TAPR IQC Egypt
Technical Assistance to Support Economic Policy Reform

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ECONOMIC GROWTH/SECTOR POLICY AND PRIVATIZATION DIVISION

ACTIVITY APPROVAL DOCUMENT

DEVELOPMENT SUPPORT PROGRAM II

(DSP II)

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LIST OF ACRONYMS

AAD	Activity Approval Document
APRP	Agricultural Policy Reform Program
ATUT	Agricultural Technology Utilization and Transfer
BOP	Balance of Payments
BOT	Build, Own, Transfer
BOOT	Build, Own, Operate, Transfer
CBE	Central Bank of Egypt
CIP	Commodity Import Program
CLDP	Commercial Law Development Program
CMD	Capital Market Development Program
CPI	Consumer Price Index
CSU	Competitiveness Support Unit
DEPRA	Development Economic Policy Reform Analysis
DSP	Development Support Program
DSPU	Development Support Program Unit
EEA	Egyptian Electric Authority
EISA	Egyptian Insurance Supervisory Authority
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFS	General Financial Statistics
GNP	Gross National Product
GOE	Government of Egypt
GST	General Sales Tax
IBRD	International Bank for Reconstruction and Development
IEE	Initial Environmental Examination
IL	Implementation Letter
ILD	Institute for Liberty and Democracy
IMF	International Monetary Fund
IR	Intermediate Results
IPR	Intellectual Property Rights
MIC	Ministry of International Cooperation
MOEA	Ministry of Environmental Affairs
MOEFT	Ministry of the Economy and Foreign Trade
MOF	Ministry of Finance
MOM	Ministry of Manpower
MOSDT	Ministry of Supply and Domestic Trade
MOU	Memorandum of Understanding
MP	Monitoring Plan
MPE	Ministry of Public Enterprises
MVEU	Monitoring, Verification, and Evaluation Unit
NIB	National Investment Bank
PCT	Patent Cooperation Treaty
PEO	Public Enterprises Office
PER	Partnership for Economic Reform

PERPP	Private Enterprise Reform and Privatization Program (EU)
PFC	Partnership for Competitiveness Project
RP	Results Package
ROSC	Report of Standards and Codes
SIPRE	Strengthening Intellectual Property Rights in Egypt
SME	Small and Medium Enterprise
SO	Strategic Objective
SOE	State Owned Enterprises
SPR	Sector Policy Reform
SPRU	Sector Policy Reform Unit
SPS	Sanitary and Phyto-sanitary
TA	Technical Assistance
TAPR	Technical Assistance to Support the Reform Activities of the Government of Egypt
TASER	Technical Assistance to Support Economic Reform
TBT	Technical Barriers to Trade
TFP	Total Factor Productivity
TRIPRS	Trade-Related Intellectual Property Rights
TSSPR	Technical Support for Sector Policy Reform Project
USAID	United States Agency for International Development
VMPK	Value of Marginal Productivity of Capital
VMPL	Value of Marginal Productivity of Labor
WB	World Bank
WTO	World Trade Organization

Executive Summary [To be done once the AAD receives initial approval.]

I. Overview

Like its predecessor, the second Egyptian Development Support Program (DSP II) is a policy reform program that will advance USAID's strategic objective of *Environment for Trade and Investment Strengthened* while supporting the Government of Egypt's (GOE) economic growth program. It reflects a priority need for most Egyptian families and is premised on the idea that a strengthened environment for trade and investment will foster more rapid economic growth. The DSP II objectives and areas, which are further defined below, are also closely integrated with current areas of USAID programmatic emphasis; e.g., privatization, financial markets, trade liberalization, World Trade Organization (WTO) Treaty compliance, fiscal policy, monetary policy and exchange rates, competition and regulation, and labor reform. In turn, DSP II reforms will contribute to broad-based increases in family income, directly reducing poverty and facilitating the gradual removal of market distortions and non-targeted consumer subsidies that hinder the market allocation of goods and services in a welfare-maximizing manner. This focus also complements the USAID's strategic goal of a *Globally Competitive Economy Benefiting Egyptians Equitably.*

DSP II is a policy reform program that involves the disbursement of cash to the GOE upon its achievement of agreed-upon policy reform measures. Through the design of DSP II, USAID will identify, in collaboration with the GOE, those policy reforms that are critical for economic growth and helping Egypt compete effectively in the global economy.

The areas identified in this paper, while covering a broad spectrum, concentrate on important constraints to investment and trade. The principle guiding the design of DSP II is the identification of policy problems in a comprehensive and dynamic manner. Because of limited staff resources, initiatives will be prioritized for immediate, medium-term, and long-term engagement. For example, WTO compliance issues are well defined and dialogue for reform can begin immediately. On the other hand, issues related to civil service reform are long-term. Policy issues relating to strengthening the banking sector may be addressed in the medium-term.

It is anticipated that the DSP II program will span **six years** with approximately **$200** million in annual obligations. Its funds may be directed to finance reforms in other sectors; e.g., health, environment, and education.

A. Statement of the Problem

1. Summary

The most significant social and economic problems in Egypt are unemployment and underemployment. Underemployment earnings are not sufficient to provide living incomes for most families. About one fifth of total households in Egypt are female headed, the majority of whom are poor. The alleviation of this poverty will follow the simultaneous expansion of the number of working hours and the enhanced productivity of employment that accompanies investment. The experiences of successful economies indicate that this will occur if the employment expansion takes place in a competitive, private sector led economy that promotes gender-sensitive human resource development and management policies. Private investment as a share of gross domestic product (GDP) must expand significantly, if Egypt is to achieve the 6-8 percent per year growth needed to productively employ in excess of 700,000 new labor force entrants annually while simultaneously reducing unemployment.

