the U.S. embassy and representatives of the government of Egypt in Cairo. At the AID mission, we interviewed the mission director, his senior staff, and senior project officers. At the U.S. embassy, we interviewed the ambassador and his senior officers. The representatives of the Egyptian government we interviewed were ministers or their deputies, whom we were told by mission officials could provide us with the views and opinions of their government. The AID/W officials we interviewed were senior officials in the Near East Bureau and policy, program, and project groups.

To identify the conditions and constraints under which AID must operate its assistance program, we reviewed legislation and studies on U.S./Middle East relationships and used previous GAO work, AID Inspector General reports, and articles and studies by analysts in and outside of both the U.S. and Egyptian governments. We discussed the conditions, constraints, uniqueness, and history of the program with key officials at AID headquarters and the State Department in Washington, D.C., at the mission and embassy in Cairo, and at Egypt's ministries. We interviewed the two AID mission directors who managed the ESF program from July 1976 through fiscal year 1984. One director initiated the bulk of AID's current program and served until August of 1982. The other, who was the director during our fieldwork in Cairo, served until November 1984. In addition, we reviewed internal AID documents suggesting changes in the mission's operation and assistance strategy.

Our review focused on the ESF program, which accounts for approximately three-fourths of U.S. economic assistance to Egypt. To determine the progress AID has made toward long-term economic development and the effect of program conditions and constraints on this progress, we examined the efforts AID had made toward meeting sector development goals and the results of AID's efforts to help the Egyptian government bring about economic reforms. We concentrated on development sectors that AID officials consider crucial for economic development--industry, economic infrastructure (power and water and wastewater), and agriculture. At AID's suggestion, we also examined AID's efforts and accomplishments in the population area and in health and education. It was not our purpose to make a detailed review of each of these sectors; we therefore relied on discussions with AID, the State Department, and Egyptian government officials. Further, we reviewed project papers, existing evaluations and assessments, AID Inspector General reports, and previous GAO work to provide us with an assessment and understanding of AID's progress in these sectors.

Our work was performed between March 1984 and February 1985 and was conducted in accordance with generally accepted government auditing standards.

CHAPTER 2

PROGRAM CONDITIONS AND CONSTRAINTS

CHALLENGE MISSION'S PROGRAM MANAGEMENT CAPABILITIES

The AID mission in Cairo has been given the unique and difficult task of designing and implementing an effective economic assistance program for which the funding has been set at a high level in response to political objectives. This has

--raised differences of opinion over how both the political and economic goals can be achieved effectively and

--created an AID mission work environment where the pressure to annually obligate the high level of funds dominates mission efforts.

Major U.S. participants in the implementation of the assistance--AID/W, the Cairo mission, and the State Department--have not been in total agreement on a consistent economic assistance strategy for Egypt; similarly, there has not been total agreement between these U.S. participants and the government of Egypt.

UNIQUENESS OF EGYPT PROGRAM MAKES AID'S TASK DIFFICULT

ESF assistance for Egypt will amount to $815 million for fiscal year 1985, second in size only to the cash assistance program for Israel. Funding is kept at this high level for political purposes--peace in the Middle East. While Egypt does have substantial economic needs, the consensus of the development experts (in and outside of the U.S. government) with whom we spoke was that U.S. economic assistance to Egypt would range from $100 million to $200 million if it was based solely on relative economic need. Moreover, the United States has limited resources to help meet Egypt's economic need and those of other developing countries.

Most AID programs (excluding Public Law 480 food aid) to other countries for fiscal year 1983 were less than $30 million a year and concentrated on relatively small projects aimed at key developmental problems in a few sectors--mainly agriculture, health, education, population, and rural development. For instance, typical African projects in health or education receive less than $10 million. The scale of project expenditure in Egypt is much higher; for example, if AID converted the entire $450-million project budget for fiscal year 1984 into typical $10-million units, it would have 45 projects at the end of the first year and, assuming an average life-of-project of 5 years and continuing high levels of funds, a portfolio of 225 projects by the 5th year. According to AID officials, this would be an unmanageable number given AID's normal management practices. To avoid such a situation, the mission has included

large capital infrastructure projects, such as electrical generating plants; additional development sectors, such as telecommunications and energy; and any viable "target-of-opportunity" (projects chosen mainly for their ability to absorb large amounts of funds rather than priority toward achieving long-term economic growth). Mission officials stated that the need to annually obligate the large funding package has created considerable pressure on mission staff.

According to mission officials, although some development sectors have not reached full potential, Egypt has a well-developed government structure, substantial technical and management sophistication, and a strong sense of national identity and pride. Consequently, the GOE does not wish to be a passive partner in its own development. For example, it insists that its own programming procedures be observed.

In addition, important philosophical and practical differences exist between AID and the GOE over what the program should accomplish. For instance, AID wants to strengthen the Egyptian private sector while the GOE puts greater emphasis on developing public sector industries; AID wants to emphasize the basic human needs sectors while the GOE wants AID to concentrate on infrastructure, such as, electrical power generation and water and wastewater. These differences cause occasional delays and, sometimes, confrontation. AID officials commented that these differences with the GOE are not as strong as they were earlier in the program.

Egypt program challenges AID's usual pattern of operations

Many mission officials contend that the uniqueness of a high dollar-value assistance program like the one for Egypt warrants special solutions. AID/W, however, has managed the program for Egypt along traditional development lines, including strong AID/W management control over the program and mission activities. The size, political sensitivity, and public visibility of this program make AID/W extra cautious about the structure of the program and the activities of the mission. This close AID/W management control frustrated many mission officials, who told us they needed more flexibility to meet the challenge of implementing Egypt's unique assistance program.

The ambassador and his senior staff and GOE officials told us that the mission's lack of authority hindered the smooth operation of the program. They believed that the program warranted more mission autonomy. They pointed out that program and operational decisions were greatly delayed while awaiting AID/W action. A September 1984 independent staff utilization study[1] ordered by AID/W stressed the need for AID/W to confine itself to general policy questions and to let the mission fulfill its own responsibilities unimpeded.

[1] Near East Reviews, Staff Utilization Report For Egypt (Sept. 12, 1984).

In commenting on our draft report, AID informed us that on November 15, 1984, through the urging of the newly appointed mission director, the AID Administrator approved an increase in the authority delegated to the Egypt mission director. This redelegation of authority (amended in January and April of 1985), among other things, includes the authority to (1) authorize and amend project and non-project activities without dollar limitation, (2) implement projects, and (3) approve waivers with regard to specific project and non-project activities. The mission director can exercise this authority after certain preconditions are met; for example, AID/W retains the authority to approve initial proposals for projects and programs in excess of $20 million--this includes most of the mission's proposals. In addition, the AID Administrator retains concurrent authority to exercise any of these same functions delegated to the mission director. If this redelegation authority is implemented and maintained in the spirit it was intended, it should provide the mission director with greater autonomy to manage program operations.

CONFLICTING VIEWS ON HOW BEST TO ACHIEVE POLITICAL AND ECONOMIC GOALS

The methods for realizing the program's political goal and its longer term economic goal are not always the same and sometimes they conflict. That is, some actions taken to support the political purpose of the program may not be of optimal value in working toward the longer term economic development goal. AID/W, the mission, the State Department, and the GOE differ over how both goals can be effectively achieved. One of the strongest pressures on the mission is to obligate ESF funds on high-visibility, capital-intensive projects which will, at least in the short run, demonstrate U.S. support for the Egyptian government and its role in the peace process. According to many AID/W and mission officials, while these projects have some economic merit, they may not have as high a priority/value for economic development as other possible programs or projects.

In 1974 when the U.S. assistance program to Egypt resumed, its political purposes were clearly paramount. Disbursement of the funds demonstrated tangible U.S. support for President Sadat and the peace process in the Middle East and thus met those political goals. This clear picture soon became more complex. The choice of AID to administer economic assistance to Egypt, often through development projects, led over time to the articulation of a second goal--the long-term economic development of Egypt.

Many top AID/W officials view economic development as a prerequisite for the long-term stability of Egypt. Senior Near East Bureau officials stress that the GOE has the time and the opportunity to work on its major economic problems and believe that Egypt should take advantage of this window of opportunity now. World Bank and International Monetary Fund representatives also share this view of Egypt's economy. AID sees securing

economic reforms as one of its main responsibilities and therefore stresses policy reform in its discussions with the Egyptians.

While recognizing the need for economic development, State Department officials emphasize the overriding priority of the immediate political goal and believe, in general, that goal is being met. Similarly, AID commented that the assistance program "has contributed importantly to U.S. foreign policy objectives. Peace between Egypt and Israel has been maintained, and Egypt has continued to be a full and supportive partner in the peace process."

However, although State officials agree with the need for structural changes in the economy in the long term, they believe that pushing too hard for these changes may raise political tensions. In commenting on our draft report, the State Department said that it "is not opposed to pushing hard on economic reform because the reform may cause political tensions, rather State opposes pressing for reforms in a manner which is both ineffective and could adversely affect other important aspects of our bilateral relationship." The State Department provided an example of an instance where it believes AID pressed for reform in an inappropriate manner. State said that the United States had urged the Egyptians to increase electricity tariffs to recover operations, maintenance, and other recurring costs. The GOE did so, agreeing that an increase was needed. According to the State Department, it had not been made clear to the Egyptians how much of an increase the United States was suggesting; however, AID stated that it considered the increase inadequate to cover these costs and pressed for a further increase. The State Department said that "the Egyptians felt misled," and in its view, "this was a case in point of how not to go about leveraging reform." AID subsequently funded the power project. Representatives of the mission's planning and programming groups told us that the pressure to obligate funds strongly influenced AID's final decision to fund the project.

The GOE, while welcoming U.S. assistance, questioned whether the United States (1) is giving Egypt equal political treatment with Israel, which gets assistance in the form of cash transfers rather than development projects constrained by U.S. rules and regulations, and (2) is taking into account Egypt's own priorities for economic development.

The United States and Egypt also differ over the emphasis and content of AID's program. The GOE

--believes that AID should provide more assistance to public sector industry;

--wants the U.S. government to cut back its activities in health and education (in favor of funding for infrastructure and industry), but AID has decided to continue to fund these sectors; and

--sees desert reclamation as a priority, but AID believes it is not cost beneficial.

This lack of an overall agreement between the two governments raises tensions in a program intended to promote good relations. It also leaves the program with no agreed upon standard to determine success and to judge, at least in terms of economic development, when the program should phase down. This is despite the fact that both the GOE and AID agree that the program should eventually be phased down.

DEVELOPING AND IMPLEMENTING A CONSISTENT STRATEGY PROVES DIFFICULT

The AID mission has been unable to agree on a consistent development strategy for Egypt and has been pulled in different directions by AID/W, the State Department, and the GOE. As a result the development focus is inconsistent, sometimes emphasizing long-term development benefits in such sectors as education, health, and agriculture and at other times placing priority on such large visible infrastructure projects as water and wastewater projects or an electrical generating project which have some economic merit and can absorb large amounts of funding.

AID has had difficulty in finalizing a Country Development Strategy Statement

AID's forward planning document for mission development activities, the Country Development Strategy Statement (CDSS), is intended to be a 5-year document with annual reviews.[2] However, because of lack of agreement between the mission and AID/W on a development strategy for Egypt, it has been difficult to obtain AID/W approval for a proposed mission CDSS. AID/W did approve a CDSS for the mission in fiscal year 1984, but only after high-level negotiations and modifications to the proposed CDSS.

A high-level mission official remarked that each year the CDSS for Egypt allocates resources among the sectors but agreement is not really achieved among mission officials on an overall strategy. Thus, the following year there is new debate on how to reallocate resources. This official believed these annual shifts confuse the GOE and frustrate mission staff. The September 1984 staff utilization study agreed that there was a lack of clear guidance on both overall policy and program strategy and reported that the strategy question produced confusion among the staff and adversely affected program planning and

[2]AID commented that it has changed this process to a 3-year CDSS cycle starting with fiscal year 1984. CDSS's approved in fiscal year 1984 apply to fiscal years 1984 through 1986. AID commented that there will be annual budget and program reviews during the 3-year cycle.

implementation. Mission and AID/W officials told us that the mission staff was divided again in 1984 over the development strategy submitted to AID/W for approval. For example, programming staff for health, training, population, and agriculture believed that their sectors have greater needs than were recognized in the CDSS.

It has been difficult to get AID/W to approve the mission's proposed CDSS because of differences of opinion over a development strategy. For the mission's latest proposed CDSS, the AID Administrator took a strong leadership role in resolving the disputes between AID/W's Near East Bureau and the mission over the content of the CDSS, thus ensuring an approved CDSS for the 3-year period commencing with fiscal year 1984.

