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PD-AAD-983-B1

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DEPARTMENT OF STATE

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON D.C. 20523

PROJECT PAPER

EGYPT: PRIVATE INVESTMENT ENCOURAGEMENT FUND

PROJECT NO. 263-0097

SEPTEMBER 1979

UNCLASSIFIED

Appendix 5A to HB 3, Part I

BEST AVAILABLE COPY

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT PAPER FACESHEET

TRANSACTION CODE: A

PP

DOCUMENT CODE: 3

COUNTRY/ENTITY: Arab Republic of Egypt

PROJECT NUMBER: 263-0097

BUREAU/OFFICE: NE 3

PROJECT TITLE: PRIVATE INVESTMENT ENCOURAGEMENT FUND

ESTIMATED FY OF PROJECT COMPLETION: FY 84

ESTIMATED DATE OF OBLIGATION: INITIAL FY 79 QUARTER 4

ESTIMATED COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY FX	FIRST FY L/C	FIRST FY TOTAL	LIFE OF PROJECT FX	LIFE OF PROJECT L/C	LIFE OF PROJECT TOTAL
AID APPROPRIATED TOTAL						
GRANT	31,000	2,000	33,000	31,000	2,000	33,000
LOAN						
OTHER U.S.						
HOST COUNTRY		200	200		200	200
OTHER DONOR(S)		45,000	45,000		45,000	45,000
TOTALS	31,000	47,200	78,200	31,000	47,200	78,200

PROPOSED BUDGET APPROPRIATED FUNDS ($000)

APPROPRIATION	PRIMARY PURPOSE CODE	PRIMARY TECH. CODE GRANT	PRIMARY TECH. CODE LOAN	1ST FY GRANT	1ST FY LOAN	2ND FY GRANT	2ND FY LOAN	3RD FY GRANT	3RD FY LOAN
ESF	700	840		33,000					
TOTALS				33,000					

A. APPROPRIATION	4TH FY GRANT	4TH FY LOAN	5TH FY GRANT	5TH FY LOAN	LIFE OF PROJECT GRANT	LIFE OF PROJECT LOAN
					33,000	
TOTALS					33,000	

IN-DEPTH EVALUATION SCHEDULED: 06 81

DATA CHANGE INDICATOR. WERE CHANGES MADE IN THE PID FACESHEET DATA BLOCK ... IF YES, ATTACH CHANGED PID FACESHEET

1 = NO

ORIGINATING OFFICE CLEARANCE

SIGNATURE

TITLE: Director, USAID/Egypt

DATE SIGNED: 7/11/79

DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION

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EGYPT: PRIVATE INVESTMENT ENCOURAGEMENT FUND

SUMMARY AND RECOMMENDATION

1. Grantee: The Government of the Arab Republic of Egypt (GOE)

2. Implementing Entity: The Ministry of Economy and Economic Cooperation

3. Grant Amount: $33.0 million (Thirty-Three Million U.S. Dollars).

4. Purpose: To establish credit facilities available to medium and larger sized private sector enterprises for improvement of productive facilities.

5. Project Description: To finance

   a. Sub-project costs of equipment, materials and services imported from the U.S. in participation with domestic banks and

   b. Advisory services for implementation, training bankers in project appraisal, and performance of project appraisals.

6. Total Project Cost: $78.2 million of which this grant will finance $33.0 million and Egyptian sub-project owners, bankers and the GOE will finance $45.2 million in local and other currencies.

7. Grant Application: The GOE has requested an AID grant of $33.0 million to assist in covering foreign exchange costs of this project. The application is attached as Annex A.

8. USAID/Views: USAID/Cairo has recommended that this grant be authorized

9. Source of U.S. funds: Fiscal Year 1979 Economic Supporting Funds

10. Statutory Requirements: All statutory criteria have been satisfied See Annex B.

11. Recommendation: That a grant of $33.0 million be authorized on the terms and conditions described in the draft authorization shown in Annx C, including requests for authorization to purchase Egyptian Pounds and to waive competitive proposal requirements.

12. Project Committees:

USAID/Cairo
Chairman: Thomas R. Tifft
Economist: Peter C. Davis
Counsel: Theodore B. Carter
Program Officer: George Flores
Controller: Raymond De Bruce

AID/Washington
Chairman: Robert H. Bell
Counsel: S. Carlson
NE/EI/E: J. Sperling
NE/DP: S. Chernenkoff
NE/TECH: R. Mitchell
NE/PD: L. Rosenberg
NE/PD: S. Lintner

I. INTRODUCTION

1.01. The Government of the Arab Republic of Egypt (GOE) has requested AID assistance in providing medium to long-term credit to assist in financing the foreign exchange costs of sub-projects of private sector enterprises in the medium to larger sized range, to improve productive facilities. This credit will be channeled through participating banks from a Private Investment Encouragement Fund (Fund), located in the Ministry of Economy. The program was appraised by Robert R. Nathan Associates, Inc. (Nathan), a management consulting firm prominent in the field of credit

facilities in developing nations. Nathan's services were financed from funds made available from AID's Technical and Feasibility Studies - IV (Grant No. 263-0042) under Work Order No. 19 to IQC Contract AID/ofr-C-1380. The feasibility study, completed in mid-August 1979, forms the basis of the project analysis herein.

1.02. This project will form part of the U.S. assistance program to Egypt which aims to accelerate the pace of private sector productivity and improve the quality of life by providing increased employment opportunities, higher income levels for workers, and reduced foreign exchange expenditures. One of the key elements in the AID private sector development program is making available medium-term funds for investment in new and expanded private enterprise facilities. The establishment ot this Fund will encourage sub-project sponsors and their bankers to undertake investments in productive enterprises which are not being undertaken because of the lack of funds available for longer maturities of debt (5-12 years) and for equity.

1.03. The AID private sector development program originated with the Humphrey Amendment Report prepared in February 1978. This report recommended a variety of steps to be taken by AID in cooperation with the GOE to expand productivity of the private sector. Most of these recommendations have now been translated into projects proposed for funding during fiscal years 1979-1981. A key recommendation was the establishment of expanded credit facilities beyond those presently available. The USAID Country Development Strategy Statement (CDSS) includes the concept that in dealing with the needs of the private sector, assistance must provide for the investment requirements of the two major components of the private sector: (a) medium to large companies and (b) small scale enterprise including artisans. This project addresses financial needs of medium to larger sized companies; a separate project, under development, will address small scale enterprise needs for both credit and advisory services. Other projects in the USAID private sector development program address a variety of credit and institutional constraints.

1.04 Assistance for private sector credit facilities was included in AID's FY 79 Congressional Presentation at $50.00 million under the title Private Sector Credit, which included this project for Small Scale Enterprise Credit and Advisors. The GOE's request for assistance is included as Annex A to this paper. All statutory criteria have been satisfied, and the checklist is included as Annex B.

II. BACKGROUND

A. Private Industrial Sector

2.01 Until the Revolution in 1952, the private sector dominated commerce and industry in Egypt. With nationalization of the early 1960s, most firms employing more than 50 workers or holding assets over LE 10 million were expropriated and the private sector reduced to a minority position in the Egyptian economy. Even before nationalization, the government undertook large-scale projects in industrial areas where the private sector had neither the interest nor capability. As a result, large-scale industry has for many years been the sole province of the public sector.

2.02 While the private sector has since the 1960s been limited primarily to smaller-scale industries, it has maintained an important position. The private sector has displayed a remarkable resiliency and even expanded output in certain sectors. Currently, it accounts for one-third of total value added in industry, 55% of industrial employment, and one-quarter of industrial production. Although the private sector produces a minimal percentage of exports, its share has increased substantially in recent years. Private sector share of manufacturing is given in Annex G. There are some 3,800 private sector establishments in Egypt employing more than 10 workers, excluding the artisan sector defined as less than 10 employees. Of this total, 90% employ 10-50 workers and account for 57% of total employment in this sub-sector. Companies employing 50 or more workers total some 350; 10% of all such establishments employ 43% of private sector industrial workers. A table showing size distribution of private sector industry is attached as Annex H.

2.03 Existing public and private sector industry in Egypt faces many constraints to its further development. In many cases, machinery is antiquated, inefficient and not well maintained; productivity levels for both capital and labor are low; skilled manpower is in short supply; quality standards are below international norms; management and production techniques may be deficient; and working conditions are poor. Also the lack of adequate industrial infrastructure in Egypt, in such things as land sites, transport, utilities and communications, hinders the development of industry. It is widely felt that with some incentives, political stability and provision of a range of technical and financial assistance, a competitive and aggressive private sector can expand with efficiency and quickly overcome these problems. Private sector concerns face problems in securing raw materials and in obtaining finance. The lack of longer-term credit facilities and the severe collateral requirements of the commercial banks represent a real constraint to the expansion and modernization of private sector companies. The previous lack of access to foreign exchange has especially inhibited private sector development. Private firms also suffer from a system of price and profit controls and a burdensome taxation policy which in the current inflationary period further complicate their operations.

2.04 The environment for the growth and expansion of the Egyptian private sector has been measurably enhanced since passage of the Foreign Investment Law No. 43 of 1974. Under that law, intended to attract private foreign investment, investors were offered incentives regarding the right to repatriate capital, income taxation and tax holidays. Law 32 of 1977 amended Law 43 and extended benefits to Egyptian domestic investors. Law 43 signaled the beginning of the government's "Open Door" policy of economic liberalization, which recognized a greater role for the private sector in economic development. It had four primary objectives: <u>first</u>, decentralization of decision-making in state-owned enterprises; <u>second</u>, encouragement of the private sector to play its role in the economic development of Egypt; <u>third</u>, provision of incentives to stimulate and encourage private foreign investment; and <u>fourth</u>, expansion of economic cooperation with Western and Arab countries. As far as foreign investment is concerned, the "Open Door" policy has so far achieved only mixed results. On the one hand, the new General Authority for Foreign Investment and Free Zones has approved more than 900 projects, of which 335 are nominally in production and 350 more are in execution. On the other hand, no substantial investment or participation by major foreign manufacturers has occurred. The bulk of investment has centered on banking, investment and consulting services, and touristic projects, rather than productive manufacturing.

2.05 Nonetheless, the transition from the centralized public sector economy of the past to a more liberal environment in which the private sector will assume a larger importance is well underway. Foreign private investment is being encouraged and private domestic activities are gradually expanding. Moreover, a loosening of restrictions on foreign exchange has enabled private concerns to import spare parts and new equipment more easily. What the private sector most requires now is a sustained period of governmental support and favor to overcome a continuing fear of nationalization born of past experience. With a secure investment climate in place, the caution of many private entrepreneurs will disappear and the private sector will develop. In particular, the quality and viability of projects being considered should then improve, and the current tendency toward small, quick payback schemes should fade. Interviews with private entrepreneurs, investment firms and all major banks confirm this view.

B. Financial Sector

2.06 Over the past 25 years, the Egyptian banking system has undergone several radical changes in structure. Until the early 1950s, European-owned banks dominated the scene. Following the Suez crisis in 1956, British and French banks were sequestered. In 1957, all remaining banks were "Egyptianized" and by 1961 the entire banking system had been nationalized. Between 1957 and 1971, consolidation of the banking system left Egypt with only four large public sector commercial banks, each with a particular sector specialization. All four banks were owned, financed and under the direct control of the Central Bank.

2.07 Consequent to the nationalization of industry and the banking system, the public sector became the major source of mobilizing and allocating domestic resources for economic development. Resources were obtained by the government through taxation, price controls and ownership of the principal means of production. They were then allocated in accordance with national economic development plans. Egyptian banks became passive agents of the government in this process, collecting private and parastatal savings, and transferring resources according to government directives conveyed through the Central Bank. Under this system, banks provided public sector companies with short-term (one year) credit for working capital needs. For long-term investment resources these companies, which after nationalization represented more than 90% of total corporate assets, relied on the Investment Fund of the Ministry of Finance. Private sector companies had no access to government funding, and the banks were only permitted to offer them short-term credit. The severe collateral requirements of the banks, however, prevented many would-be borrowers from the use of such facilities. Although these one-year loans were sometimes rolled over and thus became "disguised" term loans, they did not provide an entrepreneur with the latitude to plan long-term investments. Such investments could only be financed through internally generated funds.

2.08 With its policy of economic liberalization, the current Egyptian government has removed the official discrimination against the private sector. It has not yet developed an active program to encourage private concerns; government resources are still directed primarily toward the public sector. For the private sector, the "Open Door" policy essentially means that private firms are being invited to expand and develop, as long as they can identify their own sources of finance.

2.09 Egyptian private sector companies require capital and term-credit in both local and foreign currencies. They have three sources of such finance: internally generated funds, foreign investment, and private domestic resources. The first source has clear limitations, especially with regard to financing new starts and the generation of foreign exchange. Foreign investment has lagged and in any case cannot be expected to carry the brunt of domestic financial requirements. For the long-term, private sector finance, both capital and credit, should come primarily from private domestic resources. However, such resources continue to be restricted, a reflection of the general problem of domestic resource mobilization. For example, many projects require a 1.5:1 debt to equity ratio to obtain bank credit in Egypt today, but only a small class of wealthy entrepreneurs can satisfy such capital requirements for middle to larger sized projects. With no substantial base of privately held capital resources or capital markets, many new projects have difficulty meeting minimal equity requirements. Obtaining of bank credit also represents a major problem for the private investor. Despite improvement since the "Open Door" policy, little long-term credit is available in either local or foreign currency. Short-term credit remains the standard form of private project finance today for both local and foreign currency requirements.

2.10 The shortage of private capital and the unavailability of term credit for the private sector results from low domestic savings. Such savings have recently reached very low levels and constitute a serious constraint to long-term development. A major cause of this problem has been a rate of taxation imposed on dividends and interest payments so high as to constitute a clear disincentive to saving and investment. The problem is compounded by the lack of a variety of long-term financial instruments. The range of instruments available is narrow and because of the low nominal interest rates permitted, real returns are negative after taxation and inflation. (See Annex I for interest rate structure.) Practically all accounts maintained in state commercial banks are demand deposits. Even the time deposits are subject to notice ranging from 15 days to one year. Banks cannot invest or extend much long-term credit backed only by customers' short-term deposits. The lack of an inter-bank transfer system and also of a rediscount mechanism further inhibits banks from extending long-term credit.

2.11 A major objective of the "Open Door" policy was to begin the institutional restructuring required to deal with some of these fundamental problems. An important first step was taken with the enactment of Banking Law No. 120 in 1975 to liberalize and activate the domestic banking system. It introduced a more flexible and expanded role for the Central Bank; abolished the Bank's legal ceiling on interest rates; eliminated the sectoral specialization of the four state commercial banks, allowed them to offer a complete range of banking services (including term lending and equity participation), and provided them with greater operating authority.

2.12 Even prior to liberalizing the national banking system, the government provided for the re-entry of foreign banks under Law No. 43. It was hoped that foreign banks would create healthy competition for the national banks, import modern banking technology, stimulate reform of the existing system, and act as vehicles for the inflow of foreign capital. Foreign banks may engage in either commercial or investment banking. To operate as a commercial bank and deal in local as well as foreign currency, a foreign bank must participate in a joint venture in which the Egyptian partner holds 51% of the ownership. A foreign bank may also incorporate as an investment or merchant bank, either wholly owned or in joint venture with an Egyptian partner; they are only permitted to deal in foreign currencies. Thus far Law 43 has led to some of the effects desired: there has been a substantial expansion of banking activity and a considerable inflow of major international banks. There are now 45 banks and foreign branches operating in Egypt, including several new, wholly or primarily Egyptian-owned private banks. In addition, 28 foreign bank representative offices and 10 other financial institutions, including investment firms and branches of foreign investment houses, have now been established. The institutional environment for meeting private sector financial needs has greatly improved since 1974. (See Annex J for a list of financial institutions.)

C. AID Private Sector Assistance

2.13 One of the key elements of the AID program in Egypt is the furnishing of capital and technical assistance to speed development of the private sector so that it can undertake a larger share of the economic development task. This aspect of the AID program was examined during the review required by the Humphrey Amendment Report, and that 1978 report recommended several specific areas for AID assistance. All of those recommendations are now translated into projects proposed for design and funding in FY 79-81. CDSS puts a strong emphasis on this program element, and the potential role for Egyptian private sector participation is now reviewed in most projects. Results of these efforts are expected to be: increased productivity, additional employment opportunities, improved technology, higher wages with corollary higher standard of living, greater mobilization of domestic and foreign financial resources, and improved foreign exchange position.

2.14 The AID private sector development strategy has concentrated on selected developmental problems areas which effect private sector productivity. Based upon sub-sector studies, projects are being tailored to resolve major problem areas and to create institutions which can continue to address these and other problems as they arise in the future. The strategy for the private sector provides for a broad and interlocking matrix of specific thrusts, through projects, to resolve the principal developmental problems currently facing the Egyptian private sector. The impact of this program is expected to be of a long-term nature, but AID's active role will diminish with improved Egyptian institutional capabilities.

2.15 Key developmental problems currently addressed by present and proposed projects are:

(a) Provision of investment capital - direct foreign exchange resources on medium/long-term are provided by: DIB-I; Commodity Imports Program; Private Investment Encouragement Fund (investment component); SSE Credit & Advisors (sub-loans) and specific project financings (Cement, Flat Glass, etc., plants).

(b) Mobilization/allocation of financial resources - institution building in the financial sector is provided by: DIB-II; Private Investment Encouragement Fund (training program); Advisory Services on Credit; and Money Market/Stock Exchange.

(c) Investment stimulation - investment promotion, information, and incentives are provided by: Private Sector Investment Studies; Egyptian Investment Center; and Industrial Free Zones.

(d) Technology transfer - modern and appropriate technology and management techniques are provided by: Middle Management Education Program; SSE Credit & Advisors (technical advisory component); continued support of International Executive Service Corps; and Business Management Training projects.

(e) Regulations/practices - regulatory and policy matters affecting private business are included in the following projects: tax administration; tax restructuring; investment-oriented seminars and workshops with Ford Foundation; and legal education.

Additional details on these projects are included in Annex K.

III. DEMAND FOR INVESTMENT FUNDS

A. Target Group of Investors

3.01. The basic Egyptian private sector enterprise is wholly owned locally, escaped the nationalization process, and usually owned by individuals, families or partnerships and operates under existing company law. Also, under the provisions of Law 43 (as amended by Law 32), the definition of the private sector was expanded to encourage new investment, and a foreign company can organize a wholly-owned enterprise or a joint venture with either a private or a public sector partner. All such ventures are by definition under Law 43 in the private sector, even if they involve a public sector company. Law 32 amended Law 43 to enable wholly owned Egyptian enterprises, new or existing, to take advantage of Law 43 privileges. As a result of Law 43 and the Open Door Policy, a corporate private sector is beginning to take shape in Egypt in which the public sector, private individuals and foreign investors participate in about equal degree.

3.02. A substantial number of investments are occurring in the range of $1-50 million, apart from very large "public/private" projects. Although in a middle-size range by international standards, the financial needs of these projects are considered "large-size" by current Egyptian standards. For instance, the AID loan to the DIB* has helped to finance private projects costing between $1-10 million. Investment Authority figures show that as of the end of 1978 the average size of newly approved industrial projects was $8.6 million. The MIDB* focuses on projects costing $5-25 million; and through May 30, 1979, approved assistance to 13 private industrial projects ranging in total cost from $2.8 to $24.6 million.

3.03. With respect to the foreign exchange requirements of these projects, the DIB-AID loan provides useful data. According to the 21 largest project appraisals, foreign exchange requirements were 53 percent of total investment, with the ratio of AID financing to total investment being 28 percent. For solely industrial projects, the corresponding ratios have been 65 percent and 21 percent. Under the AID loan, larger sized DIB sub-loans have ranged between $350,000 and $3,000,000. The average size of sub-loans above the $400,000 "free limit" under the recent $40 million IBRD loan to the DIB was expected to be $1 million. MIDB's participations in projects have been between $400,000 and $2,700,000. The Arab African International Bank estimated that its longer-term loans ranged between $2-15 million, implying that its involvement was with rather large private sector investments. The Arab Investment Bank, on the other hand, indicated that its loans fell in the range of $0.5 - $2.5 million.

* Respectively: Development Industrial Bank (DIB) and Misr-Iran Development Bank.

3.04. The conclusion to be drawn is that a substantial segment of current investment activity in Egypt is being undertaken by projects whose total longer-term financial requirements range somewhere between $1-50 million, of which more than half will be in foreign exchange. Indications from the above sources are that this type and size of investment will dominate the investment picture in the coming years, at least in total investment cost per project.

B. Demand and Supply of Funds

1. Demand for Funds

3.05. Bankers, businessmen, government officials and others feel that, given regional political stability, the Egyptian private sector will exhibit a strong investment demand over the next few years, perhaps even an exceptional demand. Private investors are still wary of the future of the liberalization policy, but with the passage of time, those who believe in the permanence of the policy increase. Foreign investors are still troubled by the difficulties of doing business in Egypt, particularly by the lack of infrastructure and uncertainty of foreign exchange and raw materials. Foreign investment, nonetheless, is gaining steam gradually.

3.06. Another indication of demand can be found in the Ministry of Economy and Economic Cooperation's recent projection of investment by the private sector over the Five-Year Plan period 1979-1983. Total investment requirements are estimated at LE 4.5 billion ($6.5 billion equivalent) of which LE 1.8 billion ($2.5 billion) is the foreign exchange component. (See Annex L.) Industry and mining, sectors of prime concern to the Fund, are expected to invest LE 700 million, with a foreign component of LE 355 million. The latter equals more than $0.5 billion, an average of $100 million per year.

3.07. Examination of other sources confirms a strong demand for funds. For example, the MIDB pipeline has four industrial projects which will require $55 million in foreign exchange, of which the MIDB can finance only about 25 percent. The DIB pipeline appears to be equally full: 76 projects are under review whose total investment will be $250 million, with at least half in foreign currency. An additional 130-140 project applications have been received and await screening. The Arab Investment Bank reported a current pipeline of 45 projects. It also is noted that in 1978 it had rejected six good projects for lack of a capacity to provide the long-term credit required.

3.08. Statistics published by the Investment Authority, which reflect activity under Law 43, are probably the most up-to-date and detailed assessment of the strength of private sector investment demand. The Authority classifies projects under three categories: approved, under execution, and in production. According to the Authority, at the close of 1978 the value of total industrial projects under execution stood at LE 906 million and two-thirds of this amount appears to be in foreign exchange equalling $867 million. With adjustments to eliminate large textile projects, a substitute figure of total investment of LE 604 million represents the equivalent of $578 million in foreign exchange. Although this figure does not indicate demand in 1979, since demand is likely to be spread over several years, it is a significant index of the demand for foreign currency funds. Another measure of demand can be determined from Investment Authority sources over the last six months of 1978. The increase in the value of approved industrial projects was LE 226 million, representing foreign exchange requirements of $216 million, or on an annualized basis, $432 million.

3.09. In conclusion, the quantitative survey appears to bear out the prevailing view of bankers and businessmen: assuming stable political conditions, private sector investment demand ought to be strong in the next few years. With respect to foreign exchange requirements, the Ministry of Economy estimate of $100 million per year appears conservative; a figure nearer $200 million per year could prove to be more accurate. Demand for imported investment goods by the target group of larger-sized private sector borrowers could average $125-150 million per year over the next few years. Although much will depend on the incentives, procedures and policies incorporated into the Fund, it is estimated that between 15 and 30 percent of this demand could be captured by investment goods from the United States. Taking the lower figure of the range, this could amount to approximately $20-40 million in each of the next few years.

2. Supply of Funds

3.10. In recent years, the traditional problem in Egypt has been over the lack of foreign exchange. An Egyptian pound shortage has now also become a major concern in financial circles. This shortage is attributed to several factors. First, under the impetus of the IMF, the Central Bank of Egypt is maintaining a tight money policy with strict ceilings set on the total amount of credit banks may offer. Second, public sector activities continue to increase and thereby absorb most available investment and operating capital. Third, public sector companies often delay or default on loan repayments to the state banks. Fourth, the four state commercial banks' new policy of taking equity in Law 43 projects is draining a portion of available money supply. Fifth, private investors are borrowing Egyptian pounds to purchase foreign exchange in the "own" exchange market, outside the government's system of allocation, thus eliminating foreign exchange availability problems.

