AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) Amendment Number

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: Egypt

3. PROJECT NUMBER: 263-0147

4. BUREAU/OFFICE: Near East Bureau NE/03

5. PROJECT TITLE: Production Credit

6. PROJECT ASSISTANCE COMPLETION DATE (PACD) MM DD YY: 09 30 84

7. ESTIMATED DATE OF OBLIGATION (Under 'B:' below, enter 1, 2, 3, or 4)

A. Initial FY 82 B. Quarter 4 C. Final FY 82

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY B. FX	FIRST FY C. L/C	FIRST FY D. Total	LIFE OF PROJECT E. FX	LIFE OF PROJECT F. L/C	LIFE OF PROJECT G. Total
AID Appropriated Total	59,000	1,000	60,000	59,000	1,000	60,000
(Grant)	(59,000)	(1,000)	(60,000)	(59,000)	(1,000)	(60,000)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
Host Country					17,000	17,000
Other Donor(s)						
TOTALS	59,000	1,000	60,000	59,000	18,000	77,000

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. PRIMARY TECH. CODE 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. OBLIGATIONS TO DATE 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. AMOUNT APPROVED THIS ACTION 2. Loan	F. LIFE OF PROJECT 1. Grant	F. LIFE OF PROJECT 2. Loan
(1) ESF	701	819		60,000				60,000	
(2)									
(3)									
(4)									
TOTALS				60,000				60,000	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE

To expand investment for productive private sector enterprises.

14. SCHEDULED EVALUATIONS

Interim MM YY MM YY Final MM YY 06 84

15. SOURCE/ORIGIN OF GOODS AND SERVICES

☐ 000 ☐ 941 ☐ Local ☐ Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a _____ page PP Amendment)

17. APPROVED BY

Signature

Title: Acting Director USAID/Egypt

Date Signed MM DD YY: 08 0 82

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION MM DD YY: 08 06 82

AID 1330-4 (3-79)

PRODUCTION CREDIT

(263-0147)

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(263-0147)

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I. SUMMARY AND RECOMMENDATIONS

A. Project Title: Production Credit

B. Project Number: 263-0147

C. Grantee: The Government of Egypt (GOE)

D. Coordinating Entities: The Office of the Deputy Prime Minister for Economic and Financial Affairs, the Ministry of Investment and International Cooperation (MIIC) and a Private Sector Steering Committee.

E. Implementing Entities: Private banks in Egypt (joint venture or Egyptian owned), public sector banks, the Central Bank of Egypt, and the Development Industrial Bank.

F. Amount: $60 million

G. Terms: Grant to the Government of Egypt with lending terms to implementing entities agreed upon by AID and the GOE.

H. Life of Project: 2 1/2 years (Extension of LOP is contemplated since the project design includes a framework for additional financial assistance to Egypt's private sector.)

I. Strategy:

The goal of this project is to increase the private sector's contribution to Egyptian productive output. Linked to this goal is the development of a financial system with the capability and capacity to service a full range of short-, medium-, and long-term financial needs, to support the growth of productive private sector enterprise.

The proposed allocation of $60 million represents an increase in AID and GOE financing commitments to the private sector. While initiating the program with short-term and small scale enterprise credit components, the project provides a framework for expansion to other components of the credit system. The project will not allocate resources to banking institutions in advance but rather make them available against specific transactions as needed and according to commitment and disbursement performance. Allocations will be guided by a simplified system of GOE official circulars describing the terms and conditions for all sub-loan transactions. In addition, the project contemplates reallocation of amounts between credit components if the need arises.

At the outset, two credit components will be funded: (1) Short-Term Credit for production imports ($52.0 million) and (2) Small Scale Enterprise lending ($7.0 million). Technical assistance, training and studies ($1.0 million) also will be financed.

Short-term credit (STC) funds will be made available on a transaction basis to eligible private and public sector banks on terms and conditions described in an official GOE circular. Funds will not be reserved to any bank, but rather committed on a first-come, first-served, transaction-by-transaction basis. AID review and approvals will be similar to those currently in place for the Private Sector Commodity Import Program. Procurement will be governed by AID Regulation 1 requirements.

Small Scale Enterprise (SSE) credit funds will be made available to banks which demonstrate sound lending practices and provide term lending to clients who meet small scale enterprise criteria, on terms and conditions also described by official GOE circulars, reviewed and approved by AID. AID Regulation 1 also will apply to this component. The only bank initially eligible will be the Development Industrial Bank (DIB). The intention is, however, to include other banks which demonstrate capacity and have small scale enterprise clients. Should the DIB or other banks fail to commit funds at a reasonable pace, the funds may be re-allocated to the short-term credit component, with AID approval.

Technical assistance, training and studies are also proposed. The Project may fund training activities to improve a variety of banking skills, including staff project appraisal capability and bank management capacity to review, approve and monitor transactions or subloans which may be financed. Funds for technical assistance will also be available for credit policy analysis and development of new financial instruments for the Egyptian banking system.

A mechanism will be created to provide private sector program and policy oversight. To be established by the Deputy Prime Minister for Economic and Financial Affairs (DPM), the Private Sector Steering Committee (Committee) will assist in the execution of the program. It will monitor performance, guide the organization and management of program components, consider new credit activities, and propose reallocation of funds between components.

In addition to the regular meetings of the Committee, the Government of Egypt has agreed to semi-annual consultations with AID under the auspices of the Deputy Prime Minister for Economic and Financial Affairs. Discussions will include a broad range of issues, including the financial requirements of the banking system, the business climate and the design of new financial instruments.

J. Major Pre-Authorization Achievements:

1. Agreement with the GOE, by the Deputy Prime Minister for Financial and Economic Affairs, to semi-annual consultations on credit, business environment and related matters.

2. Establishment of a Private Sector Steering Committee with responsibilities for AID private sector programs and related GOE private sector policies.

3. Adoption of a transaction approach which puts private sector banks on an equal footing and in direct competition with public sector banks.

4. Development of a design model which permits easy expansion to additional financial components.

5. An increase in the level and prospects for private sector programming in Egypt and a design model to sustain such growth.

6. Direct involvement of the Central Bank of Egypt in both the program and policy aspects of the project.

K. Recommendations

USAID recommends authorization of a grant to the Government of Egypt in the amount of $60.0 million on the terms and conditions described in the Draft Authorization contained in Annex C. This grant will be used to provide credit for the purchase of goods and services, as well as fund technical assistance, training and studies.

USAID recommends that a determination be made under Section 612(b) of the Foreign Assistance Act of 1961, as amended, to permit dollar cost financing of local costs (Annex E). The waiver is requested because the anticipated supply of US-owned Egyptian currency will not be sufficient to meet the requirements of this project and other obligations of the US Government in Egypt.

II. PROJECT CONTEXT

A. Background

1. The Development Problem

The goal of this project is to increase the private sector's contribution to productive output in Egypt as the best means to promote long-term economic growth and employment. Linked to this goal is the development of a financial system with the capacity to service the full range of short, medium and long-term financial needs to sustain a growing and diverse private sector. The project's purpose is to expand investment for productive private sector enterprises.

There are two major constraints on private sector growth:

a. Public sector firms produce 70-80% of industrial output and the GOE is generally unwilling to allow private sector competition on an equal footing with the public sector, which includes both credit access and credit terms;

b. There is considerable uncertainty among potential private investors as to the medium- and long-term political environment in Egypt with respect to the treatment of the private sector.

These factors, combined with bureaucratic resistance to the official GOE "Open Door" policy, produce an investment environment which is inadequate to promote a large amount of medium- and long-term investment in productive assets. The credit structure is heavily biased in favor of trading. It actively discriminates against private sector end-users, implicitly favors public sector borrowers, and fails to reward risk taking. This project will provide credit to end-users, or only those traders who clearly service private sector end-users.

Public sector borrowers can obtain financing at subsidized interest rates through their annual investment budgets; private borrowers must obtain all financing needs from the banking system at set higher rates (now 13% - 16%). Public borrowers can repay FX loans at the official exchange rate. Private borrowers face an uncertain FX market; their FX loans are accompanied by volatile repayment schedules influenced by free market movement of the exchange rate. The financial system's risk-averse psychology is empirically revealed by the skewed maturity structure of private sector borrowing. By year-end 1981, 88% of all loans were for one year or less. Within this category, trade-related loans predominate.

Risk figures prominently in the unwillingness of the financial system to finance productive activities in the private sector. Only 2% of the system's assets were loaned out for maturities of greater than one year as of December 1981. In an uncertain political and economic environment where macro-risk variables are somewhat negative, combined with the high opportunity costs of production lending, (short-term trade financing is very profitable and relatively risk-free), the credit structure in Egypt concentrates on risk-avoidance behavior by financing activities with risk free, short-term paybacks.

Recognizing that assistance to the financial sector is a complex undertaking with multiple facets having policy implications, the project will seek to lay the groundwork for future interventions in the structure of the financial markets to give greater support to private sector productive end-user activities. The Production Credit project will mark the beginning of discussions on such interventions with the Egyptian private sector and Government.

2. Macro Setting for Production Credit

The period from 1978 through 1981 was marked by sustained high growth in the Egyptian economy, dramatic expansion in the foreign trade sector and steady growth in capital investment in both infrastructure and productive capacity. In aggregate terms the past five years has been a period of high performance in the Egyptian economy. Beneath the surface, however, lie a number of structural problems which have persisted through the high growth period and which have the potential to jeopardize economic performance in Egypt over the 1980s.

The foreign exchange boom of the late 1970s was fueled by the rapid growth in oil profits and the repatriation of wages from a large number of Egyptians working abroad, mostly in OPEC nations. Both of these phenomena were, to a significant degree, one-shot quantum gains which are unlikely to be matched. While Egypt can probably consolidate and sustain most of the increased levels of FX earnings from these sources, there are already significant signs that the growth rates have leveled-off (and have even turned negative in the short run).

After several favorable years, Egypt is facing serious balance of payments problems. The IMF is estimating a current account deficit for the 1981/1982 year (July 1981 - June 1982) of $3.2 billion. The IMF's estimate for the capital account surplus (which has traditionally offset current account deficits in Egypt) is $1.76 billion, leaving an overall balance deficit of over $1.4 billion compared to a deficit of only $142 million in 80/81 and surpluses in 1979 and 1980. An overall deficit of $2 to 2.5 billion is possible in the current FY 82/83 year.

The growth in commodity export earnings, led by petroleum and cotton, has been outstripped by large and fast growing imports of a wide range of goods and services during 1981/1982. With continued

Egyptian requirements for food, consumer durables, investment goods and raw materials, it is difficult to foresee a significant decrease in import requirements, at least in the short run. Basic foodstuffs and industrial raw materials and spare parts are among the most important goods which have to be imported and costs of these items are rising steadily each year. World inflationary pressures, population growth, and rising expectations compound the problem.

Egypt's traditional sources of FX, all of which provided significant earnings during 1976-1981, have recently experienced a leveling off in growth. The most evident concern is the soft oil market. Egyptian oil export earnings for 1981/82 have already been revised downward to reflect the reduced prices. Soft prices plus continued growth in local petroleum consumption may cause oil export earnings to level off, or even decline, in the coming years.

Other major FX earners in the services account also are showing negative trends. Official tourism and worker remittance figures are down (although much of that reduction is probably due to diversion of these revenues from the banking system into the own exchange market). Underlying these concerns is the possibility that the demand for Egyptian labor in the OPEC countries might drop off, resulting in lowered worker remittances, which are the major earner of FX in the services sector. Tourism earnings are stagnant. This may be a temporary phenomenon since most projections of tourist revenues show expansion as a result of the significant new tourist-oriented investments taking place. Suez Canal revenues also show signs of leveling-off following several years of vary rapid growth. This reflects, in part, lower levels of trade, the drop in oil tanker traffic, and generalized world recession conditions.

The high GNP growth rates of the past few years parallel the FX situation in that the sectoral sources of growth reveal the prominence of exogeneous influences and the relative insignificance of domestic production as an engine of growth. Sectoral growth has been concentrated in transport, communications, petroleum, trade and finance. Agricultural growth has barely kept pace with the natural increase in Egypt's population. Industrial growth (at about 7 percent per year) has lagged behind the aggregate 8.5 percent increase in GDP. Additionally, industrial and agricultural growth have been the indirect result of growth in other economic sectors. As a consequence of these trends, the commodity producing sectors have declined in overall contributions to GDP. The industrial sector, in particular, declined in terms of contribution (at factor cost) to the economy over the 1970s and now accounts for less than 17 percent of Egypt's GDP.

The longer term prospects for economic development in Egypt clearly rest in significant measure upon improved performance and sustained growth in the productive sectors of the economy. Increased efficiency and productivity in the public sector can be promoted as a result of an expanded private sector. This poses a major challenge to the private sector in Egypt in terms of its contribution to national economic growth in the 1980s.

The commodity producing private sector in Egypt has grown over the past five years and the private sector now has a dominant share in a number of production subsectors: foodstuffs, printing, clothing, footwear and leather products. The public sector still dominates not only heavy and "basic" industries, but a wide range of intermediate and light engineering subsectors: beverages, tobacco, spinning and weaving, transport equipment, and other light and intermediate subsectors. If the GOE is serious in the pursuit of present investment policies, the 1980s will present major opportunities for private sector growth — both for expansion in areas where they are already strong and for an increasing private share of those subsectors where public sector expansion will be limited by the lack of public investment in new capacity.

Realization of this opportunity for private sector growth depends upon a number of changes in the Egyptian economy. Private enterprises face numerous inequities in the Egyptian marketplace. Whereas public firms can get low-cost, long-term capital from government budget allocations and elsewhere, private producers face a banking system which is essentially risk-averse. The differences are pronounced in the foreign exchange area. Public sector investors have access to FX in the so-called Commercial Bank Pool at the attractive official ("incentive") rate of exchange (currently LE 0.84 = US$1.00) while private investors seek access to FX from the "own exchange" market where it sells at a premium of the 20-30 percent over the official rate. The present GOE policies on FX transactions actively work against the private entrepreneur.

The macro-impact of the Production Credit project upon foreign exchange availabilities in the banking system will be a modest one. At the end of 1981 there were more than $6 billion in private sector deposits in the Egyptian banks. More than $2 billion of this amount was in foreign currency. The first increment of project financing, therefore, will be less than one percent of total private sector deposits or about three percent of total private sector FX deposits. Viewed in terms of impact on loan flows, however, the project will have considerably more impact. Some $900 million worth of FX loans were made to the private sector in 1981. Against this sum, the $60 million in AID credits planned for disbursement from the project will represent something like 7 percent of the historical levels of FX lending to the private sector.

While attractive Euromarket rates continue to draw FX out of the Egyptian banking system, leaving the banks as net exporters of foreign currency, AID project funds will be strictly tied to lending within the domestic market. The project anticipates credit policy reviews with the Private Sector Steering Committee and GOE aimed at freeing up the banking system, identifying and removing bottlenecks and increasing capital flows to the private sector. One area of consideration may be how to draw Egyptian generated foreign exchange away from the Euromarket and back into the Egyptian economy.

A discussion of the macro setting of the Production Credit program would be incomplete if it did not move from the question of the magnitude of credit available for the private sector to the issue of the structure of credit available to private industry. Until 1978 virtually no long-term funds were available to private investors. Since that time, term lending (defined by the Central Bank as loans with a term greater than one year) has grown 500 percent in five years. Total term lending still amounts to less than two percent (430 million Egyptian Pounds) of total bank assets in Egypt (LE 27 billion), however, and the potential for growth in the term market is significant. In an environment where government economic policies are generally perceived as unpredictable and profits from short-term low-risk activities are high, there are real limits to the speed with which banks will move to meet the need for term lending.

The Production Credit project provides a means for AID to participate with the GOE in elaborating sectoral credit policies which will be more favorable to term lending. Initial project funding is concentrated in short-term financing and in small scale enterprise credits; but the program is designed to permit AID to move increasingly into term financing as appropriate mechanisms are structured and as government policy and the market place can be brought into closer convergence.

An AID Private Enterprise Bureau Reconnaissance Team report, completed in June 1982, states: "In the environment described above, the PRE Team finds it important for AID to expand its support for the private sector. This conclusion rests on the merits of economic efficiency and the critical development role that the private sector can play in increasing production, employment and living standards in all segments of society. It is strengthened, however, by the fact that the level of AID assistance is determined by political considerations, and funds not provided in support of the private sector will go to the public sector. The amounts and approaches currently being considered by USAID/Cairo appear justifiable. Despite the availability of funds in the Egyptian economy, it is appropriate for AID at this time to stimulate longer term investment through the provision of medium and long term financing. Government policy changes, which ultimately can accomplish this through market mechanisms, will come slowly." It is USAID's judgment that the project described in the following pages represents a realistic, achievable course for AID to support the private sector.

B. Banking and Credit in Egypt

1. Credit Policy Overview

Financial sector policy development by the GOE is in a period of transition. By promoting the Open Door Policy since 1974, the GOE set the stage for significant changes in the financial sector. The most significant result so far has been the large increase in the number of financial institutions, almost all of which provide services to the private sector. By liberalizing banking regulations, the GOE encouraged the financial system to become more flexible and more oriented toward servicing market needs. Increasing diversification and sophistication of credit and services is becoming evident as banks compete for shares of the growing private sector business.

GOE development policies within the financial sector center on the need to provide expanded credit and services to the public and private productive elements of the Egyptian economy and to mobilize savings.

On the demand side, the GOE has pursued a policy of controlled credit expansion through a policy of establishing "bands" of on-lending interest rates, and a mix of reserve and other requirements. The GOE has periodically raised on-lending interest rates since 1975. The latest adjustment in July 1982 modified the "band" of on-lending rates from 13-15% to 13-16% and mandated different interest rates for different sectors (the 16% rate is the minimum rate which can be charged for "commerce" related activities -- there is no upward limit in this category).

Illustrative of the GOE's increasing concern with real production, it is significant that the new rates for commerce and trade activities were increased to a minimum of 16% with no upward limit. This will mean at least one major segment of borrowers will be responding to interest rates with an upper limit set by market forces; and for the first time in recent history, AID-supplied funds will be on-lent at "market rates." By setting no upper band on interest rates for commerce and trade, the GOE has taken a significant step in moving, or experimenting with, interest rate reform based on market forces.

The lower rates for other categories, such as industry and agriculture, represent an effort to stimulate end-user investment in these categories. Nevertheless, while the lower mandated rate for industry and agriculture will potentially increase effective credit demand, effective supply, other things equal, may be reduced (or at least would not increase) since banks would perceive reduced profitability in lending to this category. Overall, these changes represent positive moves by the GOE to gradually reform financial sector policy along more market-oriented lines with the objective of better allocation of these funds in productive investments to increase the private sector's share of GDP.

AID's Private Sector CIP program represents a good example of the quick upward movement of on-lending rates by A.I.D. When the CIP was first established, rates were pegged at 2 1/2 - 5%. These were gradually increased to 10-12% in the present program. They will be within the Central Bank band for this program.

On the supply side, the GOE has centered its efforts on mobilizing savings by gradually increasing the interest rates paid on LE deposits, narrowing the gap between foreign and domestic interest rates. (The rates were changed in July 1982.) To stimulate the growth of longer term deposits, the GOE has allowed higher rates to be paid on longer term time deposits such as Certificates of Deposit and is investigating other ways to increase the supply of funds to the system. As an additional incentive to save, in 1978 the GOE exempted from tax all earnings from savings deposits. The net result of these measures has been large growth in both time and demand deposits mobilized by the financial system.

Total deposits have grown from LE 3 billion in 1978 to almost LE 11 billion by 1981; savings and time deposits have grown at far higher rates than demand deposits, principally due to the tax exemption of interest earnings. The GOE has fostered the growth of FX savings by permitting private organizations and individuals to hold FX accounts in the expanded banking system and by allowing interest rates paid on the accounts to follow international market determined levels.

2. Recent History of the Banking Sector

The Egyptian banking system has undergone a series of radical changes in both its institutional framework and operations. Foreign banks dominated the financial sector until the mid-1950's. In 1956 the GOE sequestered the assets of British and French banks after the Suez Affair. Also in 1956 the GOE "Egyptianized" a number of foreign banks by acquiring majority ownership and control through transfer of their assets to existing or newly created "Egyptian" banks.