In its proposed CDSS, mission management put forth plans to better concentrate program efforts by

--cutting back on new projects in the basic human needs sectors;

--stressing large infrastructure projects, including possibly a roads project; and

--beginning a major public sector industrial project.

As in previous years, the Near East Bureau disapproved key portions of the new document. However, the AID Administrator made a series of decisions on the content of the CDSS to resolve the disagreements between the mission and the Bureau, including a directive to the mission to focus efforts in each of the basic human needs sectors. He also agreed to pursue an industrial project, such as a fertilizer plant, but stipulated that (1) funding for the plant, must come from the CIP, (2) the plant should be in the private sector but if it was not there would have to be significant policy changes, and (3) the plant's product would have to be sold through private channels at world market prices. A senior Near East Bureau official believed that these conditions were chosen to unofficially end the possibility for a public sector industry project. Upon learning the results of the CDSS review in 1984 some mission officials believed that their efforts to concentrate the program into fewer sectors had been reversed.

Some mission officials questioned the value of a detailed CDSS for Egypt even if approved by AID/W. One associate director stated that the need to obligate new projects made the CDSS quickly outdated. He said that the mission is still forced to adopt elements of a targets-of-opportunity approach to obligate the funding.

PROGRAM IS DIFFUSE AND LACKS FOCUS

Many of the officials we interviewed at AID/W, the mission, and the U.S. embassy attributed the program's diffuseness and

lack of focus (or inconsistent focus) to the (1) beginning of the program when targets-of-opportunity were chosen for obligating funds, (2) continued pressure to find viable projects which can absorb large amounts of annual funding, and (3) lack of agreement between AID/W and mission management on a development strategy.

AID/W and mission officials stated that because of pressure to annually obligate the large funding package through projects, many discrete projects, particularly in the earlier stages of the program, were chosen as targets-of-opportunity which could absorb large amounts of money. Although these large capital projects can be justified on an individual basis, a senior Near East Bureau official observed that they were not necessarily a priority for Egypt's development. This official and others cited some of the efforts in power, water and wastewater, and telecommunications as examples. Some mission officials stated that because of the pressure to annually obligate the large funding, some projects may still be selected as targets-of-opportunity.

Further, an associate director at the mission stated in a December 1983 memorandum to the director that "there is no logical framework for project undertakings. That is, the linkage between groups of projects we have chosen to undertake in a sector and a sector goal is not apparent. Nor is the linkage among projects apparent." Using agriculture and irrigation as examples, he stated, "we have 13 projects, but there is no apparent conceptual or actual integration of the projects that could produce a 'multiplier effect'." Going further, he stated that "the USAID has not been able to provide a coherent linkage between sector goals, multi-sector (e.g., human resources) goals, and national development goals." The September 1984 staff utilization study agreed and stated that the mission's "project design work does not seem to flow logically from a specific strategy" and that program and project designs are based on "different interpretations of sector strategies." The study attributed this situation, in part, to staff confusion resulting from a lack of clear guidance on overall policy and program strategy from AID/W and mission management.

The former mission director[3] also criticized the project portfolio for being too large and diffuse, stating that as a result "project design quality and implementation deteriorates; administrative requirements multiply; and management control weakens or becomes nonexistent." In this memorandum written in early 1984, the former director further noted that the Egyptians have also concluded that the program is too diffuse and that this may impair the program's desired political effect. Mission management officials told us that they are attempting to better focus future efforts by concentrating on several key sectors and projects.

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[3]This was the director who served from mid-1982 to November 1984.

AGENCY COMMENTS AND OUR EVALUATION

AID disagreed with our statements with regard to levels of assistance for Egypt, the differences of opinion concerning achievement of the program's goals, and the statements with regard to the program's focus.

Levels of U.S. assistance

AID commented that our remarks concerning the justification for the high levels of U.S. assistance to Egypt should be modified to take into account Egypt's economic need and the total assistance it receives to help meet this need. AID pointed out that "Egypt still has a long way to go before the basic indicators of underdevelopment (illiteracy, infant mortality, income, etc.) are improved." AID also said that the level of U.S. assistance should be viewed in the context of total donor assistance in relation to Egypt's need and that U.S. assistance merely compensates in part for the loss in Arab aid after Camp David. AID noted that Egypt's balance-of-payments prospects are worsening.

While we agree with AID's statements concerning Egypt's economic conditions, the high levels of U.S. assistance to Egypt are justified mainly on Egypt's political and security importance to the United States. Further, we were advised by development experts, some within AID, that U.S. economic assistance levels for Egypt would range between $100 and $200 million if based solely on relative economic need and limited U.S. resources to help meet this need.

Achieving the program's political and economic goals

AID stated that it has no disagreement with State on program objectives and the strategy for achieving these objectives. Further, AID commented that any conflict between the program's participants over the goals of the program and methods for achieving the goals is only natural and can be helpful to the planning process. State, however, commented that our draft report "recognizes [that] the various Egyptian and U.S. organizations associated with the program disagree on how to best . . . maximize the political and economic impact of our ESF assistance" and the tension that we observed between these goals is better described as "conflicting views as to how to maximize those goals."

As we have stated, we believe that the methods for realizing or "maximizing" the political and economic impact of the ESF for Egypt are not always the same and sometimes conflict, to the detriment of accomplishing the long-term economic goal. This is an important program condition which State and AID must constantly be aware of in their efforts to develop and maintain a coherent assistance strategy for Egypt.

AID also commented that we interpreted the continuing discussion of the program's strategy as confusion over the program's purposes and lack of consensus on overall strategy. On the contrary, we believe that more discussion is needed among all parties associated with the program to avoid confusion and to reach a consensus on program matters. The statements with regard to program "confusion" and "lack of consensus" that AID refers to were related to us by senior mission officials (some of them cited in this chapter) and similar concerns appear in AID memorandums and in independent studies.

Program focus

AID commented that because its Eygpt program is large and complex, the program's "focus will always be wider than most conventional programs." AID also stated that in the aggregate it considers its 10-year support for (1) rebuilding Egypt's public infrastructure, (2) upgrading human capabilities, and (3) expanding productive activities in agriculture and industry a consistent focus for the program. In addition, AID commented that the mission is currently attempting to concentrate the program on a smaller number of projects.

We discussed the program's focus in our report because of the many comments we received criticizing its diffuseness and lack of consistent focus. We were especially concerned by the comments provided by high-level mission officials and those contained in some AID documents and independent studies. These sources cited the lack of coherent linkages between the program's project, sector, and national goals; the heavy management and administrative burden caused by the program's diffuseness and the adverse effect that this had on the quality of the program and the apparent confusion among the mission staff resulting from a lack of clear guidance on the program's policy and strategy.

Selection of projects

We stated in our draft report that the mission was under pressure to select projects which provide visible evidence of the benefits of U.S. aid and which can absorb large amounts of funding. Further, we stated that although these projects provide some economic benefit, some of them may not be a high priority for Egypt's development and may not be the most effective in achieving long-term economic development. AID commented that this was not true. State said that this was true earlier in the program, but it believed that this project selection practice has been eliminated.

This selection practice may not necessarily be the dominant one used by AID in Egypt and, as State has said, this practice may have been more prevalent earlier in the program. However, documentation shows that the potential political visibility of a proposed project and the amount of funding it can absorb are still strong considerations, and projects selected using these

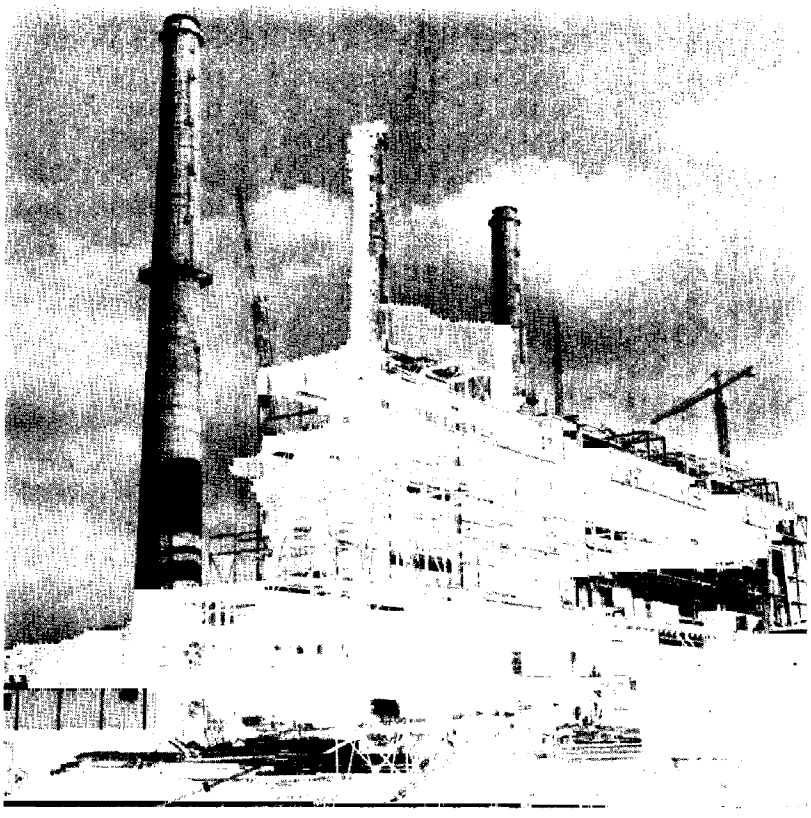
criteria may not be the best ones for achieving long-term economic development goals. For example, AID informed the Congress this year that creating visible projects to demonstrate the benefits of U.S. aid will be emphasized. In addition, AID/W orders the mission to select such projects even though they may have a lower development return than other projects. AID/W's guidance to the mission emphasizes the need to select projects which will provide clear examples to the Egyptian and American public of the progress attributable to U.S. aid to Egypt. Further, AID/W has acknowledged in its guidance to the mission that focusing on such highly visible projects may result in the selection of projects which have a lower development return. However, AID/W stated that this is an acceptable trade off to gain highly visible results of U.S. assistance. We recognize this method of selecting projects given the dominant political purposes of this assistance program. Our intent is to point out that AID does select some projects this way and to some extent this makes the achievement of longer term economic goals more difficult.

CHAPTER 3

PROGRAM EFFORTS AND PROBLEMS

AID can claim important project accomplishments in some development sectors. However, to accomplish more, many AID/W and mission officials believe that the GOE needs to move faster toward making significant economic reforms which will allow its economy to grow. Nonetheless, these officials recognize the reasons for GOE's reluctance to do this. In addition, the ESF program's large project component has exacerbated the mission's difficulties in establishing and operating the program. Further, the provision of large amounts of project type aid challenges the GOE's management, technical, and funding capacity to effectively absorb such assistance.

Since 1975, the AID mission has designed and managed the implementation of many projects, such as clearing and reopening the Suez Canal, electric power generation and distribution facilities (see photo), water and wastewater projects, cement plants, rehabilitation of a textile plant and a grain storage facility, agricultural research (see photo), and family planning projects. In addition, AID and the GOE have taken several steps to improve program management, such as conducting semiannual reviews to identify problem projects, developing alert and action lists for problem projects, and using the deobligation authority recently granted by the Congress for taking corrective action on slow-moving projects.



ELECTRIC GENERATING PLANT
Source: AID

AGRICULTURAL RESEARCH PROJECT
Source: AID

ECONOMIC POLICY REFORM DIFFICULT TO ACHIEVE

It has been difficult for AID to influence the GOE to quicken its pace in making economic policy reforms mainly because of (1) AID's lack of overall program funding leverage (the ability to withhold ESF funding), (2) GOE's concern that moving too quickly may be politically destabilizing and, to a lesser extent, (3) the need for the AID mission to do more in-depth policy reform analysis. In addition, some officials within the mission, the U.S. embassy, and the GOE questioned the appropriateness of an aggressive approach to policy reform in the context of this program.

Documentation that we reviewed and individuals that we interviewed, including GOE officials, agree that Egypt needs to reform certain economic policies in key areas, such as industrial input and output prices, electricity tariffs, and food subsidies. Existing policies provide for consumer subsidies and pricing controls which are costly to maintain and which tend to impede economic development. Without these reforms the GOE cannot pay for recurring costs, such as annual operations and maintenance expenses. For instance, the cost of providing electricity is not covered by utility tariffs, which results in a drain on the GOE's budget and encourages industries to use energy inefficiently.