3.11. Although the supply of Egyptian pounds has been tight, foreign exchange also continues to be a problem. There is generally more foreign currency available now than previously. But for the private sector, foreign exchange is not available in large supply on a dependable long-term basis. The private sector has three principal sources of foreign currency: it can earn its own hard currency from export or work abroad; it can purchase or borrow from officially regulated sources in the "unified" rate market; or it can purchase from the free or "own" exchange market. The "own" exchange market is most commonly used by private sector importers to buy foreign exchange at a slight premium (5-10%) over the unified rate, to get hard currency quickly and outside government regulation. This system provides hard currency to help the private sector meet short-term money needs to which the government would not be responsive.

3.12. Some limited medium-term lending of foreign currency is being carried out by the banking system. The following table provides an estimate of the foreign exchange term lending currently available to the private sector in Egypt. According to the banks interviewed, most of the amounts will be allocated to middle-sized private sector undertakings.

Estimated Supply of FX Credit
For Private Sector Medium to Long Term
($000)

	1980	1981	2-Year Total
Commercial Banks	$30,000	$36,000	$66,000
DIB	30,000	36,000	66,000
MIDB	10,000	12,000	22,000
Other Merchant Banks	10,000	12,000	22,000
Multinational Banks	25,000	30,000	55,000
Foreign Branch Banks	15,000	18,000	33,000
	$120,000	$144,000	$264,000

3.13. As the table shows, the principal single sources of foreign exchange term lending for the private sector are the Development Industrial Bank (DIB) and the Misr-Iran Development Bank (MIDB). The DIB will soon have a total of approximately $75 million in new foreign exchange credits from the World Bank and the European Investment Bank. Of this $75 million, some $30 million will be committed for medium and long-term loans in 1980, including $18 million for loans of 5 years duration or more. Also, the MIDB has just doubled its capital to $40 million. Operating on a 4-to-1 debt to equity ratio, this additional $20 million provides MIDB with $80 million more potential exposure. Coupled with $35 million in new lines of credit the MIDB will have $115 million in resources. Based on past performance, the bank expects to commit only $10 million in loans in 1980, including $5 million for longer than 5 years.

3.14. Other merchant banks will provide an additional $10 million in term credit of which not more than $2 million will be beyond 5 years duration. Commercial banks are expected to extend $30 million in medium to longer-term loans in 1980, of which not more than 10% will be for longer than 5 years. Multinational banks may extend as much as $25 million in longer-term credit in 1980, but only some $5 million for longer than 5 years. Foreign branch banks will offer term credits in the range of $15 million, of which perhaps $2 million will extend beyond 5 years.

3.15. As the table below indicates, there will be a total of approximately $35 million in term lending beyond 5 years available to the private sector in 1980 and $44 million in 1981. A large portion of such credit will be allocated for projects in the middle size range to which the proposed Fund is directed.

Estimated Supply of FX Credit
for Private Sector 5 Years or Longer
($000)

	1980	1981	2-Year Total
Commercial Banks	$ 3,000	$ 5,000	$ 8,000
DIB	18,000	22,000	40,000
MIDB	5,000	5,000	10,000
Other Merchant Banks	2,000	3,000	5,000
Multinational Banks	5,000	6,000	11,000
Foreign Branch Banks	2,000	3,000	5,000
Total	$35,000	$44,000	$79,000

Source: RRNA estimates

3.16. In addition, banks and investment companies will provide hard currency as equity participation. The investment firms are financed by private capital from the Arab oil producing states. Indications are that the capital already in place will not be affected by current inter-Arab political problems, and private investors are reportedly even paying in additional capital. The following table indicates that venture capital available in 1980 will not likely exceed $22 million.

Estimated Supply of FX Equity
for Private Sector
($000)

	1980	1981	2-Year Total
Commercial Banks	$ 3,000	$ 3,500	$ 6,500
DIB	-	-	-
MIDB	5,000	6,000	11,000
Other Merchant Banks	2,000	2,500	4,500
Multinational Banks	5,000	6,000	11,000
Foreign Exchange Banks	2,000	2,500	4,500
Investment Firms	5,000	6,000	11,000
Total	$22,000	$26,500	$48,000

Source: RRNA estimates

3. Conclusions on Demand/Supply of Funds

3.17. An examination of the outlook for the supply of and demand for long-term finance in foreign currency in the private sector discloses the following. Overall demand is expected to be relatively strong, reaching upwards to $125-150 million per annum; of this some $20-40 million represents potential demand for U.S. capital goods and equipment by the medium to larger-sized projects the Private Investment Encouragement Fund proposes to assist. On the supply side, even a liberal estimate of some $55 million available from banks and investment firms leaves a shortfall of $75 million. Were the proposed Fund established at a level of $25-30 million, there should be a strong demand for its resources.

C. Demand for U.S. Capital Goods

3.18. To determine what kinds of U.S. capital goods are or could be competitive in the Egyptian private sector, it is first necessary to identify those sectors of the Egyptian economy in which private entrepreneurs are active, which ones will attract investment in the coming years, and what sorts of import requirements will exist for investment goods in those sectors. The following table provides an indication of private sector activity by broad category of industrial production.

Distribution of Private Sector Industrial Production, by Sector (1977)

Industry	Percent
Food Processing	24.7%
Textiles	20.1
Chemicals and Building Materials	27.4
Engineering	14.7
Metallurgical	2.3
Electrical	2.0
Training Centers	8.8
Total	100.0%

Note: Includes establishments of 50 persons or more.

3.19. Private industrial production is concentrated in such sectors as food processing, textiles, chemicals and building materials where consumer goods industries predominate. The private sector has developed virtually no capacity for capital and intermediate goods production. As for future developments, projections from the Five Year Plan in Annex L indicate the likely pattern of private sector investment. Apart from land reclamation, three sectors will receive 62.5% of total private investment; housing, reconstruction and new communities, and unspecified industry and mining. Building and construction materials and tourism are two other significant investment sectors.

3.20. Egypt currently imports some LE 850 million in industrial commodities, a figure that is expected to increase, and U.S. manufacturers have an obvious potential to satisfy much of this demand. The U.S. has already developed a modest 9.2% share of this market, although much has been financed through AID. A review of the experience of two AID programs provides some indication of where and under what terms and conditions U.S. goods are competitive.

3.21. One program, the Commodity Import Program (CIP), permits Egyptian private sector firms to import U.S. capital equipment. Thirty-five million dollars have been earmarked for the private sector in 1979, and there has been a brisk demand (see Annex M). Utility vehicles and vans along with automotive spare parts are the biggest items imported in dollar terms. Bulldozers, graders, CATS and other construction machinery are the next biggest category, followed by refrigeration equipment. General machinery such as pumps, compressors and the like are next; these categories comprise two thirds of all commodities. The refrigeration generation and food processing equipment are for hotels and food processors. The utility vehicles are intended for commercial/light industrial transportation; the vans, for the tourist trade. There is also a reasonable demand for productive light industrial equipment such as tools, electrical and welding goods for special product manufacturing.

3.22. From a project oriented point of view, DIB's use of AID funds also indicates types of demand. Borrowers from the food processing industry signed the most loan contracts for refrigeration service, cold storage or producing confectionery items. In the tourist sector, the next biggest category, loans were mainly allocated to new hotels for equipment purchases. These two categories composed two thirds of the dollar value of loan contracts signed. Most of the remaining sub-borrowers represented light or ancillary industry, and purchased productive equipment for the textile, leather, metal products, paper and plastics industries. Annex N provides a detailed breakdown of sub-loans by sector.

3.23. A final indicator of potential demand for U.S. goods is a list of 30 projects proposed in the May 1979 Egypt-U.S. Joint Business Council meeting to invite joint ventures with American partners. As shown in the table at the end of this chapter, these projects total $234 million in value and include the following: agro-industry plants, a brick plant, a carbon paper plant, textile mills, food processing plants, and internal airline utilizing seaplanes on the Nile and the seacoasts, as well as automotive plants; a plastic plant, a construction machinery plant, and a pump manufacturer.

3.24. Clearly, the Egyptian business community perceives many opportunities to use U.S. productive equipment and technology requiring investments of a size relevant to the proposed Private Investment Encouragement Fund. It seems clear that the Egyptian private sector has a strong desire for a link with American manufacturers, either through joint ventures or the use of U.S. products. Egyptian entrepreneurs express a lively sense of admiration for the quality and technological advancement of American industrial products.

3.25. Egyptian businessmen are also quick to point out obstacles to the purchase of American goods, of which the most frequently mentioned is price. Egyptian businessmen are generally more price than quality conscious in procurement, and they perceive most U.S. goods to be much higher priced than European products. There is considerable difference of opinion on this score, however, and many business and finance sources stated that U.S. goods are price competitive nearly across-the-board. There are other constraints to the sale of American products. For example, few U.S. manufacturers have full-scale sales and service operations in Egypt; few store goods in free zones or warehouses for display and demonstration; and geographical proximity works against commerce with the U.S. Trade with Europe is easier, less costly and faster. A final, and important constraint is that Egypt has traditionally been a European market. Most of the Egyptian industrial plant is European, and Egyptians have a long-time familiarity with European equipment and business practices.

3.26. To discover methods of compensating for these constraints it is instructive to review the CIP and DIB programs which finance the bulk of U.S. goods imported by the Egyptian private sector. The CIP program provides highly concessional interest rates (2-1/2% to 3 years for materials and 5% to 5 years for equipment); CIP funds are moving at an increasingly rapid pace. The CIP program is, however, a program tailored to meet immediate and urgent needs. A more appropriate model for the Private Investment Encouragement Fund is the DIB loan. The DIB loan moved expeditiously when two conditions were operative: first, when the DIB had little alternative foreign credit available because its second IDA loan had been exhausted; and second, when sub-loans were denominated in Egyptian pounds at the highly inflated "official" rate of LE .40 to US$1.00. When the World Bank made a $40 million loan to the DIB in untied foreign currency, the drawdown of AID dollar funds decelerated immediately thereafter, despite the fact that World Bank sub-loans were pegged to the "parallel" rate and therefore much more costly to the sub-borrower than the AID funds. It seems clear that the availability of untied funds was the controlling factor. This fact leads to the following conclusions. When offered a choice of dollar-tied funds versus untied foreign currencies, a sub-borrower tends to take the latter, even at a substantially higher cost. Put another way, in the presence of alternative untied foreign funding, dollar loans are not currently competitive in Egypt even on highly concessional terms. This is due to the Egyptian proclivity, for various reasons, to buy European products.

3.27. With regard to the proposed Fund, a further conclusion can be drawn: Were alternative untied funds available in abundance, there would be no firm justification for the proposed Private Investment Encouragement Fund, which would presumably operate primarily if not entirely in tied dollars. There are only two significant sources of longer-term foreign currency funding for the private sector, the DIB and the MIDB, and very little available venture capital. Both the DIB and the MIDB have institutional limitations to the number of loan applications they can process each year. Thus, even together they do not represent competition for the proposed Fund, in view of existing overall demand. Other banks that might participate in the Fund currently have almost no foreign currency resources available for longer-term lending or venture capital to compete with the dollar resources to be offered by the proposed Fund.

3.28. Although the proposed Fund would likely operate without serious competition, it must still provide some incentive terms to the sub-borrowers due to the various constraints on marketing of U.S. products in Egypt. These constraints are sufficiently serious that the total package of incentives must be attractive enough to ensure an expeditious movement of funds. Dollar loans through the CIP and DIB programs have only moved at all under highly concessionary terms. Although the terms offered may have been more liberal than necessary, the point still holds. Recommendations on incentive terms are described in Chapters V and VII; costs of tied aid funds are described in Annex S.

Projects for Possible Financing
by
Private Investment Encouragement Fund

Industry Category and Project Description	Total Investment ($000,000)
Agriculture	
1. Land reclamation and agro-industry development	$14.0
2. Agro-industry development	9.7
Construction Materials	
3. Brick plant	4.0
Paper Industry	
4. Tissue paper	33.9
5. Cigarette paper and filters	17.8
6. Carbon paper	3.5
Metal Industry	
7. Cast roll manufacturing	35.4
Textile Industry	
8. Textile finishing plant	42.8
9. Garment manufacturing	2.7
10. Garment manufacturing	1.0
11. Garment manufacturing	8.0
Food Processing	
12. Corn syrup manufacturing	25.3
13. Soya bean processing	8.6
14. Animal feed	1.9
15. Soft drink bottling	6.8
Transportation	
16. Internal passenger airlines	n.a.
17. Automotive components	6.1
18. Automotive filters	.6
Petrochemicals	
19. Polyvinylchoride (PVC) mfg.	n.a.
Construction and other machinery	
20. Heavy equipment leasing	10.0
21. Pump Manufacturing	1.9
TOTAL	$234.0

Source: Data collected by the Egypt-U.S. Business Council and furnished by USAID. Table compiled by RRNA.

IV. THE PROJECT

A. Goal and Purpose

4.01 The purpose of the project is to provide medium to long-term credits for larger sized private sector enterprises for improvement to productive facilities. The credit will be channeled to participating banks through a Fund located in the Ministry of Economy. Although the Fund will receive repayments on sub-project loans and dividends on equity investments, it will be several years before these reflows reach significant levels. Even then, the Fund will experience substantial depletion through inflation and absorption of the foreign exchange risk on repayments. Consequently, the Fund is viewed primarily as an administrative unit for this project rather than as an institutional creation to stimulate or make available medium to long-term credit on a continuing basis. The project goal is to increase productivity of the private sector. A logical framework is attached as Annex F.

B. Project Description

4.02 The project will establish a Fund to provide medium to long-term credit and equity to private sector companies to finance new productive facilities and expansion and modernization of existing production facilities. The Fund will be a co-financier and will hold in its portfolio the longer maturities whereas Participating Banks will hold the shorter maturities. Participating Banks will manage Fund investments as agent. In addition, the project will develop institutional capabilities through advisory services for project implementation, project appraisal, and a training program in project appraisal.

4.03 The medium to long-term investment financing field has few active participants in Egypt. Although many are licensed to do so, most financial institutions prefer the less risky and more profitable financing of trade at short-term; lack adequate sources of long-term funds for investment; or hold their assets as cash and real estate. Medium to longer-term credit is available to only the bluest of blue chip companies. The most important exceptions are the Development Industrial Bank and Misr-Iran Development Bank, both of which are highly active in providing medium term investment finance. Both of these banks are expected to become participants in this project; the DIB is expected to join after it has authorized most of its present AID loan.

4.04 This project does not have any clear precedent wherein AID has provided investment funds to financial institutions on a sector-wide basis to support private sector enterprise. We recognize that approaches and objectives as initially perceived many have to be refined in the light of experience and better information. The development problem is complicated, and the project is difficult to program with accuracy. We anticipate an involvement and rolling planning because there are no school solutions. Under the conditions, we feel that the approach recommended is promising.

C. End of Project Status and Assumptions

4.05 As a result of this project, we expect to encourage development of longer-term investment finance for private sector productive facilities. These results are to be achieved by project elements which:

- Encourage financial institutions to undertake longer-term investments, using Fund assets;

- Encourage financial institutions to collaborate more closely, including commercial banks, investment development banks, insurance companies, pension funds, etc. to draw on each institution's unique financing capabilities;

- Establish a Fund for Repayments for future projects, although this Fund for Repayments will not be large for over a decade and real value will be eroded by inflation;

- Train bank officers and others in appraisal of investment projects;

- Establish a design for a training program in project appraisal taught by Egyptians in Egypt; and

- Encourage use of Egyptian consultants and experts in project appraisal teams, when financial institutions lack a special expertise, usually in technical fields.

- Study financial sector institutional problems to encourage development of long-term sources of funds.

4.06 Accomplishment of results rests on a number of assumptions. Some of the more important assumptions are:

- Government of Egypt will continue to expand its efforts to encourage private sector development;
- Investors and Participating Banks will be sufficiently confident to enter into long-term investments;
- U.S. capital equipment will be competitive in price, quality, and delivery time with other suppliers, particularly European;
- GOE Fund Advisory Board and permanent staff will actively promote the Fund and support its activities;
- Private sector investors will be competitive in providing goods at fair prices and employment opportunities at reasonable wages; and
- Participating Banks will want to use the Fund to complement their present activities.

D. Differences From Previous AID Assistance

4.07 AID has previously provided credit facilities for the private sector, including allocations of $35 million from the Commodity Import Program and a $32 million loan for the Development Industrial Bank, which lends chiefly to private borrowers. These two facilities have provided substantial benefits but also have some built-in limitations which we expect to liberalize through this project. The CIP's purpose is to provide commodities and equipment, chiefly of a non-project nature. It is oriented to furnishing goods and materials for resale or processing but also provides some capital equipment. These funds are adminstered by the four government commercial banks and are available only to 100% Egyptian-owned companies. While these funds do provide investment finance, it is because of the repayment terms (to 5 years) rather than the institutionalization of investment banking. In addition, the Development Industrial Bank has approved approximately $27 million of its $32 million AID loan since 1977 and still has available $5 million for sub-loans. However, other Egyptian banks are authorized and anxious to provide investment finance for private sector projects and are being encouraged by the GOE to do so, but lack access to sufficient sources of long-term funds. Because of the expansion of financial institutions since establishment of the Open Door Policy, we feel that these Funds should be available to the entire range of qualified banks rather than be restricted to one or small number.

4.08 This project is unlike previous AID credit support for the private sector in four chief respects. The proposed strategy incorporates suggestions of bankers with whom the project has been discussed. These are:

(a) Provides both loan and equity financing. Many projects, which are otherwise attractive, have not been financed because of insufficient equity funding. Bankers have been hesitant to contribute equity for a variety of reasons: their loan exposure is sufficient, that may not be equity purchasers (e.g., U.S. commercial banks), or because the small stock exchange does not permit ready market ability.

(b) Makes funds available to a variety of financial institutions which have the experience, capability, and interest in extending medium/long-term financing. This should encourage development of longer term financing facilities in a variety of financial institutions including joint venture and private banks in addition to government-owned banks. The objective is to encourage participation from a broad spectrum of banks. However, the development, joint-venture and foreign branch banks, which are more accustomed to dealing in relatively longer term investment financing will most likely be the leaders in using these funds. Other banks, including commercial banks which tend to operate principally in short-term trade financing, will be encouraged to develop the capabilities of participating in this project.

(c) Provides for feasibility studies of proposed investments to be prepared by Participating Banks and special consultants. Bankers have advised us that many projects appear suitable for development but that potential investors are unable to prepare adequate technical/economic/financial studies and, as a result, projects are not financed. This project will provide special consultants to assure adequate feasibility studies.

(d) Requires mobilization of external financing on a formula basis from other sources, including financial institutions and investors. This feature should encourage closer cooperation among financial institutions, including banks, insurance companies, pension funds, etc. Previously, AID has encouraged mobilization of capital from other sources but has not required it as an integral part of project structure.

V. TECHNICAL DESCRIPTION

A. Private Investment Encouragement Fund

5.01. The technical description of the Fund is based upon the Nathan report and USAID recommendations thereon. Fund characteristics described below, particularly in relation to Fund contribution criteria are considered guidelines rather than restrictions. Consequently, they are not to be included as conditions precedent or covenants in the Project Agreement. Fund characteristics, including determination of criteria, will be made by the Fund/Ministry of Economy with assistance of the project management consulting firm and will be included in the implementation plan to be submitted as a condition precedent to issuance of letters of commitment for sub-projects.

1. Size, Duration and Use of Fund

5.02. Based on analysis of supply and demand, a fund will be established in the amount of $30.0 million, of which not more than approximately 10 percent should be allocated for equity participations. The closing date for commitments by the Fund should be two years after the effective date of the agreement between USAID and the Government of Egypt. The bulk of Fund resources will finance importation of investment goods and materials. Some purchasing of land and buildings might occur under a provision for converting equity participation to local currency recommended in a later section of this chapter. Borrowers are not, however, expected to use loans to hire U.S. engineering or management consulting firm services. U.S. manufacturers often provide technical assistance in the installation of equipment. Many projects need other types of technical help in marketing, production and managerial areas which local entrepreneurs cannot afford to pay for. The Fund should service these needs by serving as a channel for the provision of consultants through the International Executive Service Corps.

2. Speical Allocation for Employment/Environment

5.03 Within the $30.0 million Fund, a special allocation of $5.0 million will be reserved for sub-projects which not only satisfy the financial/technical/economic criteria of the Fund but which also create substantially higher than normal new employment opportunities and satisfy environmental concerns described below. Usage of this special allocation will be reviewed with the Fund staff one year after operations begin to determin its effectiveness. At that time, a decision will be made to continue it, modify sub-project appraisal criteria, or discontinue it and restore the special allocation to the Fund. Criteria for project appraisal in regard to employment generation will be prepared by the Fund in conjunction with the project Consulting Firm. Criteria regarding environmental concerns will include siting in a fashion consistent with the decentralization policies of the GOE.

3. Fund Owner

5.04. AID will create the proposed Fund by a grant to the Government of Egypt. The Ministry of Economy and Economic Cooperation, because of its responsibilities for the economy, the financial system, and, in particular, for the development and implementation of the Open Door policy, is the appropriate implementing Ministry. The Ministry has indicated its willingness to house the Fund, and we are negotiating a proper administrative structure, which is expected to be close to the structure outlined below. Establishment of a Fund organization satisfactory to AID will be a condition precedent to disbursement.

5.05. The Ministry will establish a special section for the Fund staffed by one professional economist or financial specialist, with banking experience, if possible; one professional staff assistant; and one secretary. This staff will be paid from Fund earnings in order to be self-supporting and, thereby, free of the government budgetary process and personnel system. It will have responsibility for the following activities:

- Promotion of the Fund with potential Participating Banks.
- Preliminary screening and pre-selection, in conjunction with USAID, of projects proposed by interested Participating Banks.
- Organization and provision of local or foreign consulting assistance to a Participating Bank when requested or when deemed necessary. Such assistance may be required by some banks in the area of project appraisal or to review questions relating to specialized marketing or product issues.
- Final review and approval of sub-project proposals; USAID will also review sub-projects until the Fund gains sufficient experience.
- Liaison with Participating Banks to ensure appropriate reporting on Fund investments. Semi-annual reports should generally be considered sufficient.
- Organization and management of Fund-sponsored training programs for Participating Bank staff.

5.06 Also, an Advisory Board to the Fund should be created to review and monitor the implementation of the Fund, and report its findings and recommendations to the Ministry. This would enable the Ministry to ensure that the Fund is responsibly managed without the need for an expensive complement of permanent staff. This board should be limited to four or five individuals drawn from the highest professional levels of banking, finance, government and business circles in Egypt. It might include a deputy minister from the Ministry of Economy to represent the Government; a chairman or general manager of a state commercial bank and a chairman or general manager of a joint venture or a privately-owned bank to represent the fields of banking and finance; and the Chairman of the Federation of Egyptian Industries and the Chairman of the U.S.-Egypt Joint Business Council to represent the private sector. The Advisory Board should meet approximately three times annually. Its function should be exclusively advisory in nature; the Ministry of Economy would retain full authority to accept or reject the findings and/or recommendations of the Board.

5.07 A principal-agency relationship will be established between the Fund and a Participating Bank to administer Fund investments. This relationship will invest the Participating Bank with authority to manage the Fund's contribution to a particular sub-project, whether a loan or an equity participation. The responsibilities, obligations, rights and privileges of both parties should be defined in a written agreement. The Participating Bank as agent will assume responsibilities of disbursements, collections, sale of equity, and reporting.

B. Participating Banks

5.08 The Nathan consulting team canvassed most of the principal financial institutions in Egypt to ascertain their interest in and capability to collaborate with the proposed Fund. In general, the response was positive. Most of those interviewed believed there was a need for the Fund and thought that it would offer opportunities for collaboration with their institutions. Bankers said they would welcome another source of credit and equity, particularly hard currency over the medium to longer-term, if the Fund undertook the longer maturities, the banks could finance more projects. The Nathan survey report, attached as Annex O, is summarized below together with recommended qualifications and a list of candidate Participating banks.

1. Summary of Survey

5.09 The joint venture commercial banks currently represent the best source of potential collaborators for the Fund. They have sound management experience in medium-term lending, deal in both local and foreign currency, and are interested in and capable of expanding their longer-term investments in middle-sized private sector projects. With 51% Egyptian ownership, they are in the Egyptian environment without being entirely of it. Having close relations with the four public sector commercial banks, their involvement with the Fund and policy changes deriving from it are likely to impact practices of those state banks. All five banks interviewed were interested in the proposed Fund.