At the firm level, there are a number of significant problems that can be addressed through improved design and implementation of market-oriented policies. The GOE is reducing its direct role in the production of goods and services. This is the continuation of a program that has been under way for a number of years. Privatization of state owned companies has slowed within the past year, primarily because the domestic and international climates for investment are not as favorable as before. There is a critical need to define rules promoting competitive domestic economic activity. Barriers to market entry and other forms of non-competitive behavior are serious obstacles to domestic and foreign direct investment. These rules are generally referred to as commercial law and corporate governance. Safeguarding intellectual property rights will strengthen the incentives for domestic innovation and reduce the perceived risks for foreign direct investment.

Globalization offers perhaps the best opportunity for Egypt to attain rapid and sustainable growth. An export-oriented economy can take advantage of the country’s location and its abundant labor supply. Egypt has acceded to the WTO, which gives it both rights and obligations. Access to the domestic market of member states under a predictable set of rules is the most significant of those rights. Clearly then, compliance with those obligations and rights should be a priority. In terms of the actual export of goods and services, the ability to access intermediate goods and raw materials will significantly improve competitiveness. Thus, tariff and non-tariff barriers to trade are significant constraints to growth in Egypt.

As an economy becomes more globally integrated, the challenges to economic policy management increase. The global marketplace is highly demanding as the lessons of the Asian crisis and more recently those of Turkey show. Problems that might not have been recognized or whose resolution has been postponed deserve immediate action given their tendency to provoke crises with negative implications for investment. In this context, it is important to examine the issues that have caused the current economic slowdown or liquidity crisis in Egypt. Problems include the budget deficit and reduced liquidity in the banking system. Excessive budget deficits in fiscal years 99-01, coupled with inconsistently applied and ineffective administrative controls, have reduced aggregate demand and crowded the private sector out of financial markets. There is a compelling need to streamline current fiscal practices.

If Egypt is to maintain price stability while capturing the benefits of trade, it will need to proactively manage the exchange rate. At this stage of the development of its policy agenda, the DSP has no specific recommendation as to relative merits of a fixed or flexible exchange rate. In general, the optimal management of the exchange rate depends on policymakers' economic objectives, the sources of shocks to the economy, and the structural characteristics of that economy. A general, but recurring theme in the economic literature is that neither of the extremes of permanently fixed or completely flexible exchange rates is optimal in seeking macroeconomic stability. Instead, some intermediate degree of flexibility is more likely to succeed in stabilizing the economy in response to random shocks. In fact, such managed or ‘flexibly fixed’ exchange rates constitute the most common arrangement in developing countries. The challenge for the GOE and DSP is to determine the degree of flexibility that should be adapted to the specific circumstances facing Egypt.

The current stabilization policy places acute pressure on the exchange rate and, in an effort to maintain prevailing rates, the foreign currency reserves has been reduced. The policy tradeoffs should be considered; the desire on one hand to maintain the purchasing power represented by a strong currency versus the desire for increased exports and jobs on the other.

Although devaluation is seen as being politically sensitive, current policy is unlikely to significantly either increase domestic production or reduce excess aggregate demand unless domestic output prices of tradable commodities are allowed to rise relative to non-tradables and domestic competitiveness is enhanced through greater ease of entry of new firms. This serves to reinforce the need for policy consistency; i.e., responsive fiscal and exchange rate policies must be reinforced with sound monetary policy. In addition, the financial sector must be strengthened in its role as the source of long and short-term credit. A healthy credit delivery system; i.e., loans are made and repaid, is necessary for sustainable economic growth.

Finally, credible data on the state of the economy will promote faster growth. It will aid the investment decision-making process. It will reduce uncertainty; hence, the risk and, by extension, the cost of credit. It will enhance the efficient allocation of resources, as investors will be able to quickly identify promising new areas for investment while avoiding the less productive ones.

2. Macroeconomic Considerations (to be updated/revised)

Table 1 shows that real GDP growth has been both relatively high and increasing over the last four years up through June 2000. During the same period, officially reported unemployment and inflation have been relatively low and declining. The data and trends present an internally consistent and quite positive picture of macroeconomic developments.

Table 1: GDP Accounts, Unemployment, and Inflation

	96/97	97/98	98/99	99/00
1. Real GDP/capita (LE)	2,884	2,991	3,101	3,232
2. Real Growth Rate (%)	5.3	5.7	6.1	6.5
3. Unemployment Rate (%)	8.8	8.3	7.9	7.4
4. Annual Inflation Rate (%)	6.2	3.8	3.8	2.8

Source: Monthly Economic Digest, MOEFT: Feb. 2001.

Few observers believe the data in Table 1, but it is difficult to find an alternative consistent scenario. The press and many observers of the economy believe that 1999/00 was a ‘slowdown’ year with a real GDP growth rate of less than 6.5 percent. Many also believe that the 2.8 percent inflation rate is understated. These observers make an important distinction in that the slower GDP growth took place in the 'formal' economy while at the same time national account estimates have been expanded to cover more of the 'informal' economy without previous years being correspondingly adjusted upward.

Table 2 shows that there was a large recorded increase in GOE capital expenditures that affected the overall deficit in 1998/99 and 1999/00, but which may reflect sizable 'off-budget' expenditures that began earlier. The financing of the large deficit increase was mainly through increased borrowing from the National Investment Bank (NIB), which was a relatively indirect and low-interest/low cost way of financing the deficit.