AID has little leverage to influence policy reform

One of the questions that arises in connection with this assistance effort is how much should/can AID attempt to influence the GOE to reform economic policies. In many programs for developing countries, AID controls the amount of program funding. If it believes that policies or other conditions need to be changed for the recipient country to effectively use the funding, AID may withhold funding in an attempt to influence the recipient government to make these changes. For Egypt, the high levels of U.S. aid are based mainly on Egypt's commitment to peace. The GOE therefore resents any attempts to condition this aid on commitments to economic reforms.

It is AID's position that the GOE should institute significant economic reforms more rapidly, and in spite of its minimal funding leverage, AID has recently attempted to more aggressively influence the GOE to make these reforms. However, such AID efforts often must give way to the political realities of the program, including the necessity of annually obligating the large assistance package.

The GOE has instituted some policy reform, and while AID/W and the mission generally laud these efforts, they consider these changes too small in real terms. For instance, although the GOE has increased electricity tariffs in recent years, AID stated that the increases have barely kept up with inflation[1] and the tariffs cover only a fraction of the costs of producing the electricity. According to AID/W and mission officials, the GOE has passed laws to ease the entry of private sector firms into industrial production, but the public sector industry is still a long way from approaching a market economy orientation. Agricultural subsidies have been removed from a few commodities but new ones have been granted on others, and such major crops as wheat are still heavily subsidized. In the water and wastewater sector, the GOE has made some movement toward structural reforms which would increase administrative efficiency and rates. However, AID/W and the mission do not perceive these changes as adequate to pay for the operation and maintenance of facilities.

Until 1981, AID believed a cautious approach to economic reform was best and was officially against attaching conditions to assistance to Egypt. In commenting on our March 1981 report concerning U.S. assistance to Egyptian agriculture (see p. 5), AID stated that:

> "Our approach to policy reform has emphasized the definition and analysis of critical issues

[1]The effective rate of inflation for 1983 was about 20 percent according to U.S. embassy economists in Cairo.

> in order to help Egyptian leadership better deal with policy rather than to force policy decisions through conditionality. While United States assistance in analyzing problems has generally been welcomed, the Egyptian Government would greatly resent any effort on the part of the United States to condition or even create the appearance of conditionality being attached to assistance."

In 1981, the new AID Administrator made policy reform dialogue a foreign assistance priority. Since then, AID has attempted to obtain policy changes in Egypt by making the funding of some projects, and even entire sectors, contingent upon specific reforms. For example, the mission has committed no funds to capital projects in public sector industries since 1978 because of pricing policies, the need for the sector to improve its operating efficiency, and AID's desire to promote the private over the public sector in Egypt. AID's 1982 commitment of an additional $1 billion to the water and wastewater sector was made contingent upon the GOE raising water tariffs, introducing tariffs for wastewater, and instituting structural reforms to increase administrative efficiency in the sector.

Recent events, however, demonstrate that the political realities of this program make it difficult for AID to steadfastly follow a strategy of denying funding to a sector or project if the GOE does not make policy reforms. Both AID and the GOE know that the funding must be obligated each year and that projects and sectors that can absorb the funding should be funded. Consequently, although the mission tells the GOE that funding may be withdrawn from a sector or project unless some reform is made, mission program planning officials stated that they know of no instance in which the mission did not eventually give in and obligate the funds to the specified sectors as planned. For example, substantial amounts of funds have been obligated to the water and wastewater sector over the years despite little movement toward policy changes. AID/W and mission officials described recent GOE movements toward agreed upon reforms in water and wastewater as inadequate but nonetheless obligated $200 million for this sector in fiscal year 1984. In the electric power sector, AID agreed to fund a new power generation project even though it said it considered GOE's progress in increasing electricity tariffs inadequate. Representatives of the mission's planning, programming, and evaluation group told us they believe that the decision was made to go ahead with the funding of this project primarily because of the need to obligate funds. In addition, while no capital projects have been programmed for a public sector industry since 1978, the mission programs most of the $300 million (fiscal year 1984) in CIP into the public sector each year.

Some officials believe aid should not be conditioned

Some mission management and project officers told us that even though it is AID's position, funding to Egypt should not be made contingent upon policy reforms. They cited several reasons for their position. First, the strategy has had limited success within the context of this assistance program. Second, attempting to condition sector funding on policy reform may be unrealistic within the context of this program and it forces the mission to move from development sector to development sector, making it more difficult to establish a consistent and focused strategy. Third, delaying project obligations while seeking policy concessions from the GOE increases the difficulties of having to obligate the large funding package on time each year; this tactic often results in a year-end rush to get all the funds obligated. Still other mission officials told us that they consider many of the projects fundamental to development so they should not be linked to policy issues.

GOE believes slow pace best

According to the GOE's recent 5-year economic development plan and our discussions with the ministries, many GOE officials have come to agree with AID and others on the need for policy reform. However, they believe that changes must be instituted much more slowly than AID wants because (1) current policies are complex and widespread and have been in place many years and (2) policy changes are likely to have an adverse impact on most Egyptians, who receive over 30 percent of their real incomes from government subsidies. Several GOE ministers and their deputies cited the recent riots in Tunisia and Morocco and a riot in Egypt in 1977 resulting from an increase in bread prices. More recently, President Mubarak ordered price rollbacks on certain commodities and a halt to other proposed increases to help quell an October 1984 riot caused in part by price increases. The State Department, however, commented that it considers the GOE committed to price reform.

Senior embassy officials agree with slow, steady pace

Senior embassy officers told us that a slow steady pace for reform is advisable and warned that pushing too aggressively for reform can be politically disruptive. They pointed out that Egypt is going through a turbulent period which could threaten its stability. For example, Egypt is (1) undergoing an experiment in democracy after a recent history of one party rule, (2) trying to be one of the leaders for peace in the Middle East, and (3) trying to strengthen its economy while still retaining a strong measure of social equity between income classes. State Department and embassy officials said that Egypt has undertaken economic reforms, such as increasing electricity tariffs, which although not considered significant by many outsiders are

significant for the Egyptians. In addition, they stated that the Egyptians have promised more reforms in the future. They point out that the Egyptians are more aware than outside donors of what the "traffic will bear" in needed reform.

Embassy officials emphasized that the United States should continue to help the GOE achieve needed economic reform by continually discussing economic issues with the GOE. They stated that pursuing policy reform too aggressively by trying to attach strong conditions to the funding of projects will only lead to continuous frustration and consternation on both sides and will dilute the political benefit of U.S. aid.

Need for more analyses to support policy dialogue

The mission has performed some analyses of Egypt's development sectors and the economic policies that affect these sectors, but further analyses are needed to help bolster policy dialogue efforts. Such analyses would enable the mission to better assist the GOE toward policy reform, including identifying the potential effect of these proposed reforms on the different segments of the Egyptian society.

GOE's Minister of Investment and International Cooperation told us that donors, including the United States, have not analyzed who would be the "gainers and losers" in Egyptian society from proposed policy reforms. A ranking AID/W official in program design also commented about the lack of in-depth analyses of some development sectors. The official, citing Egypt's water and wastewater as an example, stated that the mission was attempting to have the GOE raise tariffs but did not know how much they should be raised for each type of user to cover recurring operating and maintenance costs.

Mission management agreed in our closeout briefing at the end of our fieldwork in Egypt that more and better analyses are needed to support policy reform dialogue with the Egyptians. Officials of the mission's program, policy, and evaluation group stated that there has been less analyses in the last 2 years compared with earlier years. They attributed this to insufficient management emphasis, a need to better organize the analysis effort, and lack of time and proper people to make in-depth analyses. Mission management told us it was making efforts to correct this situation.

LARGE PROJECT PORTFOLIO INCREASES MISSION'S DIFFICULTIES

The large size of the mission's project portfolio has made it difficult for the mission to establish and operate an effective assistance program, raised questions concerning needed staffing levels, and contributed to a large funding pipeline of obligated but undisbursed funds.

Current project portfolio may be too large for mission staff

The mission has had difficultly effectively managing the large portfolio of projects which dominates the ESF assistance program for Egypt. According to many AID/W and mission officials and reports and evaluations, important program tasks, such as project monitoring, evaluation, and analysis, have not received adequate attention because of an insufficient number of staff.

Most of the current ESF program for Egypt consists of a large portfolio of projects (77 in 1984) representing approximately $4 billion as of fiscal year 1984. Projects provide AID with a high degree of control and accountability over the assistance provided and thus help to protect against diversion of resources for unintended purposes. In addition, projects usually provide visible evidence of the benefits of U.S. aid and according to AID are usually the best instrument to accomplish development impact. On the other hand, the project mode of assistance generally requires more mission staff and more time to disburse funds than non-project modes, such as CIP, sector grants, or cash transfers.

The AID mission is budgeted for 222 direct-hire personnel (131 U.S. and 91 foreign national employees) to manage the assistance program. About 70 of the personnel are project officers and the others are management, administrative, and technical support personnel. The mission may not have all its allotted people "on board" at any one time. For example, at the end of fiscal year 1984 the mission had 112 direct-hire U.S. personnel, 81 direct-hire foreign nationals, and 9 personnel on loan to AID from other U.S. agencies. The mission also has approximately 175 contract personnel who directly support the AID mission.

Project efforts are demanding on mission staff. AID mission staff must identify, design, and justify a project through the authorization process; negotiate project conditions with recipient-government personnel; and implement, monitor, and evaluate the project. A review of project files and discussions with mission project officers revealed that this process can take in excess of 5 years. If a mission has a large portfolio of projects and/or these projects are large and complex, the task can be even more demanding, difficult, and time consuming for the staff; such is the case for AID's Egypt program.

Important tasks need more attention

Even though the Egypt program is staffed by AID's largest overseas mission, project implementation, monitoring, evaluation, and analysis have suffered because of insufficient staff to manage the large project portfolio.

Many AID officials, including the former mission director (who served until November 1984), commented on a lack of staff compared to the size of the project task. This director stated that many implementation problems occurred because of insufficient monitoring and "hands-on management" (direct management control) by mission staff. He said that projects should have been monitored more closely but there is only so much the mission can do with the number of staff it has.

Audit reports and evaluations have also noted performance problems attributed to a lack of staff. For example, in an April 1984 Study of the Host Country Contract Payment Process, Arthur Young and Company stated that it could not certify the adequacy of the mission's controls in this area. It observed that AID project officers in Cairo are frequently required to administer a larger number of more complex contracts than their counterparts at smaller AID missions and are often unable to spend sufficient time on monitoring each project and contract. In addition, a November 1983 mission report concerning the project portfolio stated that project officers were overburdened and not able to visit project sites to monitor program activities and accomplishments.

According to AID's Regional Inspector General in Cairo, many of the mission's project implementation problems, including lack of monitoring, can be attributed in part to insufficient staff. Further, he stated that "project officers seem to give most of their attention to obligating funds rather than monitoring ongoing projects." As an example of insufficient staff to monitor and otherwise manage a project, he cited the family planning program; an audit in 1979 and a 1982 population sector assessment questioned whether the program had sufficient staff to adequately monitor project activities. The 1982 assessment stated that the "four-person professional staff of the USAID Population Office (three Americans and one Egyptian) is hard pressed to manage the current $67 million population portfolio." This case culminated in a September 1983 request by the mission director for an audit of the program based on allegations of fraud.

We have questioned the adequacy of the monitoring of this large project portfolio in previous reports. For instance, in our July 1984 report, Direct Contracting By The Agency For International Development Can Be Better Managed (see p. 5), we found that the monitoring of projects in Egypt was questionable because existing staff were overburdened; for example, 15 AID mission direct-hire personnel were responsible for overseeing the activities of about 140 contractors representing a total of $1.3 billion in direct and host-country contracts/projects. Project officers at the Egypt mission stated that it is common for a project officer at other missions to have one or two projects of $5 million or less to manage.

Project evaluation also needs more attention. An April 30, 1984, memorandum from AID's Near East Bureau to the mission

stated that "major program decisions (both funding and otherwise) regarding the Egypt program are still being made or contemplated without the benefit of shared evaluation findings," and cited five major projects as examples. For instance:

--The pilot elements of one project were never carried out and the analytical aspects were neglected; however, the project continued without any modification to correct these problems.

--Current evaluation information was not available to support funding decisions for one of the five projects; in another case, no evaluation was made, thus there was no basis for recommending authorization of increased funding.

--One project's design was so radically changed after a mission evaluation that AID/W believed the project would not accomplish the goal and purpose for which it was originally justified.

The memorandum was written so that mission management could discuss these problems at a project portfolio review meeting held in May of 1984. The memorandum noted that AID/W and the mission were in the process of negotiating solutions in the five cases cited.