5.10 The four investment or merchant banks also represent potentially active users of the Fund. They have good management (partly foreign), the necessary organizational mandate for long-term investment, and an ongoing term lending program. All four are 50% owned by Egyptian public sector firms, mainly the state commercial banks, and their involvement with the Fund could have positive influence on the term lending policies of the national banks. All but one are limited to foreign currency dealings, however, which would necessitate access to Egyptian pounds through local partners. The two banks interviewed stated an interest in collaborating with the Fund.

5.11 The multinational banks are considered good potential participants as they have an established long-term policy of investment. They also appear to have the necessary organizational capacity to collaborate effectively with the Fund. Although limited to dealing in foreign currency, all three take equity as well as extend long-term credit to projects in the medium to larger size range. Each expressed interest in working with the Fund.

5.12 Foreign branch banks, having access to an international institutional base, can arrange project investment. Only two branches of foreign banks operating in Egypt, Citibank and Bank of America, have developed active medium-term lending programs and can be viewed as good prospects to collaborate with the Fund. These banks are restricted to dealing in foreign currencies, and pound financing would have to be found from other sources.

5.13 The Egyptian private sector banks, such as the Nile Bank, the Delta Bank and the Suez Canal Bank, should be encouraged to participate. Private sector banks are the natural financial agents of private sector industry, and these three banks indicated an interest in cooperating with the Fund. However, any early collaboration with these banks will require technical assistance and close monitoring because of their newness and general lack of institutional experience.

5.14 The four state commercial banks did not seem genuinely excited about the proposed Fund. Their operations are so vast and their obligations to the public sector so well established that the possibility of obtaining some modest funding for small private sector projects apparently does not greatly interest them. Even if they do not become Participating Banks, it is hoped that they will join in syndications with the Fund.

5.15 The Development Industrial Bank would be an ideal collaborator for the Fund, but has not expressed any strong degree of interest in this Fund. In any case, the DIB should be invited to participate after it has approved sub-loans for nearly $5.0 million of unexpended AID loan funds. It has the necessary experience and mandate for term-lending to the private sector. It also has untied long-term hard currency available from the World Bank and others and thus has the flexibility to mix AID dollars with other currencies to suit the needs of any project.

2. Criteria of Qualification

5.16 Based upon a review of bank capabilities, experience, and interest, the following eligibility criteria are recommended for Participating Banks:

a. Be interested and willing to participate according to the terms and conditions established by the Fund.

b. Have sound management and a regular staff of investment and credit analysts.

c. Meet professional standards of investment administration, procurement, disbursement, and collateral requirements.

d. Have at least one year's operating experience in Egypt.

e. Have a portfolio of at least 5 medium-term (1-5 years) loans of a total value of $1.0 million or the equivalent, or, in the case of the four state commercial banks, a demonstrated policy of term lending.

f. Submit to a thorough, independent audit annually.

g. Either deal in or have ready access to both local and foreign currency for investment purposes.

h. Have assets of at least $25.0 million or the equivalent.

3. Candidate Participating Banks

5.17 Based upon the survey, the following banks appear to be most interested in and qualified to collaborate with the proposed Fund:

(a) Cairo Barclays International Bank

(b) Misr-Iran Development Bank

(c) Egyptian-American Bank

(d) Misr America International Bank

(e) Chase National Bank

(f) Arab Investment Bank

(g) Citibank

(h) Bank of America

(i) Suez Canal Bank

(j) Delta International Bank

(k) Bank Misr

(l) Development Industrial Bank (after present AID loan committed)

C. Fund Criteria

1. Project Eligibility Criteria

5.18 The Fund will finance qualifying enterprises meeting the following criteria:

a. Private sector ownership; excluded will be firms with more than 75 percent non-Egyptian ownership and/or more than 33 1/3 percent public sector ownership, even though both kinds of investments would be considered private according to Laws 43 and 32;

b. Both new enterprises and expansion/modernization are eligible;

c. Project total investment cost should be in the range of $1-50 million;

d. Sectors of eligible activity include: manufacturing, agro-industry, mining, education, health, housing, transportation, tourism and industries providing ancillary goods and services to manufacturing, petroleum and transportation;

e. Sectors of ineligible activity include:

(1) projects involving the production, processing or marketing of sugar, palm oil, or citrus for export;

(2) projects which establish or expand the production of any commodity for export if the commodity is likely to be in surplus on the world markets or if it is likely to cause substantial injury to U.S. producers;

(3) projects involving importation of the following commodities or services: military equipment, surveillance equipment, police or other law enforcement equipment, abortion equipment, luxury goods and gambling equipment, weather modification equipment.

2. <u>Project Appraisal Criteria</u>

5.19 Projects must demonstrate technical, financial, and economical feasibility, and take into account potential environmental effects.* A technical feasibility analysis should precede the financial and economic feasibility analyses, particularly if a new or advanced technology is to be introduced through the project. The project should have an acceptable financial internal rate of return or net present worth. In addition, the project should be appraised from the economic point of view to subject project choice to a consistent set of national policy objectives. A minimum economic IRR of 15% will be considered satisfactory, and most projects are expected to exceed this rate. A minimum financial IRR must exceed the effective cost of funds or the project will not be worthwhile to the investor.

5.20 Although USAID supports equity through employment generation, we have not included a separate employment generation criterion for project selection, except for the Special Allocation of $5.0 million. It is difficult to draw conclusions from studies of how development finance has affected employment. If capital cost

*Please see Section VI for environmental discussion.

per direct job is taken as an indicator, and projects that have high capital cost/job ratios are rejected, numerous projects which are both financially and economically sound when appropriate shadow prices are applied will be rejected. Similarly, projects with low capital cost/direct job ratios that are likely to be uneconomic will be accepted. One study on lending by a development finance company in Colombia showed that small firms had a much larger impact on employment primarily due to their capacity to generate employment indirectly. While that study's findings are not conclusive in regard to the proposed Fund, it is expected that Fund investments will generate direct and substantial indirect employment.

3. Fund Contribution Criteria

5.21 Fund contributions to project financing are proposed on the following bases:

a. For Loans

(1) Size: Minimum $350,000 and maximum $5,000,000. Assuming that on average a project's requirement for dollars would be 30 percent of total project cost, this range would allow the Fund to participate in the financing of investments typically ranging between $1.0 million and $17.0 million,given the other criteria described below.

(2) Tenor: Not more than 12 years, including grace period. Loan repayment schedules will generally include later maturities and run for 7 to 12 years, including the grace period, and probably will not be less than 5 years;

(3) Amortization: At least semi-annual repayments of principal and payments of interest;

(4) Collateral: Equal to that required by the Participating Bank;

(5) Compensating Balances: None to be permitted on Fund investments;

(6) Commitment Fee: 1% p.a. on undisbursed balance of loan;

(7) Interest Rate: Prevailing rate for medium/long-term funds, as decreed by the Central Bank of Egypt, presently 10-12% p.a., to be fixed for the life of the loan at the time of signing of a sub-loan agreement with the Fund.

(8) Currencies of Disbursement/Repayment: Disbursements will be made in U.S. dollars under letters of credit to suppliers. Repayments will be made in Egyptian pounds;

(9) Foreign Exchange Risk: To be borne by the Fund not the investor. The rate of exchange for converting dollar disbursements into equivalent Egyptian pounds will be determined on the date of signing the loan agreement with the Fund, based upon the unified rate, presently LE 0.70 = US $1.00.

b. For Equity

(1) Size: Minimum -0- and maximum $1,000,000;

(2) Participation not to exceed the lesser of 12 1/2% of total equity or 5% of total project costs. (Note: the Nathan report recommends that the Fund be permitted to take up to 33 1/3% of equity so long as it is not the largest shareholder, because of the dearth of external funds for equity purchase. While we agree that equity may be hard to find, we feel that the Fund, owned by the GOE, should be a passive, portfolio investor with only a small share of equity.)

(3) Initial equity contributions of 25% may be paid in Egyptian pounds by the Fund; maximum amount is not expected to exceed $750,000 for which a waiver of FAA Section 612(b) is attached in Annex E;

(4) Voting rights: Non-voting shares to be held by Fund with conversion to voting shares immediately upon sale;

(5) Sales by Fund: To be sold, within 5 years after sub-project start-up, only to Egyptian citizens, to be offered first to existing shareholders.

c. Overall Limitations

(1) Size: Minimum $350,000 and maximum $5,000,000;

(2) Fund contribution: Not to exceed 50% of total project costs including working capital;

(3) Total Fund contribution: Not to exceed 3 times Participating Bank contributions;

(4) As a general guideline, not more than 10% of the Fund's total assets are expected to be equity participations. This guideline is not to be enforced on a project-by-project basis;

(5) Debt:equity ratios: To be examined on a case-by-case basis. We do not expect to finance any project leveraged more highly than 3:1. (Note: The Nathan report recommends a maximum debt:equity ratio of 1.5:1 but we feel this could be restrictive and may not provide the flexibility needed for this project.)

d. Participating Bank

(1) Size Minimum $350,000 or equivalent;

(2) Maximum Fund usage per Bank: $15,000,000;

(3) Management fees for acting as Fund's agent to be:

(a) For loans: 1 1/2% flat on amount of Fund loan plus 1/2% p.a. of the outstanding balance;

(b) For equity: 1% flat on amount of Fund equity participation plus 10% of any dividends paid.

D. Fund for Repayments

5.22 A fund for repayments in Egyptian pounds should be established in the Ministry of Economy and Economic Cooperation. It should be a revolving fund comprised of the repayments of loans and the sales of project shares. With a commitment period for projects of 2 years after effectiveness of the Fund, full repayment would not occur for about 14 years. Its operating features and essential objectives could nonetheless retain the features of the proposed Private Investment Encouragement Fund. Moreover, the relatively small size and long period for repayments of the proposed Fund inject uncertainty into the development of the Fund for Repayments. Unlike the case with the proposed Fund, USAID recommends against involvement in the management of the Fund for Repayments. The responsibility for this Fund should lie solely with the Ministry of Economy. The Fund for Repayments may be used in connection with the future establishment of institutions resulting from the long-term finance studies and dialogue described below.

E. Consulting Services

5.23. Consulting services are proposed in three areas: project implementation advisor, project appraisal consultants, and a training program in project appraisal and implementation, to be furnished under a contract with a management consulting firm. The purpose of these advisory services is to help the Fund get launched in a professional and expeditious manner. In addition, the training program in project appraisal will improve Participating Bank staff capabilities and, if sufficient space is available, other banks and companies will be invited to attend. Consulting services requirements are summarized below and outline of scopes of work is attached as Annex P.

5.24 The project implementation advisor will assist the Ministry of Economy in establishing the Fund. This advisor will work directly with the Fund's permanent staff for up to one year. Extension of services for a second year is not contemplated at this time, but will be considered if required and funding is provided if necessary. The advisor will assist in establishing operating procedures, maintaining liaison with Participating Banks and others, screening of potential projects, preparation of reports, assistance with AID procurement regulations, etc.

5.25 Project appraisal consultants may be needed to assist Participating Banks in preparation of project appraisals. While Participating Banks expect to prepare most of the appraisal, it is recognized that they do not maintain large staffs to cover all areas in depth and often rely on outside, specialized consultants for certain portions of appraisals in specific areas, such as a chemical process or special marketing survey. These specialists are expected to be hired for periods of up to two months and may be obtained from the U.S. or Egypt, as individual consultants including IESC volunteers. We want to encourage IESC involvement because volunteers could not only be of direct assistance in helping appraise specific sub-projects but might also be of indirect assistance to investors in broader management areas, thereby increasing the impact of technology transfer. When capability exists and is available within Egypt, we will attempt to obtain such services to encourage development and usage of local capabilities, not only for conduting feasibility studies, but also for advising investors on sub-project development. Inasmuch as both IESC and Egyptian source special consultants will require payment in local currency, we are applying under FAA Section 612(b) to convert up to $600,000 of project funds into Egyptian pounds, attached as Annex E. Other project appraisal consultants are expected to be hired from the U.S. as individuals or to be furnished by the project management consulting firm.

5.26 A training course in project appraisal and implementation will benefit Participating Bank staff. Aside from this particular project, many bankers, investors, businessmen, and government officials have indicated a desire for such a course. Because of the immediate need for this project and because of the more far-reaching need of others concerned with the allocation of investment resource, whether in the private sector or government, the management consulting firm will both give such a course and investigate supply, demand, and institutional capability for course repetition. The training program in project appraisal and implementation will be available for staff of Participating Banks and repeated approximately three times per year for 20 students. The training program will be organized by the U.S. consulting firm but staffed principally by Egyptian instructors. The result will be to initiate a course which both satisfies international standards for content and also draws principally on Egyptians for conduct of classes. This training program is to be completed either as two three-week courses (introductory and advanced) or as a single course of up to eight weeks.

5.27 The U.S. consulting firm will also conduct a supply and demand study of the need for and availability of similar courses, to be made available to bankers, investors, businessmen, government officials, and others concerned with the appraisal of projects and allocation of resources. It is obvious to many several-year residents of Egypt that international standards of feasibility studies are not prevalent in decision-making by investors, that many investors desire such techniques to be readily available, and that a cadre of Egyptian professionals in government, universities and consulting firms, have excellent teaching and consulting credentials in this area. The purpose of the demand/supply study will be to determine whether the expressed demand for good quality feasibility studies can be satisfied by Egyptian professionals, if properly organized. If there are shortcomings in demand, supply, or organizational structure, then we would like to determine whether AID can assist.

F. Long-Term Finance Studies

5.28 Egypt presently has an insufficient supply of long-term funds available to finance projects of the nature contemplated by this credit facility. As part of this project, we will initiate a dialogue with the GOE to identify and investigate the constraints on the development of long-term financial markets. These investigations will be developed in cooperation with the Ministry of Economy and may cover a variety of topics including regulatory/policy, institutional, and marketing/instruments aspects. As specific areas of concern are jointly identified, investigations will be undertaken by management consulting firms under host country contracts. Some of the potential areas for investigation include: subsidy/rationing of credit; mobilization of savings by increasing interest rates and variety of instruments; impediments to investors in financial instruments including taxation and lack of marketability; inducements to increasing long-term lending, such as guarantees; methods of encouraging syndication among commercial banks, insurance companies, and others; need for improved monetary statistics; supply and demand for funds by categories; etc.

5.29 Institutional structure of long-term lending organizations will also be examined. In this connection the GOE may wish to use the Fund for Repayments in one of a variety of ways to encourage development of long-term financing facilities. Some ideas to be examined would include: establishment of a new institution in the private sector, establishment of a guarantee or insurance program, extension and expansion of the Fund itself in a modified form. To carry out the studies contemplated in long-term finance, the amount of $600,000 has been allocated.

G. Cost Estimate

5.30 Total project costs are estimated at approximately $78.2 million, of which AID will finance $33.0 million through a grant to the GOE. Other project costs, to be financed by others including Participating Banks, private sector investors, and the GOE, are estimated at $45.2 million or equivalent in local or foreign currencies. A summary of total project costs follows ($000 or equivalent):

	AID Grant			
	U.S. $	Local Currency	Others	Total
(a) Investments in Sub-projects	$28,800	$1,200	$45,000	$75,000
(b) Consulting Services				
(i) Project Implementation Advisor (up to 2 yrs.)	250	50	200	500
(ii) Special Consultants (30 persons x 2 person/mo)	600	600		1,200
(iii) Training Program	350	150		500
(c) Long-term finance study	600			600
(d) Contingency and Escalation	400			400
TOTAL	$31,000	$2,000	$45,200	$78,200

VI. ENVIRONMENTAL ANALYSIS

6.01 This project will finance additions to existing plants and establishment of new plants. Specific sub-projects to be proposed for finacing are not known at this time. As specific sub-projects are proposed, environmental concerns will be addressed. The attached Initial Environmental Examination recommends a negative determination (See Annex Q).

6.02 To prevent adverse environmental impact, a mechanism will be developed in the analysis of sub-project applications to assure that environmental considerations are taken into account. All projects which are reviewed by AID will receive written clearance from the Environmental Officer, USAID/Cairo, and copies of these clearances will be sent to the Environmental Coordinator, NE/PD for inclusion in permanent files. Environmental review of industrial facilities should place emphasis on siting, alignment of transportation and utility rights-of-way, review of production processes, noise exposure levels, housekeeping practices and wastewater systems; consistency with existing zoning and land use plans; and non-usage of agricultural land.

6.03 The project appraisal training program will include a component on environmental evaluation, to expose personnel to environmental issues, sources of technical assistance and socio-economic benefits associated with environmentally sound investments. Efforts should be made to use this as a device to institutionalize environmental review in investment analysis.

6.04 Also, procurement will be limited to those items eligible under the AID Commodity Eligibility List, eliminating pesticides, chemicals, and related products which produce adverse environmental impacts.

VII. FINANCIAL ANALYSIS

A. Financing Plan

7.01 Project total costs of $78.2 million are expected to be financed from the AID grant, Participating Banks and sub-project investors, and the GOE, as follows (figures in $000 or equivalent).

	AID Grant				
	Dollars	Local Currency ($ Converted)	Investors/ Banks	GOE	Total Sources
(a) Sub-Project Investments	$28,550	$1,200	$45,000	-0-	$75,000
(b) Consulting Services					
(i) Project Implementation Advisor	250	50		$200	500
(ii) Appraisal Consultants	600	600			1,200
(iii) Training Program	350	150			500
(c) Long-term finance Stdy	600				600
(d) Escalation & Contingency	400				400
TOTAL	$31,000	$2,000	$45,000	$200	$78,200

(B) Incentives to Investors

7.02 As described above in Chapter III, U.S. equipment may not be price competitive in Egypt. Costs of tied aid are described in Annex S. Egyptian investors have been hesitant to use AID funds available through the DIB.

In comparison, CIP funds have been drawn down comparatively rapidly because they are priced to the investor at 2 1/2% for up to 3 years (for materials) and at 5% for up to 5 years (for equipment). The Fund, however, is intended to complement funds from existing financial institutions and, while we are interested in offering incentives to compensate for costs of more expensive, tied AID, we feel that incentives should result in terms fairly close to commercial terms from Participating Banks. Consequently, inducements to use these funds, listed below, have been discussed with potential Participating Bankers, who feel that they should provide sufficient incentives. Incentives are:

(a) Interest rate of 11% p.a., without compensating balances, compares favorably with the 15-16% p.a. effective rates of commercial loans priced over London Interbank Offered Rate (LIBOR) and loans priced with compensating balances;

(b) Interest rate is fixed and not subject to volatility of the international money markets;

(c) Foreign exchange conversion rate for repayment is fixed, thus removing foreign exchange risk from the investor;

(d) Term of loans can extend to 12 years, including grace period, when such loans are available only in limited amounts;

(e) Repayment is in Egyptian Pounds, which removes the necessity for earning or converting to obtain foreign exchange;

(f) Equity participation funds are available, which are difficult to obtain from financial intermediaries at present;

(g) Foreign exchange will be made available, which carries a premium in the market;

(h) A broad range of banking institutions will offer Fund facilities, thereby enabling investors the flexibility to maintain established relationships or shop for new ones;

(i) Investment appraisals will be conducted by Participating Banks and special consultants, thus assuring investors of greater success rates; and

(j) Technical services of IESC can complement Fund investments, thus providing highly experienced advisors at relatively low cost, if desired.

7.03 The Nathan report recommends that AID provide one additional incentive; partial relief from AID's U.S. source/origin requirements. The recommendation is that when a sub-project is prepared to acquire $1.0 million or more of U.S. goods, the Fund should be permitted to finance in other foreign currencies up to an additional 30% of the total Fund contribution. For example, if the Fund contributed $1,430,000, then $1,000,000 would be tied to U.S. source/origin procurement and $430,000 would be available in other foreign currencies. In addition, whenever this incentive is accepted, then the investor would bear the foreign exchange risk instead of the Fund, thereby giving up one Fund incentive in exchange for another. This recommendation was made because of the risk of slow implementation and also because of the lack of availability of other foreign currencies on medium or long term.

7.04 USAID has carefully considered this recommendation and, based upon many of our personal experiences,feel it is well thought through and has much merit. However, because of AID's firm Congressional direction to finance goods only of U.S. source/origin, we are not proposing this recommendation be included in the project at this time. We feel that the presently proposed incentives, summarized above and the absence of any substantial competition from untied foreign exchange sources, described in paragraph 3.03, may be sufficient inducement to entrepreneurs to use these funds. If, however, this project lags in the first year of implementation, we expect to assess promptly the reasons, and, if they are caused by the lack of untied funds, we may reconsider this initial position and ask for authority to purchase a limited amount of imported equipment from non-U.S. sources.

VIII. ECONOMIC ANALYSIS

8.01 It is impossible to determine a priori what the economic internal rate of return (ERR) will be on Fund investments. Each subproject assisted by the Fund will have its own level of investment and its own expected net income stream; both of which will have to be evaluated in economic terms using shadow prices to estimate the economic value of costs and value of income. This process can only be initiated when actual loan applications are made; therefore, a precondition to receiving project funds is that the activity have at least a 15 percent economic internal rate of return.

8.02 However, it is not impossible to determine what might be expected as an average economic rate of return for Fund assisted projects, based on data derived from past private sector investments and on certain reasonable assumptions. Although there is no data available on actual private sector investments, the Ministry of Industry has compiled planned employment, output, and investment data for 1977 from 504 private sector industrial activity proposals.1/ These data indicate that for every $1.00 of total capital invested about $0.50 would be the expected net value added, including labor costs but excluding depreciation. This is equivalent to saying that the expected unadjusted ERR on the investment would be 50 percent.

8.03 This can not be considered an economic rate of return for several reasons:

1. It is based on a planned or expected output/capital ratio which may not be realized when the investment is carried out and actual production begins. (For example: if the planned output/capital ratio assumes 100 percent production yet only an average 80 percent production level is realized, then there would be a 20 percent reduction in the unadjusted ERR; or, if actual capital costs exceed the planned level, then the realized output/capital ratio would be lower and the real ERR reduced.)

2. It is based on financial, not economic, values for the investment and production costs, and the sales proceeds. (For example, we know that certain subsidies exist on construction goods, and input costs such as fuel and electricity, and that output prices in some cases are directly controlled by the GOE or indirectly influenced by public sector production of similar goods at less than market prices.)

1/ Industrial Activities of the Private Sector Supervised by the Ministry of Industry and Mining 1977, August 1978

3. It assumes a risk free environment which does not exist in reality.

8.04 We do not know what the exact adjustments should be to derive the ERR from the unadjusted one. However, we can make a set of reasonable assumptions about what the adjustments might be, and determine the implied ERR.

8.05 There are numerous factors which could be incorrectly accounted for in planning an investment. Also, in general, one would expect the output/capital ratio to decline over time as investments are made first in those areas where the return would be highest. Therefore, to be conservative it seems reasonable to assume that the effective output/capital ratio could be as much as 30 percent less by the time private sector projects are implemented during the time frame of this project. Also, it does not appear that past private sector investments have been made in areas where there would be substantial gain from the use of subsidized inputs or where there exist significant output price distortions. Therefore, a 20 percent reduction at most in the unadjusted ERR, which was based on financial values, would seem to be appropriate to account for the use of shadow prices. Finally, concerning the risk factor, let us assume that 10 percent of the investments fail to produce anything.

8.06 Based on the assumption in Paragraph 8.05, the compounded or cumulative impact on the unadjusted ERR would be to reduce it by 50.4 percent yielding an adjusted ERR on private sector investment of 25.2 percent.

8.07 This would be a fairly accurate estimate if the initial investment would maintain its productive capacity over a long time frame with no reinvestment needed to keep up the capacity. However, this is not a very likely outcome. Therefore, we have assumed that the productive life of an investment is only ten years with no salvage value. On this basis, the resultant adjusted ERR would be 20.9 percent. This is a more accurate measure of the ERR on private sector investment.

8.08 The one remaining question is whether or not it can be assumed that this ERR would also apply to investments assisted by the Fund. The original analysis was carried out on planned firms of a size and type similar to those expected to be financed by the Fund. It seems probable that composition of projects financed by the Fund should correspond somewhat to the composition in the original analysis. The only identifiable difference is that during the feasibility study it was indicated that there is a cost of one type or another to the investor of our tying aid to U.S. origin purchases (see Annex S for a fuller discussion). A precise measure of this cost was not made. However, for the purposes of this calculation we have assumed that it is 15 percent. This implies that the net productive value to Egypt of having to procure U.S. goods would be 85 percent of what could be obtained if these goods were purchased elsewhere.

8.09 Applying this factor to the assumed average proportion of the total investment associated with our tied aid (40 percent) results in an adjusted ERR of 19.5 percent for Fund assisted projects.