The GOE nationalized the National Bank of Egypt (NBE) and Banque Misr in 1960. In 1961 the GOE spun off the NBE's central banking subsidiary to form a full-fledged autonomous Central Bank. The NBE thereafter became Egypt's dominant public sector commercial bank. By 1961, the GOE had completely nationalized the entire banking system and began a slow merger/consolidation process which, by 1973, reduced the number of banks operating to four very large public sector commercial banks, three smaller specialized banks, and two offshore units. (See Annex I).

With complete GOE control of the banking sector during the 1960s-70s, the Central Bank ceased to develop as a traditional central bank and became more of a GOE agency which acted as central "cashier" for the GOE's public sector businesses. At the same time, the Ministry of

Economy gradually became the dominant financial policy maker. By 1973, the banking sector had become segmented with each institution undertaking specialized functions. The four large nationalized banks (National Bank of Egypt, Bank of Alexandria, Bank Misr, and Banque du Caire) divided up public sector transactions on a functional basis and shared the limited private sector trade which persisted during the socialist years. While two Arab-financed off-shore banks operated from an Egyptian base handling external investment projects, domestic banking was virtually monopolized by the "big four" public sector banks and little attention was given to servicing private sector needs.

Egypt's Open Door Policy had its banking equivalent in three new laws which changed the institutional framework of the sector by allowing substantial expansion and diversification. Through Law 43 of 1974, foreign banks were able to form joint ventures (initially with public sector banks, subsequently with many GOE organizations) and set up operations in Egypt. Law 32 of 1977 permitted private Egyptian banks to operate. Law 120 of 1975 expanded the scope of the CBE's powers, eliminated the sectoral specialization of the public sector banks, and provided the entire system with a great deal of operating flexibility to service the growing needs of the private sector. As of 1981, 88 banks were operating in Egypt (Annex I) and competing in the marketplace where only 9 banks existed ten years ago. The banking sector now comprises a large number of differently chartered institutions ranging from the 4 large public sector commercial banks through various specialized, investment, free zone, offshore, Islamic, foreign branch, representative office and private sector Egyptian and joint venture banks. This diversification and expansion of the sector have led to a significant increase in the amount of credit and the range of services available to private sector borrowers.

3. Recent Growth and Performance of the Banking Sector

The banking sector has grown significantly over the past few years. Total assets (including the CBE) were slightly over LE 27 billion in 1981, an LE 17 billion increase since 1977, or an average annual growth of about 30%. During the same period, total deposits increased from LE 3 billion to LE 10.5 billion. Time and other savings deposits grew at faster rates than demand deposits reflecting a real increase in savings mobilization. Time and savings deposits grew from LE 1.2 billion to LE 7.0 billion; demand deposits grew from LE 1.8 billion to LE 3.5 billion. Due to the general weakness of the Egyptian Pound, and the widening spread on interest rates paid on LE and FX, time and savings deposits provided by private sources and held in FX grew to 43% of the total deposit base in 1981 from 20% in 1977.

Loans and advances increased from over LE 3.0 billion in 1977 to LE 11.0 billion in 1981 of which LE 3.5 billion were loans and advances to the private business sector. Total short-term lending (less than one year maturity) represents about LE 3.0 billion of total lending to the private business sector. Total term lending (more than one year maturity) to the private business sector amounted to LE 430 million in 1981, distributed as shown in Annex J.

With respect to total lending to the private business sector, trade and commerce uses predominate, representing over 43% of all lending in 1981. Total lending to industry is about 31% of all lending to the private business sector. Short-term lending to industry is 29% of all short-term lending while term lending to industry represents about 43% of total term lending to the private business sector.

Lending to small scale enterprises (SSE) as defined in this Project has not been significant in aggregate terms. Only the 4 large public sector banks and the DIB undertake any significant lending to the SSE sector; among these, the DIB is by far the largest provider of funds.

All major indicators of the sector - total assets, deposits, loans and advances (including term loans) - have increased over the past several years. The sector has mobilized savings in both LE and FX, with FX savings increasing even more rapidly due to interest rate differentials on FX and LE deposits. In responding to changing economic conditions, the banking sector has increased on-lending rates to borrowers from 7-8% in 1975 to the current 13-16% range. In July 1982, the on-lending rate for traders was established at a minimum of 16% interest with no maximum, thus potentially a true market rate insofar as there is no ceiling. Rates paid on savings deposits have doubled since 1977; and with interest earned on savings exempt from taxes, both time and savings deposits now account for over 53% of all deposits in 1981, up from 34% in 1977.

The private sector has increasingly turned to the banking system by increasing its time and savings deposits held with banks. Private sources account for about 60% of the total banking system deposit base. The average maturity of LE time/savings deposits is 12 months (CBE estimates). FX denominated time savings deposits have an average maturity of 2 months. In an attempt to lengthen the maturity structure of their deposit liabilities, many banks are developing new time deposit instruments, some of which have 10 year maturities.

While term lending has increased from only LE 83 million in 1977 to LE 430 million in 1981, it still represents less than 2% of the total asset base of the sector. This is supplemented, however, by roll-over of short-term loans, undertaken by many banks for preferred customers. Many banks roll-over such a considerable volume of short-term loans that their portfolios could be considered to have large medium-term components.

Liquidity management among banks is concentrated mainly on compliance with CBE regulations. It is not focused on the more usual treasury and other operations to reduce interest rate risk and term exposure due to differing maturities of assets and liabilities. Joint venture and foreign branch banks undertake the most active management of liquidity, mainly as a result of their home office ties.

The banking system is highly legalistic in orientation and conservative in operation. Lending practices are predominantly influenced by collateral and guarantees. Commercial and real estate mortgages are preferred collateral with securities (stocks, bonds, bills, and personal guarantees) also accepted in many cases.

4. Banking Sector Regulation

a. Legislation

The Central Bank of Egypt regulates the banking system through a series of laws and periodic issuance of regulations. The "Banking and Credit" Law (Law 163 as amended in 1974, 1975 and 1977) empowered the CBE to (i) influence credit availability and direct its flow to designated sectors (commerce, industry, agriculture, service, etc.), (ii) supervise/control banks' operations, (iii) take monetary measures to correct economic dislocations, and (iv) administer the GOE's gold and FX reserves. Banks are required to submit monthly financial statements reflecting their current financial positions and have their books annually verified by certified auditors. Law 163 empowered the CBE to formulate credit policy through issuance of periodic rules and regulations regarding the structure and operation of the banking system. The CBE issues regulations on (i) interest rates (both for debtors and creditors), (ii) reserve requirements, (iii) liquidity ratios, (iv) credit expansion control, (v) FX reserve deposit requirements, and (vi) banks' participation in projects, among other minor regulations.

b. Interest Rate Policy

(1) Lending Rates

GOE interest rate policy is implemented by fixing lending and deposit rates in officially published schedules. As money supply aggregates and economic conditions change, the CBE, in consultation with the Ministry of Economy, establishes new domestic interest rate ceilings. (The CBE does not regulate interest rates on FX loans, which follow rates set in international capital markets.) Since 1975 this has resulted in a periodic upward ratcheting of rates displayed in Annex K. Given the high levels of worldwide inflation throughout the late 1970s, the CBE made eight upward adjustments in interest rates with three adjustments taking place in 1980 alone.

Effective July 1, 1982, the CBE set new interest rates for both deposits and loans in Egyptian Pounds by all commercial banks. The CBE discount rate, which is more of a general reference rate for the banking system since it is not a rediscount rate as with the Federal Reserve, was raised from 12 to 13 %. The CBE revised the interest rate schedule for on-lending for all commercial banks in Egypt. Lending rates previously had to fall within a 13-15% range. The CBE has modified this range and incorporated certain sectoral distinctions to reflect GOE development priorities. In addition, it has opened up interest rates for commerce transactions to allow rates to climb to market equilibrium. The schedule for on-lending interest rates is as follows:

Sector	Interest Rates
Agriculture	Maximum rate of 13% (no minimum)
Industry	Maximum rate of 13% (no minimum)
Services	13-15%
Commerce	Minimum rate of 16% (no maximum)

Exceptions to the current interest rate structure include 10% refinancing of exports and discounting of export documents, 11-13% rates for cotton crop financing and 10.5% rates for low to middle income housing loans. For agro-industries, food security projects can receive 6% financing if approved and financed by one of the four large public sector banks or the public sector Principal Bank for Agricultural Credit.

In certain cases involving foreign donor funds, the CBE has stipulated that the discount rate be used as the on-lending rate. This rate is used for on-lending in the PIE Fund (263-0097). Other donor financing packages usually provide for on-lending at rates which fall within the schedule set by the CBE. The AID CIP program provides financing for US equipment imports from 10% for end-users and 12% for trade activities. Using AID and World Bank funds, the DIB has on-lent at rates which have fallen within the (as changed) CBE interest rate schedule.

The above schedule of on-lending rates represents nominal rates charged to borrowers. For many transactions and in particular for short-term loans, the effective interest rate paid by the borrower is several percentage points higher due to additional fees and charges. Annex L provides a listing of the types of fees which banks can charge borrowers above the nominal rate schedule.

(2) Deposit Rates

Several changes in interest rates have taken place since 1975. Rates on Egyptian pound savings have more than doubled from 4% to 10% as of July 1982. Interest earned on savings also is exempt from taxes. The new interest rate schedule for savers is as follows:

Instrument		New Interest Rate	Previous (Before July 1982)
Savings Accounts		10.0	8.5
Certificates of Deposits:			
1-15	Days	5.0	5.0
15-30	Days	6.0	6.0
1-3	Months	7.5	7.5
3-6	Months	8.5	8.5
6-12	Months	9.5	9.5
1-2	Years	11.0	10.0
2-3	Years	12.0	11.0
3-5	Years	12.5	11.5
5-10	Years	13.0	-

(3) Legal Reserve and Other Requirements

As a means of controlling credit expansion, the CBE requires daily average reserves of 25% of total deposits in LE. These reserve requirements are computed by adding all cash-on-hand to all bank FX and LE accounts held at the CBE to form the numerator; total bank deposits form the denominator.

Use of maximum loan/deposit ratios is the CBE's principal tool to control credit expansion. In October 1981 the CBE set the maximum legal loan/deposit ratio at 65% of total deposits (interbank deposits excluded). Banks exceeding this limit must deposit the amount in excess with the CBE, at no interest, until the ratio falls within the limit. Banks are expected to meet this 65% guideliine on a quarterly reporting basis.

All banks are required to deposit 15% of their FX deposits in reserve accounts with the CBE. Banks earn approximately LIBOR (3 month) interest rates on these deposits.

Although the CBE defines non-commercial banks (i.e., specialized, investment, and real estate banks, etc.) as those not accepting deposits, it decided in 1978 to allow non-commercial banks to accept demand and time deposits so long as their total did not exceed the paid-in capital and reserves of the bank.

The CBE restricts bank equity investment in any one project to a maximum of 25% of the project's paid-in equity.

C. AID Involvement in Private Sector Credit in Egypt

USAID has financed a range of private sector credit programs in Egypt since 1976. The three main AID credit vehicles for the private sector in Egypt have been:

1. Annual Private Sector CIP financing of private import transactions by Egyptian businessmen. This program has disbursed over $93 million in short-term financing for US equipment since 1979.

2. A loan to the Development Industrial Bank (DIB), supplemented later by a technical assistance grant, provided $31.5 million in credit for private and public sector term lending. This loan has committed $26 million and has disbursed $21 million as of July 1982. The technical assistance grant provided management assistance to the DIB. These programs have been in operation since 1976 and 1979, respectively, and have worked in parallel with a series of World Bank and other donor loans.

3. The Private Investment Encouragement Fund (PIE Fund) was authorized in 1979 to provide longer term financing to private enterprises in association with participating Egyptian bank co-financing. Although the program has been slow in getting underway for institutional reasons, many potential investors and banks have expressed interest in the program. The project has a "shelf" of sub-loan candidates which, if approved, would absorb about one-half of the approved $30 Million available. (Since April 1982, USAID has temporarily suspended proposed sub-loans until certain institutional arrangements have been put in place).

In addition to these credit projects, USAID has undertaken a series of activities and analytical efforts in the development finance area. These include financing an IFC-sponsored report on Egypt's capital market requirements in 1980, training for capital markets professionals, continuing small scale industry training and TA support to the Central Bank, technical assistance for the development of the revised Companies Law (159/1980) replacing Law 26/1954, sectoral analyses of industrial and finance constraints in Egypt by Arthur D. Little Inc. and Robert R. Nathan, a survey of Egypt's banking sector, and a study of small scale enterprise finance requirements.

III. DETAILED PROJECT DESCRIPTION

A. Project Summary

The project will expand the flow of credit to Egypt's private sector by providing $59 million of the $60 million project for on-lending through a broad range of Egyptian public and private banks. The project is designed to lay a foundation for provision of a broad range of AID credit activity to the Egyptian private sector starting in FY 1982 and continuing through the mid-1980's. The current proposal seeks funding for FY 1982, but it also sets a framework for additional future year obligations, subject to the availability of funds. In addition to credit assistance, the project incorporates features designed to involve the GOE in substantive collaboration with AID in private sector programming.

Egyptian banks (public and private for the first time) will be the implementing entities. They will fix the project within Egypt's commercial system and provide USAID with linkage to Egyptian private enterprise. Project design incorporates considerable programmatic flexibility. Project funds will not be allocated to institutions. Rather, through official GOE circulars defining the terms and conditions of the program in detail, different Egyptian financial institutions will be encouraged to participate in channeling funds to the private sector. (Circulars will be subject to AID approval.) The project includes the reallocation of funds among project components if the need arises.

A Private Sector Steering Committee (Committee) will play a major role*. (See Annex M which contains a translation of the draft decree forming the Committee.) The Committee will engage in regular discussions with USAID on credit and conditions for Egypt's private sector. The Committee's responsibilities will be broader than the Production Credit project itself; however, it is expected that a major portion of time and effort will be devoted to private sector credit-related matters in the initial phases. Other responsibilities, inter alia, include functions with regard to the Business Support and Investment project and the Private Investment Encouragement Fund, which complement this project. Future emphasis will be on private sector development which integrates credit support and general business sector activities.

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* The Committee President is expected to be the President of the Bank of Commerce and Development; membership to consist of a Central Bank representative, the Senior Undersecretary of the Ministry of Investment and International Cooperation (MIIC) as well as representatives of the Investment Authority.

The Committee will be permanent, will meet regularly and will have both advisory and executive functions. AID will serve as an ex-oficio observer to the Committee. For the Production Credit Project, the Committee will serve as the central coordination point for all components and, in effect, will represent the GOE in project-related matters.

The project includes three components for FY 1982:

(1) short-term credit for productive imports ($52 million)

(2) credit for small scale enterprises ($7 million)

(3) technical assistance, training, and studies ($1 million)

1. Short-Term Credit: Short-Term Credit funds will be made available to participating banks on a transaction-by-transaction basis. Terms and conditions for credit use will be set forth in an official GOE circular. (See Annex N for draft version.) This circular will be made available to all participating banks and to potential eligible importers. Lending rates will fall within the Central Bank interest rate band (discussed on page 14). Lending terms will be as follows:

> Productive equipment and machinery for end users - 25% downpayment, up to 3 years repayment.
>
> Productive equipment and machinery for traders - 25% downpayment, up to 1 year repayment.
>
> Raw materials for all users - 25% downpayment, up to 1 1/2 years repayment.

Participating banks will evaluate all transactions, assume credit risks, and be responsible for insuring the eligibility of each transaction.

2. Small Scale Enterprise Credit: Funds will be made available to participating banks and borrowers which meet lending criteria set by an official GOE circular. (See Annex O for draft version.) For FY 1982, small scale enterprises are defined as private firms with less than 350,000 Egyptian pounds in fixed assets, excluding land and buildings. Eligible participating banks in this component will be those which have small scale enterprise clients and demonstrate sound lending practices. The DIB, through its past AID credit and other experience, has demonstrated its eligibility to participate in the small scale enterprise component and already has in place acceptable sub-project aproval procedures. Other banks will be encouraged to participate. Lending terms will be as follows:

Interest:	13% (or maximum allowable by CBE for such projects)
Maximum grace period:	2 years
Maximum repayment period:	10 years
Equity funding:	Up to 10% of total sub-project cost not to exceed $70,000 or 20% of total sub-project equity.

Sub-loan repayments will be in local currency at the highest official exchange rate on the date of repayment.

3. Technical Assistance, Training and Studies: Technical assistance and training will be made available to meet specific needs identified and agreed to by the Committee and USAID. Activities will be designed to improve a variety of banking skills, including staff project appraisal capability and institutional capacity to review, approve and monitor transactions or sub-loans which may be financed under this program. In addition, funds will be made available for studies related to credit and the development of new financial instruments for the Egyptian banking system.

B. Short Term Credit

1. Demand

Provision of short term credit will assist the private sector to expand its share of productive assets and contribution to GDP. The private sector has exhibited strong continuous demand for funds as evidenced by AID'S highly successful private sector CIP program. Since its commencement in 1979, this program has opened Letters of Credit for over $102 million and disbursed $93 million for more than 320 private Egyptian importers for a variety of productive end-use and trade activities. In addition to providing credit the program has motivated participating banks to be more responsive to their private sector clients' needs. Importers participating in the program have experienced a gradual increase in their lines of credit accompanied by a liberalization by the banks of their financing conditions. Moreover, a number of private Egyptian banks have expressed interest in participating in the program to better service their clients' needs.

This program has disbursed rapidly. Monthly disbursements have averaged over $2.3 million; this figure was achieved with a small number (5) of participating banks. In the 90 days after letters of commitment were opened under FY 81 obligated funds, participating banks approved 70 private sector transactions and opened L/Cs for $16 million. Based on this past disbursement experience and with an expanded number of participating banks in the new program, it is considered likely that monthly disbursement will surpass this level. This is reinforced by the increasing number of Egyptian importers which have approached current participating banks and been turned down because remaining funds are fully committed. Therefore, an even greater number of private importers will be able to participate through an expanded number of participating banks which should result in fast commitments and disbursements.

The short-term credit provided by this project will build upon the market demand in part developed by the private sector CIP. It will offer credit to a more limited clientile, namely private sector productive end-users or those traders who clearly service such end-users. Further, it will expand the number of bank outlets channeling funds to them. With this AID financing assistance the target group can continue and expand its imports from the US. In 1980, US exports to Egypt totalled over $2.0 billion. Fully one-half of this trade was financed by AID sponsored programs, assisting US suppliers to enter the Egyptian market and to make Egyptian importers more aware of US products. The short-term credit provided by the project will assist in maintaining this market penetration momentum, especially for US supplied raw materials and manufactured items which are increasing as a share of US exports to Egypt. Additionally, it will be important to keep financing channels open for spare parts and other equipment of US manufacture to service US equipment already in Egypt and build solid supplier-user relationships.

2. <u>Design Focus</u>

The short-term credit program design incorporates a transaction-based allocation scheme and an expansion of the number of participating banks, specifically to include private banks, which will channel funds to the Egyptian private sector. This represents a significant change from operation of the current private sector CIP mechanism which operated primarily through allocation quotas to the four large public sector commercial banks (and to a lesser extent the DIB, the Agricultural Credit Bank, and the National Bank for Development). The short-term credit program will continue to use these banks. The program will expand by including selected joint-venture and wholly-owned private Egyptian banks. This constitutes a major policy advance in the short-term by liberalizing credit access and terms of access to the private sector. Joint-venture and private banks participating in the program will, for the first time, be allowed to compete on equal terms with the four public sector banks on a transaction basis by being allowed to (i) participate and have access to AID-supplied funds, and (ii) commit funds according to their capability and client demand. In the earlier private sector CIP program, private banks participated in only a limited way through a public bank. Access was limited to clients and transactions with which the public sector banks were in agreement, and fees/commissions were split. Each participating bank now will be able to serve its clientele independently, at its own pace and to its own profit. Other banks, not initially eligible, will still be able to participate through banks with access to program funds.