Discussions with mission and Near East Bureau officials and a review of evaluation files also revealed that the mission had evaluated very few of the projects which eventually ended up on their list of projects considered to be in trouble. These projects (covering most of Egypt's development sectors) ended up on the alert list of problem projects because of a range of implementation problems, including poor performance by contractors and cost overruns.

The mission's evaluation officer stated that while there is no set number of required evaluations each year, up until a few years ago too few were being performed for a portfolio of over 70 projects. Currently, about 15 evaluations are performed each year. The evaluation officer noted that many project officers believe that they do not have enough time with their heavy workloads to participate in project evaluations.

AID/W officials said that the mission's analyses of Egypt's development sectors should also be improved. Some program design officers in the Near East Bureau believed that mission staff may not have or take the time to do sufficient analyses of the development sectors because of their heavy workloads, the pressure to obligate large funding levels, and an emphasis on implementation. They told us that mission staff need to gain more knowledge of Egypt's development sectors to design good projects for these sectors. Citing the water and wastewater,

irrigation, public industry, and transportation sectors as areas where the mission needs to do more analyses, the officials stated that projects have been and are still being designed on the basis of incomplete knowledge of a sector's problems. As a recent example of possible future problems, the officials cited plans to fund millions of dollars in road construction projects without first having made a detailed analysis of Egypt's transportation sector. AID/W mentioned the road construction project in its fiscal year 1985 CDSS guidance to the mission; AID/W emphasized the need to select "highly visible" projects to demonstrate the benefits of U.S. assistance.

Many sources have cited project monitoring and the other difficulties discussed above; while these are not peculiar to the Egypt AID program, the large size of this program has exacerbated them. In addition, the sources citing these problems agree that they have been a contributing factor in implementation delays and thus have slowed the accomplishment of the program's goals.

Pressure to limit staff size

The U.S. embassy in Cairo has expressed concern over the size of the mission's U.S. staff and the presence of large numbers of American contractors in Egypt--the mission estimates that 1,000 American contractor personnel are working on various AID projects. Showing concern over the security of the Americans living in Cairo, senior embassy officials stated that the large American presence could become a target of resentment if the Egyptian economy worsens. These officials pointed to the low profile staffing patterns of other bilateral and multilateral donors in Egypt and other recipient countries and asked why the AID mission needs "so many staff" in Egypt.

The mission is currently studying staff organization and use. Mission management told us they believe that workload problems can be somewhat alleviated by shifting staff to the areas where workloads are particularly heavy or forming a support group to aid different mission groups on an as needed basis. Mission management has also suggested the use of more foreign service nationals to replace or augment U.S. project officers. In addition, AID/W believes that developing fewer and larger projects would require less staff than the current portfolio. However, according to mission planning officers, with continued high and increasing levels of funding, programming in multiple sectors, and the use of the project mode, future staffing will most likely remain constant.

Slow disbursement of funds

The assistance program has a large backlog, or "pipeline," of funds that have been obligated to Egypt but have not been disbursed for use. The pipeline tends to be the natural result of the large funding levels, the predominant use of the project

mode (including project implementation problems), and the life-of-project funding method--obligating the total project cost in the year funding is approved. AID commented that it must maintain a funding pipeline of obligated but unexpended funds adequate to fund project contracts "up front." Most of these are multi-year contracts. Thus, life-of-project funding must be used for many of AID's projects. For example, in one year alone, $99 million was committed to the Ismailia Electric Power Plant, $90 million to the Suez Cement Plant, and $96 million to the Mahalia Textile Plant. For such large capital projects, funds may not actually be disbursed in significant amounts for a long time. The early phases of a project involve planning, design, and contracting, which take years to complete and do not require large outlays of funds. According to mission officials, just the planning and design of water and wastewater projects can take as long as 3 to 4 years under the best circumstances. Disbursements do not begin to accelerate until the actual construction or implementation phase.

With the maturing of the Egypt program and with some projects and CIP now disbursing more rapidly, the funding pipeline has decreased. Annual mission expenditures exceeded obligations for the first time in fiscal year 1983; the pipeline decreased from $2.7 billion at the end of fiscal year 1982 to a little under $2.5 billion at the end of fiscal year 1983. AID was able to drop the pipeline to approximately $2.4 million by the end of fiscal year 1984; this further decrease in the pipeline was aided by deobligating slow moving projects and reobligating the money as faster disbursing CIP and a cash transfer. A mission assessment of the pipeline concluded that further drawdowns are contingent upon continued high CIP levels and increased use of fast-disbursing mechanisms. AID commented that while the CIP does disburse faster than projects, it can, in some cases, experience delays of up to 3 years because of difficulties in obtaining and implementing CIP agreements.

The mission financial officer stated that other options are being considered for reducing the pipeline, such as

--obligating project funds in increments, possibly based on phases of project development, rather than using life-of-project funding;

--adding on to existing projects, thus avoiding the long lead times for planning and designing new projects;

--programming projects which are faster disbursing; and

--using the deobligation/reobligation authority to move funds from slow-moving projects to projects that are faster disbursing.

However, some AID/W and mission officials believe that the continued use of a large project portfolio will keep the pipeline in the $2-billion range. We should also add that some efforts to cut the pipeline may lead to other difficulties; for example, adding funding to some existing well-established projects may possibly foster and support the continuance of any program diffusion and lack of development focus. In addition, it would be difficult for AID to use incremental funding rather than life-of-project funding for capital projects.

In commenting on our report, AID stated that "from the GOE viewpoint, there is no pipeline problem." This contradicts what GOE officials told us and also their statement of concern in a 1982 President Reagan and President Mubarak joint communique. Both sources voiced concern that AID find ways to more quickly disburse funds from the pipeline because these funds represent a substantial resource to Egypt.

EGYPT'S CAPACITY TO ABSORB MORE PROJECT AID QUESTIONED

The large number of projects funded by the United States and other donors in many different development sectors challenges Egypt's capacity to absorb project type assistance. According to mission officials project gains may be lost over time unless the GOE can effectively assume the management and financial responsibility for these projects. Donors may have to provide more technical assistance for some sectors and carry more of the burden for long-term recurring project costs, such as operations, maintenance, and training.

Egypt's ability to effectively absorb large amounts of project assistance depends on the technical and management capacity of its institutions and on the GOE's financial ability to meet matching funds requirements and recurring costs associated with the projects. Although Egypt's public sector institutions are advanced compared with many other developing countries, mission program design and project officers stated that the GOE's current institutional capacity varies and this occasionally delays implementation. For example, the Ministry of Industry, and in particular the General Organization for Industry, needs to improve its operation to more efficiently and rapidly implement projects. A 1984 mission report stated that the water and wastewater sector needs to improve operations so that it can absorb the planned level of U.S. investment. The report further commented that the Egyptian construction sector is already stretched thin and cannot realistically be expected to accommodate the extraordinary requirements of the planned water and wastewater program. In contrast, mission officials consider the Suez Canal Authority and the Ministry of Electricity to be relatively efficient organizations capable of managing large amounts of donor assistance. Egypt's agriculture sector, which is heavily staffed with college graduates, is also seen as more developed and more capable.

In addition, mission officials stated that the "brain drain" in Egypt may have had a detrimental impact on the GOE's institutional capacity. According to embassy officials and articles in Egyptian journals, possibly as many as 2 million Egyptians, particularly in skilled and professional occupations, have left to work in other Arab countries.

The GOE is required to provide matching funds as well as to finance recurrent costs for many AID-funded projects. According to mission and embassy officials this requirement adds to the GOE's already substantial debt burden and thus can be inflationary. Mission reports estimated required matching funds for fiscal year 1983 at 227.5 million Egyptian pounds (LE) ($270.8 million) and for fiscal year 1984 at LE 401.8 million ($478.3 million).[2] For the water and wastewater sector alone, subsidies to support recurrent costs (operations and maintenance and training) are estimated at LE 445 million ($530 million) by 1990.

AID is attempting to persuade the GOE to raise tariffs and to make structural reforms to help pay for recurring costs; however, as previously discussed, progress has been slow. According to mission management, AID may have to consider funding recurring costs until needed policy changes are implemented. However, AID's funding of these costs may undermine efforts to have the GOE raise tariffs.

AGENCY COMMENTS AND OUR EVALUATION

AID made specific comments with regard to our statements on the program's funding pipeline; however, AID did not address a major point of the report regarding the adequacy of mission staff to effectively manage the program's project portfolio.

The funding pipeline

We stated that the pipeline is mainly the result of the large use of capital projects, which tend to disburse funding slower than other modes, such as the CIP, cash transfers, or sector grants. We did not intend to criticize the use of projects in discussing the pipeline issue or make a judgement on the size of the pipeline. We did intend, however, to point out that much of the pipeline's size results from the program's large funding levels and the current mix of ESF distribution modes.

AID commented that it must maintain "a pipeline adequate to fund contracts up front for the duration of the project. In most cases these contracts are multi-year instruments for provision of equipment, technical services, long-term training, or construction. Three to five years is the usual time horizon." We agree that this is the usual "nature" of projects and the

[2]Using an exchange rate of one dollar equals approximately .84 LE.

procedures that AID must go through to fund these projects. Thus, it is our view that the dominant use of the project mode in this large program is the major contributing factor to the size of the funding pipeline.

Management of the project portfolio

A major point discussed in our report is AID's ability to manage the program's large portfolio of projects. We presented examples and documented statements questioning the adequacy of AID's staff to monitor, analyze, and evaluate projects. Further, we expressed our concern that any future increases in the program's project component will exacerbate AID's current difficulties in managing the project portfolio. AID did not respond to this major point of our draft report, except to state that

> "the GAO report gives important emphasis to the staffing requirements necessary to effectively manage a program of the magnitude and complexity of that in Egypt."

The State Department commented that, to improve AID's management of assistance programs, the "focus should be on changing [AID's] regulations and procedures so that our aid programs can be implemented as effectively or more effectively with fewer people." State's suggestion may merit some consideration, not necessarily with the objective of cutting AID staffing but perhaps with the possibility of increasing program effectiveness and efficiency.

CHAPTER 4

ALTERNATIVES TO THE CURRENT PROGRAM

In response to program difficulties in Egypt, officials in the AID mission, the State Department, and the government of Egypt have suggested that changes in the programming approach are needed. The suggested changes range from continuing with the project approach but programming fewer and larger projects to going completely to a cash transfer, as is done in Israel. There are also other non-project alternatives for some part of the large annual project assistance, such as sector grants and increased commodity imports.

The non-project mode of distributing ESF is less staff-intensive, faster disbursing, and may be more conducive to policy reform dialogue. However, it may also lead to differing results in achieving the program's political and developmental goals and in ensuring program control and accountability.

To choose one mode or a specific mixture of modes for disbursing the ESF assistance will involve trade-offs in terms of program goals, administrative requirements, and level of program control and program accountability. The mission has attempted to use alternative modes, such as sector grants, but AID/W generally has been unwilling to accept the trade-offs necessary for any fundamental shift in the program without substantial Egyptian commitments for economic policy reform in exchange for these shifts. In particular, AID/W is concerned with losing the control and accountability inherent in the project mode.

INTEREST IN MODIFYING PROGRAM

Key officials in the mission, the State Department, and the GOE are interested in modifying the program approach. The mission has taken an increasing interest in alternative modes to (1) be more responsive to the Egyptian government, (2) find better ways to deal with program design and implementation problems, and (3) ease the burden on mission staff of managing the large project portfolio. Since 1981, the GOE has asked AID to increase program flexibility through the use of sectoral approaches and cash transfers. State Department officials have questioned the need for AID to use a staff-intensive approach, such as the project approach.

For several years, mission officials have expressed concern that the project portfolio is too large for the current staff to manage effectively. AID/W officials said they also recognize this as a problem and have pressed the mission to come up with options to limit the demands placed on the program's staff. AID/W has suggested that fewer and larger projects would be less staff-intensive and would provide more visible evidence of U.S. assistance to Egypt.

Staff papers and memorandums also show the mission's frustration and suggest a change may be desirable in the mix of the mode for disbursing the ESF. For example, a staff paper suggested that AID "must reorganize the total portfolio systematically toward other than the project specific mode."

Another paper stated that:

> "In many AID-recipient countries (e.g., Egypt and India as well as Zimbabwe) both project and existing non-project formats are to some extent inappropriate. Projects tend to bog down in time-consuming documentation and incur heavy staff costs; while non-project assistance . . . must overcome a heavy burden of proof at headquarters."

A memorandum written by a high ranking mission official in 1984 stated that:

> "Most of the structural characteristics of the Cairo program reflect entrenched Agency, and sometimes U.S. Government policies and procedures, and the result--the status of the Egyptian AID program today--is that there are rigidities that cannot be attacked piecemeal. To put the matter bluntly, attempts to modify the Cairo assistance program within the guidelines of current Agency operating procedures and handbook regulations will accomplish little."