8.10 See Annex R for a discussion of some other economic impacts.

IX. SOCIAL ANALYSIS

9.01 The central social objective of any program of industrial investment in Egypt should be to produce:

(a) income streams to more individuals; and

(b) larger income streams to individuals.

9.02 The analytical problem in designing an industrial investment project with these social objectives is to select an optimal path between labor creation and reasonable wages per worker. In countries where labor is a scarce and costly factor of production this task can be extremely complex; however, in cases such as Egypt where the labor supply is not severly constrained and the unit cost of labor makes it a relatively inexpensive factor, the problem of social optimality is somewhat simpler. The investor's goal of optimizing net productivity from all factors biases his investment selection (under Egyptian conditions) towards moderate labor intensity and moderate labor productivity.

9.03 The private industrial sector has distinctive characteristics with respect to labor productivity, wage rates, capital costs of job creation and capital/land/labor factor ratios. In the analysis we will attempt to look at these unique features of private industry in Egypt and how they relate to the task of finding the socially optimal path to more jobs and higher wages.

9.04 The overall development investment policy vis a vis output should not be to maximize output per unit of capital investment. Such as strategy is too simplistic and would tend to emphasize labor intensive projects utilizing a large number of workers per unit of output, a strategy sure to result in low-wage job creation. Since there is an abudance of low wage jobs in Egypt and low open unemployment, a development investment policy which only emphasized labor productivity would not be best serve Egypt's needs nor should development investment policy be geared towards maximizing jobs created per unit of investment for the same reasons. This kind of strategy would similarly tend to emphasize labor intensive investments generating low wage employment.

9.05 The employment policy goal of programs like the Fund should concentrate on enhancing overall productivity. This generally requires an increase of the productive capital investment per job, what economists call "capital deepening." The aggregate consumption/production objective should be to encourage private capital formation (investment) with a view towards efficiently maximizing output given Egypt's resources. Since it appears that the appropriate employment objective should be to attempt to enhance worker productivity rather than create jobs per se, it can be concluded that there is little conflict between the two principal investment policy concerns of the Fund, employment impact and production efficieny.

9.06 Development of Egypt's urban based industrial sector is an appropriate development strategy, given both the present socio-economic situation and underlying long-term trends. Egypt's countryside cannot continue to support her population; new means must be found to support the burgeoning urban population in a reasonable degree of comfort.

9.07 In particular, it seems that industrialization is about the only long-term solution to one of Egypt's greatest economic dilemmas; i.e. that she is both a country whose economy is highly dependent on agriculture and a nation with a large foodstuffs import requirement. The most practical way for Egypt to generate foreign exchange and reduce net import requirements is to industrialize. The private sector is being looked to by the government to play an important role in this process. A program such as the proposed Fund would support this policy goal. (See Part I, Annex T for a more detailed discussion.)

9.08 Summarized below are various social implications of the proposed Fund. (A more detailed discussion can be found in Part II of Annex T.)

(a) Based on 1977 data for comparable private sector firms, projects assisted by the Fund will directly create 10,300 jobs and indirectly probably create an additional 10,300 jobs. (Note there is no data on the percent of jobs held by women in this segment of the private sector. However, there is no reason to believe that women would not maintain their relative proportion of jobs created by the Fund.)

(b) On the average in Egypt there are 3.2 persons per employee so Fund investments would directly support about 33,000 citizens.

(c) Average wages paid in the private industrial sector reportedly are higher than those in the public sector and are increasing faster. They also appear to be less than is paid by joint venture companies in Egypt.

(d) Social benefits directly attributable to the project's \$30.0 million Fund and the total expected \$75.0 million of investment will be varied and substantial. Private sector firms will earn profits; labor employed will earn wages; and, the Egyptian Government will receive transfers in the form of import duties, corporate and personal income taxes, and loan repayments. Based on the analysis in Part II.D of Annex T which in part contains assumptions of a 15 percent social discount rate and of a 15-year life of project for investments, the social benefits from the \$30.0 million Fund will be about \$53.5 million and from the total \$75.0 million of investment will be about \$146.1 million. Of the \$53.5 million: 34 percent would flow to the private sector firms for distribution as dividends or for reinvestment; 15 percent would flow to labor; and 51 percent would flow to the GOE to be redistributed to other sectors of the economy based on the government's expenditure policy (discussed in Paragraph 9.09 below).

9.09 Data on the Egyptian Government's expenditures indicates that over three quarters of the budget is aimed at directly improving the social welfare of the population through the provision of economic and social services; and subsidies. Thus a large proportion of the social benefits from the Fund will reach the poor. All things considered, it appears that the Fund would not exacerbate the relatively good income distribution in Egypt. This is reinforced by the fact that secondary, tertiary and income effects of the overall program would tend to be weighted in favor of labor and the general population.

X. PROJECT IMPLEMENTATION

A. Implementing Agencies

1. Ministry of Economy Committee

10.01. The Ministry of Economy and Economic Cooperation will own the Fund and will be advised on policy by a Fund Advisory Board. This Board will be comprised of government and private sector representatives. To assure continuity and to handle day-to-day problems as they arise, the Ministry will have a small staff expected to consist of a senior professional, as assistant, and a secretary, to be hired specially or seconded from a pertinent organization such as the Investment Authority. The GOE will approve sub-projects for Fund financing. Criteria for approval will be established by the Fund Advisory Board; however, approvals for specific sub-projects will be granted by the permanent staff within established criteria. USAID will participate in a joint approval process for sub-projects, if doing so will speed issuance of approvals, during the Fund's start-up period and for a while thereafter; when the Fund has sufficient experience, USAID will drop out of this process. Additional description and details regarding the GOE Implementing Agency are given above in Chapter V.

2. Participating Banks

10.02. Participating banks will be responsible for day-to-day implementation of Fund investments in sub-projects. Fund investments will generally be made on the same conditions as Participating Bank investments. Participating banks will provide continuous management of Fund investments on behalf of the GOE. The administration will provide maximum discretion in management to the participating banks, as is customary in U.S. trustee relationships, and minimum cumbersome government controls and regulations. The proposed Participating Banks have satisfactory management and staff capabilities to carry out the responsibilities of managing Fund assets; they have favorable reputations in Egypt; and senior management teams, known to USAID and the Embassy, are highly regarded. Additional description and details regarding the Participating Banks are given above in Chapter V.

B. Implementation Plan & Procurement

1. Fund Investments in Sub-Projects

10.03. The implementation plan is similar to plans for intermediate credit institution projects. In this case, implementation will include the following principal steps for each sub-project: (USAID's role is expected to decrease as the Fund gains experience.)

(a) Sub-project sponsor prepares preliminary sub-project description and takes it to a Participating Bank;

(b) Participating Bank makes preliminary evaluation to determine whether the sub-project is acceptable and, if so, prepares a project appraisal plan, including a description of the need for project appraisal consultants;

(c) Participating Bank approaches Fund staff and USAID with: preliminary description, its preliminary evaluation, and appraisal plan;

(d) Fund staff and USAID approve appraisal plan and obtain services of project appraisal consultant to work with Participating Bank appraisal team;

(e) Appraisal if undertaken and completed;

(f) Participating Bank approves its share of financing, subject to obtaining of Fund resources;

(g) Fund staff and USAID approve Fund investment on basis of appraisal and Participating Bank commitment;

(h) Participating Bank concludes investment agreements and other documentary requirements with sub-project sponsor and Fund;

(i) Upon request, AID issues Letter of Commitment in amount of Fund's investment to include all items eligible under the AID Commodity Eligibility List, including provision for standard advance payments. Letters of Commitment will be issued uniformly on this broad basis to minimize potential delays from having to issue amendments;

(j) Sub-project sponsor obtains bids and makes awards to equipment suppliers (for expenditure of Fund resources only) on the basis of AID regulations using negotiated procurement procedures described in AID Handbook One, Supplement B, Chapter 19;

(k) Participating Bank issues letters of credit, goods arrive and are installed; plant begins production;

(l) Participating Bank services its own and Fund's loan/equity including records of disbursement and repayment; compliance with covenants, continued validity (and reduction if provided) of mortgage or other security arrangements; etc.

In the case of Fund sub-loans, the Participating Bank's management obligation ceases with final repayment; in the case of equity investments, the Participating Bank's management obligation ceases upon delivery to the Fund of sales proceeds. For these services, the Participating Banks will receive a management fee.

2. Advisory Services

10.04. Advisory services, including a project implementation advisor, project appraisal consultants, and a training program in project appraisal will be obtained from a management consulting firm. Host country contracting procedures will be used, and we are requesting a waiver for negotiation with a single source. The single source will be Robert R. Nathan Associates, of Washington, D.C. which performed the feasibility/design study under an IQC contract. The reason for the request is to shorten the time required before project implementation is started, based on a variety of reasons. Contract cost is estimated at approximately $800,000. Please see Annex U for the request for a waiver.

3. Long-Term Finance Studies

10.05. Long-term finance studies will be undertaken after establishment of a dialogue with the Ministry of Economy. Areas to be covered will be jointly decided and investigations will be carried out under host country contracts. The dialogue will be initiated early, and we hope to identify areas for early investigation shortly after the Fund starts operations.

C. Implementation Schedule

10.06. USAID plans to work closely with the GOE Ministry of Economy and the Fund Committee to expedite project start-up. The Ministry has been responsive to date, and we are confident it will continue to assign this project a high priority. After completion of establishment of the Fund, most of the responsibility for project implementation will shift to the Participating Banks, and we have been assured they will proceed in a fast and businesslike manner. The implementation schedule is estimated as follows:

Event	Date
Ministry of Economy establishes Fund Committee	October 1979
Negotiation of Contract	October 1979
Contractor Starts Work	November 1979
First Sub-Project Approved	January 1980
First Bank Training Program	April 1980
Last Sub-Project Approved	January 1982

10.07. Assuming that the Fund can begin operations by early 1980 and that all sub-projects are approved within two years thereafter, the project disbursement schedule for the AID grant only is summarized below ($000's); a more detailed schedule is attached as Annex V.

Item	1980	1981	1982	1983	1984	Total
Fund for sub-projects	$2,550	$9,550	$9,100	$6,000	$2,800	$30,000
Consultants						
(a) Project Implementation Advisor	145	145	10			300
(b) Project Appraisal Consultants	600	600				1,200
(c) Training Program	200	200	100			500
Long-term finance study		300	300			600
Escalation/contingency	130	190	80			400
TOTAL	$3,625	$10,985	$9,590	$6,000	$2,800	$33,000

D. Terminal Dates

10.08. The terminal date for satisfaction of conditions precedent to initial disbursement (including signatures and project consulting firm) will be three months from the date of grant signing.

10.09. The Project Assistance Completion Date is set at June 30, 1984, which will allow a little more than two years to approve sub-projects plus two years to receive equipment and have it operating. The terminal date for opening letters of commitment will be June 30, 1983, which is a little over one year after the last sub-project is expected to be approved. The terminal date for disbursements will be September 30, 1984, which is one year after issuance of the last letter of commitment. This one year period should permit delivery of goods and disbursements of funds under letters of credit opened pursuant to the last letter of commitment.

E. Monitoring and Reporting

1. Monitoring

10.10. Monitoring of this project will be undertaken by USAID staff which will be in frequent but not daily contact with the project management consulting firm, Fund staff, Participating Banks, and sub-project sponsors to monitor project progress and visit project sites. The USAID project manager (a loan officer) will draw on assistance from other divisions as needed, including engineering, legal, etc. In addition, periodic consultations will be scheduled with the Ministry, Fund Advisory Board and staff to assess portfolio impact, problems, management, and appropriate amendments to the implementation plan. Regular bi-monthly reviews of progress will also be conducted by the USAID Mission's top management staff. Such reviews, when required, will be followed by substantive meetings on project problems with the Ministry, Fund Advisory Board or staff and Participating Banks.

10.11. USAID approval of sub-projects proposed for Fund investment, presently planned to be done in cooperation with the Fund staff, will follow standard mission procedures. These procedures require review by a permanent project committee and approval by the USAID Director based on an Action Memorandum. This procedure is used for approval of DIB sub-loans, Industrial Production sub-loans, and others.

2. Reporting

10.12. Upon signing of the Grant Agreement, USAID will issue an Implementation Letter which will contain the necessary guidance on types of reports (progress, financial, shipping, etc.) and formats and schedules to be followed. The reports will be prepared by the Fund staff based upon information provided by the Participating Banks. During the initial stages, the project management advisor will assist in preparing these reports and obtaining pertinent data from the Participating Banks.

F. Evaluation

10.13. This project is designed for approximately a five year life, but all sub-projects are expected to be approved for financing during the first two and one-half years. The most critical measure of success will be the length of time required to commit all project funds to the financing of specific sub-projects. The first evaluation, covering both Fund investments and effectiveness of training, will be performed by outside experts one year after implementation has started, or approximately mid-1981. At this stage, the project's success can begin to be meaningfully evaluated, and USAID expects to be considering further assistance of a similar design. An outside evaluation will bring fresh insight and perspective to the project and its structure and could serve as a basis for a second such project. A final evaluation will be performed by the USAID project committee after project funds are fully disbursed. Objective criteria for project evaluation will be developed in cooperation with the project management consulting firm and will be based upon information on specific sub-projects and the training program, available from Participating Banks and sub-project sponsors. Such information will include sector of investment, contribution to GDP, employment effect, foreign exchange effect, etc., for sub-projects and will include number, job categories, qualitative improvements, etc., for the training program. Evaluation will also be made of the impact on mobilization of private sector resources for long-term finance and the results and plans resulting from the long-term finance studies and dialogue between the GOE and AID.

XI. RECOMMENDATIONS, CONDITIONS AND COVENANTS

A. Recommendation

11.01 Subject to the conditions and covenants listed below, we recommend that AID authorize a grant to the Government of Egypt (GOE) in the amount of $33.0 million for the Ministry of Economy and Economic Cooperation to establish a Private Investment Encouragement Fund.

B. Conditions Precedent to Disbursement

11.02 Prior to the first disbursement or the issuance of the first Letter of Commitment under this Grant, the GOE shall furnish to AID in form and substance satisfactory to AID:

(a) A statement of the names of the persons authorized to represent the Grantee and Ministry as specified in Section 8.02, and a specimen signature of each persons.

(b) An acceptable contract for Project Consulting Firm Services for the Project.

11.03 Prior to any disbursement or to the issuance of documentation pursuant to which disbursement will be made for sub-projects to be financed by the Private Investment Encouragement Fund the GOE shall furnish in form and substance satisfactory to A.I.D.

(a) An implementation plan for the Fund developed jointly with the Project Consulting Firm for administration and implementation of the Fund. The plan shall include project eligibility and appraisal criteria, including a mechanism to ensure that environmental concerns are taken into account, Fund contribution criteria, and a description of procurement procedures consistent with ID regulations to be required for all Project-financed procurement - commodities, equipment, services, and so forth.

(b) Evidence of formal establishment of the Fund and affiliation of the Fund with an Agency of the Government of Egypt to include:

(1) A commitment by the Agency to furnish a structure or facility to house the fund (2) establishment of a special section within the agency to be staffed with one professional economist or financial specialist with banking experience, one professional staff assistant and one secretary, (3) evidence of establishment of an organizational plan for the Fund including delineation of operational responsibilities.

(c) Evidence of establishment of an Advisory Board to the Fund together with an acceptable procedure for the review and monitoring responsibilities agreeable to the Grantee, its implementing agency, and AID.

11.04 Prior to any disbursement or to the issuance of documentation pursuant to which disbursement will be made for any long-term finance studies, the GOE shall furnish in form and substance satisfactory to AID, an acceptable contract for the conduct of such studies with an economic or management consulting firm.

C. Covenants

11.05 In addition to the Grant Covenants of Annex 2 of the Project Grant Standard Provisions Annex, all of the Standard covenants prescribed by AID Handbook 3 shall be included in the Grant Agreement. In addition the following special covenants shall be included:

(a) The Grantee, in addition to the assistance received from the Grant, shall provide all funds necessary to carry out the Project and shall endeavor to secure supplementary participating funds from other sources in Egypt to assist the project to achieve its goals.

(b) The Grantee shall require the Fund to enter into an acceptable formal arrangement between the Fund and a participating bank or banks for all transactions that the bank would arrange and administer on behalf of the Fund.

(c) The Grantee shall undertake a series of discussions with AID on means to improve the availability in Egypt of long-term financing facilities to be available to the private sector, including appropriate institutional arrangements to achieve this objective.

D. 612(b) Application

11.06 Based upon Annex E, it is recommended that a 612 (b) determination be made for the purchase of Egyptian Pounds for local currency costs of operating this project, including payment of management placement fees; initial equity, if necessary; project appraisal services of consultants; and trainers; and general project support costs of management consulting firm.

E. Waiver For Negotiation With a Single Source

11.07 Based upon Annex U, it is recommended that a waiver be granted for negotiation with a single source for procurement of management consulting services for project implementation advisory services. This waiver request is based upon Handbook 11, Chapter 1, Section 2.4.2, and the value of this procurement is expected to be approximately $800,000.

BEST AVAILABLE COPY

Annex A

MINISTRY OF STATE
ECONOMIC COOPERATION

Mr. Donald S. Brown
AID Director
U.S. Embassy
5, Latin America Street
Garden City, Cairo

Cairo August, 1979

Dear Mr. Brown,

The Government of the Arab Republic of Egypt requests USAID assistance in establishing a new credit facility available to medium and larger sized private sector enterprises for improvement of productive facilities.

As you are aware, the U.S. management consulting firm, Robert Nathan Associates, Inc., has prepared a feasibility/design study of the project including a reasonably firm cost estimate which supports the need for such credit facilities. The proposed Private Investment Encouragement Fund will require approximately $30.0 million in foreign exchange plus advisory assistance for the initial period to establish the Fund.

We are hereby requesting the Agency for International Development to provide $30M. grant assistance to finance the foreign exchange costs of the project and appropriate funding to cover the advisory assistance. It is planned that participating banks and private investors will provide other financing requirements including major local currency credit requirements.

Sincerely yours,

GAMAL EL-NAZER
Minister of State for
Economic Cooperation & External Finance

ANNEX B

5C(2) - PROJECT CHECKLIST

Listed below are statutory criteria applicable generally to projects with FAA funds and project criteria applicable to individual fund sources: Development Assistance (with a subcategory for criteria applicable only to loans); and Economic Support Fund.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? Yes
HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT? Yes

A. GENERAL CRITERIA FOR PROJECT.

1. FY 79 App. Act Unnumbered; FAA Sec. 653(b); Sec. 634A.

   (a) Describe how Committees on Appropriations of Senate and House have been or will be notified concerning the project; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that figure)?

   (a) An advice of Program Change will be transmitted to the appropriate committee of Congress. Obligations under this change will not be made prior to 15 days of the date of delivery of this notification.
   (b) The intended obligation is within the level of funds appropriated for Egypt for FY 1979.

2. FAA Sec. 611(a) (1). Prior to obligation in excess of $100,000, will there be (a) engineering, financial, and other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

   (a) Yes

   (b) Yes

3. FAA Sec. 611(a) (2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   None required

A.

4. FAA Sec. 611(b); FY 79 App. Act Sec. 101. If for water or water-related land resource construction, has project met the standards and criteria as per the Principles and Standards for Planning Water and Related Land Resources dated October 25, 1973?

Not applicable

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistance Administrator taken into consideration the country's capability effectively to maintain and utilize the project?

Yes

6. FAA Sec. 209. Is project susceptible of execution as part of regional or multilateral project? If so why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

This project is not susceptible of such execution at this juncture, but efforts are being undertaken to obtain the future, substantial participation of other donors.

7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

(a) Project will increase the flow of international trade.

(b) Project is limited to private sector participation.

(c) No direct encouragement is provided

(d) Project will encourage private sector competitive production.

(e) Project will improve efficiency of private firms.

(f) No direct strenthening is provided.

8.	FAA Sec. 601(b). Information and conclusion on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	Private U.S. business joint ventures will be eligible for financing. Also, U.S. business will furnish goods and services for the project.
9.	FAA Sec. 612(b); Sec. 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized to meet the cost of contractual and other services.	The Project Agreément will so provide. See Annex E for a request for a determination under Section 612 (b) that dollars be used to procure local currency despite availability of excess local currency.
10.	FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	Yes. See Annex E for reasons U.S. - owned local currency will not be used.
11.	FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes.
12.	FY 79 App. Act Sec. 608. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?	No. The Project Agreement will contain a prohibition against financing of such sub-projects.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

Not applicable

a. FAA Sec. 102(b); 111; 113; 281a. Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Sec. 103, 103A, 104, 105, 106, 107. Is assistance being made available: (include only applicable paragraph which corresponds to source of funds used. If more than one fund source is used for project, include relevant paragraph for each fund source.)

B1

(1) [103] for agriculture, rural development or nutrition; if so, extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, is full account taken of needs of small farmers;

(2) [104] for population planning under Sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems and other modes of community research;

(3) [105] for education, public administration, or human resources development; if so, extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, or strengthens management capability of institutions enabling the poor to participate in development;

31

(4) [106] for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is:

(i) technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;

(ii) to help alleviate energy problems;

(iii) research into, and evaluation of, economic development processes and techniques;

(iv) reconstruction after natural or manmade disaster;

(v) for special development problem, and to enable proper utilization of earlier U.S. infrastructure, etc., assistance;

(vi) for programs of urban development, especially small labor-intensive enterprises, marketing systems, and financial or other institutions to help urban poor participate in economic and social development.

c. [107] Is appropriate effort placed on use of appropriate technology?

31

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or has the latter cost-sharing requirement been waived for a "relatively least-developed" country)?

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"?

f. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental and political processes essential to self-government.

g. FAA Sec. 12[illegible](b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

B.

2. Development Assistance Project Criteria (Loans Only)

Not applicable

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, including reasonableness of repayment prospects.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete in the U.S. with U.S. enterprise, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?

3. Project Criteria Solely for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance support promote economic or political stability? To the extent possible, does it reflect the policy directions of Section 102?

Project will increase productive capacity and employment opportunities in the Egyptian private sector. Policy directions of Section 102 will be indirectly reflected through increased eomplyment of urban poor and possible location of sub-projects in small towns and rural areas.

b. FAA Sec. 533. Will assistance under this chapter be used for military, or paramilitary activities?

No.

5C(3) - STANDARD ITEM CHECKLIST

Listed below are statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. Procurement

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of goods and services financed?	**Yes. Goods and services to the extent possible will be procured through competitive procedures which allow small business to participate.**
2. FAA Sec. 604(a). Will all commodity procurement financed be from the U.S. except as otherwise determined by the President or under delegation from him?	**Yes.**
3. FAA Sec. 604(d). If the cooperating country discriminates against U.S. marine insurance companies, will agreement require that marine insurance be placed in the U.S. on commodities financed?	**Yes.**
4. FAA Sec. 604(e). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity?	**No such procurement is planned.**
5. FAA Sec. 608(a). Will U.S. Government excess personal property be utilized wherever practicable in lieu of the procurement of new items?	**Consideration will be given to use of excess property when practical.**

A.

6. <u>FAA Sec. 603</u>. (a) Compliance with requirement in Section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S.-flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.	**Yes.**
7. <u>FAA Sec. 621</u>. If technical assistance is financed, will such assistance be furnished to the fullest extent practicable as goods and professional and other services from private enterprise on a contract basis? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?	**Yes.**
8. <u>International Air Transport. Fair Competitive Practices Act, 1974</u> If air transportation of persons or property is financed on grant basis, will provision be made that U.S.-flag carriers will be utilized to the extent such service is available?	**Yes.**

A.

9. FY 79 App. Act Sec. 105. Does the contract for procurement contain a provision authorizing the termination of such contract for the convenience of the United States?

Contract will so provide.

B. Construction

1. FAA Sec. 601(d). If a capital (e.g., construction) project, are engineering and professional services of U.S. firms and their affiliates to be used to the maximum extent consistent with the national interest?

Yes.

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?

Not applicable.

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million?

Yes.

C. Other Restrictions

Not applicable

1. FAA Sec. 122(e). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter?

2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights?

Not applicable

C.

3. FAA Sec. 620(h). Do arrangements preclude promoting or assisting the foreign aid projects or activities of Communist-bloc countries, contrary to the best interests of the U.S.? — Yes.

4. FAA Sec. 636(i). Is financing not permitted to be used, without waiver, for purchase, long-term lease, or exchange of motor vehicle manufactured outside the U.S., or guaranty of such transaction? — Yes.