USAID considers expansion of this program to have significant program and policy ramifications. AID funds will move through a widened bank network. The number of potential private sector end-user clients will be greatly expanded. The amount of resources available to the GOE which are directed at assisting risk takers, will be increased. Commitment of funds should be rapid with correspondingly quick disbursements. A portion of AID funds will be channeled to private sector traders at potentially market rates since commerce related loans will carry a minimum 16% rate with no upward limit. Experience gained from program implementation should provide impetus to further expand credit access to larger portions of the banking sector. Good performance by the private sector banks should provide increasing motivation to GOE authorities to acquire confidence in private banking elements and to eventually equalize treatment of the private sector through more of the financial system.

3. Institutional Responsibilities

a. Private Sector Steering Committee (Committee)

The Committee will provide policy and program direction and will meet periodically to (among its other duties) review the status of the short-term credit program, address any problems which occur and recommend solutions. It will assist representatives of the CBE and MIIC in initial preparation of the program circular, describing terms and conditions, and it will make recommendations for changes as needed. The Committee, in conjunction with the MIIC, participating banks and AID, will set free approval limits for transactions and will review and decide on all transactions above these limits.

As representative of the GOE for the program, the Committee will review Financing Requests (FRs) made by the MIIC to AID to open Bank Letters of Commitment in US correspondent banks. Apart from these specific actions, the Committee will monitor program performance, and as needed select additional participating banks and modify the terms and conditions of the Circular.

b. Technical Secretariat

This group will give technical and administrative support for the Committee. The Secretariat will support the Committee's operation by coordinating the flow of information between participating banks, the Committee, the MIIC and AID. It will maintain program records, prepare the agenda for committee meetings, distribute reports, and provide general back-up support.

c. Participating Banks

Bank eligibility will be determined by the DPM, on advice of the Committee. The four large public sector commercial banks, in addition to several (3-6) joint venture and wholly owned private Egyptian banks, are expected to participate initially. Banks will have responsibility for evaluating the viability of loan proposals. This will include determination of eligibility of the sub-borrower, the commodity and transaction under the guiding circular, and appraisal of the sub-borrowers, general financial standing and credit-worthiness. For all transactions, banks will bear repayment risk. Participating banks will maintain records of all transactions. Banks will be responsible for submission of a package of material to USAID describing the proposed transaction (Annex S) indicating compliance with the circular. After USAID review and written concurrence, the banks will enter into a loan agreement with the importer, issue a letter of credit (L/C) for the US supplier chosen by the sub-borrower, and provide a copy of the L/C to USAID.

d. Ministry of Investment and International Cooperation (MIIC)

This Ministry will serve as the GOE counterpart agency for operations, and along with the technical secretariat, will provide support to the Committee. The Undersecretary of State for Economic Cooperation with the US will serve on the Committee. The MIIC will be the approved applicant for opening Letters of Commitment. The MIIC also will coordinate the technical assistance, training and studies component of the project with advice from the Committee and with final review and approval by USAID.

e. Ministry of Finance (MOF)

The MOF will establish a sub-account in the Central Bank to which participating banks will make LE repayments. This is the current mechanism for repayments made by public sector banks in the Private Sector CIP program and is readily adaptable for new private sector bank participants.

f. USAID

USAID will review all transactions processed by participating banks, as is the practice under current private sector CIP program. This review will focus on compliance with the terms of the Grant Agreement, confirmation of Schedule B numbers, review of pro forma invoices for compliance with good commercial practice, and maintenance of records on the transaction. After review, USAID will advise the participating bank by letter, whereupon the bank will open a letter of credit in favor of the US supplier. USAID will retain copies of all letters of credit issued by banks and will record the dollar amount of commodities actually shipped.

SER/COM/AID/W will maintain records for each transaction and review AID Forms 11 and 282.

g. US Supplier

The US supplier will be required to comply with AID Regulation 1 by submitting to SER/COM/AID/W an AID Form 11 (Application for Approval of Commodity Eligibility) and signing an AID Form 282 (Supplier's Certificate) in addition to the other documents required under the letter of credit.

4. Funds Allocation

Execution of the Grant Agreement by the Deputy Prime Minister for Economic and Financial Affairs and satisfaction of the CPs will initiate the flow of funds for the short-term component. The Grant Agreement will earmark $52.0 million for short-term credit through eligible participating banks.

Funds will flow to participating banks on a transaction basis with no prior allocations or reservations of funds made for individual banks. Terms and conditions and other requirements of the GCE and AID will be defined by a circular. The circular will be prepared by the GCE and approved by AID upon recommendation of the Committee in cooperation with the appropriate representatives of the Central Bank's offices of Foreign Relations and Bank Control. The circular will be made available to participating banks and their clients through the MIIC and USAID.

The MIIC will be the approved applicant for opening of Letters of Commitment; the Undersecretary of State (of the MIIC) for Economic Cooperation with the US will sign all Financing Requests. After determining bank eligibility, the Committee will select a set of US banks with extensive corres- pondent relations in Egypt. Many large Egyptian banks and especially the large public sector and private banks have correspondent relations with numerous US banks. Funds will be made available to participating Egyptian banks through a series of Bank Letters of Commitment with these US banks. It is expected that not more than five to ten US banks would be required for adequate coverage of the program.

Interest rates will follow the on-lending rate schedule set by the Central Bank. This schedule is periodically revised and was last amended on July 1, 1982. Section IIB4.b.(1) discusses this new schedule. Short-term credit transactions for traders will carry a minimum nominal interest rate of 16% with no set maximum rate. Any transactions involving importation of goods/equipment for an agricultural or industrial end-user will carry a maximum 13% nominal interest rate. (As discussed in Annex L, the final effective interest rate which the importer pays is usually several points higher due to additional bank fees and charges.)

All importers will be required to make a 25% down-payment on the amount of their transaction. Funds will be made available for up to three-year maturities. Actual terms, conditions and maturity period for each transaction will vary according to determination of client credit-worthiness by banks and actual financing needs.

All banks will bear risk for every transaction until the importer repays his debt obligation. The importer will repay his dollar loan in Egyptian pounds at the highest official exchange rate in effect when the US supplier is paid.

AID Regulation 1 procedures will govern procurement of US goods and equipment.

The project will provide the Egyptian importer with flexibility in shipping arrangements. For cargo preference compliance only, the project will be tied to Loan Agreement 263-K-052 (see para. 3 of STATE cable 178397 contained at Annex P).

C. Small Scale Enterprises Credit

1. Demand

Major Egyptian industry is operated through the public sector. Privately owned small scale enterprises (SSE) currently contribute only 23% of total gross manufacturing output, yet SSEs are responsible for 78% of all private sector manufacturing, and numerically represent 94% of all public and private industrial enterprises in Egypt. A number of problems exist which prevent SSEs from reaching their full potential in contributing to employment and income generation for Egypt's long-term growth and prosperity.

a. Small scale enterprises are neglected by existing policies which mainly encourage the establishment of new, large, joint venture firms.

b. The growing credit market is currently dominated by short-term and large transactions. Therefore, many SSEs have difficulty in obtaining FX and local currency credit.

c. Past regulatory government attitudes discouraged small firms from developing and maintaining efficient financial and managerial systems.

The problem is to attack those constraints, and unlock the latent potential of small scale enterprises in ways which insure their continued viability in the Egyptian economy, and promote a constructive relationship with financial institutions. Phase I of the SSE credit activity is comprised of $7.0 million, including: 1) A $6.3-$7.0 million sub-loan program which will provide market rate foreign exchange loans to SSEs for expanding production capacity; 2) up to $0.7 million equivalent could be available to allow SSEs with inadequate loan collateral to increase their equity base and obtain access to credit. Participation will be limited to industrial enterprises with less than LE 350,000 in fixed assets excluding land and buildings (1). During Phase I, the Development Industrial Bank is expected to be the first bank to participate because of its role as Egypt's leading lender to SSEs. The Committee will investigate the feasibility of other financial institutions, and sub-lending will not be expressly limited to the DIB. Because of the commitments banks must make to participate in this program, Letters of Commitment will be opened in amounts which can finance a number of sub-loans.

Phase II will consist of further expansion of SSE activities to other credit institutions and the implementation of new activities. These may include additional technical assistance to SSEs and credit institutions, as well as innovative banking approaches such as a guarantee mechanism or rediscount facility specifically directed at SSEs. Phase I results will determine the appropriate level of expansion and the choice of new activities.

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(1) The SSE definition is similar to that used on funds loaned to the DIB by the IBRD for SSE on-lending.

2. Constraints to SSE Growth

An AID funded study, through Arthur D. Little, identified a number of high priority constraints which impede the growth and expansion of private small scale enterprises. These constraints are presented in Annex R. They can be classified as (a) constraints requiring changes in GOE policy; (b) constraints initially requiring some form of technical assistance; and (c) constraints requiring some form of credit intervention. The three major credit constraints are:

a. Lack of medium term working capital.
b. Limited channels for lending to SSEs.
c. Inadequate response of financial institutions to special problems of SSE lending.

The Production Credit project will serve to initiate discussions and encourage GOE actions regarding the first set of constraints. The DIB is currently receiving technical assistance through the USAID DIB-II project and is expanding a technical assistance program for SSEs with World Bank support (see Annex Q). A new initiative in technical assistance may be started when specific needs can be clearly delineated based on experience accumulated in the current DIB programs. The third set of SSE constraints will be addressed by this project.

3. Design Focus

The limited Phase I effort results from the need to address the following concerns:

1. As the analysis in Annex R reveals, private small scale enterprises need increased access to credit and, over the longer term, technical support in order to fulfill their potential in contributing to economic development.

2. The DIB is clearly the best available institution for early initiation of an SSE credit extension effort. While the DIB's performance on previous donor loans is generally considered good, as evidenced by continued donor support, its capacity for marketing narrowly targeted, soundly priced funds tied to US procurement is untested. The initial Phase I period is designed in part to test this capacity.

Other institutions, with a mandate or desire to extend productive loans to small enterprises, may wish to use AID assistance in providing FX and TA for the SSE segment. These institutions will be able to participate according to the terms and conditions described in the small scale enterprise lending circular to be distributed to banks.

4. Terms and Conditions

a. Funding Arrangements

Funds for this activity will be granted to the GOE. These funds will then be available to qualified banks through the opening of letters of committment requested by eligible banks. (The DIB is already qualified to participate in the program.) The participating banks will request AID, through the MIIC, to open a Letter of Committment with an approved US correspondent bank. Letters of Credit for approved SSE sub-loans will then be issued. As other banks are approved by AID, similar procedures will be developed.

b. Components

Of the total $7.0 million available, no more than $0.7 million can be used for equity financing. The two components proposed are:

(1) FX credit for medium-term working capital and purchase of new machinery and equipment. Total funding: $6.3-$7.0 million.

(2) Equity fund to be converted to LE and used for increasing total equity and thereby improve SSE access to credit. Total funding: up to $0.7 million (LE equivalent).

c. Eligibility Criteria

Participation will be limited to small scale enterprises defined as private firms with less than LE 350,000 in fixed assets excluding land and buildings. Applicants will meet conditions normally required by the DIB for SSE loans. The terms to all SSE borrowers, unless otherwise agreed by AID, will be as follows:

Interest rate:	13% (or maximum allowable by CBE for industrial projects)
Maximum grace period:	2 years
Maximum repayment period:	10 years
Maximum loan size:	$350,000
Maximum debt/equity ratio:	2:1
Minimum loan size:	none

Repayment will be in LE with the borrower assuming full risk of an official exchange rate change. (Thus, the LE amount required to meet FX repayment obligations will vary according to the highest official exchange rate in effect on the day of repayment.)

d. Equity Participation Criteria

Banks will limit equity funding to SSEs with a debt equity ratio not exceeding 2:1. To ensure that a bank does not become the main sponsor of an SSE project, an upper limit of 10% of total project cost, $70,000, or 20% of the firm's total equity, will be used. Equity will be available only to SSEs which borrow from the FX loan component of this project. Failure to repay by the enterprise will not abrogate the bank's responsibility to repay the GOE.

Should any equity remain uncommitted by the end of Phase I, the CBE may allow the fund to shift to the loan component.

Because of the size limit on equity participation and the prevailing tendency of SSE to be partnerships, the equity financing may take the form of the Islamic banking concept of "Mosharkah." This is a partnership where the bank's funds are managed by its client with profits distributed according to a formula agreement.

e. Terms to the Intermediary Institution

Banks will pay for use of project funds at an interest rate determined by subtracting 4.5 percent from the CBE lending rate for industrial projects (which in July 1982 was 13 percent.) Funds will carry a 3-year grace period and 20-year repayment period to enable participating banks to have use of reflow LE funds for more than one SSE borrower. A 0.5% commitment fee may be charged on uncommitted balances.

f. Sub-lending Policies

To ensure that relending based upon the AID loan will be for viable projects, sub-loans will be required to generate an adequate financial rate of return. (Financial rates of return on the Bank financed projects have ranged between 17 and 48 percent; and the economic rates of return for subloans above the "free limit" were between 20 and 58 percent.) Sub-loans will be made only to enterprises to carry out projects that require the importation of productive capital equipment. Sub-loans will not be made to finance the importation of commercial commodities for resale or for recurring requirements for materials.

It is anticipated that 25 to 35 private sub-projects will be financed from this component and the equity funds will be utilized to capitalize 20 to 35 companies.

D. Technical Assistance, Training and Studies

The technical assistance, training, and studies sub-component provides important resources to create the environment in which a broader credit policy dialogue may emerge.

A project objective is to widen discussions between AID and the GOE to work cooperatively toward a more rational credit structure in Egypt. To do so effectively will require improving the credit data base which will underpin such discussions, and which will ultimately serve as the basis for new policy directions. The existence of a significant gap in this area was confirmed in the course of preparation of an AID-financed Banking Sector Survey. The survey, completed in July 1982, sought to consolidate diverse information relating to the Egyptian banking system. It was a major undertaking primarily because there is an inadequate collection of data, a lack of system-wide information, and insufficient analysis of available information. The problem is compounded since no GOE entity (including the CBE) sees its task as effectively drawing such material together.

A regularly functioning GOE committee or organization which examines credit options also appears lacking. The Central Bank, GOE committees or individuals concerned with credit have tended to address operational or short-term issues. Their role has not included analyzing new credit approaches or mechanisms, or developing a long-range credit policy strategy. Thus, in-depth studies of a discount mechanism, a guarantee fund, alternative long-term credit vehicles, and analysis of the entire credit continuum to develop a framework have not taken place in any organized manner. By making $500 thousand available to respond to proposals designed to provide better analytical data or better knowledge of specific credit alternatives, AID will improve the prospects for putting in place the building blocks for a constructive policy dialogue.

An effort to rationalize credit or make more efficient use of existing credit should include some capability to improve technical skills. It is widely recognized that training is required at both the macro-credit and commercial bank management levels. With regard to macro-credit training, approximately $500 thousand of AID funds would be available to respond to proposals to train CBE, Ministry of Finance, and Ministry of Economy staff in key aspects of banking and credit, auditing of the banking system, as well as monetary tools which might be applied in Egypt. Such training could be accomplished either through in-country seminars or short-term overseas training. With regard to commercial bank skills, a weakness in the existing system has been the level of middle management expertise in project appraisal techniques, portfolio management, and even in dealing with basic international banking instruments such as Letters of Credit. Funds will be available to improve the capacity of banks participating in the short term credit program, or those which might be considered for eligibility in the small scale enterprise program.

Though DIB has the capacity to serve SSEs, USAID has no experience with other potential lenders. Thus, prior to AID approval of additional bank participation in the use of AID funds for SSEs, an analysis of the banks' procedures, its capacity to analyze and evaluate SSE loan applications, and ability to assist a sub-borrower and monitor an approved sub-loan, would be required. Further, AID would require a summary audit of any such bank by an outside professional. Technical advice in ways to improve a bank's capacity to appraise projects and service an SSE portfolio would be grant funded under this sub-component.

This component also will finance the overall project evaluation described in section VI. C.

While USAID has allocated tentatively $500 thousand to each sub-component, the full $1.0 million should be made available to either category and overall project evaluation, depending upon actual requirements.

E. FY 1983-84 Program

The proposed FY 1982 project obligation is an important step in moving AID into position to provide a broader assistance package. During implementation of the FY 1982 program, AID will seek ways to use additional assistance to induce positive GOE actions to stimulate longer term investment through the provision of medium- and long-term financing to the private sector. The establishment of a fund to support analysis and assessment of private sector credit and other issues represents major progress. Agreement on semi-annual consultations with the GOE at the Deputy Prime Minister level on credit, investment climate and private sector matters also is a significant milestone. Expansion of the short-term credit program to include direct private sector bank participation and a general allocation process are similarly significant. These features, combined with operational experience gained during implementation and technical assistance providing insight into the credit structure and longer term approaches, suggest consideration of future year private sector credit requests as amendments to this project, rather than new proposals.

USAID proposes seeking incremental funding for continuation of the short-term credit component, the small scale enterprise program and a sizeable medium-term credit component in FY 1983-84 under the umbrella of this Production Credit project. The PID described a multi-year program in the order of $250 million. While we consider it premature to propose funding levels at this juncture, the order of magnitude continues to be in that range.

Various follow-on proposals and mechanisms, for providing medium- and long-term credit and for establishing a joint venture fund, a discount mechanism, and a guarantee fund, have been suggested in the PID and this PP for future funding. These include (i) a restructuring or reorganization of the PIE Fund, (ii) use of a qualified financial institution as a vehicle for provision and leveraging of term credit by syndication, co-financings and loan blend programs, etc., or creation of a new funding mechanism, and (iii) development of ways to increase the system's deposit maturity structure to permit more term lending.

As the AID-GOE dialogue continues, the most promising approaches for continuing and additional activities will be identified by mutual agreement. Structural modifications to the credit system, which are seen as freeing up capital for longer term lending, will be encouraged as a way to provide innovative assistance. A larger, more structured technical assistance, training and studies program for the credit and banking sector also will be appropriate for future year funding.

Development of the FY 83-84 program will evolve from semi-annual consultations on credit and on the business environment for the private sector. The agenda for this dialogue will be formed in the context of Production Credit program implementation. Since the initial year of the program concentrates on commercial credit and small scale enterprise credit, we expect the first year policy agenda to include such issues as:

Foreign exchange risk: identifying the bearer (sub-borrower, bank, or GOE); analyzing the effect of FX risk on business development; developing tools to spread or manage this risk.

Competition in banking fees and charges: the impact of bank fee policy on business efficiency.

Small borrowers and the banking system: alternatives to the onerous collateral and compensating balance requirements which keep small borrowers out of the banking system.

Reviewing CBE operations (interest rates, discounting, liquidity and reserve rules) to better support business expansion.

As the project moves further into implementation the agenda for discussion could focus on role of the financial system in Egypt's economic development. The discussions to be undertaken reflect USAID's concern for the guidance from the Administrator that projects which involve substantial resource transfers must:

- provide those resources in a sound market-oriented economic policy context or in ways which lead the host country to undertake the reforms which produce such an environment;

- strengthen the host country's private and public institutional capacity to solve its basic development problems;

- result in the application of productive technology which accelerates the growth of production, employment and incomes.

USAID expects that the dialogue will be carried out within the framework of the Private Sector Steering Committee. We anticipate that, periodically, the process will warrant moving items up to the agenda of the bilateral economic relationship between the senior-most US representatives in Egypt and the Deputy Prime Minister and his three economic ministers. Indeed, the agreement to semi-annual consultations provide an institutional forum for such discussions. Proposed basic changes in the interest rate structure and the development of new capital market institutions are examples of changes which will inevitably need to move from the credit sector level to the national economic policy level. The function of this Project will be, in part, to permit the competent technical elements of the GOE and the Egyptian private sector to have a hand in contributing to and developing the recommendations and options which will receive national level review. Much of USAID's frustrations over the past years has resulted from our efforts to pursue policy change at the topmost level in Government when the relevant staffwork was lacking to permit the GOE to make informed choices. The Project does not promise to finally and fully resolve all outstanding issues in the credit sector. The project does establish a framework for initial credit provision, credit management and credit policy to be introduced at the financial sector level to public and private sector managers. It also permits policy evolution at the sector level and more informed macro-policy review and development at the national level.