Table 2: National Budget and Domestic Debt (LE Billion)

	96/97	97/98	98/99	99/00
1. Total Revenues	64.5	68.0	73.3	79.4
2. Total Expenditures	66.8	70.8	86.0	91.7
2a. Current Expenditures	53.0	54.7	60.2	67.2
2b. Capital Expenditures	14.0	15.6	25.3	24.1
3. Overall Deficit	2.3	2.8	12.7	12.3
4. GOE Borrowing from NIB	35.0	52.0	70.0	87.0

Source: Monthly Economic Digest, MOEFT: Feb. 2001

This increased deficit is a significantly complicating matter for macroeconomic stability. The GOE seems to have relied on a series of non-market, administrative interventions to suppress the inflationary impact of the deficit increase. These interventions apparently included: informal pressure to encourage price restraints; imposing additional restraints on private sector imports such as including raising local currency coverage requirements to 100 percent; using GOE dominance of the banking sector (not interest rates) to impose restrictions on credit to the private sector; and building up GOE accounts payable to the private sector (arrears). The result of these actions is that accommodation to the deficit increase was forced onto formal sector private businesses and to some extent consumers.

Concerning issues of trade, the exchange rate, and foreign debt, Table 3 shows a huge disparity between Egypt's high levels of imports and relatively low levels of exports of visible goods. This has led to large deficits in the balance of trade. However, this deficit is nearly offset by large currency inflows from surpluses of service exports and from transfers from abroad. The result is that Egypt has relatively low BOP current account deficits that would be the envy of most other countries with economies the size of Egypt's. At its highest (1997/98), the BOP current account deficit was 2.4 percent of GDP expenditures. In all other recent years, it has been a much lower percentage.

Table 3: BOP Accounts, External Debt, and the Exchange Rate

	96/97	97/98	98/99	99/00
1. Imports ($ B)	15.6	16.9	17.0	17.9
2. Exports ($ B)	5.3	5.1	4.4	6.4
3. Trade Balance ($ B)	-10.3	-11.8	-12.6	-11.5
4. Net Service Exports ($ B)	6.2	4.7	6.0	6.4
5. Net Transfers ($ B)	4.0	4.6	4.9	4.7
6. Net BOP ($ B)	0.1	-2.5	-1.7	-1.2
7. External Debt ($ B)	28.8	28.1	28.2	27.8
8. LE/$ Exchange Rate	3.40	3.41	3.42	3.65

Source: Monthly Economic Digest, MOEFT: Feb. 2001.

Substantial non-export foreign exchange receipts, and correspondingly low BOP current account deficits, has allowed Egypt to use some capital inflows to retire some external debt during a period when several major developing countries have been increasing and/or rescheduling it. This is a marked improvement over the late 1980s, when mounting external debt servicing problems resulted in the GOE undertaking a three-stage rescheduling program beginning in July 1991. Since then, the GOE not only slightly reduced external debt, but also increased international currency reserves from about US$12.0 billion at the end of 1991 to a high of slightly over US$20.0 billion in July 1997. Thereafter, international reserves fell relatively quickly to US$14 billion in June 2000 as the GOE defended a LE3.40 to US$1.00 exchange rate that appears to be overvalued.

The GOE's defense of an overvalued exchange rate through administrative interventions and sales of US$6.0 billion of foreign exchange is not consistent with incentive-based policy initiatives. Strengthened management of the foreign exchange rate will require the use of more sophisticated policy instruments. It will also require that there be increased price flexibility and fewer obstacles to competitiveness in the domestic economy. In any event, it is not clear that a drastic, once-and-for-all devaluation will change much in the real formal economy given GOE willingness to influence prices and costs. To be effective overtime, devaluation must raise output prices relative to input costs in order to increase the profitability of formal sector production/investment. Price interventions to suppress inflation are not likely to be compatible with the higher output prices needed to increase the profits of private businesses and make the devaluation effective.

In this context, recent discussions regarding initiating large Euro-Bond debt issues are a matter of concern. While public sector foreign borrowing may be appropriate in situations involving a significant volume of highly profitable domestic investments and an acute shortage of domestic savings, (As reflected by very high, market determined domestic interest rates.), until markets are liberalized, returns to investments will be low and there will likely be excess, or involuntary domestic savings.

On initial analysis, the enormous excess of imports over exports would appear to demand the adoption of 'export promotion' policies/programs. However, the relatively small BOP current account deficits dictate caution. The success of such export promotion programs will, necessarily, rest on expanded production/investment of the private formal sector. This is precisely the sector, rather than household consumers, that has been forced to reduce its activities in order to accommodate the deficit increase.

3. Microeconomic Considerations

Microeconomics mainly concerns incentives in, and structures of inputs (labor and capital) and output markets. The actual incentives are the incomes and profits earned by the private owners of these inputs and outputs. Differences in income and profit earnings are determined by differences in prices and costs, which are in turn determined by free markets that represent consumers' economic preferences. Thus, in a free enterprise economy, free markets determine prices that in turn affect profits, and through them, production and private investment. Different economic structures affect the distribution pattern of incentives differently. In Egypt, there are essentially two sets of these markets, one set for the 'formal' economy and one set for the 'informal' economy. The structures and incentive (prices and costs) patterns in these two economies are very different.

An examination of the current microeconomic status of the economy suggests that there are four areas requiring immediate attention:

- One concerns the importance of allowing complete **ease of entry** in the formal economy in order to stimulate **price**

competition. Greater competition will increase productive efficiency and through that lead to higher growth in employment, income, GDP, and exports.

- A second is that a primary ingredient in easing private investor entry or participation in the formal economy is faster, more complete and credible 'privatization' that reduces GOE involvement in production.
- A third concerns questions of financial viability of some large financial institutions. This may lead to a need for a balance sheet rescue operation, but it should be done in such a way that moves the banking sector toward 'arms-length' relationships between borrowers and lenders, and is consistent with the development of a host of new, private competing **for profit** providers of financial services.
- Finally, there is the issue of how to expand trade (domestic and foreign) in welfare increasing ways. A crucial step is to accept all of the WTO agreements. Beyond this, it is best to recognize that the best way to promote more trade/exports is to reduce intervention and monopoly behavior in the domestic economy, so that competition can flourish and productive efficiency and private investment can grow more rapidly.