5. Will arrangements preclude use of financing:

   a. FAA Sec. 104(f). To pay for performance of abortions or to motivate or coerce persons to practice abortions, to pay for performance of involuntary sterilization, or to coerce or provide financial incentive to any person to undergo sterilization? — Yes.

   b. FAA Sec. 620(g). To compensate owners for expropriated nationalized property? — Yes.

   c. FAA Sec. 660. To finance police training or other law enforcement assistance, except for narcotics programs? — Yes.

   d. FAA Sec. 662. For CIA activities? — Yes.

   e. FY 79 App. Act Sec. 104. To pay pensions, etc., for military personnel? — Yes.

C5

f. FY 79 App. Act Sec. 106. To pay U.N. assessments? — Yes.

g. FY 79 App. Act Sec. 107. To carry out provisions of FAA sections 209(d) and 251(h)? (Transfer of FAA funds to multilateral organizations for lending.) — Yes.

h. FY 79 App. Act. Sec. 112. To finance the export of nuclear equipment, fuel, or technology or to train foreign nations in nuclear fields? — Yes.

i. FY 79 App. Act Sec. 601. To be used for publicity on propaganda purposes within U.S. not authorized by Congress? — Yes.

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D. C. 20523

OFFICE OF
THE ADMINISTRATOR

PROJECT AUTHORIZATION
AND REQUEST FOR ALLOTMENT OF FUNDS

PART II

Name of Country: Arab Republic of Egypt

Name of Project: Private Investment Encouragement Fund

Number of Project: 263-0097

Pursuant to Part II, Chapter 4, Section 531 of the Foreign Assistance Act of 1961, as amended (Economic Support Fund), I hereby authorize a grant to the Arab Republic of Egypt (the "Cooperating Country") of not to exceed Thirty-Three Million United States Dollars ($33,000,000) (the "Authorized Amount"), to assist in financing the foreign exchange and local currency costs of goods and services required for the Project as described in the following paragraph.

The Private Investment Encouragement Fund Project will assist Egypt to establish credit facilities for larger-sized private sector enterprises for the improvement of productive facilities and thereby increase the productivity of the private sector. The Project will establish a Fund to provide medium to long-term credit to such private sector enterprises. Of the Authorized Amount, an allocation of $30,000,000 will be made for the establishment and initial operation of the Fund, which will include a special allocation in the amount of $5,000,000 for subprojects which meet special employment generation and geographic location criteria, unless A.I.D. agrees otherwise. The remaining $3,000,000 of the Authorized Amount will be allocated for advisory services to be provided for the initial operation of the Fund, subproject appraisal, training in project appraisal and studies of Egyptian long-term finance.

The entire amount of A.I.D. financing herein authorized for the Project will be obligated when the Project Agreement is executed.

I hereby authorize the negotiation and execution of the Project Agreement by the officer to whom such authority has been delegated in accordance with A.I.D. regulations and Delegations of Authority to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate:

A. Source and Origin of Goods and Services

Goods and services financed by A.I.D. under the Project shall have their source and origin in the United States and the Arab Republic of Egypt, except as A.I.D. may otherwise agree in writing.

B. Conditions Precedent to Initial Disbursement

Prior to any disbursement, or to the issuance of documentation pursuant to which any disbursement will be made, the Cooperating Country shall, except as the Parties may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(1) a statement of the names of the persons authorized to act as the Cooperating Country's representatives, plus a specimen signature of each person; and

(2) an acceptable contract for Project consulting firm services for the Project.

C. Conditions Precedent to Additional Disbursement

Prior to any disbursement or to the issuance of the documentation pursuant to which disbursement will be made for the Fund, the Cooperating Country, except as the Parties may otherwise agree in writing, shall furnish in form and substance satisfactory to A.I.D.:

(1) an implementation plan for the Fund developed jointly with the Project Consulting Firm for administration and implementation of the Fund. The plan shall include project eligibility and appraisal criteria, including a mechanism to ensure that environmental concerns are taken into account; special employment generation and geographic localities criteria for the $5.0 million allocation; a description of procurement procedures consistent with A.I.D. regulations to be required for all Project-financed procurement of commodities, equipment, services, and so forth, and Fund contribution criteria;

(2) evidence of formal establishment of the Fund and affiliation of the Fund with an Agency of the Government of Egypt to include: (a) a commitment by the Agency to furnish a structure or facility to house the Fund; (b) establishment of a special section within the Agency to be adequately staffed; (c) evidence of establishment of an organizational plan for the Fund including delineation of operational responsibilities; and

(3) evidence of establishment of an Advisory Board to the Fund together with an acceptable procedure for the review and monitoring responsibilities agreeable to the Cooperating Country, its implementing agency, and A.I.D.

D. Conditions Precedent to Long-Term Finance Studies

Prior to any disbursement or to the issuance of documentation pursuant to which disbursement will be made for any long-term finance studies, the Cooperating Country shall furnish in form and substance satisfactory to A.I.D. an acceptable contract for the conduct of such studies with a consulting firm.

E. Covenants

(1) The Cooperating Country, in addition to the assistance received from the Grant, shall provide all funds necessary to carry out the Project and shall endeavor to secure supplementary participating funds from other sources in Egypt to assist the Project to acheive its goals.

(2) The Cooperating Country shall require the Fund to enter into an acceptable formal arrangement between the Fund and a participating bank or banks for all transactions that the bank would arrange and administer on behalf of the Fund.

(3) The Cooperating Country shall discuss with A.I.D. means to improve the availability in Egypt of long-term financing facilities to be available to the private sector, including appropriate institutional arrangements to achieve this objective.

F. Waivers

(1) Based upon the justification set forth in Annex E of the Project Paper, I hereby determine, in accordance with Section 612 (b) of the Foreign Assistance Act of 1961, as amended (the Act), that the expenditure of United States Dollars for the procurement of goods and services in Egypt is required to fulfill the purposes of this Project; the purposes of this Project cannot

be met effectively through the expenditure of U.S.-owned local currencies for such procurement; and the administrative official approving local cost vouchers may use this determination as the basis for his certification as required by Section 612 (b) of the Act.

(2) Based upon the justification set forth in Annex U of the Project Paper, I hereby approve, in accordance with A.I.D. Handbook 11, Chapter 1, Section 2.4.2 a waiver to negotiate with a single source for procurement of management consulting services for project implementation advisory services.

Robert H. Nooter
Acting Administrator

Date

ANNEX D

CERTIFICATION PURSUANT TO

SECTION 611(e) OF THE

FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED

I, Donald S. Brown, the Director for the Agency for International Development in Egypt, having taken into account, among other things, the maintenance and utilization of projects in Egypt previously financed or assisted by the United States and technical assistance and training planned under this Project, do hereby certify that in my judgment Egypt has both the financial capability and human resources capability effectively to maintain and utilize the technical and capital assistance to be provided to the Ministry of Economy and Economic Cooperation for establishment of a Private Investment Encouragement Fund.

Donald S. Brown
Director

Date

ANNEX E
Egypt: Private Investment Encouragement Fund
263-0097

Recommendations to Authorize Purchase of Egyptian Pounds with U.S. Dollars

Recommendation:

Over the life of the Project up to $2,000,000 will be used to support local currency expenditures for specific goods and services in support of this project. Dollars funds will be used in association with GOE disbursement of Egyptian pounds for funding the following costs;

(1) Equity contributions........................ $750,000

25% of equity must be paid in before a company can be established, and the Fund may be required to make such payments. Authority to make such payments in Egyptian Pounds is sought to provide sufficient flexibility in administering this requirement.

(2) Participating Bank management fees.............$450,000

Participating Banks are to receive placement fees of 1 1/2% and 1%, respectively, for loans and equity, at the time of signing agreements. Some of these agreements will be signed before the Fund generates any revenue, and management fees will become due. Authority to make such payments in Egyptian Pounds is sought until the Fund generates sufficient income to pay these fees.

(3) Project appraisal consultants......................$600,000

Some project appraisal consultants are expected to be Egyptian citizens, who should be paid in Egyptian Pounds; also, some IESC volunteers will need per diem and travel paid in Egyptian pounds. In addition, other U.S. consultants will need per diem, travel, and support costs paid in pounds.

(4) Training Program Consultants..................$150,000

Local currency costs of the training program will include salaries of Egyptian teachers and project support costs of the management consulting firm.

(5) Project Implementation Advisor................ $50,000

This advisor will have per diem, travel, secretarial, and other project support expenses payable in Egyptian Pounds.

The mission will purchase Egyptian pounds with U.S. dollars provided by the Project. The Egyptian pounds will in turn be made available to the various appropriate Egyptian entity(s) responsible for project implementation for disbursement in accordance with the agreements reached between USAID and the GOE in the Project Agreement.

Justification:

The Mission considered the use of granting U.S.-owned local currency for Egyptian pound costs. Such excess currency, however, is committed to other projects and is now in limited supply.

The use of local currency would also add no additional real resources to the Egyptian economy. Under the terms of the current IMF Standby Agreement with Egypt (which the United States and other donors have strongly supported) and the related need of the GOE to restrict the growth in the money supply to correspond to the growth in real resources in the economy, the inflationary impact of using U.S.-owned local currency would have to be offset by reduced GOE disbursements. If U.S.-owned local currency were used in this project, it is doubtful that the various Egyptian entities could enter into agreements related to it, as they would have to sustain corresponding budgetary cutbacks in other areas. On the other hand, dollar funds used in conjunction with Egyptian pound costs represent an additional real resource to the economy, provide means for speedy implementation of the project and offer some incentive for the GOE to implement new initiatives that it might not otherwise be able to undertake. And even if the various Egyptian entities were to obtain budgetary funds to provide a full portion of project costs, it is doubtful they could commit them to this project unless the added fill-in of dollar funding for local currency were assured.

In view of the above considerations and the fact that the project supports the U.S. foreign policy objective of encouraging private sector development, we have concluded that certain project costs should be dollar funded.

AID 1020-28 (1-72)

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project
From FY 79 to FY [illegible]
Total U.S. Funding $32,400,000
Date Prepared 8-24-79

Project Title & Number: Private Investment Encouragement Fund (263-0097)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: Increase productivity of private sector providing improved industrial base for Egypt's development.	Measures of Goal Achievement: 1. No. of private companies assisted. 2. % of increase in GDP attributable to sub-projects.	1. Participating Bank statistics 2. Government statistics on private sector output.	Assumptions for achieving goal targets: 1. GOE will continue to encourage private sector development through policy changes and incentives. 2 Private sector investors will respond to opportunities to increase production by investing. 3. Private sector will be competitive in pricing goods [illegible]
Project Purpose: Provide medium/long-term credit for larger sized private sector companies to finance new and modernized productive facilities.	Conditions that will indicate purpose has been achieved: End of project status. 1. Banks undertaking longer-term investments. 2. Broader range of financial institutions involved in investment. 3. 12 new private sector enterprises functioning as a result of credit inputs.	1. Participating bank sub-project investment records. 2. GOE Fund records.	Assumptions for achieving purpose: 1. Participating Banks will invest own funds at longer maturities with positive Fund experience. 2. GOE incentives will encourage and assist private sector.
Outputs: 1. Participating Bank credit facilities established. 2. Fund for Repayments established. 3. Participating Bank staff trained in project appraisal and implementation. 4. Preliminary design for institutionalization of training in project appraisal.	Magnitude of Outputs: 1. 12 Fund investments to private sector companies. 2. 120 bankers trained in project appraisal.	1. Examination of records	Assumptions for achieving outputs: 1. Goods of U.S.source/origin are competitive given incentives under the Fund. 2. Participating Banks and investors will find Fund facility attractive. 3. GOE will assist in developing private sector credit facilities and will not impose restrictions.
Inputs: 1. Grant resources to finance: a. P.I.E. Fund ($30.0) b. Advisory Assistance (1.5) c. Training Opportunities (0.5) d. Other costs to cover escalation / contingency (0.4) e. Long-term finance study (0.6) 2. Bank/Investor investment capital (45.0) 3. GOE implementing Staff (0.2)	Implementation Target (Type and Quantity) 1. U.S. Contribution @$33.0 million a. $30 million (to include conversion of $1.2 to LE) b. 150 person months-various training specialties. c. 120 or more trainees at professional level 2. Estimated @$45.0 million/ equivalent LE 3. Numbers to be determined, now estimated at 3 (LE 140,000 estimated)	1. Controller records. 2. Participating Bank/GOE records.	Assumptions for providing inputs: 1.Participating Banks and investors willing to invest own funds. 2.GOE will establish Fund staff and Advisory Board. 3.U.S. and GOE funds available.

Private Sector Share in Gross Value Added
in Manufacturing, 1966/67 and 1975
111 Manufacturing Establishments
Percentages

Industry	1966/67	1975
Tobacco	6	6
Basic Metals	6	11
Chemicals	6	18
Rubber	7	7
Textiles	8	23
Paper	9	2
Electrical Machinery	10	10
Beverages	12	15
Non-Electrical Machinery	25	12
Non-Metallic Products	35	18
Food	40	63
Transportation Equipment	41	13
Metallic Products	49	35
Leather	80	82
Furniture	80	89
Wood	80	80
Weaving Apparel	86	86
Painting	86	55

Source: Adapted from R. Mabro, Industrialization in Egypt 1939-1973, 1976, p. 97, 1975 data from Ministry of Planning, Arab Republic of Egypt. Reported in World Bank Report No. 1818-EGT, 1977.

Table 2. Size Distribution of Private Sector Industry

Size of Establishment by Employment	Number of Establishments	Percent	Number of Workers[1]	Percent	Average Employment per Establishment
10 - 24	2,572	66.6	39,213	32.1	15
25 - 49	923	23.9	30,343	24.8	33
50 - 99	214	5.5	14,468	11.9	68
100 -499	142	3.7	26,902	22.0	190
500+	10	0.3	11,184	9.2	1,118
Total	3,861	100.0	122,110	100.0	31

1. Including employers.

Source: Central Agency for General Mobilization and Statistics, December 1975, as reported by IBRD Mission.

ANNEX I

Interest Rate Structure

(Main Deposit and Lending Rates)
Effective Since January, 1, 1979

Deposits with commercial banks	Percentage
1. Demand desposits	0 %
2. Time and notice deposits	
- 15 days notice (minimum amount LE 10,000)	5.0%
- 30 to 90 days	5.5%
-90 to 180 days	6.0%
- 180 to 260 days	6.5%
- 1 to 2 years	7.0%
- 2 to 3 years	7.5%
- 3 to 5 years	8.0%
- 5 years	8.5%
3. Savings deposits (maximum amount LE 10,000)	6.0%
Lending Rates for Local Currency	
1. Maximum rate	12.0%
2. Minimum rate	10.0%

Transactions in Foreign Currencies (At going international rates)

Principal Financial Institutions
Serving Egyptian Private Sector

	Operating Currency d - domestic f - foreign
I. Central Bank (public sector)	d + f
II. Commercial Banks	
A. Public Sector	d + f
1. National Bank of Egypt 2. Bank of Alexandria 3. Banque Misr 4. Banque du Caire	
B. Private Sector[1] (primarily Egyptian owned)	d + f
1. Nile Bank 2. Suez Canal Bank 3. Delta International Bank 4. El Watany Bank of Egypt	
C. Private Sector[1] (joint ventures)[2]	d + f
1. Chase National Bank of Egypt 2. Misr International Bank 3. Egyptian American Bank 4. Misr America International Bank 5. Banque du Caire et de Paris 6. Misr Rumanian Bank 7. Alexandria Kuwait International Bank 8. Societe Arabe Internationale de Banque	
III. Development Banks (public sector)	
1. Development Industrial Bank	d + f

(Continued)

	Operating Currency d - domestic f - foreign
IV. Investment or Merchant Banks[3] (private sector)[1]	
A. Joint Ventures (50% Egyptian, 50% foreign)	
1. Misr-Iran Development Bank	f
2. Cairo Barclays International Bank	f
3. Credit International d'Egypte	f
4. National Societe Generale	d + f
B. Foreign Branches	f
1. American Express International Banking Corporation	
2. National Bank of Abu Dhabi	
3. Citibank	
4. Bank of America	
5. Grindlays Bank Limited	
6. Bank of Credit and Commerce International	
7. Bank Saderat Iran	
8. Banca Commerciale Italiana	
9. Bank Melli Iran	
10. Arab Bank Limited	
11. Lloyds Bank International Limited	
12. National Bank of Pakistan	
13. Rafidain Bank	
14. Bank of Oman	
15. Bank of Arab Solidarity	
16. Bank of Nova Scotia	
V. Free Zone Banks[1]	
1. Manufacturers Hanover Trust Company	f

(Continued)

	Operating Currency d - domestic f - foreign
VI. <u>Others</u>	
A. <u>Investment Companies</u>	
1. Kuwaiti-Egyptian Investment Company	f
2. Saudi Egyptian Company for Investment and Finance	d + f
3. Arab Multinational Finance Company	f
4. Arab Investment Company	f
B. <u>Insurance Companies</u> (4)	d + f
C. <u>Nasser Social Bank</u>	d
D. <u>Pension Funds</u>	d
E. <u>Stock Exchanges</u> (2)	d
F. <u>Multinational Banks</u> (headquartered in Egypt but not subject to Egyptian laws and banking control)	
1. Arab International Bank	f
2. Arab African Bank	f
3. Arab Investment Bank	f
G. <u>Representative Offices of Foreign Banks</u> (28)	f

1. Institutions established under Foreign Investment Law No. 43.
2. All these institutions are at least 51% Egyptian owned, with the exception of the Societe Arabe Internationale de Banque, which has primarily foreign ownership.
3. As defined in Article 17 of Banking Law No. 120 and Article 3 of Foreign Investment Law No. 43. Apart from the Misr-Iran Development Bank, which has an established operating policy of long-term project development, these banks operate as commercial as well as investment banks.

PRIVATE SECTOR STRATEGY

USAID and GOE have undertaken and are planning several private sector projects which address GOE priority concerns and will assist in establishing a base for economic progress and technological transformation. The projects respond to the more pervasive problems of: (1) scarcity of credit; (2) support systems for private sector industry (and artisans); and (3) improvement of institutional operations, monetary and financial policy.

1. Ongoing projects providing new resources and technology include:

   A. Development Industrial Bank

      1. A $32.0 million loan provides funds for medium-term sub-loans together with advisory services and equipment for the Bank.

      2. A $2.0 million grant finances advisory services, training and some equipment for the Bank.

   B. Suez Cement Company

      A $90.0 million grant finances equipment and services for design, erection, operation and maintenance of a portland cement plan capable of producing one million tons of cement per year.

   C. Quattamia Cement

      A $95.0 million loan finances equipment and services for design, erection and maintenance of a portland cement plant capable of producing 1.2 million tons of cement per year.

   D. Commodity Import Program

      $35.0 million in loans to finance private sector procurement of equipment and materials through government banks.

   E. Related and Supportive Activities

      1. Middle Management Education Program (MMEP)

         A pilot stage program for training Egyptian private and public sector middle managers in American management practices is underway.

      2. Tax Administration/Tax Laws

         An ongoing tax administration program is now at a pilot stage, and also two American comparative tax law experts are assisting the GOE in developing a new global tax structure, in part aimed at providing tax incentives to private enterprise.

3. Legal/Reform/Legal Education

In conjunction with Ford Foundation, USAID is funding a third one-month seminar at Harvard Law School as well as workshops in Cairo on legal aspects of investment and on laws and regulations affecting exports. In legal education, a law professor is assisting in developing a core curriculum in investment-related subjects and a continuing education program for members of the Bar has been begun by the Egyptian Society for International Law.

4. International Executive Service Corps (IESC)

USAID provided ad hoc support services during IESC start-up in early 1979 and maintains contact to seek areas of cooperation.

II. Planned Projects include:

A. Finance

1. Private Investment Encouragement Fund

An FY 79 project to establish credit mechanisms for larger-sized private sector enterprises in cooperation with existing banks.

2. Commodity Import Program

For FY 79 an additional $25.0 million is proposed for the private sector.

3. Small Scale Enterprise Credit & Advisors

An FY 80 project to increase productivity of the private sector by establishing credit facilities and improving technical advice available to small scale enterprises.

4. Development Industrial Bank - III

An FY 80 project to fund sub-loans for private sector companies together with advisory services and equipment for the Bank

B. Technical Assistance - Private Sector Support Systems and Mechanisms

1. Private Investment Studies

An FY 79 project to finance partial reimbursement of U.S. investors' feasibility studies and advisory services to conduct pre-feasibility studies.

2. Egyptian Investment Center

An FY 80 project to finance advisory services, training and equipment to strengthen this institution's investment information and promotion activities.

3. Agribusiness Development

A proposed project to finance U.S.-Egyptian agribusiness projects and related institutional development activities.

4. Industrial Free Zones

An FY 80 project to finance equipment and services to improve the operation and physical facilities of industrial free zones.

5. Business Management and Training

An FY 81 project to finance equipment and advisory services for establishment of modern business education facilities for private sector businessmen and students throughout the Middle EAst.

C. Advisory Services to Financial Sector

1. Advisory Services on Credit

   An FY 80 project to finance advisory services and equipment for a bank training institute and improvements in bank operational procedures.

2. Money Market/Stock Exchange

   An FY 81 project to finance advisory services and equipment for rejuvenation of the stock exchanges and other modernizations of capital markets.

D. Production Industry

Flat Glass

A $36.0 million project to finance equipment and services for establishment of a joint venture glass manufacturing company with a capacity of 60,000 to 100,000 MTs per annum.

E. Agriculture

Cooperative Marketing

A small farmer assistance project designed to establish an improved system for private sector cooperative marketing of fruits and vegetables. Other related assistance is provided by the IBRD.

Projection of Investment by the Private Sector
in the Five-Year Period 1979-1983
(in millions of Egyptian pounds)

Sector	Total Investment (Absolute)	Total Investment (in Percent)	Foreign Exchange Component
Land Reclamation and Agriculture	350	8	100
Mills, Silos and other	100	2	60
Housing	1600	35	220
Reconstruction and New Communities	540	12	250
Construction Material Companies	200	4	150
Building Factories	200	4	120
Transportation	200	4	180
Tourism	250	6	140
Industry and Mining	700	16	355
Trade and Finance	200	4	100
Services	200	4	100
Total	4540	99	1775

Source: Ministry of Economy and Economic Cooperation.

Private Sector Imports
Commodity Import Program, as of July 31, 1979

Commodity Category and Description	Invoice Value ($000)	Percentage
1. Transportation vehicles, automotive supplies, some marine and aviation equipment	$3,671.6	27.0%
2. Construction Machinery bulldozers, graders, etc.	2,543.9	18.7
3. Refrigeration Equipment includes refrigerators, ice makers, food processors, etc.	1,467.7	10.8
4. Machinery not elseqhere specified includes spare parts, pumps, compressors, etc.	1,379.5	10.1
5. Electrical equipment, machinery, generators and air conditioners	957.1	7.0
6. Metal Industry includes welding equipment, tinplate, etc. (some intermediate goods)	785.4	5.8
7. Construction Materials especially prefabricated (intermediate goods)	768.5	5.6
8. Tools mainly hand tools, some electrical	570.1	4.2
9. Other Intermediate and Capital Goods:photo equipment and key cutting machinery	547.0	4.0
10. Chemicals includes plastics (intermediate goods)	440.0	3.0
11. Textile Industry includes equipment and intermediate goods	349.9	2.6
12. Foodstuffs frozen chickens (consumer goods)	139.8	1.0
Total	$13,621.1	100.0%

Source: Commodity Import Program, United States Agency for International Development, Cairo, Egypt

Private Sector Imports
(DIB sub-loans, as of Dec. 31, 1978)

Borrowing Sector and Goods Financed	Amount ($000)	Percentage
Food Processing Industry		
icemaking, cooling and refrigeration equipment; icecream and confectionery manufacturing equipment; soft drink bottling equipment; electirc generators	$7,354.8	35.6%
Tourism Sector		
furniture, kitchen and laundry equipment, mini-buses, intercommunications equipment, electirc generators, freezers, air conditioners, etc.	6,178.0	29.9
Construction Industry		
two prefabricated structures for an industrial plant	3,000.0	14.5
Spinning and Weaving		
knitting, dewing and weaving machines; dyeing, cloth printing and textile finishing equipment	2,223.4	10.7
Leather Industries		
shoe making equipment; artificial leather manufacturing equipment	984.6	4.8
Metal Industries		
melting furnaces, electrical and hydraulic equipment, casting and grinding machines	393.1	1.9
Chemical Industries		
medicinal oil distilling equipment; injection moulding machines for plastics	366.5	1.8
Printing and Paper		
napkin folding machinery	133.2	0.6
Other		
Computer equipment	47.1	0.2
Total	$20,680.6	100.0%

Source: DIB Quarterly Report as of December 31st, 1978. Data furnished by USAID/Cairo.