IV. IMPLEMENTATION PLANS

A. Short Term Credit

1. Implementation Arrangements

The project will be implemented over a 2 1/2-year span. This life-of-project comprises a 6-month period for satisfying conditions precedent and a 2-year period for disbursement of funds by participating banks (represented by payments to US suppliers under Letters of Credit) and arrival of goods/equipment in Egypt. However, USAID expects that virtually all of the short-term credit will be committed and disbursed in a much shorter period.

Following signature of the Grant Agreement, initial implementation arrangements for the project will be undertaken by the Committee supported by the MIIC and USAID. The first major action will entail final preparation of a detailed circular which describes the short term credit program. The Committee may form an operational sub-committee to undertake this task, composed of representatives of the MIIC, Finance Ministry, Economic Ministry and Central Bank.

Simultaneous with preparation of the circular, the GOE will select the group of public and private banks which will participate in the program. This selection will be based upon a set of criteria acceptable to AID. It is expected that 3-6 private sector banks will be direct participants in addition to the four large public sector banks. Following discussions with participating banks and agreement on the terms of their participation, the Committee will select US correspondent banks for the program. The MIIC then will submit Financing Requests to USAID, requesting opening of Letters of Commitment in favor of the US correspondent banks in amounts pre-determined by the Committee (An Egyptian bank directly participating in the program will choose from among the approved US correspondent banks for opening letters of credit.) After selection of both direct bank participants and US correspondent banks, issuance of the circular and promotion of the program among participating bank clientele, the major program elements would be in place.

USAID's Office of Finance and Investment will discuss the program and review the circular with each new participating bank to acquaint them with AID regulations, procedures, and the mechanics of the review process. This contact will likely be in the bank's Documentary Credits Department. Emphasis will be placed on understanding how to complete required documents, adherence to the circular and evaluation of the importer's credit-worthiness since banks will be bearing all repayment risk for each approved transaction. Banks will be introduced to AID Regulation 1 and its associated requirements which will govern procurement. In addition, standard formats for reporting transactions will be developed. It is expected that a variant of the Development Industrial Bank's reporting format will be used and modified as required by all banks since it provides all necessary data in a succinct format.

Existing plans for development of the circular governing use of Short Term Credit funds and progress to date on its development (See Annex N), as well as planned funding levels shown in Table I, satisfy the requirements of FAA section 611(a)(1).

2. Implementation Schedule

The implementation schedule is projected as follows:

Date	Major Actions	Responsibility
09/1982	Project Authorization/Signature of Grant Agreement	USAID-GOE
03/1983	Completion of Initial Conditions Precedent	GOE
03/1983	Initiation of Program by Participating Banks	Banks
06/1984	Evaluation	USAID-GOE
09/1984	Project Assistance Completion Date (PACD)	GOE
03/1985	All funds disbursed/Terminal Disbursement Date (TDD)	Banks-GOE

B. Small Scale Enterprise Credit

1. Implementation Arrangements

a. Participating Bank Approval Process

The names of banks expressing interest in SSE fund participation will be forwarded to AID. AID will be responsible for conferring with the banks and explaining the program and its terms. By use of the TA process described in an earlier section, an evaluation of genuinely interested banks will be conducted; short-term training may also be provided. When AID and the Committee are satisfied that the bank has the capability of responsibly using AID funds for SSE projects, AID will provide written ratification to the bank, the CBE and the Committee concerning the banks's eligibility for participation. The bank will be required to submit to the Committee a letter concurring in the terms and conditions of participation. Inasmuch as allocations for this component will be institutional, AID, the GOE and the eligible bank will then reach agreement on the amount of the Letter of Commitment to be opened for the eligible bank.

b. Sub-Loan Approval Process

Importation of capital goods must be approved by the General Organization for Industry, Ministry of Industry (GOFI). After GOFI has completed a relatively detailed evaluation of an investment proposal, the DIB undertakes its project appraisal. This procedure will undoubtedly be required for any sub-borrower through any new financial institution.

AID may initially review and approve proposed loans from banks, other than the DIB, which exceed some, as yet unspecified amount, until such time as AID, the GOE and the Committee agree that the loan approval process spelled out in the circular can be used by the Bank.

Funds will be disbursed by the US Treasury to a US bank designated by the GOE to receive an AID Letter of Commitment. Documentation requirements for Letter of Commitment and direct reimbursement financing will be provided in circular instructions agreed to by the GOE and AID.

Existing plans for development of the circular governing use of Small Scale Enterprise funds and progress to date on its development (See Annex O), as well as planned funding levels shown in Table I, satisfy the requirements of FAA section 611(a)(1).

2. Implementation Schedule

The project provides a 2 1/2-year disbursement period for implementation. The implementation schedule is projected as follows:

Date	Major Actions	Responsibility
09/1982	Project Authorization/Signature of Grant Agreement	USAID-GOE
03/1983	Completion of Initial Conditions Precedent	GOE
03/1983	Initiation of Program	Banks
07/1983	Initial Disbursement	Banks
06/1984	Evaluation	USAID-GOE
09/1984	Project Assistance Completion Date (PACD)	GOE
03/1985	Final Disbursement/Terminal Disbursement Date (TDD)	Banks

C. Technical Assistance, Training and Studies

1. Implementation Arrangements

a. Study Proposals

Study proposals financed under this project would be put forward by private or public sector banking institutions, GOE ministries, other entities, or USAID. The Private Sector Steering Committee will review proposed study concepts, make suggestions, and if appropriate, approve a specific request at a maximum level of funding to be determined. Scopes of work and contracting terms would be developed and negotiated by the entity proposing the study in consultation with USAID, administered either by the Committee's Technical Secretariat or MIIC. All studies will be approved by AID prior to contract execution and will follow AID rules in obtaining such services. A condition precedent to disbursement of these funds will be included in the Grant Agreement to assure that adequate administrative arrangements are in place.

Studies can be undertaken either by local or expatriate professionals, and may include both local cost and foreign exchange financing. Studies will generally be of short duration (less than one year), moderate cost (under $50,000), and designed to require minimum administrative support. Nevertheless, should the GOE propose a credit sector policy study which fits squarely into AID priorities, it would be, financed under this project component.

b. Technical Assistance and Training.

The Private Sector Steering Committee will approve a training or technical assistance concept and set a maximum level of funding. In consultation with AID, the proposing entity would enter into negotiation with the individual or institution which would provide the training or technical assistance, develop the program, and select the candidate, or alternatively the consultant.

AID financing will be for in-country or overseas training costs including training materials, per diem and air fare, but not including salaries. As in the case of studies, training or technical assistance activities will be administered either by the Private Sector Steering Committee's Technical Secretariat or the MIIC. These activities will be approved by AID prior to any final agreement. The Grant Agreement will include a condition precedent related to the expenditure of funds for training and technical assistance to assure that adequate administrative arrangements are in place prior to disbursement of funds.

Plans for: type of studies, technical assistance and training; means for initiating and approving such activities, and procurement of services necessary to implementation; and funding levels set out in Table I, satisfy the requirement of FAA section 611(a)(1).

2. Implementation Schedule

Implementation will take place over a 2 1/2-year period to permit sufficient time for identification of study proposals, technical assistance and training needs, and completion of these activities so that experiential data and other information can be factored into the design of Phase II and subsequent programs.

The implementation schedule for this component is projected as follows:

Date	Major Action	Responsibility
09/1982	Project Authorization/Signature of Grant Agreement	USAID-GOE
03/1983	Completion of Initial Conditions Precedent	GOE
04/1983	Initial Proposals Identified	GOE-USAID-Others
06/1983	Initial TA Needs Identified	GOE-USAID-Others
06/1983	Initial Training Needs Identified	GOE-USAID-Others
08/1983	Initial Disbursements/Terminal disbursements date (TDD)	GOE-USAID
04/1984	Final Identification of: - Proposals - TA Needs - Training Needs	GOE-USAID-Others
06/1084	Evaluation	GOE-USAID
09/1984	Project Assistance Completion Date (PACD)	GOE
03/1985	Final Disbursements/TDD	GOE-USAID

D. Consolidated Project Reporting

Reports will flow from the organizations participating in each project component through the technical secretariat to the Private Sector Steering Committee and AID.

Reports will be standardized for the short-term and small scale enterprise lending activities. These reports will include the following information:

1. Letter of Commitment (L/COMM)
   - number of L/COMM and amount
   - date of opening, validity period
   - US correspondent bank

2. Letters of Credit (L/C)
   - L/COMM number (source of funds) and number of L/C
   - amount (increases and decreases) and conditions, US bank
   - name of client, name of supplier
   - date of opening, validity period
   - disbursements and balance of L/C

3. Problems encountered and issues requiring resolution, additional information.

These reports will be presented in tabular format and modeled after the current DIB reporting format used in the private sector CIP program.

Under both the short-term and SSE credit components, each participating bank will be required to submit monthly reports to the technical secretariat or the MIIC with copies to USAID. The MIIC will be responsible for collection and aggregation of these reports by component and their subsequent distribution to the Private Sector Steering Committee. In particular, the MIIC will be responsible for documenting amounts of L/C's opened under each individual L/COMM for all participating banks. This will assist in control of funds and help ensure that each L/COMM is not overdrawn.

For the Technical Assistance, Training, and Studies component, the MIIC would prepare a quarterly status report containing the following information:

1. Proposals received during the period and short description of each.
2. Summarized comments on 1 prepared by the MIIC and AID.
3. Pro-forma budgets of each proposal.
4. Proposed implementation arrangements for each proposal for which approval is recommended.
5. Recommendations for approval by the Committee.
6. Draft standardized response letters for (i) approval, (ii) disapproval, (iii) request for additional information from proposal sponsors.

These quarterly reports would serve as agendas for Committee decisions on this component. The Technical Secretariat would inform MIIC and AID of Committee decisions and undertake needed funding arrangements with AID for approved proposals.

V. CONSOLIDATED FINANCIAL PLAN

The total cost of this project is estimated at $77 million. Of this cost, AID will provide $60 million and the program participants (public and private sector banks, importers and investors) will provide $17 million in local currency equivalent, in the form of subloan downpayments, investor equity, administrative costs and so forth. The total consolidated cost of all projects will be considerably higher than $77 million if project equity is included. As a result, significant leveraging of AID funds is expected.

The project will have an initial two and one-half year implementation period, beginning in FY 1983 and continuing through the second quarter of FY 1985. If amendments are made at a subsequent date, a longer time frame could be involved.

The disbursement schedules for each of the sub-components are summarized in this section. As previously stated, the project makes provision for transfer of funds between credit components, and among Technical Assistance, Training, and Studies when the program management and USAID management deem this necessary. Inter-activity or sub-activity transfers are not certain but rather contingently provided for in the event program performance warrants such reallocation.

AID's funds will be used for all estimated foreign exchange requirements. In addition, a section 612(b) determination to allow for local currency purchases up to $1.0 million equivalent with dollars is being sought for local currency expenditures related to Technical Assistance, Training and Studies as well as small scale enterprise debt and equity financing.

USAID has reviewed the financial plans for each sub-component and has determined that these plans are comprehensive and sound. Each sub-component is considered financially viable and the overall objectives of the project can be achieved within the estimated cost and 2 1/2-year life of project.

TABLE I

A. CONSOLIDATED COST ESTIMATE AND FINANCIAL PLAN*

(US$ 000)

	Sub-Component	(AID) (FX + LC)	Egypt (LC)	Total (FX + LC)
I.	Short-Term Credit	\$52,000	\$13,000	\$65,000
II.	Small Scale Enterprise Credit	\$7,000	\$3,750	10,750
III.	Technical Assistance, Training and Studies	\$1,000	\$250	\$1,250
	Project Totals	\$60,000	\$17,000	\$77,000

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* Local currency contribution for short-term credit is equal to the 25% downpayment made by the importer. Actual capital used by the importer probably will be much higher.

- Local currency contribution for small scale enterprise credit based on estimated 2:1 debt-equity ratio for all projects; actual contributions by sub-borrowers likely to be higher.

- Local currency contribution for the credit analysis assessment and training is comprised of in-kind services provided by the GOE and salary payments to trainees, all of which equals 20% of AID contribution.

TABLE II

B. CONSOLIDATED AID GRANT DISBURSEMENT PROJECTION*
(US$ 000)

	FY 83	FY 84	FY 85	Totals
I. Short-Term Credit	$20,000	$22,000	$10,000	$52,000
II. Small Scale Enterprise Credit				
-Credit	1,500	3,500	2,000	7,000
III. Technical Assistance, Training and Studies				
-Technical Assistance and Training	100	200	200	500
-Studies	100	200	200	500
Project Totals	$21,700	$25,900	$12,400	$60,000

*Assumptions:

Short-Term Credit Commitments will be completed 12 months after CPs are met.

Small Scale Enterprise credit commitments will be completed 18 months after CPs are met. The project will tend to finance standard machinery, which will mean relatively rapid disbursement.

Technical Assistance, Training and Study funds will all be committed in the first 18 months after Initial CPs are met.

VI. SOCIAL/ENVIRONMENTAL CONSIDERATIONS

A. Social Analysis

By providing credit for the creation and expansion of productive enterprises, the Project will foster increased real, remunerative employment.

Although Egypt's official unemployment rate is low (2-3 percent), the country faces a variety of employment problems. Many people, particularly women, do not participate in the work force. The shortage of skilled labor poses a problem, as well as diminishes the usefulness of the abundant unskilled labor supply. Throughout the economy, jobs are difficult to find and wages are low. Educational background and work skills often fail to coincide with job responsibilities. Underemployment is widespread.

Increasing productive employment (and hence wage levels) is a necessary step to ameliorate the underutilization of Egypt's labor force. The roots of the employment problem, however, are complex and embedded within the economic system. GOE price signalling, a highly regulated business climate, and uneconomic human resource investment decisions have created economy-wide, policy induced economic distortions which cannot be addressed in any significant way by project level solutions, such as inclusion of employment generation as a short-term credit sub-loan criterion. As noted in the small scale enterprises section,however, the DIB does evaluate employment benefits for each medium/long term project application. Based on a World Bank analysis of $111.3 million DIB loans, 13,900 direct jobs at an estimated $24,400 per job (in 1980 prices) were created. Employment creation as a result of all DIB loans was estimated at about 27,500 through 1980.

Recognizing that substantial changes are required to correct Egypt's employment problem, but acknowledging that direct confrontation over major policies, at least in the short-term, is not politically feasible, USAID has based the Production Credit Project on a long-range goal: expansion of private productive enterprises through augmented credit accessibility. The commodity producing and export sectors are the most likely candidates for sustaining high levels of economic growth and for providing a large number of jobs.1/ As these and other sectors engage in new projects, there will be an increased demand for intermediate goods,

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1/ The manufacturing sector provided over one-fifth (21.9%) of all new jobs during 1971-1980. Manufactured products generally have a high domestic income elasticity of demand, the possibility of export potential, and good factor substitution prospects for increasing labor usage.

which will further generate employment and capital investment. As private sector industrial and other commodity producing enterprises benefit from increased credit access and undertake additional investment, employment gains should be significant. To the extent that women participate in the work force and increase their participation in the future, the Project will enhance employment opportunities for women.

B. Environmental Analysis

The short-term credit component will provide CIP-type assistance to the Private Sector through a number of intermediate credit institutions. Knowledge of the specific sub-projects to be funded is not a prerequisite to financing. The disbursement of funds for individual sub-loans does not require AID approval. For these reasons, the STC component is exempt from an environmental analysis under the provisions of 22 CFR 216.2(c)(1)(ii), and 22 CFR 216.2(c)(2)(ix) and (x).

The SSE component will provide support for intermediate credit institutions (initially the DIB; other bank participation possible in the future). The objective is, in part, to assist in the capitalization of the institution(s) and does not include reservation of the right to approve individual loans made by the institution. Therefore, the SSE sub-component is exempt from an environmental analysis under the provisions of 22 CFR 216.2(c)(2)(x).

The Technical Assistance, Training and Studies component will not include activities directly affecting the environment. For this reason this component is exempt from an environmental analysis under the provisions of 22 CFR 216.2(c)(2)(i) and (iii).

VII. EVALUATION

AID will monitor the progress of loan and equity implementation and disbursement by reviewing periodic progress reports and by frequent informal consultations between the parties in Cairo. AID will monitor the rate of loan disbursement by reference to AID's internal financial reports. USAID/Cairo will conduct quarterly meetings to review the progress of loan implementation with the Committee and SSE participating banks. The records kept through regular monitoring will be reviewed at least quarterly, to uncover implementation problems that require action. Given the short implementation time and the nature of this project, a separate evaluation activity is not considered necessary or feasible; regular, systematic monitoring is considered sufficient.

A discrete evaluation activity will be undertaken in June 1984 in order to assess the impact of this project and to assist in designing follow-on efforts.

VIII. CONDITIONS, COVENANTS AND NEGOTIATING STATUS

A. Conditions Precedent to Disbursement

Prior to disbursement or issuance of documentation pursuant to which disbursement will be made under the Production Credit program, the Grantee shall have completed the following in form and substance satisfactory to AID:

1. General:

a. A statement of the name(s) of the person(s) authorized to represent the Grantee and a specimen signature of each.

b. Evidence of formal establishment of a Private Sector Committee.

2. For each separate component of the Production Credit Project, the Grantee shall complete the following:

a. For Short-Term Credit:

Issuance of a circular or other official document which describes in necessary and sufficient detail the terms, conditions and requirements necessary to operate the program.

b. For Lending to Small Scale Enterprises:

(1) Issuance of a circular or other official document which describes in necessary and sufficient detail the terms, conditions and requirements necessary to operate the program.

(2) Issuance of a letter by a bank or other financial institution, concurring in the terms, conditions and other requirements for small scale enterprise lending.

c. For Technical Assistance, Training and Studies:

Agreement in necessary and sufficient detail on the conditions required to operate the program.

B. Covenants

1. Grantee shall undertake periodic discussions with AID on ways and means to develop credit and other support to the private sector.

2. Grantee shall undertake at least bi-annual discussions under the auspices of the Deputy Prime Minister for Economic and Financial, with AID on credit and private sector development matters.

3. Grantee shall discuss with AID ways to expand numbers of private and public banks and productive enterprises participating in the Short-Term Credit and Small Scale Enterprise Credit activities.

4. Grantee agrees, for the Technical Assistance, Training, and Studies activity, to emphasize proposals which are supportive of private sector development and which improve the skill level of private banking and other institutions.

PRODUCTION CREDIT

(263-0147)

ANNEXES

A. GOE Grant Application

B. Statutory Checklist

C. Draft Grant Authorization

D. Section 611(e) Certification

E. Section 612(b) Application

F. Logical Framework

G. NEAC Project Paper Guidance Cable (LOU STATE 137525): Reference only -- This cable contained in NE/PD and USAID/Cairo files

H. PP Development Status Cable: CAIRO 14459

I. The Egyptian Banking System

J. Sectoral Distribution of Bank Term Lending

K. Interest Rates Structure

L. Additional Bank Fees and Charges

M. Draft Decree Establishing the Private Sector Steering Committee

N. Draft Circular: Short-Term Credit

O. Draft Circular: Small Scale Enterprise Credit

P. Cable STATE 178397: 50-50 Shipping of ICI Funded Goods

Q. The Development Industrial Bank and Small Scale Enterprises

R. The Role of Small Scale Enterprises in the Egyptian Economy

S. Short-Term Credit Transaction: Implementation Events

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ANNEX A

August 4, 1982

Mr. Owen Cylke
Director (Acting)
U.S.A.I.D.
American Embassy
Cairo, Egypt

Subject: Production Credit Program
Application Letter.

Dear Mr. Cylke:

The Government of Egypt(GOE) wishes to expand the flow of credit to the productive private sector. We believe that to accpmplish this objective a broader range of public and private sector banks should be more active in providing such credit. For this purpose, the GOE requests AID grant assistance in the amount of $60 million for the initial phase of this effort.

The U.S. grant can serve in establishing a mechanism for allocating funds for a broad spectrum of credit needs of the Egyptian economy. However, in the inital phase the Production Credit program will consist of:

(1) short-term credit for productive imports ($52 million);
(2) credit for small scale enterprises($7 million); and
(3) technical assistance and training ($1 million);

considering that funds can be shifted from one credit categoryto another as may be determined necessary and useful.

