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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

MEMORANDUM

DATE: March 4, 1988

TO: Distribution

FROM: ANE/PD, Ronald F. Venezia

SUBJECT: Partnership in Development (263-0216) PID
Asia and Near East Project Advisory Committee

The ANPAC meeting to review the subject PID will be held on March 8, 1988 at 10:30 hrs in Room 6660.

Participation in accordance with ANE Bureau guidelines is invited.

Attachments: Issues Paper
PID

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Partnership in Development Project
(263-0216)

Issues Paper

Project Summary

The Partners in Development Project will provide a grant of $97 million in ESF funds to the Government of Egypt. Dollars will be disbursed to the central government, which will, in turn, disburse local currency to an asset trust set up to handle privatization activities. A dollar disbursement to the central government will be triggered by an agreement between the Trust and a governorate to divest itself of a particular business.

The Trust is to be set up as an independent entity to carry out privatizations by purchasing businesses or an expanded interest in these, restructuring them, and re-selling the business or a substantial interest to the private sector.

The project will (a) privatize 30 governorate owned industries, and (b) establish acceptance and understanding by government officials, of the legitimacy of divestiture mechanisms for valuation, transfer and compensation. (Issue No. 4 deals with questions and clarifications concerning project objectives.)

The Project Review Committee (PRC) met on February 26, 1988 to review the Partnership in Development Project PID. The PRC recommended ANEPAC review of the PID. The meeting generated the following issues and points of discussion for ANEPAC review.

Issue No. 1.

The project is entirely capitalized by AID dollar transfers. What policy benefits are we to get from the dollars, and what is appropriate?

Discussion: Will the dollar disbursements be keyed to the amount of local currency required by the Trust to complete the purchase, restructuring and sale of the enterprise? If this is not the case, what will determine the amount of the disbursement? The PID does not specify any policy agenda or administrative changes required on the part of the central government in connection with disbursement of the dollars. The argument could be made that holding up disbursement of dollars for conditionality levied on the central government could hold up privitization actions involving the Trust and a governorate. This argument might hold true for the amounts required to move forward with a particular privitization, but it would be difficult to justify a dollar disbursement in excess of the local currency required unless some policy or administrative change were obtained. On the other hand, if such changes are required, then could dollar disbursements be made on the basis of their being obtained, with the amount of local currency going into the Trust fund unrelated to the fund's immediate needs? How does this approach fit in with AID's sector assistance policy?

Recommendation: The Mission representative should clarify for the ANEPAC, the basis on which dollar funds will be disbursed. If the disbursement is not tied to the amount of local currency required to carry thru a privitization, then the ANEPAC should consider whether the Mission needs to amend the PID to define the approach, including the policy/administrative change agenda, and show how this relates to relevant AID policy(s).

Issue No. 2.

Why is $97 million required, or does this proposed funding level relate to the question raised in Issue No. 1 above? Should initial funding be at a more modest level until a workable divestiture system is developed and proven?

Discussion: The PID proposes to privatize 30 governorate-owned firms by the end of the project. Governorate firms are likely to be in the $300,000 to $500,000 range with a top figure reaching $1 million or more. Thus, initial funds demand would be modest as the GOE is interested in privatizing the larger national owned firms only after the system is fully developed. A $97 million pilot project runs the risk of creating a significant pipeline problem if rapid divestiture does not occur. The pipeline would occur if the dollar side of dollar disbursements are keyed to privitizations. If they are linked to central government actions, a very large surplus of Egyptian currency could build up in the Trust.

Recommendation: A smaller amount of funds should be authorized and obligated in the first years of the project to establish the Trust and the divestiture system. A phased project, or projects, with further analysis and evaluation may be appropriate. Additional funds could be added in a second tranche after the system has divested several firms, GOE interest is proven and investor demand is determined including demand for any privitizations on a larger, national scale. At that point, a determination on further programming of funds remaining in the Trust could also be made.

In addition, the Mission should develop a business plan for the Trust as part of the PP design, which should be periodically up-dated. The plan should include a complete set of multi-year proforma financial statements, including a cash flow statement to help determine the appropriate final budget level to prevent pipeline problems.

Issue No. 3.

What is the nature of the Trust, which is defined as having the characteristics of an investment bank and venture capital fund, i.e. would it exist only for the purpose of privitizing publicly held businesses, or would it take on other functions as well, and at what point in time?