V. SURVEY OF POTENTIAL PARTICIPATING BANKS

In the course of its study, the RRNA consultant team held discussions with senior officials of all the major banks and investment companies currently operating in Egypt to determine their specific policies toward term lending to and equity participation in private sector projects. An attempt was also made to ascertain the interest of each institution in collaborating with the proposed Private Investment Encouragement Fund, and the capability of each to do so. The following pages record the findings of those investigations by particular groupings of institutions.

Commercial Banks (Public Sector)

Since the change in the banking law of 1975 the four national commercial banks have begun some revamping to respond to the challenges of economic liberalization. For example, all four have established special investment departments in response to their new freedom to allocate resources to longer-term investments. Only the National Bank of Egypt, however, has declared itself willing to lend longer-term, for as long as up to 7 years. But it remains to be seen how aggressive a posture the bank will take, and whether it will extend term loans to individual private entrepreneurs. At the present time, the four state banks have restricted their investments to the purchase of equity positions in Egyptian pounds in Law 43 private joint ventures involving the participation of public sector companies. Investments have been made in banks, hotels and large-scale industrial enterprises.

Since January 1, 1979, the national banks have been permitted to hold foreign exchange and are no longer obliged to forward holdings to the Central Bank. Banks obtain foreign exchange from customers' deposits and from purchases in the market or aborad. They will not generally draw on customer resources, but rather use their own resources for foreign exchange transactions. The foreign exchange demands of the public sector usually exhaust the banks' supply and little hard currency is left to finance private sector needs, especially on a term basis. According to the National Bank, the availability of foreign exchange repayable in Egyptian pounds would be helpful to them, and the other banks, as they all currently limit foreign currency credit to the private sector to firms with export earnings.

The national banks continue to follow an extremely conservative policy toward risk taking in the private sector. As a result, they tend to be very cautious in credit analysis, particularly with first-time borrowers and, when they do agree to a loan, often attach stringent collateral conditions unacceptable to many borrowers. Even with such conditions the banks claim they do not feel secure because foreclosure is such a time-consuming and usually fruitless process for them. They note that only the Development Industrial Bank has the right to foreclose directly without recourse to the courts, which gives it the security it needs. Because of the nationalization of the past, entrepreneurs for their part are reluctant to make full financial disclosure to the state banks, which prevents these banks from satisfying themselves of a private borrower's creditworthiness.

It seems fair to say that all four national banks continue to look somewhat askance at private entrepreneurs, mistrust their motives and reliability, and worry about their abuse of loan funds, an attitude grounded in the past socialist orientation of the economy. Still, all profess a desire to help the private sector and promote the Open Door policy. Some officials explained their hesitancy to get involved with the private sector on the basis that the Egyptian entrepreneurial class is depleted. This belief has led them to prefer an involvement with a foreign joint venture component to ensure good management.

Some banks also complained of a lack of good, viable private sector projects, apart from the large, joint ventures involving public sector companies. The National Bank has experimented with a project to assist small scale industry in the private sector with some success. But the project is reported to be a strain on staff resources because of all the follow-up required. It is not clear how strong a capability the national banks possess for project appraisal and credit analysis. These banks have not been obliged in recent years to undertake really serious feasibility studies of long-term projects and the new investment departments remain largely untested. Their reputation for deliberate and cautious consideration of any loan requests will not likely change very rapidly. The national banks still see their role as essentially a conservative one, to provide both the image and reality of financial soundness and stability for Egypt. As a result, they will continue to lean toward a blue-chip investment policy for the most part, catering mainly to large-scale projects involving public sector firms.

Commercial Banks (Private Sector)

Primarily Egyptian Owned

In the last two years, four primarily Egyptian owned banks have been established. The Nile and Al Watany Banks are wholly Egyptian owned, while the Suez Canal Bank includes the Arab International Bank as a 12.5% shareholder, and the Delta Bank also has some international sources of support. All deal both in Egyptian and foreign currencies. All four are essentially commercial banks, although they plan an active investment effort in terms of both project loans and equity participation. With paid-in capital of LE 7.5 million, roughly half of which is in foreign currency, the Suez Canal Bank is the largest of the four.

One, the Nile Bank, is wholly subscribed by 800 private individuals, mainly Egyptians working in Saudi Arabia and the Gulf. This bank is considering several project loans, but none longer than 4 years. Another wholly Egyptian owned bank, the Al Watany Bank, is now getting underway. Two other Egyptian private sector banks, the Suez Canal Bank and the Delta International Bank, are classified as private sector under Law 43, although both depend on public sector banks as major shareholders.

• The Delta Bank, established January 1, 1979, is oriented toward 1-2 year loans for working capital but is interested in access to longer-term funds to supplement their capability. The Suez Canal Bank, which has a special although not exclusive interest in the development of the Canal Zone, has expanded rapidly and has already made a large number of loans to private entrepreneurs. Their loans have ranged from $150-500,000, one for a term of 6 years. They have also taken equity in several projects.

As new banks, none of these three institutions appears to have adequate staff capability to undertake proper project analysis. The Nile Bank in particular needs help in this area. The Suez Canal Bank is further developed and has an investment department headed up by an individual with many years of experience in the banking system and at the Investment Authority. The Delta Bank also claims some good people. But it is doubtful that any of these banks could now produce a first-class project appraisal -- particularly in English.

In general, these banks seem to be getting underway with a somewhat more aggressive attitude toward project funding than exists in the national banks. The Suez Canal Bank especially appears more liberal in its orientation toward risk taking with the purely Egyptian entrepreneurs. Of 85 loans made so far, nearl· all are Law 43 projects, but few involve joint ventures with foreign firms. All banks give the impression of greater liberality in project review and collateral requirements than would be the case in the national banks.

Joint Ventures

Currently, there are eight joint venture commercial banks operating as private firms under Law 43 involving the participation of such well known foreign banks as Chase Manhattan, Bank of America, American Express and First National of Chicago. All but one of these joint ventures is at least 51% owned by one or more Egyptian national banks,[1] which permits them to operate in both local and foreign currency. All are relatively thinly capitalized, usually in the range of $2-3 million, which reflects their cautious attitude toward the Egyptian economy. Each operates essentially under foreign management.

As basically commercial banks, these banks are, like the four state commercial banks, limited in interest in and capability of getting involved in investment banking. Their primary concern is and will continue to be serving the deposit and commercial needs of their customers; i.e. providing working capital, financing foreign trade, opening letters of credit, holding funds. They do, however, have an interest in project financing and have a small portfolio of medium-term (/-5 years) loans and some equity positions. This interest seems to be definitely increasing.

1. Societe Arabe Internationale de Banque is primarily foreign owned by Arab sources of capital.

Chase National has made 10-12 term foreign currency loans longer than one year worth some $15 million, of which 4 or 5 have recently been extended for up to 7 years. The Egyptian American Bank has made term loans to six projects of some $15-20 million. The Misr International Bank has financed 10-15 projects, some up to 5 years duration, although none worth more than $1.5 million. Misr America Bank has financed three projects of a similar size and duration.

Like the state commercial banks, these banks take a relatively conservative investment stance and tend for the most part to support joint ventures with known foreign partners. All do, however, finance some purely Egyptian owned existing firms. They appear less demanding than the national banks in their collateral requirements, but this may reflect the banks' limited number of and careful selection of projects as much as anything.

All joint venture banks can, because of their foreign management, be considered _prima facie_ to have the capability of undertaking high quality project appraisals. For some of these banks this capacity may be somewhat restricted, however, by the number of their qualified Egyptian loan officers. Some of these banks, for example, have experienced considerable turnover of such staff, who find better jobs or start their own businesses after getting training and experience at these banks. Foreign managers are occupied with the everyday management of these banks and cannot carry a heavy load of project appraisal work and loan agreement preparation entirely on their own.

Development Banks (Public Sector)

Egypt has a single development bank, the Development Industrial Bank (DIB), whose purpose is to make medium and long-term credit available to the private sector. It is a public sector institution, but has as its mandate the development of private sector industry. It is the only financial institution in Egypt with the mandate as well as the capability to provide long-term (5-15 years) project support in both local and foreign currencies. The DIB was established in 1975 with a capitalization of LE 10 million paid by the Ministry of Finance. It has benefited from several lines of hard currency credit from the World Bank, the OPEC Special Fund, the African Development Bank, and USAID, although the AID loan is tied to U.S. procurement.

The DIB has developed in a short time into a relatively solid institution. It has strong leadership and is among the better institutions in its capability for project analysis. Its primary business is the extension of credit, although it has the mandate to take equity positions. Since the beginning of its operations, it has approved more than $70 million in foreign and local currency credits to more than 2100 projects in a wide range of industries. The DIB has a special mandate to assist small-scale enterprises. Loans to these enterprises now absorb 30% of the annual approvals given, although only 20% of the total value of credit extended. Most customers are existing Egyptian firms, although some foreign joint ventures have been financed through the DIB. Most loans are small, $200,000 or less, and large loans average around $800,000 to $1,000,000.

The DIB has a history of long deliberation over loan applications and applies stringent security requirements. This deters some borrowers, especially if alternative finance is available. Many feel that the DIB requires too much supporting information, although the DIB maintains that such thoroughness is necessary to the proper allocation of their resources. DIB foreign currency funds are more competitive than other financing because the interest rate is fixed, repayment of foreign currency can be made in pounds, and the total cost of credit is somewhat lower than other available funding.

Investment and Merchant Banks (Private Sector)

Joint Ventures (50% Egyptian, 50% foreign)

There are four joint venture investment banks currently operating in Egypt. All involve partnerships between Egyptian public sector institutions (banks and insurance companies) and primarily private sector foreign banking institutions. The Misr-Iran Development Bank, Credit Internationale d'Egypte and Cairo Barclays International Bank are in full operation, while the National Societe Generale Bank is still getting underway. The first three only deal in foreign currency but the latter obtained the right to operate in both foreign and local currencies.

The Misr-Iran Development Bank (MIDB) has a high reputation in Egypt, both for its leadership and its staff competence. It has just approved a doubling of its capitalization of $20 to $40 million. Its portfolio of 21 projects includes loans of $21 million, $10 million in equity positions, and $33 million in bank guarantees. It caters only to joint venture projects and syndicates with other banks in relatively larger projects roughly half the time. Its projects cover a range of industrial, touristic, real estate, construction and other sectors. Although MIDB can only deal in foreign currency, its two public sector shareholders, Bank of Alexandria and Misr Insurance Company, help mobilize the local currency needs of the projects it finances.

Cairo Barclays, which is a joint venture between Banque du Caire and Barclays International, also has an active investment program, having made loans in the range of $225,000 to $3 million. For the most part they do not go beyond a 5-year term, although they have joined a syndicated loan to one project of 7 years' duration. In 1978 they approved ten projects out of some 20 applications. They are actively looking for projects and will often start on a modest basis with an entrepreneur, providing him with working capital, and then nurturing the project along to a larger-scale.

Both MIDB and Cairo Barclays expressed an active interest in participating in the proposed Fund. Barclays thought that it could finance many more term projects if it could find a partner like the Fund to share the risk, something it cannot do on every project it is currently interested in.

Both of these banks have a reputation for good project appraisal and for efficient operations. Neither is known for undue collateral requirements or over burdensome administrative demands. Having an investment orientation, both banks are more aggressive toward project development than is the case with the joint venture commercial banks. The other two investment banks most probably possess the same operating characteristics, and their interest should also be explored.

Foreign Branches

Of the 16 branches of foreign banks in Egypt, most are small and only a few are really actively pursuing investment opportunities. These branch banks deal only in foreign currency, and like most other banks, lend those currencies at LIBOR plus 2-3 percentage points. They tend to finance only selected joint venture projects on term and to syndicate with other banks to reduce risk. These banks appear primarily oriented toward commercial operation, but some, especially the European and American banks, have shown increasing interest in term lending.

Bank of America, for example, in 1978 approved 10 of some 20-30 applications for term loans. This was for them a marked change in policy, as no such project loans were approved prior to a year or so ago. The largest loan was $1 million and 3-5 year terms were standard. Of the 10 projects approved, only 3 were wholly Egyptian owned, with the rest joint ventures.

Only Citibank has developed a portfolio of investment activities representing a substantial portion of their business. Investment or term-lending activities represent 35% of overall business versus 65% in the commercial area, but this is as high a ratio as the bank currently contemplates achieving. A loan of $1 million over 5 years would be liberal by this bank's current standards.

Egyptian officials have been critical of these foreign branches' lack of investment orientation. They claim that these banks entered Egypt under the guise of investment banks by seeking approval as such, but that they are mainly interested in the risk-free and more immediately lucrative commercial business, the financing of foreign trade. The observation may be an accurate one, but the banks point out that term-lending requires a more secure investment climate than yet exists in Egypt. If foreign investors themselves are not keen on investing in Egypt, these branch banks cannot be the conduit of foreign investment which the Government of Egypt expected them to be.

The lack of local currency or access to it also restricts the scope of investment prospects for these banks. They must either identify projects with the capacity to export and earn foreign exchange or syndicate with banks having local currency. Some of these banks are now in a sense following the lead of the joint venture investment banks and trying to formalize relationships with banks operating in local currency. These arrangements are taking the form of a working collaboration rather than ownership, where a local currency bank opens a "desk" at the foreign branch.

others. It now has a capital of $100 million. Originally begun as primarily a commercial bank to finance foreign trade, they now look for longer-term projects that can generate and repay in foreign exchange. In Egypt, most investments have been in large Law 43 projects involving public sector joint ventures such as 5-star hotels, banks and the sugar industry.

The Arab Federal Bank for Investment and Development, or more commonly known as the Arab Investment Bank, was a product of the short-lived federal union between Syria, Egypt and Libya in 1971. It has $15 million in paid-in capital, makes longer-term loans of up to 5 years and takes equity. It has so far financed 8 projects including a small hotel, tourist boats, cold storage, paper, cassettes, building materials and a real estate company. The largest equity position taken so far has been $3 million and the largest loan $2.5 million. Investments break down into 40% in equity and 60% in loans. They have only invested in wholly owned Egyptian projects so far and no joint ventures.

These banks all appear to have a reasonable degree of project analysis capability, although it is probably limited. The Arab Investment Bank stated, for example, that it could not do more than 5-8 project feasibility studies a year. Collateral requirements are probably less onerous than those of the state banks, and project selection careful and conservative. Dealing only in hard currency, however, limits the participation of these banks to projects that can repay in foreign exchange.

As foreign managed banks, these institutions can be presumed to have a reasonable degree of project appraisal capability. Unlike the foreign managers at the joint venture commercial banks, which are essentially Egyptian banks, the managers of these branch banks can turn to their inter ional system for help on appraisals and loan agreements on projects they wish to finance. The collateral requirements of these banks appear generally less harsh than those of the state banks, perhaps because of a cautious blue-chip investment policy.

Mixed or Multinational Banks

These are currently three large multinational banks headquartered and operating in Egypt. They all operate only in foreign currency and as both commercial and to some degree investment banks in Egypt and elsewhere. All three have official Arab government funding, although one, the Arab International Bank, has some private sector ownership.

The Arab African International Bank with capital of $100 million is primarily a partnership between the governments of Egypt and Kuwait. They made 5 investments in Egypt last year of some $30-40 million. They take equity and extend credit from between 3-7 years. Loans typically range from $2-15 million. Because they lend in foreign exchange, they are tied for the most part to export oriented projects.

The Arab International Bank is a partnership between the governments of Egypt and Libya, Kuwait, Saudi Arabia and so far and the AMFCO 3 or 4 in Egypt; the Saudi Egyptian Company is moving cautiously, with 3 projects only up for consideration by the Investment Authority and none yet underway.

Another company, called the Arab Investment Company, which is based in Riyadh and involves offical Arab government financing, was not very active in Egypt (it financed only one project in five years) and has now closed its office due to the current Arab official boycott of Egypt. Another company, a small one with a similar name of Arab Investment Company is getting started.

None of the firms interviewed thought that the current political situation would affect their work since they were operating as private firms under Law 43 and had no direct official ties to any Arab government. As for the firms having support from private Arab investors, there is confidence that private investment policy toward Egypt will not be affected by official disputes unless investments in Egypt become legally prohibited by Arab governments.

None of these companies has much project analysis capability and for such work they rely on the investors themselves or sometimes use local or foreign consulting firms. These firms are active investors in Egyptian projects and are thus oriented to the goals of the proposed Fund. As primarily investors in equity ownership, the credit facilities of the Fund would provide a useful supplement to their own investments. Since they can deal only in foreign exchange, however, None of these banks has been affected by the political quarrels of the day, even though official Arab capital is involved in all three cases. This is due to the fact that no direct relationship to the Egyptian government is entailed by another Arab government's participation in the funding of these banks. Indeed, several governments have recently paid in more share capital.

Investment Companies

In addition to the banks, there are at least three investment companies now actively investing in Egypt. All involve funding from the Arab oil-producing states and all operate only in hard currency. One, the Kuwait-Egyptian Investment Company is a 50/50 partnership between the Kuwaiti and Egyptian governments with a paid-in capital of $12.5 million.

The Arab Multinational Finance Company (AMFCO), which is incorporated in Luxembourg, is 51% owned by the Arab African Bank and the rest by primarily private shareholders. It has a paid-in capital of $5 million. The Saudi Egyptian Company for Investment and Finance is a partnership between the Bank of Credit and Commerce, an Arab owned London based bank, the Bank of Alexandria, and the Al Chark Insurance Company. It has $10 million in paid-in capital.

All three companies tend to seek out their own projects, occasionally lend money, but usually buy an equity share in a project. The Kuwait-Egyptian Company has financed 15 projects they would be limited to projects with an export earnings capacity.

Other Institutions

The Nasser Social Bank, established in 1972, is a unique financial institution in Egypt. It is essentially a bank operated according to traditional Islamic law. Since it can accordingly charge no interest on loans, it invests as a partner in every venture it finances and obtains repayment via a kind of "profit-sharing" system. In addition to some LE 20 million in social loans (for weddings, illness, etc.) made in 1978, the bank also financed LE 50 million in "loans" to small craftsmen and small businessmen to purchase such things as lathes, taxis and trucks. Loans can be repaid in 3-5 years. The bank has also begun to invest in some larger, new private sector projects such as LE 1 million for a hotel. Other projects have been financed in collaboration with IFC projects. The government provides the bank with access to LE 25 million in foreign exchange every year, which it commits with no difficulty. The bank has no project analysis capability, but uses outside consultants.

The Al Chark Insurance Company is a public sector company which since the coming of Law 43 has moved considerably away from its ultra conservative past posture of simply buying real estate and putting money in the bank. The company has, since the Open Door policy began, taken equity positions in 30 private sector projects in both local and foreign currency, of which 7 are already turning a profit. These 30 projects cover a wide range of activities and involve both wholly owned Egyptian firms and joint ventures. Misr Insurance and National Insurance Companies are now starting to invest similarly.

Institutions such as the Nasser Social Bank and the national insurance companies could possibly participate in the proposed Fund. They have investment funds available and are expanding interests in the private sector. Although they should not be neglected, their structure, operations and investment priorities are not as conductive to collaboration with the Fund as other financial institutions studied.

The Cairo and Alexandria Stock Exchanges continue to operate but have little business to perform. A study of the need for capital markets in Egypt is underway in the Ministry of Economy and the reactivation of the once large and vigourous security market may be in store. For the immediate future, however, the stock exchanges do not figure in Egyptian finance.

OUTLINE OF SCOPE OF WORK FOR MANAGEMENT CONSULTING SERVICES

I. Project Implementation Advisor

A. Preparation of brochure describing the operating procedures of the Fund.

B. Preparation of administrative procedures for the functioning of the Fund.

C. Liaison with banks and businessmen.

D. Pre-selection of projects.

E. Assistance in obtaining of special consultants for project appraisals

F. Promotion of and assistance with the procurement of U.S. goods and services.

G. Assistance in obtaining services for training program in project appraisal and implementation.

H. Preparation of reports to Ministry, USAID and Advisory Board.

II. Project Appraisal Consultants

Experts in specific technical areas, to work with Participating Bank project appraisal teams.

III. Training Program in Project Appraisal

A. Subjects to be included in this training program include:

1. Economic Development and Industrial Policy
   a) Economic growth and industrial development
   b) Import substitution and export promotion
   c) Financing of industrial projects.

2. Development Finance Institutions
   a) Role of development finance institutions in economic growth; policies, issues; objectives, functions, management; and resources
   b) Project identification and promotion

3. Project Preparation and Appraisal
   a) Project appraisal process
   b) Technical aspects of appraisal
   c) Project scale and timing
   d) Capital cost estimation
   e) Operating cost estimation

f) Appraisal of management

4. Financial Statements - Analysis
   a) Analysis of financial statements
   b) Break-even and sensitivity analysis
   c) Inflation accounting
   d) Time value of money
   e) Internal Rate of Return, Net Present Value, Benefit-Cost Ratio
   f) Risk analysis.

5. Marketing and Demand Forecasting
   a) Demand analysis
   b) Appraisal of marketing plans

6. Economic Analysis
   a) Economic costs and benefits
   b) Shadow pricing
   c) Comparative benefit-cost method
   d) Social cost-benefit analysis.

7. Project Implementation and Management
   a) Project control
   b) Use of consultants
   c) Procurement of equipment and services
   d) Project supervision
   e) Project evaluation.

8. Environmental Impact Evaluation:issues, sources of assistance,/benefits

B. Preliminary Design for Training Program in Project Appraisal

1. <u>Demand study</u>

The consultant will investigate the present and potential demand within Egypt for establishment of a training program in project appraisal to be available to banks and financial institutions, planning agencies, government ministries, and private sector institutions and companies.

2. <u>Preliminary Design</u>

If potential demand appears sufficient as determined by AID and the Ministry, then the consultant will investigate and describe appropriate institutional capabilities, in universities, bank training program, and other institutions, for establishing such a course. Prepare preliminary designs for establishment of such a course, including institutional location (existing or new) and preliminary estimates of costs including both local currency and foreign exchange (for advisors and equipment); and recommend a preferred design.

ANNEX Q

THRESHOLD DECISION BASED ON INITIAL ENVIRONMENTAL EXAMINATION

Project Location: Egypt

Project Title: Private Investment Encouragement Fund

Funding (Fiscal Year and Amount): FY 79 - $32.0 million

IEE Prepared By: T.R. Tifft Date: August 20, 1979

Environmental Action Recommended: Negative Determination

Mission Decision:
(Approval/Disapproval of Environmental Action Recommended in the IEE)

Approved : ________
Disapproved : ________
Date : 9/1/79

Clearances:
Environmental Coordinator: PShewin Date 8/20/79
Other Mission Offices ________ Date ________
____

INITIAL ENVIRONMENT EXAMINATION NARRATIVE DISCUSSION

1. Project Location: Egypt

2. Project Title: Private Investment Encouragement Fund

3. Funding (Fiscal Year and Amount): FY 79 - $32.0 million

4. IEE Prepared By: T.R. Tifft   Date: August 20, 1979

5. Action Recommended: Negative Determination

6. Discussion of Major Environmental Relationships of Project Relevant to Attached Impact Identification and Evaluation Form:

   This project will provide financial assistance to private sector, medium to large sized enterprise through Participating Banks. It will finance purchase of equipment and materials in a wide variety of fields such as: agribusiness, chemicals, metal fabrication, printing, etc.

   Specific sub-projects to be proposed for financing are not known at this time. As specific sub-projects are proposed, environmental concerns will be addressed. Analyses of sub-project applications will include environmental concerns. Also procurement will be limited to those items eligible under the AID Commodity Eligibility List, thereby eliminating certain pesticides, chemicals, and related products which produce adverse environmental impacts.