1. Short Term Credit: The funds for short term credit will be made available to the private sector to import goods for productive and development purposes, to be described in an official GOE circular, available to both banks and importers. The funds would be made available through agreed upon selected public and private sector banks on a first-come, first-served basis. The terms and conditions for use would be delineated in the official GOE circular. Such terms and conditions will be jointly reviewed and developed by the parties to the Grant,in light of current and changing circumstances. The Circular would be made available to

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all banks and to potential eligible users,on request. Lending rates would fall within the interst rate band for such transactions set by the Central Bank of Egypt(CBE). Initially lending terms would be as follows:

productive equipment and machinery for end-users	-25%downpayment, 3 years repayment.
Productive equipment and machinery for traders	-25%-50% downpayment, 1 year repayment.
Raw materials for all users	-25% downpayment 1½ years repayment.

Criteria for eligible sub-borrowers, and transactions and governmental review procedures would closely follow those applicable to the Commodity Import Program (CIP), except that Law 43 companies would also be eligible within conditions developed by MIIC. Participating banks would propose transactions, assume the credit risks,and be responsible for insuring eligibility of each transaction. For transactions in excess of $500,000, or, for any single sub-borrower to receive over $1,000,000 in a year from the program, written approval of MIIC will be required. Transactions of $500,000 or less will be handled as presently done for the Private Sector CIP program.
Sub-loan repayments will be in local currency at the highest official exchange rate on the date of repayment.

2. <u>Small Scale Enterprises</u>: Funds for small scale enterprises will be made available to agreed upon banks providing term lending to borrowers which meet productive small scale enterprise criteria, to be described in an official GOE circular,available to both banks and sub-borrowers. Initially, for purposes of the program, small scale enterprises will be defined as private firms with less than 350,000 Egyptian pounds in fixed assets,excluding land and buildings. Funds will be made available under such terms and conditions defined by the official GOE circular. Such terms and conditions will be jointly reviewed and developed by the parties to the Grant, in light of current and changing circumstances. Eligible participating banks in this component will be those banks

which have small scale enterprise clients and demonstrate sound lending practices. An example is the Development Industrial Bank (DIB), which already has in place acceptable sub-project approval procedures.

Initially lending terms will be as follows:

Interest	13% (or maximum allowable by CBE for such projects)
Maximum grace period	2 years
Maximum repayment period	10 years
Equity funding	Up to 10% of total sub-project cost

Sub-loan repayments will be in local currency at the highest official exchange rate on the date of repayment.

3. Technical Assistance and Training: Technical assistance and training under the Grant will be made available to meet specific needs identified and agreed to by the parties to the Grant Agreement. Among those activities will be those designed to improve a variety of banking skills, including staff project appraisal capability and bank capacity to review, approve and monitor transactions or sub-loans which may be financed under this program.

To provide policy guidance and direction to the Production Credit Program a Private Sector Steering Committee(hereinafter"Committee") has been established. The membership includes representatives of a private bank, the Central Bank of Egypt, the Ministry of Investment and International Cooperation (MIIC) as well as representatives of the Investment Authority. For both the short term credit and small scale enterprise credit components, the Committee shall approve: the selection and eligibility of banks directly participating in the program; the correspondent banks for AID letters of commitment; and shall advise on credit terms and conditions. The Committee shall recommend appropriate circulars for GOE approval, and such reallocation of funds between components as may be appropriate.

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AID Regulation I will govern the procurement of goods and services unless otherwise agreed in writing. The review and approval process financed under this grant will be similar to that established under the Private Sector CIP Program.

The parties to the Grant will consult at least semi-annually on a broad range of credit policy and private sector issues related to this program.

On behalf of the Government of Egypt I would appreciate your favorable consideration of this grant assistance request generally based on criteria set forth herein.

Sincerely yours,

F. Iskandar

Fouad Iskandar
Senior Undersecretary of State
for Economic Cooperation with
U.S.A.

5C(2) PROJECT CHECKLIST

ANNEX B

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A. includes criteria applicable to all projects. Part B. applies to projects funded from specific sources only: B. 1. applies to all projects funded with Development Assistance Funds, B. 2. applies to projects funded with Development Assistance Loans, and B. 3. applies to projects funded from ESF.

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

A. <u>GENERAL CRITERIA FOR PROJECT:</u>

1. <u>FY 1982 Appropriate Act Sec. 523; FAA Sec. 634A; Sec. 653(b).</u>

(a) Describe how authorizing and apppropriations committees of Senate and House have been or will be notified concerning the project;

(a) Congress shall be notified in accordance with regular agency procedures.

(b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?

(b) The intended obligation is within the level of funds appropriated for Egypt.

2. <u>FAA Sec. 611(a)(1).</u> Prior to obligation in excess of $100,000 will there be:

(a) engineering, financial or 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. <u>FAA Sec. 611(a)(2).</u> 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.
4. <u>FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501.</u> If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973? (See AID Handbook 3 for new guidelines.)	N.A.
5. <u>FAA Sec. 611(e).</u> 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?	N.A.

6.	<u>FAA Sec. 209.</u> Is project susceptible to 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.	No.
7.	<u>FAA Sec. 601(a).</u> 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; and (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 will contribute financing for the expansion of the private sector. (c) No direct encouragement is provided. (d) Project will encourage private sector competitive production. (e) Project will provide sub-loans for productive activities in areas of industry, commerce, and agriculture. (f) No such strengthening is provided.
8.	<u>FAA Sec. 601(b).</u> Information and conclusions 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.)	Most of project funds will finance U.S. goods and services.

9.	FAA Sec. 612(b), 636(h); FY 1982 appropriation Act Sec. 507. 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 in lieu of dollars.	Participating banks and sub-borrowers will contribute 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?	The project availability of excess currency pounds is fully programmed for other activities and is not available for this project.
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 1982 Appropriation Act Sec. 521. 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. procedures of the same, similar or competing commodity?	No.
13.	FAA 118(c) and (d) Does the project comply with the environmental procedures set forth in AID Regulation 16?	Yes. Components of this project are exempt under AID Reg. 16. See Section VI.B. in Project Paper.

Does the project or program take into consideration the problem of the destruction of tropical forests?	N.A.
14. FAA 121(d). If a Sahel Project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?	N.A.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(b), 111, 113, 281(a). 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;	N.A.

(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. Does the project fit the criteria for the type of funds (functional account) being used?

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

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 is the latter cost-sharing requirement being 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"? (M.O. 1232.1) defined a capital project as "the construction, expansion, equipping or alteration of a physical facility or facilities financed by AID dollar assistance of not less than $100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character."

f. FAA Sec. 122(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?

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

2. <u>Development Assistance Project Criteria (Loans Only).</u> N.A.

a. <u>FAA Sec. 122(b).</u> Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest.

b. <u>FAA Sec. 620(d).</u> If assistance is for any productive enterprise which will compete with U.S. enterprises, 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?

c. <u>ISDCA of 1981, Sec. 724 (c) and (d).</u> If for Nicaragua, does the loan agreement require that the funds be used to the maximum extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)?

3. Economic Support Fund Project Criteria.

a. FAA Sec. 531(a). Will this assistance promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102?	Project will contribute to economic and political stability and reflects Section 102 policy directions.
b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?	No.
c. FAA Sec. 534. Will ESF funds be used to finance the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?	No.
d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	Yes.

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the 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 commodities and services financed?	Yes, as per AID standards.
2. FAA Sec. 604(a). Will all procurement 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 marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?	N.A.
4. FAA Sec. 604(e), ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is	No such procurement is planned.

there provision against such procurement when the domestice price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.).

5.	<u>FAA Sec. 604(g).</u> Will construction or engineering services be procured from firms of countries otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one of these areas?	N.A.
6.	<u>FAA Sec. 603.</u> Is the shipping excluded from 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?	No, however, for cargo preference compliance only, the project will be tied to Loan Agreement 263-K-052 (see para. 3 of State cable 178397).
7.	<u>FAA Sec. 621.</u> If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized,	Yes.

are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?

8. International Air Transport. Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such services is available? — Yes.

9. FY 1982 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? — N.A.

B. CONSTRUCTION

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? — N.A.

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? — N.A.

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 (except for productive enterprise in Egypt that were described in the CP)? — N.A.

C. OTHER RESTRICTIONS

1. FAA Sec. 122(b). If development loans, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? — N.A.

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? — N.A.

3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interest of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — Yes

4. Will arrangements preclude use of financing:

   a. FAA Sec. 104(f); FY 1982 Appropriation Act Sec. 525: (1) To pay for performance of abortions as a method of — Yes family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterlization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortion or involuntary sterilization as a means of family planning; (4) to lobby for abortion?

b. <u>FAA Sec. 620(g).</u> To compensate owners for expropriated nationalized property?	Yes
c. <u>FAA Sec. 660.</u> To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?	Yes
d. <u>FAA Sec. 662.</u> For CIA activities?	Yes
e. <u>FAA Sec. 636(i).</u> For purchase, sale, long-term lease, exchange or guarantee of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?	Yes
f. <u>FY 1982 Appropriation Act, Sec. 503.</u> To pay pensions, annuities, retirement pay, or adjusted	Yes

service compensation for military personnel?

g. <u>FY 1982 Appropriation Act, Sec. 505.</u> To pay U.S. arrearages or dues? Yes

h. <u>FY 1982 Appropriation Act Sec. 506.</u> To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)? Yes

i. <u>FY 1982 Appropriation Act, Sec. 510.</u> To finance the export of nuclear equipment, fuel, or technlogy or to train foreign nationals in nuclear fields? Yes

j. <u>FY 1982 Appropriation Act, Sec. 511.</u> Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declearation of Human Rights? No

k. <u>FY 1982 Appropriation Act, Sec. 515.</u> To be used for publicity or propaganda purposes within U.S. not authorized by Congress? Yes

ANNEX C

PROJECT AUTHORIZATION

Name of Country: Arab Republic of Egypt   Name of Project: Production Credit

Number of Project: 263-0147

1. Pursuant to Section 531 of the Foreign Assistance Act of 1961, as amended (the "Act"), I hereby authorize the Production Credit Project (the "Project") for the Arab Republic of Egypt ("Cooperating Country") involving planned obligations not to exceed Sixty Million United States Dollars ($60,000,000) in grant funds over a two and one half year period starting from the date of authorization, subject to the availability of funds in accordance with the AID OYB/allotment process, to help in financing the foreign-exchange and local-currency costs of goods and services required for the Project.

2. The Project will assist the Grantee to expand the flow of credit to productive private sector enterprises in Egypt, through a broad range of public and private sector banks.

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with AID regulations and delegations of authority, shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as AID may deem appropriate.

a. Source and Origin of Goods and Services

Goods and services, except for ocean shipping, financed by AID under the Project, shall have their source and origin in the cooperating Country or in the United States, except as AID may otherwise agree in writing. Ocean shipping financed by AID under the Project shall, except as AID may otherwise agree in writing, be financed on flag vessels of the Unites States.

b. Conditions Precedent to Disbursement

Prior to any disbursement or to the issuance of any commitment documents under the Grant, the Cooperating Country shall, except as the Parties may otherwise agree in writing, furnish to AID in satisfactory form and substance, a statement of the names and titles, of the persons who will act as the representatives of the Cooperating Country, together with a specimen signature of each person specified in such statement.

4. Based upon the justification set forth in the Project Paper, I hereby determine, in accordance with Section 612(b) of 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 US-owned local currencies for such procurement; and the administrative official approving local cost vouchers may use this determination as the basis for the certification required by Section 612(b) of the Act.

Administrator

Date

ANNEX D

Certification Pursuant to
Section 611(e) of the
Foreign Assistance Act of 1961, as amended

I, Owen Cylke, the Acting 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 capital and technical assistance to be provided to the Ministry of Investment and International Cooperation for the programs to be undertaken in the Production Credit Project.

Acting Director
USAID/Egypt

8-4-82

Date

ANNEX E

Recommendations to Authorize Purchase of Egyptian Pounds with US Dollars

Recommendation:

Over the life of the Project up to $1,000,000 will be used to support local currency expenditures for specific goods and services in support of this project. Dollar funds will be used in association with GOE disbursement of Egyptian pounds for funding the following costs:

1. $700,000 for equity contributions by banks participating in the Small Scale Enterprise program. Due to the relatively small size of sub-loans in this program (estimated to be $350,000 or less per sub-loan) and size limitations on equity (not more than 20% of total project equity), participating banks may have to make their equity contributions to sub-projects by purchasing Egyptian source goods and equipment with project funding. Authority is sought to purchase Egyptian pounds with US dollars to provide sufficient flexibility in administering the Small Scale Enterprise equity component.

2. $300,000 for payments to Egyptian organizations and individuals for technical assistance, training and studies. It is expected that several studies, some technical assistance and training will be provided by Egyptian sources. Authority is sought to make payments in Egyptian pounds to provide flexibility in administering this component.

Justification for Determination Required Under F.A.A. Section 612(b):

USAID considered the use of granting US-owned local currency for Egyptian pounds 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 needs 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 US-owned local currency would have to be offset by reduced GOE disbursements.

Dollar funds used in conjunction with Egyptian pounds 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.

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

ANNEX F

[illegible]

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project:
From FY 82 to FY 85
Total U.S. Funding $60.0 million
Date Prepared: July 20, 1982

Project Title & Number: Production Credit (263-0147)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: To increase the private sector's contribution to Egyptian productive output. Sub-Goal: To develop Egyptian financial system capability to service full range of private sector financing needs.	Measures of Goal Achievement: Value added created by Egyptian private sector increases in real terms. Sub-Goal: Egyptian financial system serving full range of credit needs of productive private sector and assisting in its growth.	(1) GOE published economic statistics. (2) IMF published reports. Sub-Goal: (1) GOE published statistics (2) Central Bank of Egypt reports (3) Participating bank record (4) Project records	Assumptions for achieving goal targets: GOE continues to liberalize economy, foster private sector growth initiatives & accept AID program intervention in credit sector. Sub-Goal: (1) Project incentives adequate to encourage banking system to lend to private sector. (2) Private sector enterprises achieve greater market shares, adequate ROI (3) Banks release personnel to be trained
Project Purpose: To expand investment for productive private sector enterprises.	Conditions that will indicate purpose has been achieved: End of project status. (1) Documented increases in availability of short-term credit for imports. (2) Documented increases in availability of credit for small-scale enterprises. (3) Training in improved credit use completed; studies on credit needs and opportunities completed. TA provided.	(1) AID records (2) Bank records (3) Special studies/evaluations (4) Project evaluations	Assumptions for achieving purpose: (1) Egyptian financial system responsive to AID project initiatives. (2) Financial system continues to expand its own internal capacity/capability concommitant with AID initiatives. (3) Private sector projects requiring term financing are otherwise viable from a bankability perspective.
Outputs: (1) Funding mechanisms for (i) Short-Term Credit (STC) and (ii) Small Scale Enterprise (SSE) Credit. (2) Expanded number of participating banks in (i) and (ii). (3) Technical Assistance, Training and Studies undertaken in support of financial system and private sector development.	Magnitude of Outputs: a) Greater private sector access to & use of short-term credit (b) Larger number of banks serving private sector credit needs (2) DIB/other banks participating in SSE loan activities & use of greater credit access by SSEs (3) Trainees returning & utilizing improved credit & loan procedures; credit regulation changes made.	(1) AID records (2) Bank records (3) Evaluations	Assumptions for achieving outputs: (1) Banks actively participate in STC and SSE credit programs as planned. (2) Private Sector Steering Committee operates and functions as planned; active dialogue undertaken overtime with USAID resulting in affirmative recommendations supporting private sector development.
Inputs: (1) Short Term Credit (2) SSE Credit (3) TA, Training and Studies	Implementation Target (Type and Quantity) (000) (AID) (FX + LE) / Egypt* (LE) / Total (FX+LE) $52,000 / 13,000 / $65,000 7,000 / 3,750 / 10,750 1,000 / 250 / 1,250 $60,000 / LE 17,000 / $77,000	Project records	Assumptions for providing inputs: (1) Grant Agreement negotiations successful. (2) Conditions Precedent met in timely manner.

ANNEX G

The NEAC Guidance Cable for the Production Credit Project is LOU STATE 137525.

This cable is located in NE/PD files and the USAID/Cairo Office of Communications and Records (C&R).

ANNEX H

VZCZCCPI *
PP RUFHC
DE RUFHEG #4459/01 161 **
ZNR UUUUU ZZH
P 101919Z JUN 82
FM AMEMBASSY CAIRO
TO SECSTATE WASHDC PRIORITY 7991
BT
UNCLAS CAIRO 14459

CLASS: UNCLASSIFIED
CHRGE: AID 06/09/82
APPRV: DIR:DSBROWN
DRFTD: D/AD/IT:JSBLACK
P
CLEAR: 1. OD/IT:RSEIB
DISTR: AID-6 AMB DCM A
CHRN 10/LB

AIDAC

E.O. 12065:N/A
SUBJECT: PRIVATE SECTOR PRODUCTION CREDIT PROJECT 263-0147

REF: MISSION/LANGMAID DISCUSSIONS, WEEK OF 24 MAY 1982

1. THE PURPOSE OF THIS MESSAGE IS TO INFORM THE BUREAU OF ADJUSTMENTS TO THE DESIGN OF THE ELEMENTS OF THE PRIVATE SECTOR PRODUCTION CREDIT PACKAGE WHICH WILL BE PROPOSED FOR FY 82 FUNDING. THESE ADJUSTMENTS REFLECT THE NEAC GUIDANCE ON THE PID, DISCUSSIONS HELD WITH DAA//E LANGMAID DURING HIS VISIT, AND GOE RESPONSES TO MISSION INITIATIVES ON PRIVATE SECTOR CREDIT PROGRAMMING.

2. THE ORIGINAL MISSION DESIGN PROPOSAL AND THE NEAC RESPONSE ILLUMINATED THE TENSION BETWEEN THE ASSUMPTIONS WHICH HAD BEEN GUIDING MISSION AND BUREAU THINKING ON PRIVATE SECTOR CREDIT ISSUES. IN A NUTSHELL, THE MISSION HAD BEEN WORKING FROM THE ASSUMPTION THAT, IN AN ECONOMY WHICH IS STRONGLY DISTORTED AND HEAVILY DOMINATED BY THE PUBLIC SECTOR, THERE IS A PRIMA FACIE CASE FOR FINANCING THE EXPANSION OF THE PRODUCTIVE PRIVATE SECTOR TO SERVE AS A GROWING ALLY IN THE MOVE TOWARDS LIBERALIZATION. THE BUREAU'S ASSUMPTIONS POSIT THAT IN A STRONGLY DISTORTED ECONOMY IT IS IMPORTANT TO INSURE THAT FINANCING TO ANY SECTOR (PUBLIC OR PRIVATE) BE ON TERMS WHICH DO NOT INCORPORATE OR REINFORCE THESE DISTORTIONS. IN OPERATIONAL TERMS THIS TRANSLATES INTO THE DIFFERENCE BETWEEN PROVIDING FINANCING TERMS WHICH "MEET THE MARKET" AS IT IS VERSUS FINANCING TERMS WHICH "MEET THE MARKET" AS IT OUGHT TO BE. WE ACCEPT THE BUREAU'S DETERMINATION THAT OUR FINANCING TO THE PRIVATE SECTOR WILL HAVE TO PROVIDE RESOURCES TO SUB-BORROWERS AT COSTS WHICH APPROACH A HYPOTHETICAL FREE MARKET RATE. IN SO DOING, WE RECOGNIZE THAT THIS WILL ALTER THE SCALE AND SCOPE OF OUR ENTRY INTO THE CREDIT MARKET IN EGYPT, SINCE COMMERCIAL REALITIES WILL ONLY PERMIT OUR FUNDS TO FLOW WHERE THERE IS A REASONABLE CONVERGENCE BETWEEN THE ACTUAL MARKET AND THE HYPOTHETICAL FREE MARKET: PRINCIPALLY THE SHORT-TERM COMMERCIAL MARKET.