State Department officials, while acknowledging the accomplishments of some of AID's phojects, suggested that AID may need to re-examine the way it does business to make mission efforts less staff-intensive. These officials (while not definitive as to how much should be cash transfer) told us that the Department would not be averse to part of the assistance going to the GOE as a cash transfer to help meet the program's political objectives in the near term and to decrease the number of mission staff needed.

In February 1982, President Reagan and President Mubarak issued a joint communique containing an agreement to allow more flexibility in the way the assistance is programmed. Part of the agreement stipulated that more sector funding approaches be used and that Egypt take the lead in planning and managing these sectoral activities and, in general, have wider opportunities to participate in the design and implementation of all projects and programs funded through U.S. assistance. The impetus for this agreement was the GOE's concern over the lack of flexibility within the program to respond to GOE initiatives.

OPTIONS FOR MODIFYING THE PROGRAM

AID can distribute ESF through project or non-project modes or a mixture of these. The project mode is staff-intensive and slow disbursing and may not lead easily to close collaboration with the GOE. AID has available non-project modes of delivering assistance--cash transfers, sector grants, and commodity imports--which address in varying degrees these problems. These non-project modes each have certain general characteristics and advantages and disadvantages.

Advantages and disadvantages of non-project and mixed modes

The performance of a mode for disbursing ESF funding to Egypt can be measured in terms of the flexibility it gives AID in formulating a development strategy, its collision with or avoidance of the major constraints in the Egyptian program environment, such as staffing limitations; its capacity to assist the program in meeting its goals; and its ability to provide the necessary program control and accountability to ensure that the money is spent effectively. Choosing one mode over another involves trading off the strengths and weaknesses of particular modes, as discussed in the following sections.

Cash transfer

Cash transfers are simple resource transfers from one government to another for any one of several economic objectives, including local budget support and/or balance-of-payments support. Cash transfers have been frequently associated with larger political and economic interests of the United States. For instance, in 1980 Turkey received a cash transfer as support for adhering to a newly signed agreement with the International Monetary Fund. More recently, El Salvador has received cash transfers to provide balance-of-payments support and to bolster its economy.

Using cash transfers could provide certain advantages; for example:

--It might achieve major U.S. political goals. The GOE regards cash transfers positively as representing the way the U.S. government deals with Israel.

--A cash transfer may offer a better forum than projects for policy dialogue on macroeconomic issues because, although there may still be little leverage, the level of funding involved would capture the attention of the top levels of the GOE.

--A cash transfer would be relatively easy to administer; much fewer staff would be necessary.

Disadvantages of using cash transfers are that AID might have little control over how the transfer is used; it would be difficult for the U.S. government to ensure that the funding flows would be used for development in specified sectors. Further, AID's development goals might suffer, as many AID officials believe that cash transfers would more likely be used to finance consumption rather than development. However, specific agreements could be worked out with the GOE to help avoid or lessen some of these disadvantages.

Sector grants

Sector grants are budget support for economic assistance to specific sectors or subsectors. AID's guidelines for the use of sector grants are not well defined. Officials, therefore, hesitate to suggest their use or they lack the knowledge to pursue sector grants. Other officials see the lack of guidance as providing needed flexibility as to when and how to use sector grants.

AID officials agreed that a sector grant usually does not involve AID in the implementation of specific activities. AID regulations implementing the Foreign Assistance Act of 1961, as amended, require less documentation and monitoring for sector grants than for projects in which activities are associated with discrete development problems.

Sector grants can achieve both political and development goals, because they (1) are faster disbursing and relatively responsive to GOE priorities, (2) involve the GOE more in selecting, planning, implementing, and monitoring activities, so are less demanding on mission staff, and (3) have specific development objectives, optimally including any needed policy reform. Some mission officials see sector grants as providing more opportunity to collaborate with the GOE than do projects. For instance, under a sector grant program, design responsibilities may shift primarily to the GOE. The mission may arrange for technical assistance and would discuss program design with the GOE to ensure that the terms of the sector grant are met. Under a project mode, the mission carries responsibility for the design, often with minimal GOE participation. In commenting on GOE's possible role under a sector grant, AID stated that it is not a foregone conclusion that the GOE would have design responsibilities in sector assistance programs. AID said that the degree of collaboration for the purposes of designing this assistance would depend on the problem to be solved and the nature of the solution.

Some mission officials also believe the sector mode is ideal for testing the capability and performance of newly

strengthened recipient-country institutions. Before such testing is warranted, officials agreed that significant institutional development must have already taken place. Mission officials believe that some sectors in Egypt are ready for sector grants, and AID efforts in these sectors have matured beyond simple projects. Probably the best example of such development is the crop research and extension institutions of the Ministry of Agriculture; they are well staffed but lack the resources to test what they can accomplish.

Sector grants avoid some constraints in the Egyptian environment and facilitate formulation of a cohesive strategy. A sector grant's scope of implementation can be expanded beyond that usually associated with discrete projects. Thus, sector grants can sometimes channel high levels of funding. Sector grants can also assist in formulating strategy through serving as a vehicle to encourage AID and the GOE to focus on and negotiate sector-wide problems and goals. This lends coherency to the strategy. In addition, AID programming guidance states that sector grants are at the right level for policy dialogue. The amount of funding being made available ensures that the policy dialogue will have the attention of the GOE.

Sector grants are not well suited to attack specific development bottlenecks. For instance, a project mode may be better suited for well defined but limited activities, such as increasing electrical generation capacity. Additionally, the sectors where the GOE is best capable of managing a sector grant may not be AID's priority development sectors. Finally, although AID is still deeply involved, program accountability and control is somewhat reduced under sector grants.

Commodity imports

The ESF assistance program to Egypt for fiscal year 1984 and 1985 has a substantial Commodity Import Program component--$300 million and $200 million, respectively. The CIP, which is used mainly for recipient-country budget support and balance-of-payments assistance, provides less developed countries with (1) dollars to import various commodities to help meet resource shortfalls and (2) local currency from the sale of these commodities.

According to a May 1984 evaluation of the CIP in Egypt,[1] the CIP has promoted political stability by providing balance-of-payments assistance to the GOE and developmentally it has funded import requirements for investment goods, raw materials, spare parts and equipment, and capital goods. Between 1975 and the end of fiscal year 1984, $3.1 billion in U.S. assistance was obligated through the CIP. Industry (mainly the public sector) has received the largest share of this.

[1]Evaluation performed by Development Associates, Inc. and Price Waterhouse Khattab.

The CIP has several advantages over the project approach--it is relatively fast disbursing, flexible, and less staff-intensive. Although the CIP accounted for about 40 percent of the mission's ESF program in fiscal year 1984, it represented about 22 percent of the funding pipeline and required about 11 percent of the mission staff to manage it. CIP funds can be used to purchase a wide range of commodities in support of any or all of the development sectors. Additionally, the GOE likes the CIP and would like the funding level to remain at least at the fiscal year 1984 level of $300 million.

However, AID does not necessarily favor the CIP. Mission officials told us that some of the primary concerns over the CIP are that it (1) is mainly public sector oriented, (2) is not directed enough toward developmental goals, and (3) does not provide an adequate mechanism for institution building. For fiscal year 1985, AID reduced the CIP to $200 million. The mission's draft fiscal year 1986 Country Development Strategy Statement recommended reducing the annual CIP obligations to $100 million--a 67 percent cut over the fiscal year 1984 amount of $300 million--to make room for large infrastructure or industry projects. However, the AID Administrator decided that AID will hold the CIP level constant at $200 million until it develops options that the GOE likes better. AID plans to continue efforts to reduce the public sector share of CIP resources.

Mixed mode

A myriad of possible mixes of projects, cash transfers, sector grants, and CIP exist. AID uses projects, CIP, and recently a cash transfer in its Egypt program. Each option for mixing modes has differing implications for the impact of the program. The advantage of a mixed mode is that it offers the opportunity to minimize a particular constraint or to advance a particular goal.

AID/W has also suggested retaining the current funding mix but having fewer and larger projects which, according to AID, would decrease demands on staff and better focus the program. We believe, however, that large projects may be more complex and thus could require more staff for effective implementation. Another option could be to convert the program into one-third cash transfer, one-third CIP, and one-third projects to lower the level of project spending to where the available staff can more effectively run the program and reap the development benefits which should normally accrue to the project mode. For instance, there could be more dialogue between mission and GOE officials, as mission staff would have more time to meet with their GOE counterparts and AID project officers could better monitor their projects. Another option might be to redirect $200 million from projects to sector grants to advance policy dialogue. At the same time, the $200 million in sector grants would represent a shift in programming from the staff-intensive project mode to the less staff-intensive sector mode.

The disadvantages of mixed modes are straightforward. First, mixing modes does not remove the disadvantages inherent in each mode taken in isolation. However, the degree of disadvantage would depend on the extent of use of the mode; for example, it may be difficult to effectively implement and manage a large project component. Second, the proportion of the program given to a particular mode represents a trade off against what could be achieved by giving a larger proportion of the program to other modes.

Attitudes vary toward alternative delivery modes

AID/W officials emphasize such qualities as the need for discipline in the Egyptian program, development progress, and accountability. They are also acutely aware of the high visibility of the program to the Congress and the U.S. public. These and other considerations lead AID/W to favor the use of the project mode, which allows AID/W to more closely scrutinize the use of assistance funding for Egypt. AID commented that it selects the mode of ESF distribution based on what it believes are Egypt's economic needs and only a definite economic policy reform commitment by GOE should justify providing a "major part" of the assistance in the form of sector grants or direct cash transfers. AID/W officials believe that Congress would accept nothing less. At the same time, many AID/W and mission officials acknowledge that, politically, it would be very difficult for the GOE to appear to give in to U.S. pressure for policy reform in exchange for a sector grant or a cash transfer.

On the other hand, we believe mission officials see the desirability of moving more toward a programming approach which would allow them to

--increase management flexibility,

--reduce the burden of annually obligating and managing the large staff-intensive project component of this assistance program,

--increase the effective use of existing staff,

--speed the disbursement of funds, and

--give the Egyptians more responsibility for the development of the economy using U.S. assistance.

Top GOE policymakers and the technical ministries differ over the desirability and advantages of a mode change. GOE policymaking officials told us they want a cash transfer because it would give them more flexibility and would be more equitable treatment when compared with U.S. assistance to Israel. Technical ministries, however, are concerned that if the funding is

not tied directly to agreed upon project support, they cannot be assured of receiving it. GOE policymakers could decide that there are higher priorities for the funding.

MISSION ATTEMPTS NEW PROGRAMMING DIRECTIONS

The mission has attempted new directions for both project and non-project assistance; for example:

--Small projects have been grouped together under umbrella projects.

--Large capital infrastructure projects in many sectors have become a program focus.

--A hybrid mode has been created having some attributes of both projects and sector grants.

--Two sector grants have been attempted, although unsuccessfully.

--Cash transfers have been provided in fiscal years 1984 and 1985.

These last three examples (discussed in more detail below) are outside the usual pattern of project assistance. They are part of the mission's efforts to be more responsive to the GOE's request for greater flexibility in the program and, aside from CIP, they represent the mission's recent initiatives for non-project assistance.

The decentralization program

In response to the GOE's request in 1982 for more program flexibility, including a sector approach, AID combined under one umbrella five ongoing projects targeted at assisting the GOE to decentralize its operations. This approach, called the Decentralization Portfolio, was to be a flexible hybrid between a project and a sector grant. It more deeply involved AID in detailing when and how the program funding should be spent than in most sector grants. However, more importantly for the mission and the GOE, this hybrid approach was to give them the flexibility to subobligate funds between budget line items without seeking AID/W approval.

According to mission officials, AID/W approved the Decentralization Portfolio, but without as much flexibility as desired or originally planned, particularly in moving the funds between activities. AID/W stated that a certain amount of flexibility to move funds above a funding ceiling was allowed. The project authorization document stated that:

> "Funding levels for individual program activities may be changed from time to time by agreement in writing by A.I.D. and the Cooperating Country, except that funding for the five activities previously authorized shall not be less than the amounts obligated to date for each subactivity."

Regardless of the different opinions concerning the degree of flexibility, both AID/W and the mission consider the Decentralization Portfolio a notable success and plan a second phase for this endeavor. AID/W has stated that the second phase of the decentralization program is expected to be administered strictly as a project.