Discussion: If the Trust fund is to take on functions other than privatizing existing public industries, there is a question about potential conflict of interest. Other questions also arise concerning the ability of the Trust to carry out such expanded functions within the Egyptian legal context, (see issue no. 6) and the need for the project design to deal with the question of disposition of the fund's assets/liabilities (see issue no. 4).

Recommendation: The Mission representative should clarify the nature of the Trust as a basis for proceeding with discussion of the issues. If functions other than privatization are envisioned, the ANEPAC should consider whether this is appropriate for this project.

Issue No. 4.

Is the purpose of the Project to establish legitimacy and acceptance of the divestiture process - by having demonstrated its viability, and to complete privatization 30 governorate owned businesses? Or, does the project also encompass a longer term purpose of creating an on-going institution which will expand the privatization effort to the national level - and possibly take on other functions as queried in Issue No. 3 above?

What will be the disposition of the funds held by the Trust at the end of the project, and how does this relate to the project objectives?

Discussion: The PID does not indicate what will be the post-project future of the Trust, or its assets. If a longer-term role for the Trust is envisioned, as appears to be the case, then the current project must either a) be expanded to deal with this, or b) the design must be phased so as to provide for evaluation, review and analysis, and decisions about further programming of the funds to meet the subsequent objectives as they are defined. In any case, the PID should indicate what the various alternatives are that the Mission would consider for the ultimate disposition of the funds.

Recommendations: Assuming that the Trust is being established to have a longer term impact on privatization, the project should still be a phased one as described above. The ANEPAC should consider whether the Mission should ammend the PID to indicate how the design of the current project will deal with the issue of, "what happens next", including but not limited to the question of ultimate disposition of the Trust's assets - or even liabilities should it incur these.

Issue No. 5.

Why is a separate Trust entity needed? Why must another institution be created? Can we use existing institutions, such as the Misr-Iran Development Bank, to manage a the asset trust and its activities? Are we overloading a newly created Trust with too many tasks?

Discussion: The GOE is just beginning its efforts in privatization, has been very cautious and is risk adverse. The designers wanted to limit possible political exposure to government and private sector entities involved in the privatization process. The creation of the Trust as a separate entity, operated by a small management team, creates the political buffer necessary for successful implementation.

The PID indicates that the project does not attempt to build a large financial institution, but only a small separate entity that can quickly and simply pull together resources from several groups to fully develop a privatization process. Technical support will be contracted and the staff will be quite small, according to designers, no more than 5 people. The Trust will work closely with banks such as Misr-Iran to develop, package and divest public sector firms.

Is there a point, however, after the privatization process has been legitimized, at which it might be appropriate to turn the functions of the Trust - and its remaining funds - directly over to the regular banking institutions to administer?

Recommendation: A separate Trust entity is necessary, at least during an initial phase. It must be kept small and have flexible procedures to acquire necessary technical support and lead the privatization process. However, the long-term role of the Trust should be defined in terms of the needs and the project objectives as described in Issue Number 3 above.

Issue No. 6.

Are Egyptian laws and policies now in effect to allow the government at both the governorate and national levels to divest its assets or must new legislation be created? Can the Trust operate basically as a full function investment bank and/or venture capital fund? What are the identified policy and legal reforms necessary which must accompany the project?

Discussion: Egyptian laws and regulations are generally not conducive to private enterprise. However, the GOE realizes the importance of the private sector and is working to alleviate the problems. Recent GOE five-year plans push for a greatly expanded private sector.

Preliminary indications by the Mission's Egyptian lawyer are that, other than the general regulatory bias toward public sector enterprise, there are no significant legal constraints toward the privatization of GOE assets. There is a precedent in the Pioneer Seed Company, which encountered no legal obstacles during its privatization. The Mission will undertake a major legal study pertaining to privatization at the local and national level.

The Trust itself can be formed under several laws. Many investment companies have been formed under Laws 43 and 159 without any problem. For some national firm privatization candidates, majority ownership restrictions may apply. However, even these firms could be restructured under more liberal company laws and later privatized.

Recommendation: As planned, Egyptian legal counsel should assess the legal framework and environment for privatization during the final design process. The project design should not be finalized without all overall operational legal issues fully addressed.

Issue No. 7.

Is it necessary to capitalize the Trust with US Dollars converted by the Central Bank instead of utilizing the Special Account LEs or a mix of dollars and Special Account funding?

Discussion: It is desirable, although not required under ESF funding, to have the host country make at least a 25 percent resource contribution to the project. There is no GOE contribution specified in the PID, although the Mission representative at the PRC indicated that the GOE would make some contribution to start-up operating costs.