3. WE HAVE ADJUSTED OUR DESIGN PLANS IN THREE FUNDAMENTAL WAYS TO RECONCILE THE PROGRAM TO THE NEAC GUIDANCE:

- A) WE WILL SEEK ONLY INITIAL YEAR FUNDING RATHER THAN A MULTI-YEAR AUTHORIZATION. FUTURE FUNDING WILL BE GEARED TO IMPROVEMENTS IN THE PACKAGE OF GOVERNMENT POLICIES

WHICH INFLUENCE CREDIT AND INVESTMENT. WE ANTICIPATE AN AUTHORIZATION AND FUNDING LEVEL OF ABOUT DOLS. 65 MILLION WITH AN INDICATIVE MULTI-YEAR BUDGET RUNNING TO SEVERAL TIMES THAT AMOUNT.

- B) WE WILL CONFINE THE INITIAL PP TO TWO CREDIT INTERVENTIONS: A SHORT-TERM COMMERCIAL CREDIT PIECE AND A SMALL SSE COMPONENT. THIS REFLECTS THE FACT THAT THE CLOSEST CONVERGENCE BETWEEN REAL MARKET TERMS AND THE TERMS IN THE EGYPTIAN MARKETPLACE ARE IN SHORT-TERM FX FINANCING. THIS IS THE ONE AREA WHERE WE ANTICIPATE THAT AID FUNDS CAN FLOW TO THE PRIVATE SECTOR ON A TIMELY BASIS AND IN WAYS WHICH DO NOT INCORPORATE OR REINFORCE SIGNIFICANT ECONOMIC DISTORTIONS. WE DO NOT ANTICIPATE THAT LARGE AMOUNTS OF TIED DOLLAR FUNDS CAN BE MOVED TO SSE'S BUT WE DO FEEL THAT A SMALL PILOT PROGRAM CAN BE INITIATED WITH THE DIB WHICH PLACES AN APPROPRIATE FX RISK ON THE BORROWER, CHARGES SOUND INTEREST RATES AND IS TAILORED TO THE SSE SUB-BORROWER. FYI: THE DIB HAS RECENTLY ACCEPTED GERMAN DEVELOPMENT CREDITS WHICH CAN BE RELENT TO SMALL SCALE ENTERPRISES ON AN UNTIED BASIS FOR WORLDWIDE PROCUREMENT AND WITH NO FX RISK TO THE BORROWER.

- C) WE ARE ACTIVELY DISCUSSING WITH THE GOE THE ESTABLISHMENT OF A FRAMEWORK FOR REGULAR POLICY REVIEWS IN THE BANKING AND FINANCE SECTORS WHICH WOULD PROVIDE A FORUM FOR RAISING ISSUES OF BROAD CONCERN TO THE US/EGYPTIAN ECONOMIC DIALOGUE AS WELL AS A PLACE TO WORK ON THOSE MORE MUNDANE POLICY ISSUES WHICH WILL CONDITION THE EVOLUTION OF THE AID ROLE IN PRIVATE SECTOR CREDIT.

4. THE EFFECT OF THESE CHANGES IN THE AGGREGATE IS SUBSTANTIAL. THE LACK OF A MULTI-YEAR AUTHORIZATION WILL AUTOMATICALLY REDUCE ANY OPPORTUNITIES FOR "LEVERAGE" AND WILL GENERALLY LIMIT THE POLICY IMPACT OF AN AID PRESENCE IN THE CREDIT SECTOR. WHILE WE UNDERSTAND THE BUREAU'S RELUCTANCE TO MAKE A MULTI-YEAR COMMITMENT IN THE ABSENCE OF FX AND POLICY PROGRESS, IT MUST BE UNDERSTOOD THAT THIS WILL INHIBIT THE DEPTH AND RANGE OF OUR FUTURE POLICY DIALOGUE AND OUR ABILITY TO STRUCTURE OURSELVES AGAINST THE BROAD NATIONAL FINANCIAL SYSTEM -- FOR AT LEAST A YEAR UNTIL WE CAN SUCCEED IN ESTABLISHING A POLICY BEACHHEAD. SIMILARLY, THE INABILITY TO ENTER THE TERM CREDIT MARKET

THIS YEAR -- BECAUSE OF THE SPREAD BETWEEN THE CREDIT TERMS WHICH WILL MEET THE MARKET AND THOSE WHICH WE HAVE BEEN INSTRUCTED TO SEEK, AND BECAUSE OF SUBSTANTIAL UNRESOLVED DIFFERENCES ON THE CHOICE OF AN IMPLEMENTING INSTITUTION -- LEAVES US STRUCTURED AGAINST ELEMENTS OF THE CREDIT SYSTEM WHICH ARE IMPORTANT, BUT DEVELOPMENTALLY LESS SIGNIFICANT OVER THE LONG-TERM. A MODEST ONE-YEAR PROGRAM LARGELY CONFINED TO COMMERCIAL CREDIT WILL BE A SUBTLE VARIATION ON THE THEME OF THE PRIVATE SECTOR CIP PROGRAM WHICH IT SUPPLANTS, BUT WE SHOULD ALL BE CLEAR ON THE LIMITED IMPACT THIS IS LIKELY TO HAVE ON THE STRUCTURAL ISSUES WHICH USAID, THE IFC, THE PRE TEAM, THE AMERICAN EXPRESS GROUP AND OTHERS HAVE ALL HIGHLIGHTED OVER THE PAST YEAR.

5. THE PRODUCTION CREDIT PROJECT WILL STILL BE SUBMITTED AS A VEHICLE FOR AN EVENTUAL FULLSCALE SECTOR CREDIT PROGRAM, BUT WILL BE CONSIDERABLY MORE MODEST IN TERMS OF THE FIRST YEAR PROGRAM. WE ANTICIPATE USING OUR PARTICIPATION WITH THE CENTRAL BANK IN THE INITIAL CREDIT ELEMENTS AS A BASIS FOR BUILDING THE UNDERSTANDINGS NECESSARY TO JUSTIFY PROGRAM EXPANSION INTO OTHER AREAS OF PRIVATE SECTOR FINANCE. WE CONTINUE TO BELIEVE THAT ASSISTING THE CREDIT SYSTEM TO MOVE ITS HORIZONS OUT TOWARD LONGER TERM LENDING IN SUPPORT OF PRODUCTIVE PROJECTS IS A FUNDAMENTAL GOAL OF THE PROJECT. A FIRST-YEAR PROGRAM WEIGHTED TOWARD SHORTER TERM LENDING DOES NOT REFLECT A SHIFT IN OUR SENSE OF PRIORITIES. RATHER, IT STARTS THE PROGRAM OFF IN THOSE AREAS WHERE WE BELIEVE THAT RELATIVELY TOUGH LENDING TERMS WILL NOT PREVENT OUR MONEY FROM MOVING IN THE EGYPTIAN MARKET. WE STILL LOOK TOWARD A CREDIT PACKAGE EVENTUALLY DOMINATED BY VARIOUS KINDS OF TERM FINANCE.

6. MISSION CONTINUES TO ANTICIPATE PP SUBMISSION O/A 30 JULY 1982. THIS MESSAGE INTENDED TO KEEP BUREAU ABREAST OF DESIGN PROCESS, NOT AS AN ACTION DOCUMENT. ATHERTON
BT
#4459

NNNN

ANNEX I

EGYPTIAN BANKING SYSTEM

	12/31/1973 Number	12/31/1981 Number
Central Bank	1	1
Commercial Banks		
Public Sector	4	4
Private Egyptian Owned		9
Private Joint Ventures		11
Public Sector Specialized Banks		
Arab Land Bank	1	1
Credit Foncier Egyptian	1	1
Principal Bank Agricultural Credit	1	1
Development Industrial Bank		1
Investment Banks		
Egyptian Owned		3
Joint Ventures		6
Foreign Branches		19
Free Zone Banks		1
Other Banks		
Representative Offices of Foreign Banks		29
Nasser Social Bank		1
Multi-National Offshore Bank	2	1
TOTALS	10	89

SECTORAL DISTRIBUTION OF BANK TERM LENDING 1/
(LE Millions)

Sector	December 1978	December 1979	December 1980	December 1981
Agriculture	14	24	27	85
Industry	40	65	111	185
Commerce	6	11	21	27
Services	21	45	70	133
TOTAL	82	144	229	430

1/ Details may not add to totals because of rounding; includes loans of over one year maturity for each sector.

ANNEX K

CENTRAL BANK OF EGYPT
Interest Rates' Structure
(1977 - 1981)

Circular No.	226		228		236	241	245	248	250	260	262
Date	Dec. 29, 1975		Feb. 28,1977		June 15, 78	Dec.28,78	Mar.29,79	Mar.27,80	May 26,80	Jan.1, 81	Aug. 3, 81
Demand Deposits	--		--		--	--	--	--	--	--	--
Time & Savings Deposits											
	Indivi duals	Institu tions	Indivi duals	Institu tions							
	%	%	%	%	%	%	%	%	%	%	%
7-15 days (min.LE. 100,000)							4.0	4.5	4.5	5.0	5.0
15-30 days *	2.0	2.0	3.0	2.5	4.0	5.0	5.0	5.5	5.5	6.0	6.0
1-3 months	3.0	2.5	4.0	3.0	4.5	5.5	5.5	6.0	6.5	7.5	7.5
3-6 months	4.0	3.0	5.0	4.0	5.5	6.0	6.0	7.0	7.5	8.5	8.5
6-12 months	4.0	3.5	5.5	4.5	6.0	6.5	6.5	7.5	8.0	9.0	9.5
1-2 years	5.0	4.0	6.0	5.0	6.5	7.0	7.0	8.0	9.0	9.5	10.0
2-3 years					7.0	7.5	7.5	8.5	9.5	10.5	10.5
3-5 years						8.0	8.0	9.0	10.0	11.0	11.0
5 years						8.5	8.5	9.5	10.5	11.5	11.5
Savings Deposits	4.0		5.0		5.0	6.0	6.0	7.0	8.0	8.5	8.5
Lending Rates Minimum-Maximum	7-8		8-9		9-11	10-12	10-12	11-13	12-14	13-15	13-15
CBE Discount Rate	6.0		7.0		8.0	9.0	9.0	10.0	11.0	12.0	12.0

* Interest rates for 15-30 days deposits had a minimum amount required as follows:

Till March 29, 1979	Minimum of L.E. 10,000
From March 30, 1979 till December 31, 1980	Minimum of L.E. 50,000
From January 7, 1981 till present	Minimum of L.E. 100,000

ANNEX K

CENTRAL BANK OF EGYPT

Interest Rates' Structure

(1977 - 1981)

Circular No.	226		228		236	241	245	248	250	260	262
Date	Dec. 29, 1975		Feb. 28,1977		June 15, 78	Dec.28,78	Mar.29,79	Mar.27,80	May 26,80	Jan.1, 81	Aug. 3, 81
Demand Deposits	--		--		--	--	--	--	--	--	--
Time & Savings Deposits											
	Indivi duals	Institu tions	Indivi duals	Institu tions							
	%	%	%	%	%	%	%	%	%	%	%
7-15 days (min.LE. 100,000)							4.0	4.5	4.5	5.0	5.0
15-30 days *	2.0	2.0	3.0	2.5	4.0	5.0	5.0	5.5	5.5	6.0	6.0
1-3 months	3.0	2.5	4.0	3.0	4.5	5.5	5.5	6.0	6.5	7.5	7.5
3-6 months	4.0	3.0	5.0	4.0	5.5	6.0	6.0	7.0	7.5	8.5	8.5
6-12 months	4.0	3.5	5.5	4.5	6.0	6.5	6.5	7.5	8.0	9.0	9.5
1-2 years	5.0	4.0	6.0	5.0	6.5	7.0	7.0	8.0	9.0	9.5	10.0
2-3 years					7.0	7.5	7.5	8.5	9.5	10.5	10.5
3-5 years						8.0	8.0	9.0	10.0	11.0	11.0
5 years						8.5	8.5	9.5	10.5	11.5	11.5
Savings Deposits	4.0		5.0		5.0	6.0	6.0	7.0	8.0	8.5	8.5
Lending Rates Minimum-Maximum	7-8		8-9		9-11	10-12	10-12	11-13	12-14	13-15	13-15
CBE Discount Rate	6.0		7.0		8.0	9.0	9.0	10.0	11.0	12.0	12.0

* Interest rates for 15-30 days deposits had a minimum amount required as follows:

Till March 29, 1979	Minimum of L.E. 10,000
From March 30, 1979 till December 31, 1980	Minimum of L.E. 50,000
From January 7, 1981 till present	Minimum of L.E. 100,000

ADDITIONAL BANK FEES AND CHARGES[1/]

2 % of the loan amount to establish a contract of ownership in favor of the bank (this contract gives legal title to the bank of the goods and equipment imported until the loan is repaid by the borrower; effectively establishes imported items as collateral).

2% of loan amount to revoke the above contract when the loan is repaid by the borrower.

2% of loan amount to open a Letter of Credit in favor of a US supplier.

.5% for telex charges

1% bank commission for undertaking any studies needed for the transaction.

.5% bank commission to process and review loan application.

2/ .5% commitment fee on unused balances, charged each quarter.

3/(Variable) other charges comprised of GOE taxes, customs duties and fees, etc. (these charges accrue to GOE, not bank)

Notes

1/: These fees and charges are commonly levied on short-term loans for private sector CIP transactions in which DIB participates. Fees and charges are not always billed to importer depending on the type of transaction, goods and equipment being imported, credit standing of importer and terms/conditions of loan (i.e. terms are negotiable). Other banks charge similar fees.

2/: Size of commitment fee varies by bank; some banks charge higher or lower fees on shorter or longer periods.

3/: Customs fees can amount to 40% or more of CIF value Alexandria; other customs handling charges can amount to 5-10%; GOE also charges 10% fee for a "consumption subsidy" (if item is for resale) and a 3% "maritime subsidy" to support Egyptian shipping. These are GOE levied charges which do not accrue to participating bank - they are, however, common additional costs of an import transaction. Additionally, most of these charges are financed by the participating banks in additional loans and importers pay the highest interest rates which can be charged (16%+).

ANNEX M

DRAFT*
Decree of the Deputy Prime Minister
for Economic and Financial Affairs
and the Minister of Investment and International Cooperation

No. ______ for 1982 concerning the establishment of the Steering Committee for US Assistance focusing on the Development of the Private Sector. The Deputy Prime Minister for Economic and Financial Affairs and the Minister for Investment and Economic Cooperation, upon after reviewing perusal of the Constitution;

--- the Grant Agreement for the establishment of the Private Investment Encouragement Fund signed in September 22, 1979, between the Arab Republic of Egypt and the United States of America, and approved by the People's Assembly in February 19, 1980.

--- Law No. 163 for 1957 passing the Banks and Credits enactment.

--- The Grant Agreement for the Private Sector Feasibility Studies Project signed in September 22, 1979 between the ARE and the USA and approved in September 19, 1980.

--- Law No. 43 for 1974 (amended by Law 32 for 1977) establishing the system of investment of the Arab, Foreign and Free Zone's money.

--- Law No. 120 for 1975 concerning the Egyptian Central Bank and the banking systems.

--- Law No. 159 for 1982 concerning the regulations special for Limited Companies, Limited Liability partnerships and Limited Shareholder Companies.

--- Decree of Deputy Prime Minister for Economic and Financial Affairs and Minister of Economy No. 327 for 1980 and No. 4 of 1981.

--- and, according to what was presented by the First Undersecretary of Ministry of Investment and International Cooperation for Economic Cooperation with the USA.

Decided
Article I

The Formation of the USAID Steering Committee composing the following:

- Mr. Taher Amin
- President, Bank of Commerce and Development

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*Provided USAID, July 1982

- Mr. Ali Negm
  Deputy Governor, Central Bank

- Dr. Fouad Iskandar, Secretary
  First Undersecretary for Economic Cooperation with US.

- Counsellor Amrou El Sharkaur
  Counsellor at the General Authority for Investment

- Mr. Ahmed Abdel Salam Taki
  Sector's Chief at the General Authority for Investment

The Committee is free to invite any person to attend its sessions without giving his voice.

Article II

The above mentioned Committee shall perform the following duties and responsibilities:

1. Suggest policies and implementation steps which aim at supporting the private sector and its role in the overall development as far as projects and programs financed according to signed agreements or which are being signed between the ARE and USA specially those related to credit facilities, loans and investments.

2. Administer, follow-up and supervise the implementation of all projects and programs mentioned in the previous item. These projects and programs are those which are the subject of agreement between the two countries.

3. Taking the necessary technical and managerial measures regarding programs whether on short, medium or long-term basis, in accordance with the general plan for full scale development.

   (a) Establishing the necessary schedule for executing and managing the projects and programs concerning them and making the internal decisions and rules with regard to the financial, administrative and technical aspects of the projects without being restricted conforming to the governmental (internal) regulations and decrees.

   (b) Assign directors to the projects and programs referred to, as well as the employees necessary to insure reaching the aim required of these projects.

   (c) Forming branch committees to take the projects' responsibilities according to the plan set by the Committee as stated in this decree.

4. Other subjects which the Prime Minister for Economic and Financial Affairs and Minister of State for Investment and International Cooperation may propose to the committee.

The Committee will meet once a month at least, at the request of its president. Such meeting will be considered valid only if the majority of its members are present.

Article III

Committee decisions will be submitted to the Deputy Prime Minister for Economic and Financial Affairs and Minister of State for Investment and International Cooperation within a week of their issuance. He should state his opinion within 30 days. In the event where he would object to a committee decision, it would be returned to the committee for reconsideration, and the final decision would be the Ministry.

The Committee's decisions will expire after a 30 day period if no opinion is given on these on the part of the Minister.

Article IV

In the first meeting, the committee will:

1. Establish an internal policy for the organization of its duties.

2. Establish a technical committee responsible for subjects and studies to be submitted to the committee, recording the meeting, and responsible for the documentation.

Article V

All decisions and regulations regarding the PIE Fund and Feasibility Studies for the Private Sector facility for the private sector mentioned above are cancelled.. The committee will establish the necessary proposed action for the reorganization and execution of these projects.

Article VI

This decree is effective starting at the time of its issuance, and cancels all opposing decrees.

Deputy Prime Minister
for Economic & Financial Affairs
and Minister of Investment

DRAFT*
GENERAL CIRCULAR OF 1982
Concerning Rules for Using Productive Short-Term Credit for US Imports by the Private Sector

1. In order to encourage the Egyptian productive sector to participate in the economic development according to the national priorities, credit funds will be made available to private sector importers from the short-term credit program herein described. Funds will be made available to private sector importers engaged in the following activities:

   a. Production (foodstuffs, industry, agriculture, irrigation);

   b. Production services (transporation, means of communication, housing, rehabilitation, construction, utilities, roads, tourism)

   c. Commerce (commodities aimed at contributing to development and augmenting production capacity).

   d. Private entrepreneurs (e.g., doctors, engineers, accountants, agronomists, etc.)

2. Such loans finance the importation of capital goods and intermediate commodities (raw materials and spare parts, as well as light capital goods) from the United States. They do not finance luxury or consumer goods or foodstuffs, no do they finance commodities to be re-exported in their same condition, but they must constitute a component part of the final product.

3. The importer must have a commercial registry and a taxation card. The latter suffices in the case of private entrepreneurs.

4. The US commodity loans are not generally available to companies established under Law 43 of 1974 and its amendments. However, the Undersecretariat for Economic Cooperation at the MIIC may approve a Law 43 company's participation, on a case-by-case basis, in light of the imports necessity for the national economy.

5. The public sector's commercial and specialized banks as well as specified Egyptian and joint venture banks (and other banks working through the public sector's commercial banks) who are authorized sums of money of the US AID funds are entitled to re-loan them to their clients in the private sector referred to above to use such loans for financing the commodities which play an effective role in expanding production.

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*Draft from based upon Circular 2 of 1982 used for the Private Sector CIP.
*Draft from unofficial translation of Arabic circular.

6. The public sector and the Egyptian and joint venture private sector (participating) banks shall be indebted to the Ministry of Finance for the amounts of money used of such loans advanced to their clients of the private sector. They are obligated to pay to the Ministry of Finance's account at the Central Bank 25% of the value of the Letters of Credit that have been issued within the allowed limits at the time of opening the credit on the basis of the official rate of exchange. The client shall also deposit this percentage rate as an advanced down-payment in Egyptian Pounds on the basis of the same rates of exchange.