The factors that have led to the existence of the informal economy in Egypt are particularly relevant to issues affecting the competitiveness of the overall economy. The informal economy in Egypt is very large. At about 80-100 percent of the formal economy, it may be the largest in the world. It exists mainly because entry into the formal economy is so difficult and/or costly, and it consists of activities that are not legally constituted or licensed. They are unregulated and do not pay taxes. A most important characteristic of the informal economy, quite unlike that of the formal economy, is 'ease of entry', being open to participation by all. The informal economy has little or no legal standing and no direct access to formal sector credit or imports. Because of the way the CBE controls credit extended to buy foreign exchange and imports, informal firms cannot import directly, but must instead get their imports from formal firms.

The informal economy in Egypt can play a significant role in liberalization of the formal economy and of trade. It is very large and competitive. At present, the formal economy purchases large amounts of high value-added imports from abroad. The imports are of a 'finished' nature, by virtue of their content of service inputs from their countries of origin. Given this, Egypt could dramatically increase welfare gains, and improve their distribution by liberalizing interactions between its formal and informal economies at the same time that it liberalizes trade between its formal and the international economies.

There is considerable price flexibility due to vigorous competition in the informal economy since operators there are price takers. Increases/decreases in output demand (e.g., income-induced shifts in demand) stimulate rapid entry and exit of firms rather than changes in output prices. This too contributes to the competitive nature of the informal economy. Conceptually one can think of the supply curves in the informal economy as being extremely ‘elastic’. Because of this, profit margins are small and there is much less economic rent in the informal economy.

Much of Egypt’s formal economy is characterized by a lack of both financial and technical efficiency. Major reasons are the difficulties of freedom of entry and exit and little price competition in formal output or factor markets. Output prices are often adjusted to costs rather than the other way around. The formal economy has been dominated by public enterprises, or by a relatively few influential, non-competing private businesses. In essence, much of the formal economy has primarily public sector investment or private investment that is negotiated with the GOE.

A significant share of formal sector investment has been made by the public sector. This has mainly been in infrastructure or in large, vertically integrated public enterprise investments. Many operate in quasi monopoly/oligopoly settings. They are large but nearly always have very low productivity and low or negative real rates of return. Most do not take advantage of economies of scale, instead operating at low levels of capacity. They are overstaffed and labor productivity is low. By international standards, the resource use or technical efficiency of most of these public sector firms is low.

For the most part, enterprises financed by either public or private negotiated investment operate in small domestic markets where demand grows slowly. Most operate at less than full capacity and at less than maximum profitability. In this setting, the entry of new competing enterprises is seen as duplicative and wasteful rather than as desirable in terms of encouraging price competition and technical innovation. Cost-plus pricing rather than cost minimization is the essence of management. High levels of vertical integration mean that economies of specialization are rare.

Many of these new investments by existing businesses inhibit the entry of new investors and the enlargement of the number of investors and, therefore, increased competition. Therefore, at present a small number of business managers currently undertake most of the large private investments in Egypt. This monopoly/oligopoly structure of much of the formal economy means that many formal economy supply curves are inelastic. Without informal GOE pressures, increases in aggregate demand would mainly stimulate price rather than output increases.

The past dominance of publicly owned investments is a major reason why much of the formal economy has been monopolized and is noncompetitive. Oppositely, the lack of competition is why many formal sector enterprises, public or private are inefficient. It is for that reason that the GOE has been following a program of reducing its role in production through privatization of SOEs.

B. Activity Summary

DSP II is similar to DSP I as it provides for the evaluation of sponsored reforms, GOE ownership, and the potential disbursement of up to $200 million per year based on the achievement of agreed upon benchmarks. The DSP team, in collaboration with the GOE, will select appropriate reform initiatives that the GOE is currently pursuing. These initiatives, which are defined above, are also closely integrated with current areas of USAID programmatic emphasis; e.g., privatization, financial markets, trade, WTO compliance, fiscal policy, monetary policy and exchange rate, and labor and civil service reform. Because the pace of GOE implementation may vary across the reforms, as documented in the attached matrix, a maximum of $400 million will be disbursed over a two-year period. This allows for the possibility that the pace of reform may not meet expectations in some areas. As DSP II is predicated on collaborative dialogue, USAID and its GOE counterparts will agree on a broad array of policy reforms and then arrive at specific and mutually agreed upon policy measures. A detailed background, means of verifications, terms of disbursements will be included in the DSP II monitoring plan for each of the two years in a disbursement period.

The rationale for this approach is to support the GOE with a range of ongoing and prospective reforms meriting USAID financial support over a two-year period. Since DSP II's span is six years, the following DSP II MOUs will cover an additional two years each, for a total of three MOUs. This approach is flexible in that the GOE has a choice in the number of reforms and in the order of implementation for each MOU. It will also provide the GOE with a politically sensitive mechanism to maintain the momentum of the liberalization program and sustain the credibility of reform. However, the GOE has to achieve a minimum set of policy measures in order to receive significant disbursements consistent with a credible reform agenda.

Similar to DSP I, the DSP II policy objectives will take additional steps towards the implementation of the GOE policy reform agenda. New approaches, new policy areas and/or advanced level of policy reform benchmarks will be used in the implementation of DSP II:

a) The GOE shall take additional steps to open the economy to international trade via lowering tariffs and the elimination or reduction of non-tariff barriers. DSP II will increase Egypt's compliance with its rights and obligations under the WTO Treaty. It will reform customs and improve trade services.
b) The GOE shall take additional steps to reduce its role in the production of goods and services; i.e., privatization of public enterprises, joint venture firms, public sector banks and insurance companies, and power and telecommunications. DSP II will also use new privatization approaches to accelerate the pace of this reform. Promising new approaches include batch privatization, asset sales, and auctions.
c) The GOE shall take additional steps to manage the fiscal deficit so as not to displace resources that would otherwise be available to the private sector. Under DSP II, the GOE will improve fiscal policy (expenditure/budget controls) and public debt management.
d) The GOE shall take additional steps to reform the financial sector to ensure that national savings can be effectively and safely channeled to the private sector through improvements in regulation of banks, the financial markets (capital markets and non-banking financial institutions), and the insurance industry.
e) The GOE shall take additional steps to buttress stabilization efforts and enhance private investment by

establishing/strengthening competitive primary and secondary markets for domestic debt instruments.

f) The GOE shall take additional steps to reduce the cost of legal impediments to employment. DSP II will also address measures to improve the civil service reform in some sectors such as the MOEFT's Foreign Trade Sector.