Sector grant attempts unsuccessful

The mission has made two attempts to fund a sector grant in agriculture. In the first attempt, AID would have compensated the GOE for the costs of policy reforms needed to raise prices paid to farmers for major crops. AID brought in a team of economists to work with their GOE counterparts on the details; their work showed that the grant would have been substantially more expensive than originally anticipated. Eventually, according to mission officials, the Minister of Agriculture called a halt to the negotiations for this proposed grant. He believed that the proposed policy changes had become politically sensitive and that as a result AID should withdraw from this area. He stated that the Ministry itself would make the changes it thought appropriate at a later time and on its own. Some of those changes have taken place and without active U.S. assistance.

The second attempt had two goals: (1) to establish a higher level of annual spending for agriculture over a 5-year period and (2) to fully activate the Ministry of Agriculture's research and extension system. The rationale behind the grant was that the GOE already had a well-developed research and extension capability but lacked the proper resources to fully use it. The mission and the Ministry believed that a sector grant was the best solution to the problem. Mission officials told us that the Ministry refused the grant, however, because it believed that a sector grant, unlike a project, carried no guarantee that the Ministry's budget would actually be increased by the amount of the grant.

Many mission officials believed AID/W opposition blocked sector programming. AID/W asserted that the mission has the authorization and opportunity to develop sector grants but has not taken them. The criticism is that the mission has been focused at the project level, has not attempted to see issues on a sector level, and has put together no staff expertise or analyses to make sector grants possible. Top mission officials stated that their two efforts at sector grants in agriculture demonstrated their readiness to undertake sector grants but that

the GOE would not accept them. AID/W officials commented further that the mission paperwork submitted on the agriculture sector grant was inadequate and did not represent a well thought out approach or strategy. Poor Agency guidance on the use of sector grants may have contributed to the "paperwork" being considered "inadequate."

Cash transfers

In fiscal year 1984, the United States provided Egypt with a cash transfer of approximately $102 million from previously deobligated ESF and another cash transfer of $100 million as part of AID's fiscal year 1985 assistance program.

When AID received its deobligation/reobligation authority in 1983 for the Egyptian program, the Chairman of the Subcommittee on Foreign Operations, Senate Committee on Appropriations, urged AID to reobligate funding from newly deobligated projects and CIP agreements as a cash transfer to Egypt. AID notified pertinent subcommittees that it would do this for funds reobligated in fiscal year 1984. Several subcommittees initially opposed this but subsequently agreed when Egypt made a commitment to use an amount of local currency equal to the cash transfer to support its health and housing sectors.

AID wished to make the provision of the cash transfer in fiscal year 1984 a one-time occurrence in its assistance program to Egypt. However, according to AID officials, because of congressional action, AID devoted $100 million of its budget for fiscal year 1985 for a second cash transfer. AID's budget for Egypt for fiscal year 1985 ($815 million) was increased by $65 million over its fiscal year 1984 budget of $750 million. AID favored using this increase to fund a larger project component and therefore reduced the CIP to accommodate the $100-million cash transfer. Converting part of the CIP to a cash transfer and increasing the program's project component can be expected to increase the burden of managing the already large project portfolio.

The State Department and embassy officials are requesting that AID retain the cash transfer component as a permanent part of the program for Egypt. Although AID remains generally opposed to providing assistance to Egypt in the form of a cash transfer unless the GOE commits to needed economic policy reform as a condition of the transfer, AID will provide Egypt with at least $100 million in cash transfers in fiscal year 1986.

AGENCY COMMENTS AND OUR EVALUATION

AID made some specific comments with regard to sector grants and the difficulties of policy reform and the possibility of obtaining reform in exchange for a sector grant or cash transfer.

Sector grant efforts

AID stated that our draft report failed to give the mission full credit for its efforts to provide flexibility in some development sectors and to eventually provide sector-level funding. AID mentioned its efforts to group smaller projects under single umbrella projects in sectors such as agriculture, science and technology, and family planning. We acknowledge that the mission has made some innovative efforts in some sectors and we did discuss some of these efforts involving the decentralization project and the agriculture sector.

AID stated that it sees

> "the sector mode as increasingly attractive when cash payment procedures are used. It has many of the benefits to Egypt of cash transfers while the process of reaching agreement on sector objectives and strategy can yield many of the accountability and development benefits of project aid."

We agree with AID's statement on sector grants but, as discussed in chapter 4, efforts to establish a sector grant for Egypt have not yet been successful. In addition, AID acknowledged that it lacks adequate guidance on the use of sector grants. We believe that development of such guidance would be helpful to any effort to use sector grants for Egypt.

Policy reform within the Egypt context

AID stated that our remarks concerning the possibility of obtaining policy reform in exchange for a sector grant or cash transfer did not recognize the difficulties of obtaining policy reform in the "Egypt context." It said that policy reform in Egypt is shaped in part by historical and political forces which underpin economic conditions. AID commented that given the complexities and conflicts of modernization and development within the context of traditional Islamic values, a simple shift in assistance modes will not automatically produce policy reform.

We acknowledge in our report that it would be very difficult (for some of the reasons that are stated above) for the GOE to appear to give in to U.S. pressure for policy reform in exchange for a sector grant or cash transfer. However, we believe that because of the importance of economic policy reform to Egypt, AID should try different methods, such as offering sector grants, which might induce or make it easier for Egypt to make these reforms.

We also agree with AID's comments concerning the importance of considering the Egyptian context--its history, customs, culture, religion, politics, and language. We believe that knowledge of these characteristics is very important to effective dialogue with the Egyptians and effective design of development activities. This knowledge can be very helpful in forming

closer relations with the Egyptians as a group and on a one-to-one basis and would help to put development needs into the Egypt context. Although AID recognizes the importance of this knowledge, according to its Near East Bureau, the acquisition of this knowledge is not an AID requirement for officers serving at the Egypt mission.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

Conditions under which the ESF program for Egypt operates, such as its large funding levels and political nature, make it more difficult for AID to achieve the program's economic development goals. While State and AID may have little control over these program conditions, we believe that they have certain program structuring options for distributing ESF which, if exercised, may improve program effectiveness.

Trying to achieve the program's more immediate political goals and the longer term economic goals concurrently is difficult and has led to some disagreement over program strategy, strained mission-AID/W relations, and led to a lack of U.S.-Egypt consensus over the objectives of the program. Over time, the program has become diffuse and has lacked consistent focus because of compromises which occasionally have to be made to serve the political and economic goals (sometimes to the detriment of the longer term economic goal) and the need to continually find projects to absorb the large funding each year. Further, this large portfolio of projects has made it difficult for the mission to effectively implement and manage the program.

Although we recognize that State and AID have limited control over the program's political nature and overall size, we believe they should continually discuss and review the best way to achieve the program's economic assistance goals in the context of its political objectives. Certain topics should be considered during these discussions and certain information should be gathered to support these discussions.

While we take no position on which ESF distribution mode or combination of modes may be most appropriate for U.S. assistance to Egypt, we believe that the State Department and AID should consider the merits of the different ESF distribution mode options. These include leaving the current program structure as it is or increasing/decreasing cash transfers, sector grants, and CIP components of ESF distribution. Changing the structure has advantages and disadvantages and any necessary trade offs between these will have to be analyzed in selecting an option. That is, it may be necessary to give up some program or administrative attributes to emphasize others which are perceived as more desirable. We believe, however, that State and AID should be able to design a suitable ESF mode mix (considering the trade offs discussed below and in chapter 4) which will be flexible enough to support near and long-term U.S. political and economic objectives and to accommodate any evolution of the U.S. assistance program and the needs of the Egyptians.

OPTION ONE--CONTINUING THE CURRENT ESF MIX

The present program is structured with a large project portfolio, sizable CIP, and the recent (fiscal year 1984) addition of a cash transfer. According to AID/W and mission officials:

--The large project portfolio is difficult to manage because of the administrative and program management demands it places on AID mission staff.

--The CIP is providing a measure of balance-of-payments support; however, it does not provide the economic development impact that AID desires and the fact that it benefits mainly the public sector is unacceptable to AID.

--The recently provided cash transfer may not have the development impact desired, at least not as much as AID believes could be provided by an equivalent amount of project funding.

State and AID will have to determine whether they are satisfied that the current mode mix, considering the comments above, is the best for accomplishing the program's goals.

Increase the project component

AID recently increased the project component from $450 million to $515 million in fiscal year 1985; this theoretically would increase AID's control and accountability over the use of assistance levels. However, given the staffing ceiling, the difficulty the staff is currently having in managing the already large project component, and questions concerning Egypt's institutional and financial capacity to effectively absorb this type of aid, program control and accountability and effectiveness may diminish with increases in the size of the project component. Options for decreasing the project component are discussed in connection with the non-project options.

OPTION TWO--INCREASE/DECREASE NON-PROJECT MODES

Non-project modes include cash transfers, sector grants, and the CIP. In general these modes are better suited for short-term budget support, fast disbursement of funds, meeting political objectives at least in the short term, and providing varying degrees of economic development impact.

CIP

If the CIP were to increase at the expense of projects and/or sector grants, it is expected that the GOE reaction would be positive, as it strongly supports increasing the CIP as a mode more responsive to GOE priorities and as a step closer to cash

transfers. Additionally, increasing the CIP would reduce the demands on mission staff and increase the speed of disbursement. These advantages would be traded off against an expected decrease in development impact and reduced control and accountability over the use of the funding. A decrease in the CIP largely would be the reverse of the changes described above.

Cash transfer

If the cash transfer component is increased at the expense of either the project or CIP components of AID's program, AID will increase the rate of disbursement of program funding, reduce the mission's program administration and staffing requirements, and positively enhance the GOE's perception of the program's responsiveness. These advantages would be traded off against AID's difficulty in controlling and accounting for the use of program funding. In addition, the development impact of the funds could be greatly diminished if the GOE were to use the funds to finance something other than development.

On the other hand, decreasing the cash transfer component might be interpreted by the GOE as moving the program further away from equality with U.S. treatment of Israel, which receives all ESF assistance as a cash transfer. Decreasing the cash transfer component in favor of increased projects would again increase staff demands placed on the AID mission.

Sector grant

If sector grants increased at the expense of projects, development impact would include an entire sector rather than a single project. The mission staff demands would decrease in exchange for a diminishing of the control and accountability offered by projects. The GOE also sees sector grants as more responsive than projects to its own priorities.

On the other hand, if AID added a sector grant component to the program in Egypt at the expense of the CIP or direct cash transfers, it may have to trade the increased development impact offered by the sector grant for a somewhat less positive response to the priorities of the upper levels of the GOE and an increased administrative burden for the mission staff. Despite this reduction in responsiveness, the GOE has looked favorably on the concept of a sector grant. Sector grants also offer AID increased accountability compared with cash transfers and the CIP. If a sector grant component were to decrease as a part of the program, the effects would be the reverse of these changes.

AID has the opportunity to evaluate to some extent the viability of providing Egypt with cash transfers/sector grants in exchange for economic development commitments; it can assess the GOE development efforts agreed to and undertaken in response to

cash transfers provided in 1984 and 1985 and to be provided in 1986. AID's monitoring efforts in this matter may provide information needed for designing similar future transactions and will also provide information of interest to congressional oversight committees.

In addition to the options discussed above, another area to consider in discussions of the economic assistance strategy for Egypt is how much should/can AID pursue economic policy reform. Some say that the current pace of reform is too slow, while others say that the pace is geared more toward maintaining political stability between the GOE and the Egyptian people than satisfying longer term economic development objectives. We believe AID should continue to support the GOE's economic reform efforts by continuing discussions with the GOE on its current economic policies and proposed policy reforms in terms of the ESF program options which may best enable the GOE to make these reforms. These discussions, to be credible, must be supported by in-depth analyses of Egypt's development sectors and pertinent policy reform issues.

AID commented that it intends to continue to assess objectively and thoroughly the effectiveness of its program mix for accomplishing U.S. foreign policy objectives. AID does not support a program in which all or even a major part would be cash transfer. According to AID, GOE agreed with it on the value of project assistance. AID commented that recent GOE requests for increased assistance, while requesting cash transfers, have involved increased project assistance.

RECOMMENDATIONS

To support AID's continuing program design efforts and to assist the GOE in its economic development, including any needed policy reform, we recommend that the Administrator of AID direct the Near East Bureau and the mission to

--perform the analyses necessary to provide in-depth knowledge of Egypt's development sectors and the policies that affect these sectors and

--assess the development efforts agreed to and undertaken by the government of Egypt in response to the provision of recently authorized cash transfers.