Should the host country make a more significant financial contribution to the capital of the Trust? What is a proper contribution level and form? One possibility includes a contribution to the labor compensation fund; this would monetize the local currency involved. Another possibility is to use funds from the special account to write down assets of companies from book to market value, or to otherwise write off their debt. This would not result in monetization, i.e. it would be a book transaction, unless creditors were actually to be paid off. Moreover, there may be a need in the privatization process, at some point, to write down assets, pay off debt, and to liquidate some non-viable businesses.

Recommendation: The ANEPAC should request the Mission representative, or the Mission as required, to address the issue of a GOE contribution in terms of establishing GOE commitment, and in terms of the project needs which might be met by such a contribution.

Additional Discussion Points

1. How will the desirability of halting further nationalization of entities or expansion of continuing public sector entities be addressed by the project?

2. Will the project work to complement policy reforms in other areas such as the Mission's effort in agriculture? Will special consideration be given to certain sectors, e.g. privatizing agro-businesses such as cotton, rice and sugar mills?

Project Committee:

ANE/PD/PE:DHagen
ANE/PD/ME:JSilver
ANE/PD/ME:RSilc
ANE/DP:TMahoney
ANE/EE:RHandler
ANE/TR:DAlter
GC/ANE:HMorris
PRE/PD:LFarrell

Clearance:

		Date
ANE/PD:RVenezia	(COVER)	
ANE/PD:BOdell		
ANE/PD/ME:TJohnson	(draft)	3/2/88
ANE/TR:DAlter	(draft)	3/1/88

Drafted:ANE/PD/ME;RSilc/JSilver;rs/js;3480c;2/29/88

XD-AAX-553-A
ISN 55054

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT IDENTIFICATION DOCUMENT FACESHEET (PID)

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) Revision No. ____
DOCUMENT CODE: 1

2. COUNTRY/ENTITY: EGYPT

3. PROJECT NUMBER: 263-0216

4. BUREAU/OFFICE: A. Symbol: ANE; B. Code: 04

5. PROJECT TITLE (maximum 40 characters): PARTNERSHIP IN DEVELOPMENT

6. ESTIMATED FY OF AUTHORIZATION/OBLIGATION/COMPLETION
- A. Initial FY: 89
- B. Final FY: 93
- C. PACD: 94

7. ESTIMATED COSTS ($000 OR EQUIVALENT, $1 =)

FUNDING SOURCE	LIFE OF PROJECT
A. AID	97,000
B. Other U.S. 1.	
B. Other U.S. 2.	
C. Host Country	
D. Other Donor(s)	
TOTAL	97,000

8. PROPOSED BUDGET AID FUNDS ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. PRIMARY TECH. CODE 2. Loan	D. 1ST FY 89 1. Grant	D. 1ST FY 89 2. Loan	E. LIFE OF PROJECT 1. Grant	E. LIFE OF PROJECT 2. Loan
(1) ESF	701	810		15,000		97,000	
(2)							
(3)							
(4)							
TOTALS							

9. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 840

10. SECONDARY PURPOSE CODE

11. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)
- A. Code
- B. Amount

12. PROJECT PURPOSE (maximum 480 characters)

To assist the GOE to privatize governorate and state-owned enterprises.

13. RESOURCES REQUIRED FOR PROJECT DEVELOPMENT

Staff:
16 weeks of Mission Staff time
20 weeks of consultant time

Funds:
$150,000 Technical Cooperation & Feasibility Studies (Project 0102)
LE 50,000 AID Activity Trust Account

14. ORIGINATING OFFICE CLEARANCE
Signature: Marshall Brown
Title: Marshall D. Brown, Mission Director
Date Signed: MM 02 DD 17 YY 88

15. DATE DOCUMENT RECEIVED AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

16. PROJECT DOCUMENT ACTION TAKEN
S = Suspended
A = Approved
D = Disapproved
CA = Conditionally Approved
DD = Decision Deferred

17. COMMENTS

18. ACTION APPROVED BY
Signature
Title

19. ACTION REFERENCE

20. ACTION DATE: MM DD YY

AID 1330-2 (8-79)

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PROJECT IDENTIFICATION DOCUMENT

EGYPT: PARTNERSHIP IN DEVELOPMENT PROJECT (263---0216)

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I. Program Factors

A. Conformity with Recipient Country Strategy/Programs

Egypt's second Five Year Plan (FY 1988-FY 1992) reflects the GOE's concern for increased productivity. It continues a trend toward liberalization of the economy begun in 1974 and emphasizes an expanded role for the private sector and the need for continued policy reform. The Plan's objectives also include significant reductions in public sector expenditures and employment, from 3.2 million employees to 2 million.