IMPACT IDENTIFICATION AND EVALUATION FORM

Impact Areas and Sub-areas	Impact Identification and Evaluation1/
A. LAND USE	
1. Changing the character of the land through:	N
a. Increasing the population	N
b. Extracting natural resources	N
c. Land clearing	N
d. Changing soil character	N
2. Altering natural defenses	N
3. Foreclosing important uses	N
4. Jeopardizing man or his works	N
5. Other factors	
______	N
______	______
B. WATER QUALITY	
1. Physical state of water	N
2. Chemical and biological states	N
3. Ecological balance	N
4. Other factors	
______	N
______	______

1/N-- No environmental impact
L - Little environmental impact
M - Moderate environmental impact
H - High environmental impact
U - Unknown environmental impact

IMPACT IDENTIFICATION AND EVALUATION FORM

C. ATMOSPHERIC

1. Air additives N
2. Air pollution N
3. Noise pollution N
4. Other factors

________________ N

____

D. NATURAL RESOURCES

1. Diversion, altered use of water N
2. Irreversible, inefficient commitments N
3. Other factors

________________ N

____

E. CULTURAL

1. Altering physical symbols N
2. Dilution of cultural traditions N
3. Other factors

________________ N

____

F. SOCIOECONOMIC

1. Changes in economic/employement patterns M
2. Changes in population N
3. Changes in cultural patterns N
4. Other factors

________________ N

____

IMPACT IDENTIFICATION AND EVALUATION FORM

G. HEALTH

1. Changing a natural environment N
2. Eliminating an ecosystem element N
3. Other factors

______________________ N

______________________ ______

H. GENERAL

1. International impacts N
2. Controversial impacts N
3. Other factors

______________________ N

______________________ ______

I. OTHER POSSIBLE IMPACTS (not listed above)

______________________ ______

______________________ ______

______________________ ______

Prepated By: T.R. Tifft Date: August 20, 1979

Project Location: Egypt

Project Title : Private Investment Encouragement Fund

OTHER ECONOMIC IMPACTS

Egypt is plagued by a balance of payments problem; the lack of readily available foreign exchange exacerbates another problem, which is that most modern industrial and capital equipment must be imported. Thus, the entire value of the USG financing can reasonably be judged to be a net benefit, which both alleviates Egypt's balance of payments problem and makes available the utilization of equipment that otherwise would be unavailable.

A large amount of Egypt's imports are of consumer durables and non-durables. Egypt's private industrial sector is geared to cater to the consumer market. It appears that by encouraging the domestic production of a wide variety of consumer products, the Fund would encourage a significant (if difficult to measure) degree of import substitution. The ability of the private sector to help Egypt redress its deficit in international trade is evidenced by the fact that in 1977 the private sector earned twice as much foreign currency as it spent. Private industry exports were about LE 42.95 million ($61.4 million at the parallel rate) as compared with private industry import requirements of LE 21.30 million ($30.5 million.) Private industry exported about 5 to 6 percent of its total output in 1977.

A transfer payment of $30 million from the United States to Egypt combined with a significant reduction in Egypt's import requirements, plus some increase in exports and other foreign exchange earnings, would almost certainly amount to a significant overall net benefit to Egypt. Additional indirect benefit would also result from the fact that the activities of the Fund would mobilize foreign exchange financing through private commercial channels.

The non-artisan private industrial sector in Egypt appears to have a relatively high degree of inter and intra-industry linkage. A backward linkage of over 70 percent can be noted, that is, over seventy percent of the value of total output produced by projects comparable to those to be financed by the Fund consists of demand for production inputs produced by other firms and other industries. The "forward linkage" of private sector manufacturing is also quite high, in part because of its consumer goods orientation. Firms which produce consumer items must of necessity channel them to the public through retailers. Thus the secondary benefits, tertiary benefits, and impacts from forward and backward linkages of private sector non-artisan industrial investment are relatively quite high in Egypt, as compared to the artisan, agricultural or public sectors. This potential to apply indirect economic stimulation via inter-industry and inter-firm linkage in the private non-artisan industrial sector makes it a particularly appropriate target for development investment.

A survey of the Cairo banking scene has led to the conclusion that a program like the Fund would mobilize additional medium and possibly even long-term financing from sources presently located in Egypt. At the moment, any private project requiring long-term financing is usually shelved or restructured and scaled back to an undertaking manageable within a shorter time frame. Bankers and other leaders are interested in working with the proposed Fund and are prepared to make financing available to projects backed by the Fund. This financing in general would not be readily available in the absence of the Fund, and many, perhaps most of the projects financed by it would probably not otherwise get off the ground in any form.

Thus, it appears that the Fund would facilitate, if not generate two economically beneficial activities that would otherwise be missing in Egypt. It would facilitate the implementation of long-term private sector projects; and it would facilitate, if not help to create a market in medium and possibly long-term credit in Egypt. The potential impact of the former can be evaluated by assuming that the net value added by Fund financed projects results in "extra" consumption for Egypt. The potential value of the latter impact would be difficult to determine; however, the benefit would already be quite significant to the economic development of Egypt.

The potential benefits to consumers would appear to be similarly significant. Approximately $36.2 million (includes labor costs) in incremental value of goods produced would be supplied by Fund financed projects to Egyptian consumers. Furthermore, much of this added output would be in consumer-oriented industries. The increased incomes of consumers resulting from increased wages and profits would similarly benefit the general public.

THE COSTS OF TYING AID TO U.S. PROCUREMENT

Economic Costs of Tied Aid

There is considerable economic literature on the subject of the cost to recipient nations of tied versus untied aid. Two major costs to recipient nations identified by theorists are called the "variety-distortion costs" and the "product-distortion cost."

The "variety distortion cost" (VDC) occurs when a developing country is forced by a donor's policy to buy a variety or type of product from a source which is not the cheapest source. The VDC can be measured; it is simply the difference in the price the developing country must pay for goods due to a tied-aid policy, minus the cost of identical goods from the cheapest possible source.

The "product-distortion cost" (PDC) occurs when a developing nation is forced because of a tied-aid policy to substitute one kind of product or good for another. Because the PDC involves the intangible preferences of the purchaser it is impossible to measure, although it quite definitely represents a very real cost to the aid recipient.

Hutcheson and Porter quote several studies of tied-aid to various developing countries, which report variety distortion costs of 12 to 24 percent. (See Table S-1 on following page.) They then go on to estimate VDCs of up to 35.7 percent on USAID aid to Columbia during the 1960s.

These costs will be dependent upon the kinds of goods which are purchased. RRNA has identified the various U.S. origin goods which the Egyptian private sector buys with USAID assistance (particularly the Commodity Import Program). For many of these goods the United States is not the cheapest source, internationally, even F.O.B. plant at point of manufacture. Consequently, both VDC and PDC costs are likely to be incurred by the Egyptian purchaser.

Other aspects of USAID tied loans make the goods which they finance relatively costly to the Egyptian purchaser/borrower. The goods must travel from the U.S., rather than from Egypt's natural trading partners in Europe, therefore travelling three to ten times the distance as competing continental goods. For U.S. goods which are produced inland, an additional transshipment cost will be incurred, a cost less likely to be required of the European competition. Due to USAID regulations much of the goods must travel on U.S. flag ships, therefore paying double or triple the freight rate per ton mile that the competition must pay to 'flag of convenience' vessels. Purchasers utilizing USAID financing must wait considerably longer to receive their goods from the United States, thus incurring costs stemming from unusable capital tied up in goods in transit, as well as costs of

Table S-1 Findings on Excess Cost of Tied Aid

Nation	Source	Estimate of Excess Cost[1]
Pakistan	Mahbub Haq, "Tied Credits - A Quantitative Analysis", 1967	12
Chile	"Report on Tied Credits: Chile" (December 8, 1967)[2]	12.4
India	Deepak Lal, "A Quantitative Analysis of Aid - Financial Imports of Certain Chemicals into India" (December 3, 1968)[2]	14.9
Iran	Eprime Eshag, "Study on the Excess Cost of Tied Economic Aid Given to Iran in 1966/67" (December 13, 1967)[2]	15
Tunisia	Eprime Eshag, "Study of Tied Economic Aid Given to Tunisia in 1965 (November 30, 1967)[2]	20
Various Latin-American	V. E. Tokman, "An Evaluation of Foreign Aid: The Chilean Case" (May 1969)[3]	24

1. Methods vary somewhat among these studies, but the general procedure is described in "The Costs of Aid-Tying to Recipient Countries," UNCTAD, mimeographed (November 21, 1967).
2. UNCTAD, mimeographed.
3. In Bulletin of Oxford University, Insitute of Economics and Statistics, p. 93. This article reports results of an OAS study that includes excess costs due to freight and project preparation.

Source: Hutcheson and Porter, <u>The Cost of Tying Aid: A Method and Some Columbian Estimates</u>, Princeton Studies in International Finance No. 30, 1977, p. 5.

opportunities foregone to earn profits on invested capital while waiting for delivery. Because the trip is longer, freight insurance costs are higher. All the above cost considerations may be aggravated by the difficulty in scheduling an American flag shipper, and the uncertainty arising from possible delays. It is possible to apply for permission to use non-U.S. flag ships - but only at the cost of further delays and management time utilized to gain such clearance - and even if obtained only part of the problem is averted.

Once the U.S. goods have reached Egypt, the Egyptian businessman still incurs considerable extra costs from using American capital goods rath than those of the European competition. Most U.S. firms are not geared for business in Egypt. They are unfamiliar with local conditions and tend to have weak, if any, local representation. Because their sales volume tends to be low, they have relatively high sales costs per dollar which must be passed along to the Egyptian customer. Furthermore, fixed and variable sales and service representation costs for U.S. firms are likely to be higher than those of Europeans, simply because airfares and communication costs between Egypt and the United States are much higher than between Egypt and Europe.

Spare parts of American origin must be shipped a longer distance than those of the European competition, thus resulting in all the higher shipping costs attendant to the original purchase, plus possible additional losses due to forced "down time" while waiting longer for replacement parts. These extra equipment maintenance costs are likely to be aggravated by the thinner representation of U.S. firms in Egypt as compared with European rivals. U.S. firms are less likely to maintain local spare parts inventories and local service representatives in Egypt, simply because they have not penetrated the Egyptian market to the same degree as have Europeans.

The United States has an overall absolute advantage in world markets for agricultural products, particularly grains; high technology items such as computers, arms, aircraft and telecommunications equipment; and certain kinds of specialized industrial equipment such as heavy construction and agricultural machinery. Note that only the last mentioned category is relevant when considering possible uses of American goods and productive equipment by the Egyptian private sector; items such as aircraft, telecommunications and even international trade in bulk foodstuffs are entirely the province of the Egyptian public sector. Vis a vis Egyptian private sector needs, goods such as vans and mini-buses; refrigeration and cooling systems; airconditioning and kitchen equipment are competitive particularly when attractive financing is available. However, the age when the United States was the overall low-cost producer of any and all industrial products is long past. The time when the United States had an undisputed lead in technology is also gone. American productivity per worker and per invested dollar is no longer the world's highest and U.S. labor and other costs are quite high by international standards. In short, few if any compelling economic considerations other than possibly preference offset the costs of tied aid, at least as far as the Egyptian private sector borrower/purchaser is concerned.

A quick analysis of balance of trade statistics bears out this view. Half or more of non-military Egyptian imports of U.S. goods are financed by concessionary aid and soft loans, particularly the USAID Commodity Import Program. If these funds were not tied, there is little doubt that many of these purchases would be made elsewhere. Much of the remainder consists of non-essential luxury and consumer goods and items which, for various reasons, cannot be financed by USAID funds. In any case, a very small fraction of U.S. exports to Egypt are destined for the private business sector, if for no other reason than that the Egyptian private sector is small, capital deficient and short of foreign exchange.

Such a situation is not unnatural. The United States and Egypt are simply not natural trading partners, by and large, in the economic sense. Labor intensive, agrarian, less technologically developed Egypt is geographically situated near capital intensive, industrialized, technologically advanced Europe. Forcing an unnatural degree of U.S.-Egyptian trade linkage is sub-optimal from the point of view of international economic efficiency, and costs will be incurred which must be borne by someone. The question is, who should bear these costs?

From the viewpoint of development economics, the tying of aid monies is always a sub-optimal method of providing development assistance. The proposed Private Investment Encouragement Fund is a case in point. Why should the Egyptian private borrower, the intended beneficiary of the Fund, be required to fully bear the cost distortion of an economic dislocation over which he has no control? In the judgment of the consultant team, the borrower should not be required to do so, but rather should be given some financial concessions to partially offset the inevitable cost distortions involved in the use of tied funds.

Impact on the Financial Viability of Private Sector Projects

As explained, development aid funds which are tied to donor nation procurement entail costs to the recipient. The value of the aid funds to the recipient must be adjusted for costs, particularly the variety distortion cost, which occur when the recipient is not free to purchase goods on the international markets from the cheapest source. When the aid takes the form of a loan to a private entrepreneur, the entrepreneur will bear costs from utilizing tied funds which would not occur were he able to use untied financing.

Table S-2 hows how the financial viability of an Egyptian private sector project might be affected were it to use tied USAID financing to purchase U.S. productive equipment, if the U.S. was not the cheapest source of that equipment in Egypt.

Two general categories of VDC cost are considered. The first is the effect if the cost of the machine delivered in Egypt is higher than the cost of an identical piece of machinery from any other nation delivered in Egypt. The price at

Table S-2 Hypothetical Examples of the Potential Impact of the Cost of Tied Aid on the Competitive Financial Viability of Private Sector Projects in Egypt

Example Investment	Initial Investment Required	Net Annual Cash Flow (Profits) For Ten Years	Internal Rate of Return	Payback Period of Investment
A-I[1]	LE 1,000.00	LE 199.30[2]	15	5 years
A-II	LE 1,000.00	LE 189.30[3]	14	5 years 3 months
A-III	LE 1,000.00	LE 179.30[4]	12	5 years 7 months
B-I[5]	LE 1,100.00	LE 199.30[2]	13	5 years 5 months
B-II	LE 1,100.00	LE 189.30[3]	11	5 years 10 months
B-III	LE 1,100.00	LE 179.30[4]	10	6 years 2 months
C-I[6]	LE 1,200.00	LE 199.30[2]	11	6 years
C-II	LE 1,200.00	LE 189.30[3]	9	6 years 4 months
C-III	LE 1,200.00	LE 179.30[4]	8	6 years 8 months
D-I[7]	LE 1,300.00	LE 199.30[2]	9	6 years 6 months
D-II	LE 1,300.00	LE 189.30[3]	7	6 years 10 months
D-III	LE 1,300.00	LE 179.30[4]	6	7 years 3 months

Note: Internal Rate of Return defined by $\sum_{t=0}^{10} \frac{\text{Net Revenue}_t}{(1+r^*)^t} = 0$ such that IRR = r^*.

It is assumed that the cash flow profile is: a negative outflow equal to the initial required investment in time period zero, followed by ten equal annual inflows equal to the net revenues. 'Payback' defined by the length of time required for net cash inflows to equal the net cash outflows.

1. Examples A are a "base case" considered to be the example where the United States is the international lowest cost supplier of productive machinery to Egypt, delivered in Egypt.
2. A-I, B-I, C-I, etc. are examples where the cost of operating and main-maintaining U.S. productive machinery in Egypt is competitive with the cost of maintaining identical imported machinery of non-U.S. origin in Egypt.
3. A-II, B-II, C-II, etc. are examples where the cost of operating and maintaining U.S. productive machinery in Egypt is not competitive with the cost of maintaining identical imported machinery of non-U.S. origin in Egypt, and the incremental costs reduce annual profits by 5 percent.
4. A-III, B-III, C-III, etc. are examples where the incremental cost of maintaining U.S. equipment in Egypt rather than equipment of non-U.S. origin reduce annual profits by 5 percent.
5. Examples B-I, B-II, B-III are hypothetical examples where the initial total purchase cost of U.S. productive equipment delivered in Egypt exceeds that of the cheapest possible foreign source by 10 percent.
6. Examples C-I, C-II, C-III are examples where the purchase cost of U.S. equipment delivered in Egypt exceeds that of the cheapest possible source by 20 percent.
7. In examples D-I, D-II, D-III the purchase cost of U.S. equipment exceeds the cheapest source by 30 percent.

Source: Table compiled by RRNA.

point of manufacture may be higher in the United States than the price at point of manufacture in Europe, or the price at the factory gate in the United States may be the cheapest in the world; but shipping costs are high enough that by the time the machine arrives in Egypt it is more expensive to the Egyptian purchaser than an identical machine of European manufacture. Examples A are the "base case" for the initial purchase price; examples B are identical machines to A which cost 10% more than A delivered to the customer in Egypt; examples C cost 20% more than A initially, while examples D cost 30% more.

The other sort of costs considered are possible extra costs of maintaining a machine of U.S. manufacture in Egypt as compared to the costs of maintaining a machine of non-U.S. manufacture. For example, the equipment may be sophisticated and require an engineer with technological training specific to the machine unavailable in Egypt. To bring such a person with his family from the United States and pay him American wages may cost considerably more than the travel expenses and wages of an equivalent Dutch or Italian engineer. Or perhaps the productive equipment requires imported inputs which are more expensive in Egypt when they are of U.S. origin.

These kinds of continually occurring incremental costs the Egyptian businessman would not have to pay if he employed identical non-U.S. origin machinery which was cheaper to operate. A-I, B-I, C-I and D-I are the "base cases" where net operating cash inflows are identical to the base case A-I;

in the A-II, B-II, C-II and D-II cases, net operating cash inflows are reduced 5 percent due to the possible extra costs of using U.S. equipment; while in A-III, B-III, C-III and D-III net cash inflows are reduced by 10 percent.

The cash flow profile of this hypothetical project is assumed to be as follows in A-I: for every 1000 Egyptian pounds of initial investment, the project returns LE 199.30 each year for ten years, whereupon the equipment collapses with zero salvage value. In B-I the initial investment is 10 percent higher (i.e. LE 1100) but the cash inflows are the same as A-I (LE 199.30). In A-II the initial investment is the same as A-I (LE 1000) but the net cash inflows or profits are reduced by 5 percent to LE 189.30. In B-II the initial investment is 10 percent higher (LE 1100) than A-I while net cash inflows are reduced by 5 percent (LE 189.30); and so on.

The point of interest is the impact of these extra capital and operating costs to the financial attractiveness of the investment to the private entrepreneur. If he must pay 20 percent more for a machine of U.S. origin but nothing extra in the way of operating costs, the internal rate of return of this project will drop by over a quarter from 15 percent to 11 percent while the time he must wait to recover his initial investment will increase from 5 to 6 years. If he must pay nothing extra to purchase a machine of U.S. origin but his profits are reduced by 10 percent per annum by extra operating expenses, the IRR will drop by a fifth from 15 to 12 percent while the payback would increase 7 months. If an American machine both costs 20 percent more to an Egyptian purchaser and reduces profits 10 percent due to extra operating costs, the project which must use U.S. equipment due to the financing requirement will have an IRR of about half of that using lowest-cost-source equipment (an 8% IRR rather than a 15% IRR) while the payback period will lengthen by a third (from 5 years to 6 years 8 months).

The World Bank reports that the cost of foreign exchange loan financing in 1977 was some 10.5% to 12% per annum in Egypt.[1] Our hypothetical investment would have been profitable to an entrepreneur able to secure untied financing, at these rates, for he could have purchased the lowest-cost productive equipment. If he was unable to secure an untied loan, and was only able to get tied USAID financing, the Egyptian entrepreneur very likely would have been forced to abandon an otherwise profitable project. In our examples, he would be forced to give up the project if: a U.S. origin machine cost much over 20 percent more in Egypt than the cheapest available; if extra operating expenses of U.S. machinery reduced profits by much more than 10 percent per annum; or if both the purchase cost in Egypt was over 10 percent more than the lowest-cost machine and profits were reduced by 10 percent.

As these hypothetical examples demonstrate, tied aid can be very cost distorting. If the full costs of tied aid must be borne by private sector firms, many projects would likely be abandoned and others inefficiently implemented. If the proposed Private Investment Encouragement Fund must

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1. World Bank Staff Appraisal Report, Report No. 1809a-EGT, February 28, 1978, EMENA, pp. 13 and 14.

be fully tied to U.S.-procurement, the consultants believe that the cost of the aid provided should be reduced to ensure that the objective of facilitating private sector development can be achieved.

SOCIAL IMPLICATIONS

PART I. Utilization of Capital and Labor in Egypt

From an examination of the evidence, it appears that Egypt is quite labor intensive, even when compared to other low income developing nations. Egypt simply produces less output per man-years of labor than other comparable nations.

The Egyptian private sector* is not particularly capital intensive when measured against other low income nations. Yet it is very much less labor intensive than the rest of the economy, achieving a very high level of output per man-year of labor by Egyptian standards. In short, the private industrial sector appears to be quite efficient compared with the rest of the Egyptian economy or even against low-income nations as a whole.

The Egyptian private sector* has made tremendous gains in terms of output per man-year since 1973. At the same time, output per invested pound has remained fairly steady. During this period, the average size of projects has grown in terms of both investment and employment. The obvious inference is that economies of larger scale operations are contributing to efficiency in terms of the principal factors of production.

A. A Comparison of Public Versus Private Sector Performance

According to a report published by GOFI and the Ministry of Industry, in the 1970s the 200 principal firms in the public sector produced 65% of the country's manufactured goods while the 15,000 smaller industrial establishments in the private sector produced the remainder.

Table T.1 from the GOFI/Ministry of Industry report shows that during the 1970s, the private sector share of industrial output and the level of private sector output has grown 3 times faster than public sector output. Table T.2 shows estimates of private versus public industrial exports to both the Eastern Bloc and Western nations. Both the private sector's share of total industrial exports and the level of private exports have grown markedly in the 1970s.

The GOFI/Ministry of Industry report indicates that the total estimated industrial private sector wage bill increased over tenfold between 1970 and 1977. At the same time, the estimated number of workers employed in private industry nearly quadrupled. Average nominal wages increased some 278% between 1970 and 1977.

The report compared projected productivity in private sector versus public sector industry for 1977. The results are startling. Worker

* i.e., the private industrial sector which does not include the artisanal sector.

productivity in the private sector, measured as estimated gross output per worker employed was LE 10,900 per capita in the private industrial sector versus LE 3,637 realized in the public sector in 1977. Projected productivity (output) per pound of workers' wages from private sector projects was projected to be LE 28.5 as compared with LE 7.0 realized in the public sector in 1977.

The published figures available reporting on levels of private investment in Egypt appear to be gross underestimates of the level and proportion of total actual private investment. This is not surprising; most published measures of private activity appear to be underestimates. The public sector appears to get the lion's share of financing, in part because much private saving is channelled into "store of value" investments such as gold, valuables and real estate rather than into productive enterprises. But as the Ministry of Economy's Five Year Plan figures indicate, according to official policy some 84% of all investment officially approved will be channelled into the public sector until 1984. The inference must be that although output, employment, exports and productivity are increasing faster in the private than in the public sector, the centrally planned economy in Egypt continually channels capital into the already intensive public sector.

The World Bank reports that private sector performance has been "impressive". It reports average annual increases in private manufacturing sector output of 15 percent in real terms from 1974 to 1976. While low, private sector exports doubled between 1973 and 1975. Private sector employment increased at an annual rate of 6.7 percent during the 1966-74 period, compared with a growth rate of 2.4 percent in the public sector. The Bank reports that "The record of the Private Sector is even more impressive if account is taken of the over-staffing of public enterprises for social and political reasons." The private sector share of total industry employment grew from 47 to 54 percent in the 1970s.

At the same time, the Bank reports that the private sector's officially reported share of annual total investment has been a miniscule 4%. This tiny estimated percentage of total investment going to private firms is echoed in the GOFI/Ministry of Industry report. These estimates no doubt omit a considerable amount of officially unrecognized private investment as well as reinvestment of profits. The public sector has, of course, through its control of the banking system, traditionally been able to claim a disproportionate amount of investable funds. This general pattern continues, although it appears that the proportion as well as the rate of private sector investment is increasing.

Private enterprise produces over a third of the total industrial output with well under a fifth of invested capital, employing over half of the industrial work force. The socio-economic rate of return on capital invested in the private sector appears to be double to quadruple that achieved by the public sector. It employs more people than the public sector without "padding the payrolls" and manages to pay them higher wages as well. The private sector achieves all this in spite of the fact that it is apparently both over-regulated and shut off from the major local source of investment capital; i.e. the government.

Egypt has a shortage of physical capital investment and a surplus of available labor. The private sector uses relatively little capital and relatively large amounts of labor in its mix of the two main factors of production; it seems obvious that this is an efficient utilization of the resources available in Egypt. It further appears obvious that a development dollar invested in the Egyptian private sector results in more output and more employment than a development dollar invested in the Egyptian public sector. Furthermore, a greater proportion of the fruits of investment in the private sector appears to reach the work force than is true of the public sector.