7. The participating banks shall settle the outstanding balance (75%) of each shipment's value to the Ministry of Finance's account at the Central Bank. Also, the client shall settle the outstanding balance of each shipment's value to such bank within 1 year for trade transactions, 1 1/2 years for raw materials and 3 years for productive commodities for end-users, provided that settlement be effected by equal annual installments.

8. The participating banks shall pay an interest to the Ministry of Finance's account with the Central Bank for the outstanding balance at the rate of 13% with regard to raw materials and commodities and services imported by the productive private sector for its own use, and a minimum of 16% with regard to the comodities imported for re-sale to the productive private sector, provided that banks charge their clients upon re-loaning at the same interest rate received by the Ministry of Finance plus the banking commissions according to the commercial banks' tariff as issued by the Central Bank.

9. In the event of such banks providing credit facilities to clients for settling their advance payment or the installments on their due dates, they may charge interest in conformity with the prevailing interest rates. Banks shall retain the discretion of granting such a credit or otherwise, in the light of their study of the client's financial position, on the condition that it shall have no bearing on the commitment of participating banks to the Ministry of Finance.

10. Commencement of interest validity and the determining of the first installment and the subsequent installments for the outstanding balance shall become effective on the date of payment of the commodities' value by the US Treasury to the L/COMM bank. This is in respect to the interest due by the banks to the Ministry of Finance or due by the clients to the bank. Initially, the interest and the installments shall be calculated in Egyptian pounds on the basis of the official rate of exchange on the date the US supplier is paid under the individual L/C. The participating banks shall request banks abroad to advise them of the dates of payment by debiting to the loan's account as soon as these are effected in order to enable them to specify the dates on which the interest and installments shall fall due without delay.

11. The participating banks shall authorize (power of attorney) the Central Bank to draw down their accounts with the amount of interest and

installments due by them to the Ministry of Fianance, and furnish the Ministry of Finance (the Central Administration for Financing and Loans) with a copy of the said authorization, explaining the details related to the Letter of Credit which was drawn down by the amount of the Bill of Lading, the Bill of Lading amount and date of settlement by drawing down from the loan's account.

12. Persons of the private sector desirous of using sums of money from the short term US commodity loans directed at productive enterprises shall apply to the participating banks for financing their imports. The banks should secure concurrence of the US Undersecretariat for Economic Cooperation at the Ministry of Investment and International Cooperation in the event the sum of money requested exceeds $500,000.

13. No single client may be allowed to use sums of money exceeeding $500,000 for financing the purchase of the same or similar commodities within any 12 months period in the absence of the concurrence of the US Undersecretariat for Economic Cooperation at the Ministry of Investment and International Cooperation.

14. No single client may be authorized to use sums of money exceeding one million dollars within a period of twelve months starting from the date of opening the first credit without the concurrence of the Undersecretariat for Economic Cooperation at the MIIC.

15. Each of the following is considered one client when calculating the maximum of the sums of money to be advanced to a client under clauses 13 and 14 of this circular whenever either or both of them apply for benefiting by such loans:

A. A natural person who subscribes to a partnership company, and the company itself.

B. A partnership company and another partnership company to which the first company subscribes.

C. Natural person together with members of his family up to the fourth kin.

16. The bank shall request the client to present a reasonable number of offers, by different US suppliers of the commodities to be imported, together with a summary of offers and his recommendation, unless the provisions of AID Regulation 1 allow otherwise.

17. The bank shall send to USAID/Cairo, by transmittal letter, copies of all offers received from the loan applicant, a completed Transaction Form and the bank certification that this proposed transaction complies with the requirements of the circular.

18. USAID/Cairo shall furnish eligible banks with a list of the items that may be financed by the US fund and any amendments introduced thereto. Banks shall be committed not to open any credits for the importation of equipment and services to be debited to the US fund for the private sector other than for those items inserted on the said list as well as to forward a copy of the Transaction Form to the USAID/Cairo for review. Should USAID raise any objection, the matter would be referred to the Undersecretariat for US Economic Cooperation at the Ministry of Investment and International Cooperation for final arbitration.

19. Approvals issued for financing commodity import for the private sector by the Ministry of Investment and International Cooperation or banks shall be valid for a maximum period of two months from the date of the issuance of the approval. However, its renewal may be considered according to the circumstances of each case individually and with the concurrence of the parties which issued the approvals, provided that the importer submits a request to this effect at least fifteen days prior to its expiration date.

20. The participating banks may not issue letters of credit for any person other than the one in whose name the proforma invoice is issued by the US supplier. Nor are the banks authorized to amend any letter of credit in a manner contrary to the contents of the proforma invoice except within the limits of minor technical amendments which might be expedient for facilitating the importation procedure previously authorized. Authorizations issued in favor of anybody may not be ceded to another.

21. Credit opened for the importation of raw materials and intermediate commodities shall be valid for a period of time not to exceed six (6) months, whereas credits opened for the importation of capital goods shall be valid for a period of time not to exceed one (1) year. These time limits are not subject to renewal.

22. The bank is duty bound to furnish the US Undersecretariat for Economic Cooperation at the Ministry of Investment and International Cooperation with a detailed monthly statement showing the credits already opened during the preceding month, with a copy to the Ministry of Finance (The Central Administration for Financing and Loans) and to USAID.

23. The bank shall not issue Form (A) addressed to the Customs Department except after ascertaining the conformance of the item stated in the documents to the item specified in the credit.

24. All the formalities and contacts required for the utilization of the short term US commodity loans by the private sector shall be carried out in conformity with the rules set by this circular and the AID Regulation 1 through the concerned bank.

25. In the event of establishing a violation of any of the rules spelled out under this circular by the client, the bank shall oblige the client to settle the cost of the shipments received against the opened credits from his own means and reimburse the cost to the loan's account, advising the Ministry of Investment and International Cooperation to consider denying the client the privilege of benefiting by such funds in future.

26. The banks which opened the credits for such funds shall be responsible for executing the rules and regulations contained in this circular without breaching the rules or decisions concerning the client eligibility procedures.

27. The rules set forth in this circular shall become valid in respect to the credits opened after the effective date of its issuance, and any other rules contrary to this circular's provisions concerning such credits are canceled.

Deputy Prime Minister
For Ecomonic and Financial Affairs
and Minister of International Investment and Cooperation

DRAFT
GENERAL CIRCULAR NO. ___
Concerning Rules for Using the US Credit Program
for Small Scale Enterprises

1. In order to encourage the Egyptian private sector to participate in economic development according to the national priorities, credit funds will be made available to private small scale entrepeneurs (described below) from the credit program described below. Funds will be made available to private small scale entrepreneurs engaged in the following activities:

a. Production (foodstuffs, industry, agriculture, irrigation);

b. Production services (transporation, communications, housing, construction, tourism)

2. Eligible private small entrepreneurs are defined as those entrepeneurs which have a commercial registry, and assets, excluding land and buildings, of LE 350,000 or less, and which are engaged in activities described in paragraph 1.

3. Such credit funds will finance the importation of capital goods as well as spare parts. They will not finance luxury or consumer goods or foodstuffs, nor finance commodities to be re-exported without value added by the enterprise.

4. To participate in this program, a bank will require the prior written approval of the US Undersecretariat for Economic Cooperation at the Ministry of Investment and International Cooperation (MIIC) and USAID. (Banks obtaining such approval are hereinafter referred to as "eligible banks".) All public and private sector banks, including joint venture banks but excluding branch banks, may be eligible for relending to private clients as defined in paragraph 2. above. At the time of issuance of this circular, only the Development Industrial Bank has obtained such approvals and qualifies as an eligible bank. Factors which will affect eligibility and materials which must be reviewed, include:

a. Copies of the articles of association (or statutes), charter, term lending guidelines, statements of policy, and other documents affecting the management, administration and policies of the bank.

b. A statement as to the bank's paid-in capital, authorized capital and type of ownership.

c. Evidence that the bank seeking eligibility has the managerial staff, physical resources and facilities required to carry out productive subloans to small scale enterpreneurs. This shall include general banking, financial operations, accounting and other support services.

d. Evidence of previous experience with subloans of the type contemplated under this program, and a review of that portfolio, along with the terms, conditions, as well as collection procedures instituted by the bank.

e. A copy of the most recent annual report of the bank seeking eligibility, its prior month loan/deposit ratio, other information available to the Central Bank of Egypt.

f. Expression of interest of the bank in participating in the program. This can take the form of a letter to the Private Sector Steering Committee concurring in the terms and conditions of this circular.

5. Eligible banks shall be indebted to the Ministry of Finance for the amounts of money borrowed for loans advanced to their clients. Credit issued within the allowed limits assigned at the time of opening, will be on the basis of the current policy rate of exchange.

6. Eligible banks shall pay interest to the Ministry of Finance's account with the Central Bank for the outstanding balance at the rate described in paragraph 7 below, within 20 years including 3 years of grace. The small scale enterprise client shall settle the outstanding balance of each loan's value to such bank within a maximum of 10 years including up to 2 years' grace, provided that settlement be effected by equal annual installments.

7. The eligible banks shall pay interest to the Ministry of Finance's account with the Central Bank for the outstanding balance at the rate of 4.5 percent below the Central Bank rate for industrial loans which, as of July 1982, was 13 percent, provided that banks charge their clients upon re-loaning at the interest rate for industry fixed by the Central Bank, plus banking commissions according to the commercial bank's tariff schedule as issued by the Central Bank.

8. Commencement of interest validity and the determining of the first installment and the subsequent installments for the outstanding balance shall become effective on the date of payment of the commodities' value by USAID and debiting same to the loan account. This is in respect to the interest due by the banks to the Ministry of Finance or due by the clients to the bank. Initially, the interest and the installments shall be calculated in Egyptian pounds on the basis of the official rate of exchange on the date of USAID's settlement of the commodities' value from the loan. Eligible banks shall, without delay, request banks abroad to advise them of the dates of payment by debiting the loan's account as soon as these are effected in order to enable them to specify the dates on which the interest and installments shall fall due. Subsequent annual payments shall be made on the basis of the official rate of exchange on the due dates of payment.

9. The eligible banks shall authorize the Central Bank to draw down their accounts with the amount of interest and installments due by them to the Ministry of Fianance, and furnish the Ministry of Finance (the Central Administration for Financing and Loans) with a copy of the said authorization, explaining the details related to the Letter of Credit which was drawn down by the amount of the Bill of Lading, the Bill of Lading amount and date of settlement by drawing down from the loan's account.

10. Eligible commercial and specialized banks, seeking to assist small business clients to strengthen their financial base may also use the fund for small amounts of equity financing or partnership assistance. The equity funding, which may be issued in Egyptian Pounds may only be used in conjunction with the fund for private, small scale entrepreneurs.

11. No single small scale entrepreneur client may be allowed to use sums of money exceeding $350,000 in loan funds and LE 70,000 in equity funds for financing a project. The equity funding may not exceed 10 percent of total project cost or 20 percent of the project or company equity, whichever is less.

12. Projects to be financed by this fund must show an adequate financial rate of return to the client. Justification for the use of funds must be demonstrated by (a) the anticipated increase in employment, (b) the additional value added, (c) additional foreign exchange creation through the usage of these funds, and compliance with the criteria in paragraph 1.

13. Companies established or being established under the Arab and Foreign Investment Law #43 of 1974 and its amendments may also benefit by the fund if they meet the eligibility requirements of paragraphs 1, 2, and 3.

14. Private small scale entrepreneurs desirous of using sums of money from the fund should apply directly to an eligible bank for financing. The bank will apply for the funds on behalf of the client and will secure approval from the Central Bank or the US Undersecretariat for Economic Cooperation at the Ministry of Investment and International Cooperation.

15. No single client may be re-authorized to use the fund without first having liquidated its prior financing under the fund.

16. Given compliance with the criteria in paragraphs 1, 2, and 3, each of the following is considered one client when calculating the maximum of the sums of money to be advanced to a client under paragraph 14 of this Curcular whenever either or both of them apply for benefiting by such loans:

a. A natural person who subscribes to a partnership company, and the company itself.

b. A partnership company and another partnership company to which the first company subscribes.

c. Natural person together with members of his family up to the fourth kin.

17. The eligible bank shall request the client to show evidence of reasonable supplier competition by the negotiated procurement provisions as described in AID Regulation 1.

18. The eligible bank shall send a copy of these offers and their abstracts to the Ministry of Investment and International Cooperation and to USAID/Cairo.

19. USAID/Cairo shall furnish eligible banks with a list of the industries that may not be financed by the fund and any amendments introduced thereto. Eligible banks shall not open any credits for the importation of equipment and services to be debited to the US fund for the private sector for those industries inserted on the said list. Eligible banks shall forward a copy of the loan Transaction Form to the USAID/Cairo for review. Should USAID raise any objection, the matter would be referred to the Undersecretariat for US Economic Cooperation at the Ministry of Investment and International Cooperation for final arbitration.

20. The eligible banks may not issue letters of credit for any person other than the one in whose name the pro forma invoice is issued by the US supplier. Nor are the banks authorized to amend any Letter of Credit in a manner contrary to the contents of the pro forma invoice except within the limits of minor technical amendments which might be expedient for facilitating the importation procedure previously authorized. Authorizations issued in favor of anybody may not be ceded to another.

21. Credit opened for the importation of capital goods shall be valid for a period of time not to exceed one (1) year. The aforementioned time limits are not subject to renewal.

22. The eligible banks are duty bound to furnish the US Undersecretariat for Economic Cooperation at the Ministry of Investment and International Cooperation with a detailed monthly statement showing the credits already opened during the preceding month, with a copy to the Ministry of Finance (The Central Administration for Financing and Loans) and to USAID. USAID will provide eligible banks with copies of the reporting format to be used.

23. The bank shall not issue Form (A) addressed to the Customs Department except after ascertaining the conformance of the item stated in the documents to the item specified in the credit.

24. All the formalities and contacts required for the utilization of the US funds by the private sector shall be carried out in conformity with the rules set by this circular and the USAID rules through the concerned bank.

25. In the event of establishing a violation of any of the rules spelled out under this circular by the client, the eligible bank shall oblige the client to settle the cost of the shipments received against the opened credits from his own means and reimburse the cost to the loan's account, advising the Ministry of Investment and International Cooperation to consider denying the client the privilege of benefiting by such funds in future.

26. The eligible banks which opened the credits for such funds shall be responsible for executing the rules and regulations contained in this circular without breaching the rules or decisions concerning the client eligibility procedures.

27. The rules set forth in this circular shall become valid in respect to the credits opened after the effective date of its issuance, and any other rules contrary to this circular's provisions concerning such credits are canceled.

Deputy Prime Minister
For Ecomonic and Financial Affairs
and Minister of International Investment and Cooperation
(signed)
Mohamed Abdel Fattah Ibrahim

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ANNEX P

26 JUN 82
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ACTION TO: E.T.
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11/JM

AIDAC

E.O. 12065: N/A
TAGS:
SUBJECT: 50/50 SHIPPING OF ICI FUNDED GOODS

REF: CAIRO 15452

1. WE CONCUR IN TYING ICI PROJECT QUOTE PRODUCTION CREDIT PROJECT UNQUOTE TO AN EXISTING EGYPTIAN LOAN OR GRANT FOR THE PURPOSE OF ACHIEVING CARGO PREFERENCE COMPLIANCE. SUGGEST THAT LOAN 263-K-052 BE USED FOR THIS PURPOSE. STATUS OF THIS LOAN AS OF MAY 31, 1982 WAS AS FOLLOWS:

TRAMPS TOTAL TONS 429,465; U.S. FLAG TONS 242,664; U.S. FLAG PERCENT 56. LINER TOTAL TONS 156,477; U.S. FLAG TONS 99,717; U.S. FLAG PERCENT 64. TANKER TOTAL TONS 49,527 WITH ZERO U.S. FLAG. BASED ON FREIGHT REVENUE PAID TO CARRIERS, U.S. FLAG TRAMPS RECEIVED 72 PERCENT, U.S. FLAG LINERS 65 PERCENT WITH NO REVENUE RECEIVED BY U.S. FLAG TANKERS.

2. CONSIDERING ABOVE FAVORABLE U.S. FLAG POSITION UNDER LOAN 052, BELIEVE 100 PERCENT OF ICI FUNDED GOODS COULD BE SHIPPED FOREIGN FLAG WITHOUT THE COMBINED AGREEMENTS BEING OUT OFCOMPLIANCE.ASYOU KNOWFOREIGN FLAG FREIGHT COSTS FOR ICI PROJECT SHIPMENTS COULD NOT BE PAID FROM AID

FUNDS WITHOUT A WAIVER APPROVED BY US. SINCE REGULARLY SCHEDULED U.S. LINER SERVICE DOES EXIST TO ALEXANDRIA AND PORT SAID FROM U.S. GULF AND EAST COAST PORTS, A TRANSPORTATION WAIVER PROBABLY WOULD NOT BE APPROVED.

3. RECOMMEND THAT TERMS OF PROJECT AGREEMENT STATE THAT: QUOTE THE ICI PROJECT PRODUCTION CREDIT PROJECT IS TIED TO LOAN AGREEMENT 263-K-052 FOR CARGO PREFERENCE COMPLIANCE PURPOSES ONLY. END QUOTE. HAIG
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The Development Industrial Bank and Small Scale Enterprises

The DIB is the only Egyptian bank which has historically provided a significant level of services to small scale enterprises. Private sector banks are generally uninterested in projects of less than $500,000 and public commercial banks are principally engaged in short term commercial lending and have little experience in term working capital or fixed asset lending. Since its establishment in 1976, the DIB approved loans totaling LE 318.4 million of which LE 291.1 million (91.4%) were to the private sector. Of an outstanding loan portfolio of LE 153 million as of June 30, 1981, LE 51 million was loaned to SSEs. Most of these SSE loans (67%) were for medium term (5 year) credit. Over the next five years, the DIB will increase the share of total loan approvals for SSEs from the present 30% to 40-50% by 1985, as agreed as a special condition for its $120 million FX loan from the IBRD.

In 1976, AID provided $31.5 million to the GOE for onlending to the DIB as support for industrial development. By mid 1982, the DIB had disbursed approximately $21 million from letters of credit; had opened approximately $24 million in L/Cs; and had loan contracts totalling $26 million for use of AID funds. Over this period, the DIB's project approval authority increased from $250,000 to $1,000,000; US flag shipping interpretations were more broadly defined, and a pattern for working with AID, and its regulations, emerged.

As a development bank, the DIB has placed a strong emphasis on extending technical assistance to its clients. In the past, assistance was limited to fielding engineers who would provide advice and technical support to clients. This support focused mainly on ensuring good performance of equipment and machinery. Currently the DIB, with World Bank support, is substantially expanding its technical assistance effort to its clients. Briefly, this program includes the formation of a new Client Assistance Department which will work with Egypt's Engineering and Industrial Design and Development Center (EIDDC) and the Productivity and Voational Training Department (PVT) of the Ministry of Industry.

The DIB itself is currently a recipient of technical assistance from the EEC and the AID DIB-II project. The EEC has provided a full time consultant advisor for the DIB's SSE Department and the DIB II project is providing assistance for strengthening the overall management and staff capacity of the Bank.

A number of donors are currently helping the DIB meet its foreign exchange needs. The World Bank, African Development Bank and German Kreditanstalt Fur Wiederaufbau (KfW) bank will provide about $160 million in united foreign exchange in 1982. The majority of donor funds are expected to reach medium and large private firms with more than LE 350,000 in fixed assets. The World Bank has reserved $20 million of its funds for very small SSEs with less than LE150,000 in fixed assets. Local currency loans are financed by a LE100 million line of credit at the CBE.

There remains a gap in foreign exchange financing for SSEs in the range of LE 150,000 to LE350,000 in fixed assets. Phase I of the Production Credit SSE activity is designed to help meet the foreign exchange needs of SSEs in that range.