Furthermore, the DSP II objectives will cover ***new policy initiatives***, such as:

a) The GOE shall introduce competition regulations and protect intellectual property rights.
b) The GOE shall develop foreign exchange and monetary policies that will facilitate trade and investment.
c) The GOE shall improve the business environment and the commercial law enforcement and corporate governance to promote investment.
d) The GOE shall promote economic information, data transparency, and dissemination and improve gender-sensitive, macro- and microeconomic indicators for improved decision making process.

It is envisaged that several of these activities will take place in a sequential manner over the six-year life of DSP II, while the accomplishment of others will be spread out over the six year life of the program, i.e., trade and data management. Because of limited staff resources, areas for engagement will be prioritized for immediate, medium and long-term engagement. Thus, for example, policy areas such as trade, competition, and privatization, these are well defined and dialogue for reform can begin immediately. On the other hand, issues related to civil service reforms are long-term. For purposes of presentation, they are divided into three time series as follows:

- Immediate (Years one to two.)
  - Trade Liberalization, including Customs Regulations and Procedures.
  - Competition including Intellectual Property Rights, Information Technology, and Labor law, possibly including issues of Child Labor.
  - Privatization, including infrastructure (telecommunications), and ease of entry for new businesses.

- Medium Term (Years three to four.)
  - Fiscal Policy Reform.

- Financial Policy, Banking and Non-Banking Financial Institutions, and Capital Market Policy.
- Monetary Policy, including exchange rate policy.

• Long Term (Years five and six.)
  - Rule of Law, Commercial Law, and Corporate Governance.
  - Laying the Foundations for Civil Service Reform.

• Crosscutting Objective (All six years.)
  - Data Standardization, Transparency, and Dissemination.

C. Previous USAID Involvement with Sector Policy Reforms

Before initiating the DSP, USAID successfully undertook three Sector Policy Reform (SPR) programs with disbursements totaling US$1.2 billion during the 1992-1999 period. DSP I has potential disbursement of $400 million during 1999-2001. The SPR program included financial, fiscal, trade, business, and environment reforms. The approach and reforms in DSP II are based on the experiences and lessons learned from SPR I, II, and III and DSP I. Accordingly, DSP II's agenda will support the ongoing GOE policy reform programs while focusing on the more important issues. All its initiatives are based on a collaborative policy dialogue.

More specifically, the achievements of the SPR program included:

- Reductions in import tariffs resulting in greater competition, higher quality products, lower prices, and lower effective rates of protection across various sectors of the economy. One-stop shops for export clearance now combine all administrative personnel into one location at the major ports. A tax rebate system has also been established for some commodities whereby exporters get prompt refunds for the customs duties and sales taxes paid on imported primary products. Maritime services were opened to the private sector to promote competitiveness, lower costs, and increase productivity.

- Foreign and joint venture banks have been allowed to operate through local currency transactions, open new branches, and cut fees. The program has helped privatize joint venture banks, improve bank supervision, and permit majority foreign ownership of joint ventures, private banks, and insurance companies. Capital markets have been revitalized with primary bond issues, the sale of shares to the public, the introduction of new financial instruments, improved regulation, greater availability of information, and the establishment of new Egyptian accounting and auditing practices based on international standards. Also, prudential standards in the securities industry have been strengthened, and initial reforms were introduced to the social insurance system.

- As of March 1999, 105 out of 314 Law 203 firms have been sold, liquidated, or otherwise privatized. The program has also helped the privatization of joint venture banks and insurance companies.

- The GOE has strengthened regulations regarding air emissions from both mobile and stationary sources, started the implementation of a Lead Abatement Plan to address serious lead pollution and adopted a strategy for sustainable tourism development in the Red Sea area.

DSP I focused on six policy areas including: 1) a reduced role of government in production; 2) labor market liberalization; 3) liberalization of international and domestic trade; 4) maintaining economic stabilization; 5) improving financial inter-mediation and savings; and, 6) creating capital or debt markets. The accomplishments under each of them are as follows:

1. Reduced role of the Government in the production of goods and services.

- Between 1991 and February 2001, the government has privatized, liquidated, or leased to private operators 180 of the original 314 state owned enterprises. Of these, 24 transactions were during the period of DSP I and met the criteria for disbursement, and four more are awaiting final verification documentation.
- Three BOOT/BOT contracts were entered into that met the criteria for DSP I disbursement.
- The valuation of the 4 public sector insurance companies was completed as a key step toward their privatization.
- The proceeds of privatization have been used for the purposes agreed to.

2. Labor market liberalization.

   - After much discussion, the Peoples Assembly is giving a final review to the 1994 labor law. President Mubarak has strongly recommended that it be enacted and prospects are good that this will take place before the end of DSP I in September 2001. The Cabinet has approved the new labor law in May 2001.