B. Employment Priorities in Egypt

The "open" unemployment rate in Egypt is low, with the officially unemployed constituting a small (2-3 percent) segment of the work force. However, all other signs indicate that Egypt should be viewed as a country with an employment problem. Many people, particularly women, do not participate in the work force. Jobs are hard to find. Many people accept positions earning wages which cannot support them at even a minimum level of comfort. Many also accept part-time employment; underemployment is a widespread phenomenon. A large proportion of the population has found it necessary to squeeze into low productivity and hence low wage sectors, particularly government and domestic service. The labor force, Egypt's most plentiful resource, is underutilized.

The problem in Egypt is not a question of job creation *per se*, but rather a question of increasing productive employment and hence wage levels. Over two decades of social welfare-oriented public policy have created a large number of jobs which alleviate official unemployment but add little to Egypt's overall output of total goods and services. A beneficial result of these policies has been that sharp disparities of wealth in Egypt were ameliorated. The need to create productive employment opportunities now seems to be a more pressing goal.

Another problem is the relative shortage of skilled labor. Utilization of the abundant unskilled labor supply is problematic in the absence of skilled labor to work in combination with the unskilled. Furthermore, raising labor productivity is difficult unless the level of skill of the work force is increased, and such things take time.

C. Broad Social Impact Considerations

Regional rural labor shortages do appear, particularly when cyclical labor demand peaks at certain times during the year. However, Egypt's agricultural sector essentially has a labor force which is growing faster than the available supply of arable land. The agricultural sector is already very labor intensive by both Egyptian and international standards. Thus, there appears to be little long-term room both to add to agricultural output and increase agricultural employment, while at the same time increasing labor productivity and wage levels.

Over the past few decades, the urban population has grown faster than the rural population as people have migrated to the cities in search of a better life. Concurrently, the rate of growth of industrial production has outstripped the growth of agricultural production. Population growth pressures create a pool of excess rural labor which cannot be absorbed by agriculture except at very low wages. Fortunately, economic progress is typically accompanied by industrialization and technological progress, as consumer demands become more sophisticated. The net emigration of the Egyptian rural and agricultural labor force has been to some degree offset by increases in the industrial work force. The fact that wage levels are believed to be appreciably higher in urban endeavors may be taken as evidence that this migratory trend is both normal and probably beneficial in the economic sense. This development appears to be completely consonant with historial trends in Egypt.

PART II. Other Social Considerations

A. Employment

As of 1977, capital investment per employee in the Egyptian private industrial sector reportedly amounted to about $7,300 per job. The direct job creation impact of Fund financed projects is therefore likely to approach 10,300 jobs At an average 3.2 persons per employed Egyptian, Fund financed investment would directly support about 33,000 citizens.

Increased demand for intermediate goods caused by this increased production, that is, production inputs for the new projects requiring purchases in other sectors, would result in the immediate creation of indirect employment and capital investment. On the assumption that the immediate labor multiplier is 2 and the immediate capital multiplier is about 1.5, it can be inferred that the total amount of jobs created by Fund financed activity would be about 20,600 and that further demand for capital investment of about $37.5 million would be generated. Indirect employment, or employment generated in other sectors due to Fund-related investment in a particular sector, would constitute about 10,300 productive jobs.

There has been a trend over the last decade of increased investment per employee in Egyptian private industry. If this trend continues, somewhat fewer jobs would be created by the Fund. However, these jobs would then probably pay higher wages due to increased productivity per worker, and increased requirements for skilled workers.

B. Impact on Women

One result of the employment problem in Egypt is that women tend not to enter the work force. Of course, a bias against female employment is a legacy of cultural traditions in Egypt and the entire adjacent region. Past economic conditions have no doubt reinforced these attitudes. Thus, women lack incentive to enter the labor force both because good jobs are hard to find and because tradition is against it. Egypt does not fully utilize the services of a group potentially capable of making a significant social and economic contribution.

Several of the economic sectors where private enterprise is active in Egypt exhibit a particular propensity to hire women. Hotels and the general tourist trade find women useful in customer contact occupations. Private offices require the services of trained secretaries and administrators. Furthermore, throughout the industrial and private sectors women can now occasionally be found in key positions normally filled by men. Social change appears to be moving along with the economic trends.

A program like that of the proposed Fund would be too small to appreciably affect the lives of more than a small number of Egyptian women, but would be quite beneficial to the women concerned and would represent a useful contribution to the development of a broader trend.

It should be pointed out that the status and progress of women in Egypt compares well to virtually all her regional neighbors. Women are able to secure education and participate in the work force to a much greater extent than in other Arab countries, or for that matter in most of the less developed world. Egypt may well be the foremost country in the Arab world in providing equality and opportunity for its women citizens.

C. Comparative Wage Levels

The report Industrial Activities in the Private Sector furnishes an estimate of average annual salaries paid in private industry in 1977 of $547.69 at the parallel rate. The 1976 input/output table provides estimates of the distribution of rural and urban wages by income group, as presented in Table T.3.

One sees that the average wage paid by the private sector appears to be 25 percent above the national average wage for Egypt (not accounting for wage inflation between the two years), and higher than both the rural and the urban averages. Note that the overall urban average reported in Table T-1 includes both public and private industrial sectors; simple arithmetic indicates that private industry probably pays at least 10 percent higher wages than is true of the rest of the urban sector as a whole. Observers interviewed by the RRNA team agreed that wage levels are higher in private industry, and are increasing faster than those in the public sector. Not only do private industrial firms pay relatively well on average, but the gap between public and private sector wages appears to be growing.

A 1978 survey reported that joint venture companies in Egypt paid Egyptians an overall average of LE 655 ($937) per capita per annum in 1978. Joint venture companies are generally foreign managed and relatively technologically advanced by local standards. Their wage levels appear to be about double typical Egyptian standards and well above salaries in the Egyptian owned private sector. As the locally owned private sector develops, its salaries should begin to approach joint-venture levels, given current trends.

D. Distribution of Benefits

An estimated net direct aggregate consumption stream of $36.2 million per annum would arise from private projects financed by the Fund, plus an indirect incremental increase in production of inputs required by the project. Of this direct increase in aggregate production and hence consumption, about 36% would be directly attributable to the USG's share of the actual investment and the rest to investment from other sources.

Some assumptions must be made to continue this analysis. The following assumptions are adopted to permit evaluation:

- The social discount rate of Egypt is 15 percent.
- Projects financed by the Fund would have an average economic life of 15 years.
- These projects would have an average zero terminal value.
- One third of the projects would start production at the beginning of the fourth year of the Fund and the remainder the following year.
- The annual incremental income stream due to the U.S.G. development dollars would be $13.2 million and that due to the entire Private Investment Encouragement Fund program $36.2 million (labor costs are not netted out here).

The present social value of incremental additions to the Egyptian aggregate consumption stream attributable directly to US dollars is likely to be about $53.5 million. The present social value of increased Egyptian production and consumption attributable to both US and privately mobilized investment seems likely to be about $146.1 million. Note that the value of the US contribution under these assumptions would be worth much more to Egypt when properly invested in the private industrial sector than if it were simply consumed directly (i.e. distributed to the population, for example, in a commodity grant program).

About 14.6 percent of the net value added to aggregate output by the Fund program would likely be paid out in wages. The proportion attributed to the dollars would be a stream of some $1.9 million per year in wages, while the entire program would be a stream of wages of about $5.3 million.

The $30 million in US dollars would be earmarked for purchases of U.S. origin equipment. Egyptian customs duties on relevant productive machinery generally varies from 2 to 20 percent (and up) with surcharges such as the 'National Security Tax' often exceeding the amount of the import duty. It seems reasonable to assume that at least 10 percent of the value of the imports would be paid by the private sector to the government. (Average tariff receipts often equal 20-25 percent of the value of imports).

Therefore, about $3.0 million at least would likely be collected by Egyptian customs on U.S. exports to Egypt generated by the Fund.

The Egyptian government collects both direct and indirect taxes on industries. According to the 1976 input-output table, urban sectors paid an average of about 6.3 percent of the value of their production in tax, not including tariffs. The corporate taxes of Fund-related endeavors could reach some $2.3 million annually, with the US share equalling some $.84 million of this sum.

The Egyptian government also collects individual income taxes from over one million individuals. While realistic data on effective tax rates is difficult to find, it seems reasonable to suppose that at least 5 percent of the additional income to the private sector would be transferred to the government by personal income taxes.

The Egyptian government would also eventually receive the loan repayments and part of the interest due. The following assumptions permit evaluation of this transfer of benefits:

- One third of the loans would be disbursed in the second year and the remainder in the third year.

- Loans would be fully repaid over an eight-year period in equal installments starting the year following disbursement.

- All interest and principal payments would be "passed through" to the Egyptian government.

- The interest rate paid by private sector borrowers would be 10 percent.

Under these assumptions, principal and interest repayment would constitute $5.62 million a year over eight years, of which $3.75 million would be repayments of principal and $1.87 million would be interest payments.

How the direct benefits of the US development aid would be divided, can now be roughly determined. The private sector would reap a stream of additional profits due to US financing. Some of this benefit would go to employees in the form of wages. The government would enjoy large share of the net incremental benefits via tax revenues and the loan repayments. To determine the proportion of benefits going to each element of society simply requires the determination of the present value of each of the streams of benefits discussed so far. This evaluation is presented in Table T-4. About 51 percent of the present social value of the incremental benefit would go to the government, about 15 percent would go to employees in the form of wages, and about 34 percent to the private sector to be paid out in dividends or to be re-invested.

Note that although the net direct benefit to the private sector would be larger than the initial benefit to labor, the amount of "first round" benefits received by the government would be nearly half again as big as that of the private sector. While the distribution of the initial round of benefits would be weighted in favor of the private sector, the final overall impact in terms of final distribution of benefits would depend largely on government expenditures policy. The final distribution of benefits would also depend on indirect, secondary, tertiary, and income effects.

This allocation of benefit receipts for a program like the Fund is not atypical. A 1974-75 study of 29 loans to private firms by a development finance corporation in Columbia estimated that owners received 19 percent of net economic benefits generated by the projects, workers received 9 percent, and the government received 57 percent.

The Government of Egypt appears to have an expenditure policy which is quite "progressive" in that it favors aiding the disadvantaged sectors of society. Table T-5 itemizes Egyptian government expenditures for 1976; over three quarters of the budget is aimed at directly improving the social welfare of the population (economic services, social services, and subsidies). Economic services furnish both goods and employment; social services such as medical programs and subsidies on basic foodstuffs, in particular, reach poorer elements of the population. The government's program will in fact help the poor.

Thus, with at least three quarters of the direct benefit received by the government from the Fund's activities being returned to the general public in the form of public services and low cost goods, it appears that on the whole the Fund program would not exacerbate the gap between rich and poor in Egypt. This is particularly true in view of the fact that the overall impact of the program, which would include secondary, tertiary, and "trickle down effects," would tend to be weighted in favor of labor and the general population.

One general principle of economics is that high income groups save a larger fraction of their incomes than do low income groups. That is, profits accruing to the private sector are more likely to be channelled into productive employment-generating reinvestment than are wages paid to employees.

Another important consideration is the relative efficiency and productivity of the private industrial sector compared with all other sectors of the Egyptian economy. In short, an investment in any other sector would not produce nearly as much total net direct benefit, because the other sectors are simply less efficient. Thus, the fact that the private sector would receive a large proportion of the overall direct benefits of a program like the Fund does not mean that other segments of society would receive more if the money were invested elsewhere.

Furthermore, the private sector would bear much of the risk associated with Fund supported investments. If the total increase of net production and consumption to the economy were less than anticipated, much of the decrease in benefit would be absorbed by the private sector itself.

It must be noted that the results of this analysis are very sensitive to the assumptions used. Both the magnitude of the benefits and their distribution change as assumptions are altered. The assumption regarding the relationship of incremental capital investment to incremental output is particularly critical. There seems little doubt, however, that the incremental benefits would be large and positive; and that both the government and private sector would receive relatively large shares of these benefits, with labor receiving a small but significant share.

Table T-1. Growth of Industrial Production in Public and Private Sectors Supervised by The Ministry of Industry and Mining

Year	Production (millions of Egyptian Pounds) Total	Public	Private	Private Sector as a Percent of Total	Private Sector as a Percent of 1970
1970	1321	988	333	25,2	–
1971	1462	1103	359	24,6	108
1972	1619	1451	168	10,4	50,4
1973	1584	1414	170	10,7	51
1974	1899	1424	475	25,0	142,6
1975	2216	1561	655	29,6	221.[illegible]
1976	2459	1724	735	29,9	221.[illegible]
1977	2783	1990	793	28,5	238 [illegible]

Source: Ministry of Industry and Mining, and the General Organization for Industrialization, Industrial Activities of the Private Sector Supervised by the Ministry of Industry and Mining 1977, August 1978.

Table T-2. Growth of Industrial Exports in Public and Private Sectors Supervised by the Ministry of Industry and Mining

Year	Exports (millions of Egyptian Pounds) Total	Public	Private	Private Sector as a Percent of Total	Private Sector as a Percent of 1970
1970	105	92	13	12.4	–
1971	117	101	16	13,7	123.0
1972	59	52	7	11,9	53,8
1973	136	114	22	16,2	169,0
1974	223	169	54	24,2	415,4
1975	215,6	156,7	59	27,4	453,1
1976	207,1	163	44	21,4	341,0
1977	250	207	43	17,2	333,0

Source: Ministry of Industry and Mining, and the General Organization for Industrialization, Industrial Activities of the Private Sector Supervised by the Ministry of Industry and Mining 1977, August 1978.

Table T-3. Estimates of Annual Wage Income in Egypt, 1976
(Average U.S. Dollar Income per Employee)

Workforce Income Segment	Average Earnings per Worker
Rural Overall Aver-ge	333.12
Lowest 60%	227.56
Middle 30%	337.76
Upper 10%	952.43
Urban Overall Average	521.18
Lowest 60%	260.79
Middle 30%	563.10
Upper 10%	1957.80
Overall Average for Egypt	438.05

Source: General Equilibrium Policy Model for Egypt, 1976, input/output table, Massachussetts Institute of Technology and Cairo University Staff, furnished by USAID, Cairo.

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Table T-4. Projected Allocation of Incremental Direct Benefit Due to USAID Development Investment Via A Private Investment Encouragement Fund

Discounted Present Social Value[2]	Millions of Present U.S. Dollars[1]	Percent of Direct Benefits
Total Incremental Direct Benefit	53.5	100.0
Net Benefit to Private Sector	18.1	34
Net Benefit to Labor	7.8	15
Net Benefit to Egyptian Government	27.5	51
Import Duties	2.3	4
Corporate Tax Revenues	3.4	6
Individual Income Tax	1.0	2
Loan Payments	20.8	39

1. Data may not add to totals due to rounding error.
2. Social rate of discount is 15 percent.

Source: Compiled by RRNA.

Table T-5. Level and Distribution of Public Expenditures in Egypt in 1976

Item	Millions of Pounds LE	Percent
Economic Services	666	22
Social Services	616	21
General Administration	362	12
Subsidies	553	19
Defence	756	25
Others	24	1

Source: World Bank Report No. 181-EGT, Arab Republic of Egypt Economic Management in a Period of Transition, May 1978, Volume IV, page 7.

ANNEX U

REQUEST FOR WAIVER
FOR NEGOTIATION WITH A SINGLE SOURCE

PROBLEM: A delay of up to seven months in start of project implementation may result if competitive procedures are followed for procurement of management consulting services. Consequently a waiver is requested for negotiation with a single source, for reasons described below. Contract cost is estimated at $800,000.

DISCUSSION: The management consulting firm, Robert R. Nathan Associates, Inc. (Nathan) of Washington, D.C., conducted a feasibility/design study of this project for establishment of a Private Investment Encouragement Fund (Fund) in Egypt. This study was performed under a work order pursuant to an IQC contract with AID. Work was started in late May 1979 and the draft final report was completed in mid-August. Copies of the final report will be distributed in September. The project is scheduled for authorization in September 1979. The GOE has requested a waiver be granted.

Nathan, during the course of its work on this study, learned that bankers and potential investors are anxious for the Fund to start operations. USAID/Cairo has received numerous inquiries about the availability date for financing under the Fund. To speed project start-up we feel a waiver for negotiation with a single source is warranted, based upon AID Handbook 11, Chapter 1, section 2.4.2.

(1) Competition: Nathan's services for the feasibility study were procured under an IQC contract. Such contractors are selected and obtain their contracts with AID as a result of a competitive process. Therefore, there has already been competitive selection of Nathan, although not for this specific project.

(2) Special Capability: Nathan has achieved a special capability in Egyptian private sector investment finance, as a result of its study. Nathan is already acquainted with senior management and investment policies of Egyptian institutions involved in financing the private sector. It knows a large number of Egyptian and joint venture businessmen, their needs and requirements. It knows intermediary organizations, such as the Joint Business Council, Federation of Industries, International Executive Service Corps, General Organization for Industry, and other which will be important to project success. In addition, it has collected and appraised information from a variety of sources so that it has an unusually broad-scoped but detailed perspective of the needs of Egyptian investors and the capabilities of financial institutions to satisfy those needs.

(3) Objectives of U.S. Policy: An important objective of U.S. Government policy vis-a-vis Egyptian development is the speedy development of the Egyptian private sector.

Concern for private sector development has not been limited to AID, where it is reflected in the CDSS and a portfolio of several projects, but has also been demonstrated by:

(a) The Congress, in passing the Humphrey Amendment, which required, among other things, that AID evaluate its support for private sector development, with a view to increasing it. The resulting Humphrey Report contained many recommendations for projects, of which this is one.

(b) The executive branch with the cooperation of U.S. business, through the Strauss/Cooper and other special missions, has advocated that private business, both U.S. and Egyptian, undertake a stronger role in Egypt's development process. These missions have received Egyptian official and private support in identifying barriers to improved business relations. As one result of recent meetings, it became obvious that additional mechanisms for long-term investment finance are needed, which this project addresses.

(c) Private business, through the Joint Business Council, has strongly supported development of a better climate for increased relationships between U.S. and Egyptian businessmen. The Council has been active in bringing businessmen together, implementing and working on solutions. It recognizes the lack of adequate long-term finance facilities and some Council members, in supporting this project, have said it is important that AID make funds available quickly.

Egypt's business climate is improving, especially after the Peace Treaty, and this project is well-timed to induce investors to undertake longer-term investments. Maximum benefit can be gained for the U.S. if we demonstrate U.S. willingness to create the Fund in a prompt and expeditious manner. Such promptness will also significantly assist the objectives of the project itself. We therefore recommend a waiver for negotiation with a single source so that project implementation can start soon, hopefully before the end of 1979.

<u>RECOMMENDATION</u>: That a waiver be approved for negotiatic- -ith a single source for procurement of project implementation adv-_ory services.

SCHEDULE OF ESTIMATED BISBURSEMENTS

AID GRANT ONLY

($000's)

	1980		1981		1982		1983		1984		Total	
	Dollars	LC	Dollars	LC	Dollars	LC	Dollars	LC	Dollars	LC	Dollars	LC
Fund for sub-projects												
1. Sub-project investments (a)	$2,000	$350	$9,000	$350	$9,000	$ 50	$6,000		$2,800		$28,800	$750
2. Management & Fees		200		200		50						450
B. Consulting Firm												
1. Project Implementation adv.	120	25	120	25	10						250	50
2. Project Appraisal Consultant	300	300	300	300							600	600
3. Training Prog.	150	50	150	50	50	50					350	150
Long-term finance study			300	300							600	
C. Escalation & Contingency (b)												
1. Escalation (10%)	60	-0-	85	-0-	35	-0-					180	-0-
2. Contingency (12%)	70	-0-	105	-0-	45	-0-					220	-0-
TOTAL	$2,700	$ 925	10,060	$ 925	$9,440	$150	$6,000		$2,800		$31,000	$2,000

Notes: (a) Sub-project investment in Local Currency represent Fund equity contributions.
(b) Escalation and Contingency for Local Currency expenditures has been included in line items.

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UNITED STATES GOVERNMENT

Memorandum

TO : Near East Advisory Committee

THRU : NE/PD, Selig A. Taubenblatt

DATE: September 11, 1979

FROM : Project Review Committee

SUBJECT: Issues Paper: PP - Egypt Private Investment Encouragement Fund (Project No. 263-0097)

1. Project Purpose

Issue: The purpose of PIEF is to provide medium to long-term credit for larger-sized private sector firms in Egypt. The credit will be channeled to participating banks through a Fund located in the Ministry of Economy. Although the Fund will receive repayments on sub-project loans and dividends on equity investments, it will be several years before these reflows reach significant levels. Even then, the Fund will experience substantial depletion through inflation and absorption of the foreign exchange risk on repayments (see Issue 2 below). Consequently, the Fund is viewed primarily as an administrative unit for this project rather than as an institutional creation to stimulate or make available medium to long-term credit on a continuing basis.

The Committee believes this project should do more than simply provide credit on a one-time basis. It believes that the project purpose should be expanded to address the institutional requirements necessary to meet the private sector demand for long-term investment and venture capital.

Recommendation: The Committee recommends that a covenant be included that would seek a best-efforts undertaking by the GOE to address the shortage of long-term credit and that would provide for a continuing dialogue between the GOE and USAID on appropriate institutional arrangements for achieving this objective. In this connection, the Committee also recommends that an additional $600,000 be made available under this project for an assessment of the financial sector, including an examination of institutional alternatives for long-term development credit.

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2. Foreign Exchange Risk

Issue: The rate of exchange for converting dollar disbursements into equivalent Egyptian pounds will be determined on the date the sub-project agreement is signed, using the unified exchange rate. Thus the risk of depreciation of the pound against the dollar between time of disbursement and repayment will be borne by the Fund rather than the investor. In contrast, under A.I.D.'s loan to the Development Industrial Bank (DIB), a maintenance of value provision passes the exchange risk on to the sub-borrower. The interest rate for sub-project loans will be the same, 11 percent, for both DIB and PIEF. The issue is whether it is appropriate to establish PIEF terms for medium to large size firms that are somewhat more attractive than DIB's terms for smaller-scale firms. To bring PIEF terms into line with DIB, for example, one could either shift the foreign exchange risk to the sub-borrower or, alternatively, raise the interest rate.

After analyzing constraints to moving this kind of credit effectively and expeditiously, including those constraints experienced by the DIB, the Mission has concluded that the proposed interest rate and exchange risk provisions are necessary incentives for facilitating the use of the PIEF credit.

Recommendation: The Project Committee accepts the Mission position and does not recommend any change in the proposed interest rate and exchange risk provisions.

3. Sub-project Selection Criteria

Issue: Based on the Consultant's analysis, the project paper does not include employment generation as one of the criteria for determining eligibility under the PIEF credit. In brief, the Consultant concluded that Egypt's employment problem requires a balanced strategy of not only generating new job opportunities but also of increasing labor productivity and creating higher paying jobs.

The Committee accepts the Mission position that employment generation not be a criteria for eligibility. However, the committee does believe that in establishing priority among otherwise eligible applicants, if demand for credit exceeds available funds, preference should be accorded projects having greater employment generation potential. The Committee also believes that other bases for establishing priority among applicants, such as geographic dispersion, should be considered.

Recommendation: The Committee recommends that employment generation and geographic dispersion be used as criteria for establishing priority among otherwise eligible sub-projects, when eligible applications are in excess of funds available.

4. Sole Source Waiver Request

Issue: Under an IQC arrangement, Robert R. Nathan Associates (RRNA), was selected by A.I.D. to assess the feasibility of this project. The PP recommends that a waiver be approved for negotiation of a sole source host country contract with RRNA for provision of project implementation and training services. Justification for the sole source waiver is based on time saved in not following competitive procedures and in using a firm which, by virture of work already done, can proceed immediately with implementation.

Recommendation: The Committee is not prepared to make a recommendation until there have been further consultations with the Mission, especially with regard to whether the GOE wishes to request sole source selection. A report on NE/PD discussions with the Mission will be made at the NEAC meeting.

Clearance:

Project Committee:
NE/PD, R. Bell (Chairman)
GC/NE, S. Carlson(Draft)
NE/EI/E, J. Sperling(Draft)
NE/DP, ?. Chernenkoff(Draft)
NE/TECH, R. Mitchell(Draft)
NE/PD, L. Rosenberg(Draft)
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PPC/PB, Mr. J. Segal
PPC/WID, Ms. A. Fraser
GC/NE, Mr. J. Mullen
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SER/COM/NE, Mr. R. Looper
DS/DIU/DI, Ms. E. Falbo
NE/PD, Ms. G. Shivers
NE/EI, Mr. G. Kamens