The Role of Small Scale Enterprises in the Egyptian Economy*

I. Introduction:

The purpose of this annex is to provide a brief background overview of small scale enterprises in Egypt. Four main questions are addressed: 1) what are SSEs and what do they produce? 2) how have SSEs participated in Egypt's development? 3) what is the growth potential for SSEs? and 4) what are the main constraints faced by SSEs?

II. SSEs Defined:

Small scale enterprises are operationally defined by the DIB as those with no more than LE 350,000 in fixed assets excluding land and buildings.** The ADL-ARICON study found this guideline reasonable and further defined SSEs as non-law 43 enterprises employing from 10 to 200 full time workers. Firms with less than 10 workers are considered artisanal and were not included in the study. These two capital and labor parameters will form the basic definition of SSEs for the purposes of this paper.

Firms that fall within these limits tend to share the following less quantifiable characteristics: ownership is usually limited to a single individual or small partnership; the owner functions both as an entrepreneur and manager; production takes place in a factory with some degree of mechanization present; workers tend to have specialized tasks, work full-time and receive payments close to the minimum wage.

The concentration of ownership, management and entrepreneur roles in one individual is a key feature differentiating SSEs from other enterprises. In small artisanal enterprises with less than 10 employees, capital assets are very small and each worker typically owns his own tools. The owner or shopkeeper therefore has little of his own capital at risk. An SSE on the other hand, is formed when an entrepreneur pools his own assets with those of family and/or friends in order to make a

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* The main source of information for this annex is the recently completed study on small scale enterprises by Arthur D. Little and Arab International consultants (ADL-ARICON). This study was financed by USAID under Contract No. 263-0078-C-00-1044-00. The final Phase II report was completed in May 1982.

**The DIB raises this upper limit each year in proportion with changes in the price index. At the time ADL conducted its research (1981), the limit was LE 300,000.

substantial investment in productive capital assets. By personally assuming this position of risk with the hope of greater profit, the owner-manager becomes a true entrepreneur. In larger firms, capital requirements usually necessitate a greater number of shareholders. Ownership then becomes divorced from management and the risk faced by an owner is limited by incorporation.

There are an estimated 7,795 industrial establishments in Egypt with over 10 workers. Of these establishments, approximately 7,290 (94%) are privately owned SSEs as defined above. Another 120 (1.5%) are large private firms with over 200 employees, 148 (about 2%) are Law 43 companies, and 265 (3.4%) are public sector firms (See Table I).

Although the proportion of SSEs is very large, their relative share of production, like that of the private sector as a whole, is more modest. This reflects the fact that Egypt's largest industrial firms are publicly owned. Of an estimated total manufacturing output of LE 6.1 billion in 1980, 23% (LE 1.4 billion) came from SSEs and 29% from the private sector as a whole (Table II). This shows that SSEs are responsible for the bulk (78%) of private sector manufacturing in Egypt. Table II shows the relative contribution of SSEs in the different manufacturing sub-sectors. On the whole, SSEs produce 13% to 20% of total output in each sub-sector. Leather goods is the exception, with 90% of output controlled by SSEs. Table II also shows that except for the chemical industry, SSEs share of private sector production ranges from 65% to 95% across all sub-sectors. In terms of absolute levels of output, SSEs are most active in the leather and food processing industries (LE 405 million and LE 360 million), followed by textiles and metals and engineering (LE 280 million and LE 210 million) and finally chemicals and building materials (LE 121 million and LE 26 million).

With respect to geographical distribution, the ADL-ARICON study estimates that 50% to 55% of SSEs are located in the greater Cairo urban area and another 15-20% in Alexandria. A 1977 World Bank study suggests that smaller firms with less than 100 employees tend to be somewhat less concentrated in the Cairo-Alexandria areas than larger firms.

Regarding employment, the ADL study estimates that the average SSE employs 20 to 25 workers. This means that the 7,290 SSEs in Egypt employ roughly 146,000 to 182,000 workers.

III. SSEs and Structural Changes in the Egyptian Economy:

To understand the potential for SSE contributions to development and the constraints impinging on that potential, it is necessary to review briefly the changes in Egypt's industrial development, and the economic role of private sector industry.

The development of industrialization in Egypt during the twentieth century may be described in terms of three principal phases. The first phase started in the 1920's when the country began to pursue a more vigorous import substitution policy to offset declining exports and to protect emerging national enterprises. Egyptian capital and entrepreneurs, played a crucial role in financing and promoting industrial development as well as securing favorable protectionist legislation.

This phase was significant not only for the rapid growth of industrial output and productivity (particularly between 1938 and 1948), but also for the dominant role of the private sector. The Government's role during this time was limited to infrastructure development, mainly in agricultural irrigation systems and social services. Investment decisions were left to private industry which included both large and small enterprises.

The second phase of industrial development began following the revolution of 1952, although it did not take definite shape until the early 1960's. During its early years, the government encouraged both private Egyptian and foreign interests to play a more dynamic role in investment and industrial expansion.

This situation began to change following the Suez War of 1956 when British and French interests were nationalized. At about the same time, a Ministry of Industry was established to take a more active role in planning and management of the industrial sector. Spurred by a desire to speed industrialization, a Permanent Council for the Development of National Production was established to study and implement development programs. Its efforts gave the Government a stake in a number of important industrial projects and led to the First Industrial Plan (1957) and the First Five-Year Industrial Plan (1960/61 to 1964/65). Such steps reflected the Government's belief that the public sector had to play the leading role in capital formation and industrial development.

In 1960 and 1961, sweeping nationalizations took place which resulted in state control of most large private sector firms engaged in manufacturing, foreign trade, banking and insurance. The state also took over much of the wholesale and retail activity, particularly of basic commodities. Only small scale enterprises, most employing fewer than 50 workers, remained in private hands. It has been estimated that there were 4,047 manufacturing and mining establishments in 1961 and that the public sector accounted for about 95% of firms with more than 500 workers, 65-70% of those with 100-500 workers, 50% of those with 50-100 workers, but only 7% of establishments with fewer than 50 employees.

The nationalizations and government policy in the early 1960s discouraged growth in the number and size of private sector establishments. While the number of all manufacturing establishments increased substantially from 4,047 in 1961 to 5,259 in 1967, almost 1,000 of these new firms had fewer than 50 employees. The number of public enterprises with over 500 workers expanded substantially, while the 40-100 and 100-500 worker categories showed little expansion. This pattern indicates that opportunities for the private sector were limited to relatively small scale industries such as leather, furniture, wood, apparel and printing. Most of these are craft specializations closely tied to the artisanal sector.

The third, and current phase of industrial development strategy made its appearance in 1973 with the "October Paper" outlining the new "Open-Door" policy. This new strategy, designed to stimulate growth in the Egyptian economy, called for a greater private sector role, encouragement of foreign investment, and higher public sector efficiency. The private sector, both domestic and foreign, is now encouraged to contribute investment capital, technology, entreprenurial and management capability, and greater efficiency to the industrial sector. The government continues to provide a central planning role and maintain control over industries it considers critical. However, joint ventures between public enterprises and foreign investors are being promoted for specific projects. This new development strategy has had a significant impact on industrial growth as a whole, the private sector's share in production, and the economic role of small scale enterprises.

Statistics provided by the Ministry of Planning state that GDP in current prices grew at an average annual rate of 23.3% between 1974 and 1979. During that time, industrial production, which includes manufacturing and non-petroleum mining, increased at 14.7% per year. Between 1980 and 1982, Ministry of Planning projections show the overall GDP growth rate declining to 13.5% due to a levelling-off of production in petroleum, construction, and the distributive sector as a whole. However, industry is expected to continue a steady expansion at 14.2% per year despite the overall decline.

This fact is not surprising given GOE investments patterns. Between 1974 and 1979 industry received 24% to 30% of Egypt's total gross fixed investment while its contribution to GDP was limited to a range of 12% to 18%. As the "Open Door" induced expansion levels off, industry will therefore become a lead sector in Egypt's economic growth. This factor is particularly important for long term productive employment generation. Currently, industry accounts for 13% of total employment. Many productive jobs in other sectors depend indirectly on income generated by industry. Partly for this reason, the USAID FY 84 CDSS Employment Annex found manufacturing, industry's most important component, to be "the most likely candidate for sustaining a high level of economic growth and providing large absolute numbers of new jobs."

Statistics made available by the Ministry of Industry demonstrate that the private sector has played a key role in stimulating industrial growth since 1976. With different categories than those used in the

Ministry of Planning figures cited above, Ministry of Industry data shows industrial production averaging 20.3% annual growth from 1976 to 1980. The publicly controlled portion of industry grew at a less than average 18.9% while that of private sector grew at 23.5%. As a result, the private sector's share in industrial output grew from 29.9% in 1976 to 33.1% in 1980. The same pattern holds for exports. From 1977 to 1980, private sector generated industrial exports grew at 22.9% while public sector's grew at 19.2%. The private sector's share of manufacturing has been particularly important in foodstuffs, spinning and weaving, and engineering and electronics, with relative shares of 47.4%, 31.0% and 10.5% respectively. These figures demonstrate that the private sector is in a key position to support Egypt's goals of growth and employment generation. This is especially true given that manufacturing is expected to take the lead in attaining these goals and that the private sector has been the most dynamic element in manufacturing.

The ADL-ARICON study indicates that 78% of private sector manufacturing in 1980-81 was attributable to SSEs. Unfortunately, no trend data exists to show how production in SSEs has changed in recent years relative to the rest of the private sector. Existing data can only permit a tentative assessment.

The ADL survey of 200 SSEs shows that 8% were established after 1974 and 64% have undertaken some kind of expansion since then. All private sector expansion projects over LE 8,000 are approved by GOFI. GOFI statistics show that its approval of new projects grew from 332 (worth LE 12.5 million) in 1973 to 907 (worth LE 259.9 million) in 1980. Thus the average outlay for expansion grew from LE 37,650 to LE 286,549. A significant proportion of these projects is likely to have originated with SSEs. Indeed, it seems reasonable that some firms who were SSEs at the beginning of the Open Door period have since grown into medium and large firms. By comparison, we note that from 1973 to 1980, the Investment Authority approved LE 2.5 billion in new investments for Law 43 Companies. Although a GOFI total for these years is not available, the figures cited above show that it could not exceed $1.57 billion with a more likely figure being $.72 billion. Therefore, while it is fairly clear that SSEs have participated in Egypt's post 1974 growth, it also seems that much of the private sector's growth was concentrated in larger joint venture firms.

This conclusion is consistent with the fact that virtually all of the government's efforts at encouraging private investment has been directed at foreign and a few large domestic investors. These investors have focused their attention on larger industrial projects, and services such as banking and hotels, where profits were high and investment costs can be quickly recuperated. As the potential for further growth in these areas diminish so will the level of investment. Small scale industries will then be in a position to encourage the mobilization and investment of private capital. ADL's estimate of SSE growth trends suggest that this may already be taking place.

Without any new efforts to support SSEs, ADL expects their growth in numbers to remain at a slow to moderate rate of 2% per year and their growth in production to increase 15% annually over the next five years. By 1985-86, this would result in the creation of 760 new firms and 15,000 to 19,000 new jobs. Total SSE share of industrial output would increase slightly from the current 23% to 26%.

A major effort at removing the numerous constraints to SSE growth could substantially increase all of these projected figures and have a major impact on growth and employment in other economic sectors.

IV. Constraints to SSE Growth

The major and most salient constraints faced by SSEs in Egypt are those which result from GOE efforts over the past 20 years to structure the economy such that production of goods is determined by centrally planned directives rather than market forces. In practice, this policy required nationalization of most enterprises with over fifty employees. This resulted in a greatly diminished private industrial sector comprised of small firms, many of which remain unregistered, who operate in an informal ad-hoc way with little or no bookkeeping and without the benefit of efficient markets for purchasing inputs and selling outputs. The main behavioral goal of these firms was to maintain a stable livelihood for the owner and his family rather than maximize income or profits.

Since 1975, economic liberalization has encouraged the small entrepreneur to think of expansion, but there are a number of difficulties. The ADL survey reports a number of constraints to SEE growth including the following:

High Priority Constraints:

- The need for a a clear government policy framework regarding SSEs.
- Absence of a high level entity representing SSEs at policy making levels of government.
- Shortage of industrial sites and adequate infrastructure.
- Absence of technical assistance in project formulation.
- Lack of broad, long term, extension program for technical support.
- Insufficient technical information on production processes.
- Deficient management.
- Lack of general information and data on SSEs.

Lower Priority Constraints:

- Limited availability and dissemination of market information.
- Inadequately trained bank staff for handling SSE loans.
- Use of inadequate production technology.
- Lack of opportunities for sales to the GOE and public sector companies.
- Aversion to debt on the part of SSE owners.
- Preference for maintaining family control over means of production.

Each constraint is related to the following three generic problems:

1) The ability of SSEs to mobilize technological and managerial skills to develop new and more efficient methods of production is limited. With rapidly growing consumer demand, this means that many new market opportunities are lost to imports or remain unused.

2) Existing commercial markets in which inputs are purchased and goods are sold remain underdeveloped. This means that it is difficult to predict if and for what price a transaction may take place. Furthermore, many potential participants are excluded from making transactions due to the small size and lack of information about these markets. This is particularly the case with financial credit markets which remain inaccessible to most SSEs.

3) GOE policy has so far neglected SSEs. There is little official effort to alleviate the above two problems; as a result, potential investors and SSE owners themselves prefer to hold funds in less productive assets rather than invest in SSE expansion.

It will take time for these conditions to change. The GOE is in the process of establishing the essential base required for a successful long term SSE development effort. This base, in part, will be comprised of a healthy growing financial system which, over-time, can provide the liquidity and ease of transaction in commercial and credit markets required by SSEs.

TABLE II

Small Scale Industries Share of Manufacturing Output, 1980-81
(LE MILLION)

	GROSS VALUE OF OUTPUT 1980	TOTAL PRIVATE SECTOR SHARE (%)	10-50 EMPL. ESTABL. % OF PRIVATE	10-50 EMPL. ESTABL. % OF TOTAL	SSI[1] % OF PRIVATE	SSI[1] % OF TOTAL	SSI[1] VALUE OF OUTPUT
Textiles	1,400[2]	25%	49%	12%	80%	20%	280
Food Processing	2,000[3]	25%	60%	15%	70%	18%	360
Metals and Engineering	1,400[3]	18%	84%	15%	85%	15%	210
Chemicals	670[2]	35%	35%	12%	50%	18%	121
Leather	450[4]	94%	95%	89%	95%	90%	405
Building Materials	200[3]	20%	45%	9%	65%	13%	26
TOTAL	6,120	29%	66%	19%	78%	23%	1,412

[1]Based on definition of SSIs in footnote 2 in Table I. These percentages are ADL estimates.

[2]Ministry of Industry

[3]Ministry of Planning

[4]Ministry of Industry plus estimate of tanned leather output

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Source: Arthur D. Little estimates based on Ministry of Industry, Ministry of Planning and Federation of Egyptian Industries data. Private sector and SSI shares are derived from sub-sector profiles in Appendix A of Phase I report.

TABLE I

Number of Public, Private and Small-Scale Industrial Enterprises, 1980-81

	TOTAL[1]	PUBLIC SECTOR	PRIVATE SECTOR: TOTAL	PRIVATE SECTOR: 10-50 EMPL.	PRIVATE SECTOR: 50-200 EMPL.	PRIVATE SECTOR: 200+ EMPL	PRIVATE SECTOR: LAW 43[3]	PRIVATE SECTOR: SSIs	% OF PRIVATE: 10-50 EMPL	% OF PRIVATE: SSIs[2]
Textiles	1,642	42	1,600	1,350	215	35	24	1,550	84%	97%
Food Processing	850	50	800	650	125	25	20	760	81%	95%
Metals and Engineering	2,006	66	1,940	1,900	37	3	38	1,900	98%	98%
Chemicals	624	64	560	430	95	35	52	485	77%	87%
Leather	783	3	780	770	8	2	3	775	99%	99%
Building Materials	1,890	40	1,850	1,800	30	20	11	1,820	97%	98%
TOTAL	7,795	265	7,530	6,900	510	120	148	7,290	92%	96%

[1] Establishments with over 10 employees

[2] SSIs as defined on Page 1: establishments with 10-200 employees with less than LE 300,000 in fixed assets excluding land and building, and not organized under Law 43.

[3] In operation as of 31/12/1980. Law 43 companies are generally in the 50-200+ employee categories.

Sources: Arthur D. Little estimate based on data from Federation of Egyptian Industries and Ministry of Industry, and estimates of non-registered establishments.

SHORT-TERM CREDIT TRANSACTION IMPLEMENTATION EVENTS

The following sets forth the steps involved in a short-term credit transaction based on a circular which would govern the use of funds. Participating banks could make short-term loans to private sector sub-borrowers subject to the limitations and requirements contained in the circular.

Participating banks will have primary responsibility for the processing and approval of transactions and would bear all credit risk for each transaction. USAID would review the loan package and concur in the issuance of a Letter of Credit to complete the transaction.

The following sequence of activities would take place:

1. The participating bank receives an application from a private sector sub-borrower; the bank checks the application, and sub-borrower's credit worthiness.

2. The participating bank checks the eligibility of the client:

   (a) Does client have a tax card and commercial registration?

   (b) How is the client formed?

   (c) Has the client obtained previous loan(s)?

   (d) Does this loan exceed individual tranaction size limitation and/or total amount available to any one sub-borrower in a 12 month period?

   (e) Is the commodity eligible (Schedule B numbers and circular listing)?

   (f) Has the client obtained any previous loans using a different name(s)?

3. The participating bank records the taxation card number, importation license number, and commercial registration number. It also records the names of partners (if any) and names of principals participating in other firms and their firms names.

4. The participating bank prepares a Cover Letter (CL) with its recommendation and Transaction Form (TF) which verifies the above and certifies that the proposed transaction complies with the circular.

5. The participating bank forwards to USAID the CL, TF, and proforma invoices describing the goods/equipment to be imported. Normally, proforma invoices from three US suppliers would be required, unless the sub-borrower is the sole agent of the supplier.

USAID's role in the transaction would comprise review of the terms of the commercial sale, compliance with good commercial practice and terms of the grant agreement. (The bank's review may be less than satisfactory and not all of the required information may be provided in the package that USAID receives). In practice, therefore, the following would be closely checked by USAID:

1. Does the bank's CL refer to the appropriate transaction?

2. Prior to the use of funds by any one sub-borrower, USAID would determine if the transaction amount limits have been exceeded. If so, then the transaction would be referred to the Committee for a decision. Assuming a positive decision, and compliance with items 3, 4, and 5 below, USAID and the participating bank would proceed with processing of the transaction.

3. Eligibility of the sub-borrower according to the circular and compliance with terms.

4. Eligibility of the commodities.

5. Eligibility of the supplier and agent. Credit worthiness of the importer would not be checked by USAID. The participating bank would check this and assume all credit risks.

6. The transaction is logged and assigned a number for USAID record maintainance.

7. A package containing all relevant information of the transaction is prepared along with a form Concurrence Letter (CL) which is sent to the bank by USAID. This letter indicates to the bank that USAID has no objection to the bank opening a Letter of Credit on behalf of the US supplier selected by the sub-borrower.

Once the bank receives the Concurrence Letter it would enter into a short-term agreement with the sub-borrower within the framework of the terms and conditions established by the circular and according to the type of transaction, equipment to be imported, and credit worthiness of the sub-borrower. It would then issue a Letter of Credit (L/C) for the benefit of the US supplier chosen by the sub-borrower.

Once the L/C is issued the USAID/Controller receives a copy from the local bank. When the L/C is received, USAID is advised by the bank and the transaction is recorded on USAID's computer. The shipment of the commodity is recorded once USAID/FM/Controller has received the shipping documents from the supplier.

The supplier is required to comply with AID regulations by submitting an Application for Approval of Commodity Eligibility (AID Form 11) first to SER/COM and then, it and the Supplier Certificate and Agreement with AID (AID Form 282) to the US correspondent bank.

After disbursement under the L/C to the US supplier, and receipt of the equipment in Egypt, the sub-borrower would repay his loan to the participating bank according to a pre-set repayment schedule falling within the guidelines of the circular. The bank would transfer these payments to the CBE which would credit the Ministry of Finance's account.