Significant events:

- 1984 - The Ministry of Local Government's Popular Development Organization introduced the possibility of transferring governorate-owned projects to the private sector to expand ownership out of the government.

- 1985 - The Second National Conference for Local Government endorsed this concept and recommended immediate implementation of the program. This recommendation was affirmed by the Prime Minister at both the Higher Council for Local Government and the Governors Council.

- 1986 - Prime Ministerial Decree (No. 601) formed a Higher Committee for Local and People's Development and launched an effort to initiate the transfer of governorate-owned projects to the people. With this the implementation of the "popularization" of governorate-owned projects began. A national-level working committee was formed to provide policy guidance and support.

- 1987 - Two projects from each of the twenty-six governorates were submitted to the committee for valuation and possible privatization.

- 1987 - The Ministry of Local Government issued a decree that established a committee to implement the "popularization" program. It is comprised of representatives from the Ministry of Local Government, Ministry of Finance, Capital Markets Authority and the USAID.

- 1987 - Deputy Prime Minister and Minister of Agriculture and Land Reclamation Youssef Wally expressed his support for privatization at both the governorate and the national level. Other Ministers and the Cabinet are discussing privatization as a method to address the GOE's budget problems.

The GOE strategy is to test the acceptance of transfer of government assets to private ownership. The initial attempts at privatization through the governorates concentrate on relatively small and nationally unsensitive companies, or those "outside the mainstream" at the governorate level. The GOE is willing to experiment with various forms of privatization, the results of which will directly influence the GOE's strategy on state-owned enterprises.

This project responds to the GOE's' interests in this direction and will contribute assistance to the GOE's goal to attract LE 18 billion in private sector investment over the next five years.

B. Relationship to AID Strategy Statement

In 1979, USAID Egypt's Country Development Strategy Statement (CDSS) stated its strategy to expand private sector development in order to increase productive output. Recently, Egypt's economic position has weakened. This project plays a key role in the Mission's strategy to improve the investment climate, promote private sector investment, improve business services, and expand business finance. The FY 1989 CDSS highlights a policy effort for "privatization of public industries and allowing freer competition between private and public firms", and the "reduction in government interventions." Under this project, support for these policy initiatives include a fund to help in the restructuring and sale of public sector industries to the private sector, improved banking facilities, equity and venture capital, and the development of capital markets.

The strategy of the USAID is to support the divestiture of governorate-owned industries to improve the investment climate. We propose establishing a fund to help in the financial restructuring and sale of these public sector industries. If it is successful, we will pursue enlarging the program to the central government-owned industries.

II. Description

A. Problem

The Egyptian economy is dominated by state-owned enterprises. These public sector firms are notoriously inefficient and unproductive, and place a heavy burden on the government investment budget. The GOE is aware of the problem, and is developing plans for privatization of state-owned firms. However, there is no established system or set of procedures for effecting the orderly transfer of ownership of enterprises from the public to the private sector.

B. Goal and Purpose

Goal: To increase private sector participation in commercial enterprises in concert with the objectives of the Five Year Plan.

Purpose: To assist the GOE to privatize governorate and state-owned enterprises.

Strategy: To build experience, competence, and confidence in the GOE for divestiture of governorate and state-owned enterprises and commercial operations.

Approach: The project would operate in much the same way as an investment bank. The project will provide financial resources and technical assistance to the GOE, the Governorates, and employee purchasers through a "Trust." The Trust would facilitate the restructuring of government assets to attract private sector investors.

C. Expected Achievements/Accomplishments

The project is expected to result in savings to government budgets for investment and subsidies, as well as generating private sector productive investment in a combination of debt and equity formulas. The following conditions are expected when end-of-project status is reached:

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(1) Privatization of 30 governorate-owned enterprises will have occurred in 15 major governorates and additional privatization activity in governorates will be underway.

(2) Institutional mechanisms for privatization will be in place and the procedures will be widely understood by government. The Trust, which will acquire, restructure, and sell public sector enterprises, will be designed as a revolving fund, insuring that it will function for as long as it is needed after project completion. ESOPs will have been demonstrated as a privatization technique. A Labor Compensation Fund will be in place to provide support and training to any workers displaced by the restructuring process. The mechanics for asset valuation acceptable to the government and the private sector will be operating and broadly endorsed.