3. Liberalization of international and domestic trade.

   - The four IPR related benchmarks (Patent Cooperation Treaty, Trademark Law, Industrial Design Law, and Data Exclusivity) are now either included in the comprehensive new IPR Law being discussed in the Peoples Assembly, or are dependent upon the law being passed (the PCT treaty). The draft law incorporates many of the IPR requirements of Egypt's WTO membership, but whether the law will be fully compliant with WTO agreements cannot be determined until after enactment. Enactment is expected to occur before the end of DSP I.
   - The Government amended the Customs Law to make it compliant with WTO requirements for customs valuation. The necessary implementing regulations and revised customs operating procedures needed to make it effective have been drafted and are expected to be issued and in force prior to the end of DSP I.
   - The Government has put in place significantly simplified import sampling procedures that remove a serious obstacle to easy importation.

4. Maintaining economic stabilization.

   - In May 2000 it was realized that substantial off budget expenses were incurred beginning in FY 1999 in support of public investment projects. Although the Government took steps to avoid this problem in the future, the current level of deficits exceeds what was anticipated during the DSP I program. Working with the Government to strengthen public expenditure management will be a focus of DSP II.

5. Improving financial inter-mediation and savings.

   - As agreed to under DSP I, the Government has drafted and approved a plan for reforming the insurance industry. The first element of this plan is expected to have been implemented before the end of DSP I.

- The percentage of insurance that must mandatorily be placed with Egypt Re is being reduced as agreed to in DSP I.
- The Government enacted a Stock Market Depository Law that effectively covers legal and operational issues related to securities, settlement, depository, and registry activities.
- The Cabinet approved a new Mortgage Law that would provide for the basic regulatory structure for a mortgage market and would create a primary and secondary mortgage market. It is expected that the law will be enacted before the end of DSP I.
- The Minister of Economy and Foreign Trade issued a decree that eliminated government restrictions on broker fees. This will facilitate the Egyptian capital market setting fees in a competitive manner and will contribute to a broader and more effective market.
- The Minister of Economy and Foreign Trade issued a decree that established a code of good practices for bond rating agencies. The decree will enhance the transparency and ensure the quality of ratings.

6. Creating capital or debt markets.

- The Minister of Finance has issued a decree that allows secondary trading in Government debt. The procedures and regulations for the selection and operation of the primary dealers are under preparation. It should be possible to complete this work before the end of DSP I.
- Much of the work needed to establish a computerized book entry registry for government debt has been completed. The procurement of needed hardware and software for the system is underway. It should be possible to have the system in place before the end of DSP I.
- The Ministry of Finance established and staffed a debt management unit in the Ministry. This is an essential component of a well-managed public debt market.

D. Link to Mission Strategic Plan and Strategic Objective Results Framework

The Mission’s Strategic Plan, “Advancing the Partnership”, cites the strategic objective, SO-16, *Environment for Trade and Investment Strengthened*. Under this SO USAID has drafted three specific Intermediate Results (IRs), which are directly or indirectly supported by DSP:

a) IR 16.1 Policy Framework for Trade and Investment Improved;
b) IR 16.2 Private Sector Competitiveness Increased; and
c) IR 16.3 Opportunities for Business Growth Enhanced

Accomplishment of the DSP II initiatives and objectives will contribute to the achievement of the SO 16 objective of *Environment for Trade and Investment Strengthened*. Attainment of the corresponding IR's will transform the role of private sector enabling it to become the engine of development: to expand both productive employment and labor compensation, open the economy to international trade, and eliminate barriers to investment.

The better defined the targeted reforms and rapid their implementation, the more pronounced would be the growth in private sector investment and productive employment. Privatization of state-owned enterprises (SOEs) reduces inefficient production of goods and services, increases the efficient utilization of those assets and removes GOE dominance in the sub-sector; thus, stimulating competing investment in new productive assets (IR 16.1). The reduction of legal impediments to employment will reduce the cost of formal sector employment by decreasing labor redundancy and increasing per unit output of labor; thus, increasing private sector competitiveness (IR 16.2). Opening the economy to international competition through further liberalization of trade and capital movements (IR 16.1) will initiate and speed the practice of outsourcing or subcontracting between large enterprises that will enhance opportunities for business growth (IR 16.3) in what is now mainly informal sector activity in Egypt. This will, in part, lead to rapid investment in small and micro enterprises (IR 16.3).

Other activities proposed under DSP II will support a combination of the above IRs. For example, rationalizing the management of fiscal programs will ensure that funds are available to the private sector; thereby, promoting private investment. Undertaking financial sector reforms will promote national savings that can be effectively and safely channeled to private enterprise. This will require addressing the potential risk factor incumbent upon private enterprise. Establishing and strengthening primary and secondary markets for domestic borrowing instruments will help the Central Bank of Egypt (CBE) manage interest rates and inflation and while initiating domestic debt (asset) markets crucial to the exchange of ownership/management of productive assets.

E. Total Approved Funding Level and Life of Activity Period

It is anticipated that the DSP II program will span six years with annual obligation of approximately $200 million commencing in FY 2001 and continuing for the next five fiscal years. Three memoranda of understanding (MOUs) will be signed, one every two years. The MOUs will be amended, as needed, through revisions to the DSP II monitoring plans. These monitoring plans, including terms of disbursements and means of verification, will be developed and agreed to by both parties. Disbursements are expected to take place within two years after each obligation; i.e., the final disbursement is expected to take place in FY 2007 or no later than FY 2008. There will be up to two disbursements per year. DSP II funds may be directed to finance policy reforms in other sectors (health, environment, and education). More details will be provided in the Activity Approval Document (AAD) of DSP II.

As has been the case with DSP I, DSP II will benefit from technical assistance provided by existing USAID activities such as Partnership for Economic Reform (PER), Agricultural Technology Utilization and Transfer (ATUT), Capital Market Development (CMD), and Partnership for Competitiveness. In FY 2000, a design for the Technical Assistance to Support Economic Reform (TASER) was completed to support DSP I and future DSPs. More detailed information on these technical assistance requirements are provided in the design document for the DSP and TASER. It is likely that new technical assistance activities will be developed to support reforms in areas not convened by the current portfolio.