The information obtained from these two efforts should prove useful to the Department of State and AID as part of the necessary and continuing process of determining how best to achieve economic assistance goals for Egypt in the light of the program's political objectives.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on our proposed recommendation that AID should make more in-depth analyses of Egypt's development sectors and

the policies affecting these sectors, AID stated that we had overlooked some previous analyses that had been performed. AID disagreed with our proposed recommendation concerning monitoring the recent cash transfers provided to Egypt.

We believe that, except for engaging in knowledgeable, persuasive discussions of the issues with the GOE, AID may have little influence over Egypt's pace and direction for economic policy reform. This is why it is important that AID's knowledge of Egypt's development sectors and the policies that affect these sectors be complete. AID agreed with the value of doing in-depth sector and economic analyses to support its assistance efforts and stated that:

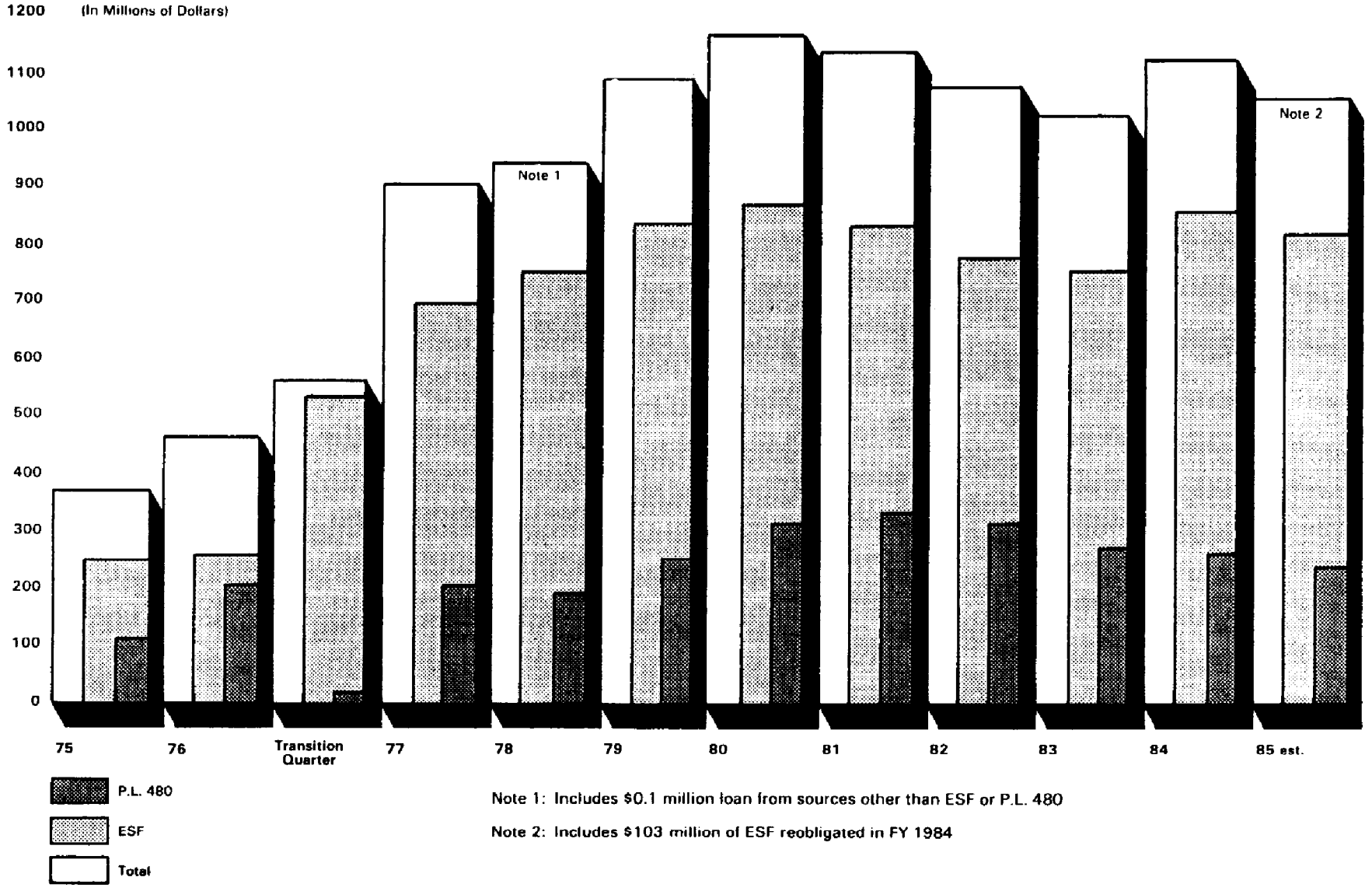
> "We certainly agree that the analytical support for our programs should be complete and thorough. Where policy action is indicated, the Government of Egypt needs to understand both the consequences of alternative policy actions as well as the consequences of inaction."

However, AID stated that we overlooked studies already performed for Egypt's development sectors and economic policies. We are aware of these studies, but discussions with mission management and project officers, AID/W officials, GOE officials, and others indicated that these studies were either incomplete (including omission of some development sectors), outdated, or did not contain enough detail. We corroborated these statements by reviewing much of the existing analyses and also by reviewing independent studies which questioned AID's knowledge of some of Egypt's development sectors. In addition, mission management agreed in our closeout conference at the conclusion of our work in Egypt that more and better analyses needs to be performed, and they told us they were working to better organize their analyses efforts. AID also commented that it was difficult to improve its analyses because of the poor quality of Egypt's baseline data. To the extent that this is the case, we believe that part of AID's analyses efforts should include working with the Egyptians to improve this data.

In commenting on our proposed recommendation with respect to U.S. cash transfers for Egypt, AID stated that monitoring Egypt's use of cash transfer dollars would be extremely "difficult and impractical" because of the unrestricted nature of this use. AID also commented that even though the GOE agreed to spend an equivalent amount of local currency for health and housing, AID could not ensure that this expenditure would be any larger than the GOE had already planned to spend in these sectors. We agree it would be difficult to monitor the budget flow and use of an unrestricted cash transfer. This was not the intent of our proposal. We believe that AID can assess the development efforts agreed to and undertaken by the GOE in response to the provision of U.S. cash transfers. For example, AID can (1) monitor GOE's adherence to the commitments it made in response to the cash

transfers, (2) evaluate what can be accomplished through such commitments, which include no agreement for the GOE to take funding (or other) actions beyond those which may already be planned, (3) identify ways to strengthen these commitments, and (4) determine what development impact realistically can be expected from the provision of cash transfers to Egypt. We have revised our recommendation accordingly. The data gathered in responding to this recommendation, although it may prove minimal in quantity, should help AID to design future cash transfer agreements with the government of Egypt and will be of interest to the Congress in its oversight responsibilities. This, together with data gathered in responding to our "analyses" recommendation will help the State Department and AID in their continuing process of determining the best way to achieve economic assistance goals in Egypt.

Summary of U.S. Economic Assistance To Egypt - Fiscal Years 1975-85



Note 1: Includes $0.1 million loan from sources other than ESF or P.L. 480

Note 2: Includes $103 million of ESF reobligated in FY 1984

APPENDIX I

APPENDIX II

United States Department of State

Comptroller

Washington, D.C. 20520

March 29, 1985

Dear Frank:

I am replying to your letter of March 12, 1985 to the Secretary which forwarded copies of the draft report: "The U.S. Economic Assistance Program for Egypt Poses a Challenge for the Agency for International Development".

The enclosed comments on this report were prepared in the Bureau of Near Eastern and South Asian Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Roger

Roger B. Feldman

Enclosure:
As stated.

Mr. Frank C. Conahan,
Director,
National Security and
International Affairs Division,
U.S. General Accounting Office,
Washington, D.C. 20548

GAO note: The page number references in the left margin have been added to correspond to the page numbers in the final report.

APPENDIX II

United States Department of State

Washington, D.C. 20520

March 27, 1985

GAO Draft Report: The U.S. Economic Assistance Program for Egypt Poses a Challenge for the Agency for International Development

This GAO report addresses the perennial and difficult question of how we can maximize the political and economic impact of our ESF assistance. The report recognizes the various Egyptian and U.S. organizations associated with the program disagree on how best to do this. The implied conclusion is that there is a mix of project, program and balance of payments support which would be more acceptable to more key players than the present mix of ESF activities. We support the concept of finding an optimal mix of activities and have been constantly engaged with AID and the Egyptian government toward this end. We welcome suggestions as to how we might better structure the program to achieve those goals but the report offers no new ideas.

Specific comments on the draft report follow:

p. ii -- p. ii: We believe there is little tension between the economic and political goals of our assistance to Egypt; rather there are conflicting views as to how to maximize those goals.

p. v -- p. ix: We do not dispute AID views that there has been insufficient project monitoring and evaluation, however, we believe our focus should be on changing regulations and procedures so that our aid programs can be implemented as effectively or more effectively with fewer people.

p. vi -- p. x: In FY 85 we have programmed $100 million not $102 million as a cash transfer.

p. 2 fn. 3 -- p. 2: From 1974-1979, Egypt received substantial assistance from Arab as well as Western and multilateral donors.

pp. 9, 15,16 -- p. 4: The obligation of ESF to achieve rapid visibility for U.S. assistance regardless of long term development impact did occur in the early years of the program. The provision of buses for Cairo is an example of such a decision. We believe this practice has been virtually eliminated.

p. 10 -- pp. 16/17 and p. 26: The report misses the real point here. State is not opposed to pushing hard on economic reform because reform may cause political tensions, rather State opposes pressing for reforms in a manner which is both ineffective and could adversely affect other important aspects of our bilateral relationship.

p. 19 -- p. 26: AID can withhold DA in order to leverage reform. However, the rationale for ESF is different. ESF is security assistance designed to enhance the security of the U.S. Examples of withholding ESF assistance to leverage reform are few and far between. Egypt is not a unique case where AID must obligate ESF in less than ideal policy conditions.

pp. 10, 20 -- p. 30: The history of AID funding for the Ismailia IV power plant referred to on this page is inaccurate. In this case, we did not establish clear conditions for our funding this project. The Egyptians did increase electricity tariffs in response to our urging. AID considered the increase inadequate to justify funding and pressed for a further increase. The Egyptians felt misled. In our view, this was a case in point of how not to go about leveraging reform.

p. 21 -- p. 31: New two piaster loaves of bread were introduced in October 1984 and accounted initially for about twenty percent of bread production. The price was not rolled back despite the demonstrations at Kafr al Dawaar. This fact is significant in that it helps to demonstrate clearly the Egyptian government's commitment to price reform. The commodities whose price increases were rescinded were minor commodities in terms of the overall subsidy budget.

p. 22 -- p. 33: The report quotes AID mission management as agreeing that more economic analysis is needed to support policy reform dialogue but that the mission lacks the needed time and people to do such analysis. The AID mission in Cairo includes a large economic staff. Perhaps better use should be made of this staff.

p. 40 -- p. 62: AID supports providing Egypt a $100 million cash transfer in FY 86.

David J. Dunford
Director,
Office of Egyptian Affairs

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

THE ADMINISTRATOR

April 18, 1985

Dear Mr. Conahan:

Given the scope of the GAO report and the sweeping assertions it contains, it is best to state in summary form A.I.D.'s position. More detailed comments on individual sections of the report are attached.

The A.I.D. program in Egypt has contributed importantly to U.S. foreign policy objectives. Peace between Egypt and Israel has been maintained, and Egypt has continued to be a full and supportive partner in the peace process. Further, this A.I.D. program has achieved significant developmental benefits. Of the $7.3 billion that have been obligated since the program was resumed in 1974, $4.9 billion has been disbursed. The rate of disbursement continues to exceed the rate of new obligations resulting during recent years in a steady decline in the program's pipeline. To mention only a few of the program's accomplishments, the war damaged canal cities area has been rebuilt; power generating capacity equal to the Aswan Dam has been installed; some 1200 classrooms have been constructed with an additional 2000 under construction; and child mortality has decreased from 30 to 20 per thousand among the pilot participants in A.I.D.'s Oral Rehydration program.

There continues to be agreement between A.I.D. and the Department of State on the objectives of the A.I.D. program and the strategy for obtaining those objectives. The A.I.D. program is undeniably large and complex. By virtue of its size, equivalent to nearly 20 percent of Egypt's annual gross investment level, A.I.D. activities are in a number of Egyptian sectors. We believe that the GAO has interpreted the continuing discussion of program strategy as implying confusion concerning program purposes and lack of consensus on overall strategy. This is not accurate.

Mr. Frank C. Conahan
Director
National Security and International Affairs Division
United States General Accounting Office
Washington, D.C. 20548

Such discussion is healthy and frequently supported by Congressional injunctions for thorough reviews of program strategy and accomplishments. The continuing process of program review and assessment has resulted in annual decisions and budget allocations, fully supported by State and A.I.D. in Washington and in Cairo.