(3) A Committee appointed by the President (chaired by a Deputy Prime Minister and composed of senior officials such as the Chairman of the Capital Markets Authority, the Ministers of Finance, Economy, the head of the Central Bank, and the Minister of Planning) to facilitate privatization will be in operation.

1. Project Outputs

(1) An effectively functioning facility for acquiring, packaging, and selling the assets (The Trust).

(2) A series of educational workships, seminars, and/or conferences will have been conducted to publicize the divestiture process.

(3) Mechanics for valuations acceptable by GOE parties and the private sector.

(4) A Labor Compensation Fund to provide severence pay, separation support benefits, and retraining for any workers released by the Trust during restructuring of an enterprise. Governorate wage rates are low, and an average worker rate of LE 200/month is probably generous. A reserve of $4,000,000 equivalent is presumed adequate, allowing for over 50,000 person months of assistance.

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2. Project Inputs

The project will provide capital, technical assistance, and training as follows:

(1) $92.1 million in funds which the revolving Trust will utilize to "bridge" the process of sale, including a $5 million reserve for the Labor Compensation Fund.

(2) $2.8 million for technical assistance, to include advisory services to the governorates and to firms and their employees undergoing the privatization process. Technical assistance would be provided through an 8(a) firm, with as much Egyptian involvement as feasible. Advisory services would assist the local government committees to define privatization approaches to be used and to undertake the privatization effort for the governorate units in coordination with the governors. These services would also be available to other elements of the GOE who seek to replicate the Governorate popularization program.

(3) $1.4 million for training, to include workshops, seminars, and conferences on the mechanisms and procedures of privatization.

(4) $0.4 million for evaluation and audit.

(5) $0.3 million for contingency.

D. Outline of the Project and How it will work

Over 250 governorate-owned enterprises have been identified that are engaged in commercial operations. Management, expenditures, and pricing are controlled by the governorate. Most governorate-owned projects do not have accounting records to facilitate a quick valuation and sale. There may be a need to restructure. An intermediary purchase/transfer of many of the enterprises to a trust is expected to enhance the attractiveness of the enterprises to the private sector.

1. GOE Strategy

A national commitment to privatization is not a precondition for governorate divestitures. The decrees already issued for governorate privatization efforts will serve as the institutional endorsement under which the project will operate.

The government's strategy is to start at lower levels of government in a low-key manner to test resistance to privatization and to experiment with the requisite policies and procedures. Potentially, the lessons learned from this effort would have mutual application. A national-level working committee was formed to provide policy guidance and support for the governorate effort. Forty-six (46) projects were submitted to the committee by the governorates for valuation and possible privatization.

The Committee on Privatization (COP) would:

- Determine which assets should be privatized.
- Establish policy guidelines for the disposition prior to sale.
- Monitor and review governorate divestiture and privatization.

To ensure maximum involvement from the governorates, and to minimize delays, technical assistance will be provided to the COP. It is expected that assistance will be structured to accomplish:

(1) The ownership of enterprises would be offered to the employees first, next to residents of the governorate. Every effort would be made to spread ownership and avoid concentration of ownership in the hands of a few. The credibility of the GOE privatization program may depend on widespread access to ownership.

(2) The management of these enterprises must be responsible to the new owners and focus on serving the market.

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(3) The transfer of assets without massive financial losses to the governorate.

(4) The enterprise must be a financially viable investment for the new owners. The new owners should not be expected to absorb losses resulting from the past.

(5) Special consideration must be given to the current employees of the project to purchase the enterprise. They would also be offered retraining, alternative employment, or compensation if they are to be separated (see Labor Compensation Fund on pages 4, 5, and 10).

This strategy suggests that the privatization be carried out in a two-stage process. The first stage would separate ownership and management from the governorate. The second stage would transfer ownership and management to private citizens. Such a two stage approach would permit governorate financial requirements to be met and allow for financial restructuring to make the enterprise attractive to buyers.

2. Privatization Trust

The two stage process would be accomplished by creating a trust which is authorized to operate as an investment bank or venture capital company for the privatization process.

Once an enterprise is brought to a condition in which ownership can be transferred, the project would assist the GOE to organize the valuation, restructuring, and negotiation for the sale of the enterprise. Valuation and appraisal would be done by an uninterested third party in the private sector (for example an investment bank). To avoid obstacles confronting the investors, and to insulate the GOE from criticism (such as allegations of crony capitalism, valuation fraud, or other conflicts of interest), the trust could assume the assets and liabilities on a temporary basis until the final sale or act as broker for the sale.