II. Activity Description

A. Anticipated Results

1. General

Overcoming poverty through full participation in the economy is basically an issue of productive employment. Addressing this issue in its broadest context will therefore benefit most, if not all, Egyptians to some degree. As was described above in the Problem Statement, while official unemployment figures for Egypt are relatively low, the productivity of full-time employment, especially in the formal sector is among the lowest in the world. Additionally, given the country's population, and especially its population pyramid, its economy must absorb a yearly increase in its labor force of an estimated 700,000 workers. The DSP program has been carefully designed to address this problem through various means including its three broad Intermediate Results: an improved policy framework for trade and investment; increases in private sector competitiveness; and, enhanced opportunities for business growth.

This package of higher-level results is itself based on the achievement of increases in the overall pace of economic growth, an emphasis on labor intensive rather than capital-intensive industries, and a stimulation of long-term capital markets to attract and retain both foreign and domestic capital investments. As such, privatization of government held enterprises, flexibility in labor markets, a relaxing of government restrictions and controls, increased foreign trade in both imports and exports, the creation and strengthening of a legal environment supportive of investment and competition, and the availability of reliable and transparent economic data for use in decision making are all anticipated results that will arise from the implementation of DSP II.

2. Customers and Partners

The USAID technical office responsible for the development and management of TASER is the Economic Growth Office, Sector Policy Division under the Strategic Objective 16 (SO-16), "Environment for Trade and Investment Strengthened." The GOE's prime implementing entity is the Ministry of International Cooperation (MIC).

Other GOE implementing agencies will include:

- Ministry of Economy and Foreign Trade (MOEFT);
- Ministry of Environmental Affairs (MOEA);
- Ministry of Finance (MOF);
- Ministry of Manpower (MOM);
- Ministry of Planning (MOP)
- Ministry of Public Enterprise (MPE);
- Ministry of Supply and Domestic Trade (MOSDT);
- Capital Market Authority (CMA);
- Central Bank of Egypt (CBE);
- Customs Authority;
- Egyptian Electricity Authority (EEA);

- Ministry of Higher Education and Scientific Research (MHESR);
- Egyptian Insurance Supervisory Authority (EISA); and,
- Public Enterprise Office (PEO).

The ultimate customers, or beneficiaries, of DSP are the consumers, producers, and citizens of Egypt, who will benefit from the creation of new and productive employement opportunites. Women, while not a separate target of DSP II activities, will fully benefit from the achievements of DSP. Comprising approximately 20 percent of the heads of households, as well as representing a disproportionate number of the poor in the country, women will benefit to a relatively greater extent than will men from increases in productive employment.

B. Activity Components

In order to assist in the achievement of SO-16 and its intermediate results, DSP II will: 1) Improve trade policy; 2) Enhance competition and the regulations that govern it; 3) Improve the efficiency of resource allocation; 4) Improve fiscal policy and public debt management; 5) Enhance and streamline the financial sector and its regulations; 6) Liberalize the foreign exchange rate and monetary policies; 7) Enhance the business environment and investment opportunities; 8) Lay the foundation for the reform of the civil service; and, 9) Promote information, data transparency, and dissemination. These activities are described in detail below. Additionally, it is the intent of the GOE and the Mission that a majority of the nine areas described below will be phased over the six-year life of DSP II. This phasing will most likely take the form of three two-year terms expressed as Immediate (Years 1 and 2), Medium Term (Years 3 and 4), and Long Term (Years 5 and 6). Nevertheless, the GOE, with Mission concurrence, may choose to adopt/implement some, or any, of the reforms sooner than what is expressed below as long as they fall within the $200 million per year funding obligation ceiling. On the other hand, the adoption/implementation of some of the reforms might well be spread over more than the two-year period set out below, i.e., Export Orientation and External Trade, for example. The details describing the policy objectives will be described in the Monitoring Plan annexed to this document, an example of which is provided below for the first policy objective.

IMMEDIATE (Years 1 and 2)

1. Improving Trade Policy

Policy Objective: The GOE shall take further steps to open the economy to international trade via compliance with the WTO, lowering tariff and non-tariff barriers, reforming customs reforms, and trade services.

Overview: The world trade system is evolving rapidly into a global market with low trade barriers and harmonized systems of standards and quality control. In Egypt there are currently serious obstacles to the globalization strategy that threaten not only export growth and investment, but also new productive jobs and new investment in currently artificially protected industries. One important component of Egypt’s strategy for increasing the role of trade in the economy has been the dismantling of tariff and non-tariff barriers because they constrain the price, quantity and/or quality of imported commodities and hence can negatively affect exports through increases in the cost of production. The impacts of trade barriers on the allocation of resources and market prices reduce the efficiency in overall national production and lower the potential for economic growth.

2. Enhancing Competition and Regulations

Policy Objective: The GOE shall take further steps to enhance competition, enforce intellectual property rights (IPR), increase access to information technology, and labor laws including child labor.

3. Improving the Efficiency of Resource Allocation

Policy Objective: The GOE shall take further steps to reduce its role in the production of goods and services by implementing the GOE Law 203 privatization plan, selling stakes in firms, and using BOOT or BOT facilities to provide infrastructure.

MEDIUM-TERM (Years Three and Four)

4. Improving Fiscal Policies and Debt Management

Policy Objective: The GOE shall take further steps to streamline the fiscal deficit to promote national savings, and establish public debt management system.

5. Enhancing the Financial Sector and its Regulations

Policy Objective: The GOE shall take further steps to enhance banking and non-banking financial institutions (NBFIs), capital market policy and regulations.

6. Maintain the Foreign Exchange Rate and Monetary Policies

Policy Objective: The GOE shall develop an exchange rate and monetary policy that will facilitate exports.

LONG-TERM (Years Five and Six)

7. Enhancing Business Environment and Investment Opportunities

Policy Objective: The GOE shall improve the business environment and the enforcement of commercial law to promote investment.