The assistance strategy has continued to emphasize policy reform, infrastructure development, productive investments and basic human needs. The modes of program delivery are an integral part of this regular review process. The balance between project or sectoral assistance and program assistance is an integral part of the annual reviews.

We believe the current program mix emphasizing project and sector activities represents highly effective utilization of A.I.D. resources for the accomplishment of U.S. political and economic objectives. The project portfolio is increasingly focused on the critical developmental problems. While admittedly projects are more difficult to manage than program cash transfers, they are achieving significant economic development results and in the present Egyptian economic policy framework, they are the most effective instrument for insuring that U.S. taxpayers' funds contribute lasting benefits. We see the sector mode as increasingly attractive when cash payment procedures are used. It has many of the benefits to Egypt of program cash transfers while the process of reaching agreement on sector objectives and strategy can yield many of the accountability and development benefits of project aid. In FY 1986 at least 30 percent of our planned project portfolio will use cash payment procedures.

Nevertheless, we agree with the GAO that there is room for improvement. A new A.I.D. Mission management team has recently been formed in Cairo with my strong injunction to continue to focus the program on a selected number of key development issues. This team has also been given extraordinary delegations of authority so that it will have all the tools necessary to design and implement a program of maximum effectiveness.

Finally, while I find somewhat incongruous the GAO's injunction that A.I.D. undertake more analytical studies given previous Congressional and Egyptian criticisms of the program for doing too much analysis, we certainly agree that the analytical support for our programs should be complete and thorough. Where policy action is indicated, the Government of Egypt needs to understand both the consequences of alternative policy actions as well as the consequences of inaction.

A.I.D. intends to continue to assess objectively and thoroughly the effectiveness of its program mix for the accomplishment of U.S. foreign policy objectives. We continue to believe that the policy environment and not the level of resources, per se, is the critical determinant of the health and vitality of the Egyptian economy. Therefore, it is particularly incumbent upon A.I.D. to insure that its resources provide optimal support in the critical policy areas.

Sincerely yours,

M. Peter McPherson

Attachment: a/s

GAO note: The page number references in the left margin have been added to correspond to the page numbers in the final report.

AGENCY FOR INTERNATIONAL DEVELOPMENT COMMENTS
On GAO's DRAFT REPORT ENTITLED
"THE U.S. ECONOMIC ASSISTANCE PROGRAM
FOR EGYPT POSES A CHALLENGE FOR THE AGENCY
FOR INTERNATIONAL DEVELOPMENT"

AID representatives have appreciated the opportunity of meeting on three occasions with GAO representatives to discuss specific issues and sections of the draft report. In those meetings we provided additional information and documentation to improve the factual accuracy of the report and to describe the important changes and developments with respect to the AID program in Egypt which occurred after the GAO team conducted its field review in 1984.

The purpose of the comments which follow is to address in more detail issues such as pipeline, portfolio size, policy dialogue, and the two recommendations concerning economic analysis and cash transfer.

pp. iv v, 22, 25, 26 The GAO's draft (pp vi, 32 & 33) expresses concern that the Mission is not undertaking the necessary studies to adequately address key policy issues either on a macro-economic or sectoral level. We believe, however, that GAO has overlooked the relevant documentation which would lead to a different conclusion.

Mission and AID/W working files are filled with studies and analyses not only from AID but from other major donors such as IBRD and the EEC. These studies have been an essential part of our policy dialogue with the Egyptian Government over the years, and have been used as the basis for project decisions.

There are certain key policy and reform issues which have underpinned the program. They include, among others, reform of energy prices, agriculture prices, subsidies, and the role of the private sector. Early project documentation indicates that the Mission has always placed emphasis on short-term and long-term policy reforms necessary to achieve Egypt's and AID's developmental goals. Policy reform and changes, however, are complex political, sociological and economic issues, particularly when they are subject to a bilateral relationship between two sovereign nations. The Mission's focus has remained, nonetheless, on key issues and it has used project and non-project assistance modes to facilitate efforts toward policy reforms. The results of such efforts are now increasingly visible in movement on policy fronts and all major policy reform issues which have been the subject of this focus.

The GAO itself has recognized the operational emphasis AID places on the policy dialogue in Egypt.

In its draft Survey of Project Conditionality, completed in February 1985, GAO states that AID in Egypt applies policy conditionality whenever it is able and frequently discusses needed policy changes with Egyptian officials.

Cash Transfer

pp. vi, 45, 46 The Report assumes at page ix (and again at pages 68-70) that cash transfer program assistance may be "monitored" to determine how viable a "development tool" it may be. This is a dubious proposition, not only because of the difficult and impracticable aspects of monitoring an unrestricted cash transfer, but because cash grants are generally made for balance of payments purposes and not for economic development projects per se. GAO's misconceptions about cash transfers in Egypt are repeated on page p. 40 69 where the report erroneously asserts, "The GOE has stated it will use the 1984 transfer for sector support in health and housing." In fact, the GOE has covenanted in agreements signed in 1984 and 1985 to budget an equivalent amount of its own local currency for use in the health and housing sectors; the GOE has no obligation to use the foreign exchange in any sector--in fact, it's only covenant is not to use it for military purposes. Furthermore, there is no way of assuring that the kind of local currency expenditures would be larger than the GOE otherwise planned.

pp. 33, 34 The Report at pages 50-51 correctly concludes that AID might have little control over how cash transfers are used, and, moreover, that it would be difficult to ensure that funding flows would be used for development in specific sectors. The conclusions seem to contradict GAO's assumption that cash can be used as a "development" tool.

The AID program in Egypt has always contained an element of balance of payments support which included the Commodity Import Program and PL 480-Title I Food Aid. Our first cash transfer to Egypt occurred in FY 84. We provided $101.9 million in funds deobligated from previous projects. Congress has mandated that another $100 million be provided as a cash transfer in FY 1985 out of the approved $815 million level. Our request that $100 million in cash transfer be provided to Egypt in FY 86 with a corresponding reduction in CIP continues this mix.

We have made this request for cash transfer in FY 86 in response to the GOE's desire for assistance in dealing with a worsening balance of payments, including a rising overall debt service problem. However, AID does not support a program in which all or even a major part of our program would be cash transfer. Both the GOE and AID agree on the value of our project assistance. Recent GOE requests for increased assistance, while requesting cash transfer have also involved increased project assistance. Therefore, we conclude that a program of balance of payments support, including some cash and a strong project portfolio represents the best mix of assistance to Egypt under the present circumstances.

If the GOE were to move forward with a major structural adjustment program, which would assure effective use of cash, we stand ready to consider increased program cash transfer to Egypt.

Pipeline

The Report reflects misunderstanding of conditions that create a pipeline of funds. For instance, on pages ix and 43, the draft states..."the use of large projects, which by nature, disburse funds slowly is expected to keep the pipeline relatively high." In fact, the magnitude of the project does not invariably determine the rate of disbursement, as Decentralization Sector Support would show.

pp. v, 26-28

Moreover, it is important to realize that the pipeline consists of those funds which have been obligated but yet not expended. We maintain a pipeline adequate to fund contracts up front for the duration of the project. In most cases these contracts are multi-year instruments for provision of equipment, technical services, long-term training, or construction. Three-to-five years is the usual time horizon. GAO's concern and criticism of this phenomenon appear to result from a failure to understand this requirement.

It should be noted that from the GOE viewpoint there is no pipeline problem. They define the pipeline as being funding which is behind its planned disbursement. By their calculation only $7.0 million of the total undisbursed balance of $2.4 billion is behind schedule.

The Size of the Project Portfolio

It appears that the size and the scope of the program continue to bother the GAO. The program is large: in the level of resources it transfers; the variety of activities it supports; and the different ways in which it delivers the goods. The focus will always be wider than most conventional programs because of: the development needs of Egypt; our dominant role in supporting that development; and the number of U.S. and Egyptian firms, public institutions, and development professionals participating in the effort. Currently, the USAID is focussing on a smaller number of discrete activities and in reducing the number of projects planned. It is important to remember that a large portion of this assistance has supported three objectives: (1) rebuilding of the necessary infrastructure required to provide adequate services to the citizens; (2) upgrading the human resource capabilities of Egypt; and (3) expanding productive activities in agriculture and industry. While these can be further disaggregated, they represent a consistent focus to our assistance program to Egypt over the last ten years.

Another related and misleading implication in the report is that large capital projects were chosen primarily for political or management reasons. This is not true. The early decision to finance power, water, sewerage, etc., were based on perceived development needs -- albeit those which were more growth than equity related.

We continue to stand by these decisions and continue to finance these programs because of their development impact.

In the context of the present program and project portfolio and continuing additions thereto, we are pleased that the GAO report gives important emphasis to the staffing requirements necessary to effectively manage a program of the magnitude and complexity of that in Egypt.

The Aid Level

p. 7 Pages 12 and 13 of the report state that "funding is kept high for political purposes" and that the annual program would range from $100 to $200 million if based on development requirements. We believe this statement should be modified.

Both Egypt's and other donor's funded development projects provide additional funding above and beyond our program, yet the absorptive capacity for development projects does not appear to have been reached. Egypt still has a long way to go before the basic indicators of underdevelopment (illiteracy, infant mortality, morbidity, income, etc.) are improved.

Moreover, U.S. assistance must be viewed in the context of total official donor assistance (ODA) when examining the adequacy of aid flows in relation to country requirements. In strictly financial terms, U.S. aid merely compensates in part for the loss in Arab aid after Camp David. Total ODA to Egypt has not regained the level that prevailed in 1976.

We believe that the final draft of the report should be revised to take these facts into account.

CDSS

pp. 11, 12 The report's assertion on Pages 18-19 that the Egypt CDSS has not received approval is misleading and incorrect. We have provided GAO representatives copies of documents that show AID/W approval of the Egypt CDSS in FY 1984 for a three year period. AID's new programming system provides for a three year approval of the CDSS but includes annual budget and program reviews.

Program Flexibility

Regarding the issue of program flexibility, the report either overlooks or misunderstands several important developments. In p.32 one instance, the Report asserts that in February, 1982, Presidents Mubarak and Reagan signed an "agreement" to allow for greater flexibility in the AID program, specifically calling for sector approaches managed by the GOE. The document, in fact, was not an agreement but was rather a joint press statement. Regarding sector grants themselves, the Report recognizes the Agency's lack of guidance in this area, but fails to cite AID's overall experience. For example, there was a major effort to provide increased flexibility in the Egypt program by moving toward sector level funding during the past three years. This effort has resulted in (1) establishment of a Program Assistance Approval Document that combined five projects into one coordinated decentralization program, (2) phasing 13 agricultural projects into three sector-wide programs, (3) redirecting hundreds of small science and technology research activities into three major programs linked to mission strategy and priorities and (4) reducing 26 separate family planning activities into a focused program through two primary institutions.

The Report also reaches conclusions regarding sector assistance which are questionable: For instance, it is not a foregone conclusion that the GOE would have design responsibilities in
p. 34 sector assistance (page 52). The degree of collaboration for purposes of designing sector assistance is a function of the problem to be solved and the nature of the solution. It may be no different than the planning of project assistance.

Attention should be given to another effort to improve flexibility and overall program management: AID's full redelegation of authority to USAID/Cairo. This authority from the Administrator permits the Mission Director to exercise maximum autonomy and initiative in planning and implementation of the aid program in Egypt. This delegation was executed on 15 November 1984. Copies of these documents were provided to the GAO during our earlier meetings.

Policy Dialogue

The Report alludes to the role of policy dialogue in sectoral assistance but does not recognize the particular constraints imposed in the Egypt context. AID's efforts to encourage policy reform in both the power and water/wastewater sectors indicate that neither the mode nor the volume of assistance determines the outcome.

On the contrary, "policy" reform in Egypt is shaped in part by historical and political forces which underpin economic conditions. Given the complexities and conflicts of modernization and development within the context of traditional Islamic values, a simple shift in assistance modes will not automatically produce policy reform. Unfortunately, the Report is either silent or provides no new insights into these critical areas.

In conclusion, it is important to note that our political and developmental objectives in Egypt are complex and over the long-term, interrelated. The resulting program, thus, is complex and plays to many audiences. There is a normal tension among its objectives and the major policy makers, but this tension is creative and serves as a check and balance system during the planning process. The report looks at this tension from a negative perspective and sets up artificial conflicts between political and developmental objectives, comparing it to perceived differences between long and short-term and State and AID objectives. We believe the collaborative effort which has been basic to the development of this program has been positive and best serves U.S. policy interests.

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