The project would establish the Privatization Trust, to acquire, reorganize, refinance, and manage the enterprises during the interim period prior to the eventual sale to the private sector.

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The Trust would be managed by a board of directors made up of a majority of members from the private sector. A President/Chief Executive Officer would be selected from the private sector with the concurrence of USAID, a Deputy Prime Minister and the Privatization Committee. The President/CEO will be selected on the basis of his knowledge of business and his commitment to the guidelines mentioned above. His compensation and incentive package will be comparable to positions with similar authority and responsibility in the private sector.

The Trust would be capitalized in foreign exchange. It could also be authorized to receive further amounts of resources from donors and the GOE as required.

(a) How the Trust Would Operate

The Trust would buy the governorate-owned enterprises. The terms of the buyout would be negotiated between the Trust and the governorate. The buyout should not disadvantage the governorate financially.

Next, the Trust would undertake necessary management and financial restructuring of the enterprise in order to make it attractive to private buyers. Employees who choose not to stay with the enterprise or who are determined to be redundant may be eligible for support through the Labor Compensation Fund.

Since the trust is a private company, the project would also be operated as a private company with input and output prices determined by the market. Because the Trust is acting in the interests of the private sector, it is assumed that the GOE will not restrict its operation.

The total time for holding turnaround enterprise transitions and the number of enterprises in the portfolio of the Trust would be limited to stimulate turnover.

The Trust is the key for achieving divestiture because the transfer from public to private control is accomplished once the Trust takes possession of an enterprise. Subsequent resale will not involve the public sector.

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3. Disbursement Mechanisms

The transfer mechanism must be agile. The objective is rapid disbursements. An initial allocation in U.S. dollars and Egyptian pounds would capitalize the project. Thereafter, disbursements would be made as follows:

- USAID disburses dollars to the GOE for the sale (at an agreed price) of each enterprise as it is privatized (sold).

- GOE disburses equivalent amount in LE to the Trust.

- Trust purchases the enterprise from the Governorate with LE.

- Private sector buyer (or ESOP) pays Trust in LE.

The Trust may decide to finance the sale of enterprises on terms other than cash if the need arises (as in ESOPs for transfers to employee ownership).

The Trust may take title to the assets when necessary but it would be preferable for the Trust to act as broker. The Trust may receive fees for investment banking services provided.

The advantage for the GOE acceptance of AID assistance for this project would be potentially rapid dollar disbursements to the GOE for enterprises divested.

III. Factors Affecting Project Selection and Development

A. Social and Economic Considerations

The principal benefits of the project would be the improved conditions for the private sector that encourage increased productivity and income through increased private sector investment.

Much of GOE expenditure this year will be used for defense, salaries, investments and subsidies. Although results accruing from this project are not likely to be significant in relation to the magnitude of the problem, these initial privatization efforts will help to reduce this burden on the GOE budget if the GOE accelerates the process.

A more direct but longer term benefit consists of increased business sector incomes as a result of more efficient capital utilization. Preliminary analysis conducted by the Misr Iran Development Bank (MIDB) with Mission assistance in the cases of Minufiya and Damietta Governorate companies indicates the viability of privatized parastatals as on-going private entities. Also, the reduced role of government in traditionally private sector areas will foster more efficient production and investment conditions.

The sale of enterprises to the private sector will enhance the development of a capital market. More specifically, in cases where Employee Stock Ownership Plans are used, employees will become shareholders building widespread ownership into the capital market.

The long-term desired change is widespread decentralized individual ownership and extension of collateral and credit for investors. The change will also result in the loss of participation of the governorate bureaucracy in control and patronage of commercial endeavors.

Egypt's private industrial activities are generally composed of small and medium-sized enterprises producing food products, light manufacturing, textiles, and building materials. This sector is said to consist of approximately 13,000 businesses with an average employment of 10 to 50 workers. Small and medium scale enterprises employed approximately 624,000 persons in FY 1982, the equivalent of just over 40% of total industrial employment. The governorate enterprises which have been identified by the local government privatization committee appear to have these same characteristics.

As the process of divestiture takes place, some employees of the enterprises to be privatized may be determined to be surplus. The Labor Compensation Fund would be established to provide retraining and severance pay to those employees affected.

This project expects goal and purpose achievement through changes in institutional practices and procedures as measured by the actual divestiture of enterprises and the corresponding support by the GOE for privatization. This project is a catalyst for critical improvements in the business climate and productivity.

B. Relevant Experience With Similar Projects

The Mission has substantial experience with the financial community and with the governorate organizations. The Mission's Private Enterprise Credit project is also designed to increase the private sector's contribution to Egyptian productive output. It provides access to medium and long-term credit and includes assistance to small-scale enterprises. The Mission's assistance to the Capital Markets Authority strengthens equity participation in the economy. The Mission also has direct privatization experience through the Private Investment Encouragement Fund's assistance to the Pioneer Seed Company which resulted in the Ministry of Agriculture reducing its equity position in the company from 51 to 25 percent, thereby giving full operating control to the private sector.

AID has experience in Costa Rica and in the Philippines with similar privatization projects. This project will build on that experience.

C. Recipient Country Agency

The primary implementing agency will be the newly established Trust as a separately functioning institution in the private sector. The GOE counterpart agency will be the Ministry of International Cooperation.

D: AID Support Requirements/Capability

This project is complex and requires full-time attention. To implement it in accordance with current USDH ceilings, the project will require the use of either a well-qualified American, Egyptian, Third Country National Personal Services Contractor or an institutional contractor. While day-to-day burdens can be reduced through general contracts for assistance to the Committee on Privatization and the Trust, continued monitoring and review will be required. Because of the policy importance attached to the project, the Mission believes the strain the project will place on its workload is well worth incurring.

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E. Estimated Costs and Method of Financing (000 U.S. dollars)

	FX	LC	TL
Technical Assistance			
COP Contractor	-	600	600
Trust Contractors	200	800	1,000
Short Term TA	200	250	450
Long Term TA	500	250	750
Sub-Total	900	1,900	2,800
Training			
Seminars/Conferences	50	150	200
Local Workshops	20	180	200
Labor Retraining		1,000	1,000
Sub-Total	70	1,330	1,400
Privatization Funds			
Trust Unit Purchases	-	88,000	88,000
Labor Comp. Fund	-	4,000	4,000
Sub-Total	-	92,000	92,000
Equipment	30	70	100
Evaluation	200	200	400
Contingency			
Other	-	300	300
Total	1,200	95,800	97,000

The life of project will be five years with funding of approximately $15 million in the first year.

The host country contribution would be the initial allocation of local currency from the Special Account to establish and start up the Trusts.

F. Design Strategy/Schedule

The Privatization project is scheduled for start-up in early FY 1989 and last for five years. It is assumed that the Mission has the authority to approve the PP and Project. The following milestones must be accomodated to assure on-schedule project authorization:

AID/W PID approval	3/15/88
Guidance Cable Receipt	3/30/88
Feasibility Studies	5/15/88
Project Analyses/Summaries	6/15/88
Other PP Sections	6/30/88

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First Draft PP	7/15/88
Final Draft PP	7/30/88
PP Approved	8/15/88
Proag Signed	8/30/88

To adhere to the design schedule, the Mission has identified the need for the following contractor expertise: (a) a legal consultant. A local legal counsel will be contracted in February; (b) a privatization contractor. The contractor should have knowledge of privatizations and be familiar with the Egyptian scene, including the capital markets. We are requesting three person-weeks of contractor services through the PRE Bureau, possibly through its Center for Privatization project. We also need one week of a valuation expert's services to review and comment on the methodology being used in the governorates to value their companies. We may also need an outside expert to critique the project's feasibility.

A selection criteria will be applied to enterprise candidates for privatization to avoid the possibility of the Trust becoming a holding company for unsalable assets. The Trust will also be subject to a "cap" on the number of enterprises and length of time that any one enterprise can be held by the Trust to assure turnover.

In addition to the above, we request three person-weeks of ANE/PD/PE staff to assist in the preparation of the PP in order to insure ANPAC guidance is satisfactorily addressed.

It is anticipated that we will need $150,000 from PD&S funds from Technical Cooperation and Feasibility Studies and LE 50,000 from the AID Activity Trust Account to assist in the preparation of the PP.

G. <u>Environmental Considerations</u>

This project provides funding, technical assistance, and training for the privatization of public sector enterprises. None of these activities will impact directly on the environment. 22 CFR Part 216.2(c)(1) (1) excludes from the requirement for any type of formal environmental assessment those actions which do not have a direct effect on the natural physical environment and 22 CFR Part 216.2 (c) (2) (x) specifically exempts support for intermediate credit institutions when the objective is to assist capitalization.

H. Policy Issues

1. Egyptian Commitment to Privatization:

In Part I it was noted that the GOE and local government are not only interested in privatization, but have been actively involved in developing a plan for "popularization" of governorate-owned enterprises. The GOE also permitted the privatization of the Ministry of Agriculture's seed marketing facility, and is assessing similar projects in the tourism sector. There is no doubt that the Egyptian Government is interested in further privatization activities. But will the powerful entrenched Nassarite bureaucracy feel threatened as privatization gains momentum, and withhold their cooperation?

The active involvement of all levels of government seems to indicate genuine commitment to the initial privatization agenda. Success of this Project will provide a solid foundation for privatization of much larger national-level enterprises, so it is carefully designed to avoid the sort of activity that would cause an incident. The Trust is intended to insulate the Government from privatization activities. Privatized firms will be offered first to its workers, and then to local investors. Every effort will be made to avoid layoffs, but if this becomes necessary, the project will make provisions adequate to avoid antagonizing workers. Thus the Project is designed with consideration for political and public sensitivities, but each step of implementation will have to be taken carefully.

2. The Trust: a New Para-Statal? Will the Trust acquire a portfolio of firms and hang onto them, becoming a new quasi-governmental holding company? As discussed in Part D. 2., safeguards will be developed to prevent this, including limitations on the number of enterprises and the time they can be held. This will be further assessed and specified during project design.

3. Egyptian Legal Environment: Egyptian laws and regulations are generally not conducive to private enterprise. Are there serious legal impediments to privatization? Preliminary indications are that, other than the general regulatory bias toward public sector enterprise, there are no significant

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legal constraints. There is a precedent in the Pioneer Seed Company, which encountered no legal obstacles during its privatization. USAID will contract for legal counsel to reaffirm the precedence and assess the legal framework pertaining to privatization at the local and national level.

There is some question about the legal status of the Trust mechanism. However, this will probably require tailoring of the Trust to work in the Egyptian legal context rather than modifying prevailing regulations. This topic is also included in the detailed examination of the Egyptian regulatory environment which USAID will commission as an important aspect of Project design.

PROJECT NO. 263-0216: PARTNERSHIP DEVELOPMENT (Privatization) PRELIMINARY LOG FRAME

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program Sector or Goal	Measures of Goal Achievement		Goal Level Assumptions
To increase private sector participation in commercial enterprise.	Proportion of governorate and state-owned enterprises to private sector companies decreased.	Government Reports Consultant Reports	Governorates will not replace enterprises they sell with new ones.
Project Purpose	End of Project Status		Purpose Level Assumptions
1. Assist the GOE to privatize governorate and state-owned enterprises. 2. Legitimacy of divestiture and mechanisms for valuation, transfer, and compensation widely accepted and understood by government officials.	1. 30 governorate owned enterprises privatized throughout 15 governorates. - Additional enterprises being considered for program. 2. # of officials familiar with and favorable towards privatization. - Amount of public criticism. - # of additional projects under consideration. - # of other ministries and government organizations considering divestiture.	Project Monitoring System Interim and Final Evaluations GOE Records	- Enterprises offered are saleable. - GOE has political will to privatize. - Capital available to purchase. - Legislation for privatization approved. - Employees amenable to privatization with adequate compensation.
Project Outputs			Output Level
1. Committee on Privatization - identifying assets to be sold within policy guidelines, and - monitoring governorate privatization. 2. Asset Trust functioning to purchase, restructure, and sell enterprises to private sector. 3. Labor Compensation Fund established to compensate and retrain redundant employees. 4. Workshops/seminars held to publicize divestiture process.	1. # of assets identified. - Policy guidelines issued. - Reporting system established. 2. $ paid to Governorates for enterprises. - Brokerage fees collected from governorates. - LE collected from purchasers. 3. # of redundant employees separated. - Amount (LE) severance pay disbursed. - # of employees retrained. 4. # of workshops/seminars held. - # of Participants.	GOE Reports Consultant Reports Site Visits Trust Reports & Financial Statements	- Trust can be implemented in legal framework.
Project Inputs	Implementation Target (000)		Input Level
AID Funds Technical Assistance	TA $2,800 Training 1,400 Funds 92,100 Evaluation 400 Contingency 300	Project Agreement Technical Assistance Contracts	- Availability of AID Funds. - Appropriate TA available.