8. Laying the Foundation for Reforming the Civil Service

Policy Objective: The GOE shall initiate civil service reforms.

CROSS CUTTING OBJECTIVE (Years One through Six)

9. Promoting Information and Data Transparency, and its Dissemination

Policy Objective: The GOE shall improve national income and output accounts, and disseminate macro and microeconomic indicators.

C. Critical Assumptions

In order that the DSP program in general, and DSP II specifically, are successfully implemented, several Critical Assumptions have been made during its design. In summary form, they are as follows:

- That the GOE political process has the political will and commitment to carry out the proposed reforms, and the implementation of the laws, policies, and procedures contained in the DSP program.

The GOE is committed to the goals of the DSP II, which are consistent with and supportive of those goals contained in its own economic reform program. DSP II and the GOE's reform programs converge with a commitment to liberalized trade and WTO compliance, enhanced competition and the role of the private sector, accelerated privatization, improved fiscal policy, streamlined financial markets, improved monetary and exchange rate policies, strengthened business environment, and a reformed civil service system. By entering into the DSP II agreement, the GOE is committing itself to a second generation of reforms that have been planned in coordination with the private sector indicative of its greater role in the policy dialogue.

From its inception, the DSP Team has endeavored to foster GOE ownership of the program. Before the initiation of the DSP II design, USAID entered into extensive negotiations with senior GOE officials, including representatives of several ministries and agencies (MIC, MOEFT, MOF, CBE), and representatives of the Prime Minister's office. The GOE representatives play a major role in advancing the GOE's position on policy initiatives mentioned above and confirmed its commitment to the expeditious execution of their initiatives. Once that commitment was secured, USAID and the GOE proceeded with the collaborative design of the DSP II. A prominent feature of the design process was its reliance on a matrix to incorporate the GOE's policy goals into the program and then to formulate a set of benchmarks that will capture the progress of their implementation. The preparation of the DSP II policy matrix included GOE approval at every step. USAID is confident that the GOE's acceptance and approval of the matrix represents an expression of its political will to make the program successful.

- That the GOE demonstrate ownership in the DSP II reform process.

A salient feature of DSP II design process is the attention paid to ensuring GOE ownership of the policy reform agenda. In other words, that it has as high a priority for the GOE as it does for USAID. The approach used for the design of the DSP II Policy Matrix was to take the overall targets specified by USAID and the Ministry of International Cooperation (MIC), share them with relevant technical ministries, and then formulate the specific objectives and benchmarks collaboratively. In addition, careful attention was paid to ensuring that the GOE is actively undertaking, or sincerely plans to undertake, the reforms represented by the specific objectives and benchmarks. It is therefore reasonable to assume that GOE ownership of the policy reform measures under future DSPs will be maintained.

- That the various ministries to be affected by the reforms will cooperate with their implementation and promote them.

- That a majority of the Egyptian people can be persuaded that the reforms are in their long-term best interest and will continue to support the government.

D. Synergies within the USAID/Egypt Mission and with Other Major Donors

1. Ongoing Mission Results Packages that Compliment DSP

The purpose of this section is to summarize ongoing Results Packages in the Mission and describe how their activities are complementary to the economic reform objectives of DSP.

- Technical Assistance to Support Economic Reform (TASER)- The overall goal of TASER is to help the GOE implement its policy reform agenda. The GOE is undertaking a program of economic policy reform that aims to increase productive private sector employment through increased trade and investment. It is anticipated that the GOE's policy reform program will generate broad-based increases in family income, thus directly reducing poverty. TASER will initiate technical assistance activities, depending on the GOE's progress towards implementing the GOE policy reform programs supported by the DSP. Technical assistance will be provided to support:

  - the monitoring, verification and assessment of the effects of the reform on the economy;
  - the policy reform formulation and implementation efforts in several sectors; coordination and management of the policy reform agenda; and
  - performance evaluation of the technical assistance program and the program itself.

Under the auspices of this agreement, the technical assistance, training, and commodities will be provided during a six-year period beginning in FY 2000, and continuing through FY 2006.

- Agricultural Policy Reform Program (APRP)- The overall goal of the APRP is to develop and assist in the implementation of policy reform recommendations in support of private enterprise in agriculture and agribusiness. In support of this goal, APRP assists the GOE to: identify remaining policy barriers to private enterprise in agriculture and agribusiness; create a liberal competitive marketing system; encourage competition among all entities involved; increase employment and income in the agricultural sector and agricultural related activities; improve efficiency of land and water use in old and new settlement areas; and, target food subsidies to the poor to improve their food security.

  As a broad-based reform program, several ministries in the GOE actively participate. They include: the Ministry of Agriculture and Land Reclamation, the Ministry of Trade and Supply, the Ministry of Public Enterprises, the Ministry of Public Works and Water Resources, and the Ministry of International Cooperation.

- Partnership for Competitiveness Project (Privatization)- This RP, approved in September 1998, allocates $40 million over four years to assist the privatization process in Egypt. Its specific results are to: increase private sector participation in the economy from 65 percent to 69.2 percent of GDP; increase the number of privatization from 84 to 150 by 2002; and, increase the impact of privatization from LE 12.7 billion to LE 19.8 billion by 2002. A steering committee consisting of seven key GOE agencies plus USAID and the private sector will provide overall guidance for this RP, and a Competitiveness Support Unit (CSU) will provide technical assistance to the committee. The policy goals of this RP are directly in line with the privatization objectives of DSP, and the work of the CSU is expected to provide progress reports useful in justifying achievement of privatization benchmarks in accordance with the DSP Monitoring Plan.

- Telecom Sector Support: Privatization and Regulatory Reform- Since August 1997, USAID has provided approximately $7.3 million in technical assistance to support policy reforms at Telecom/Egypt under a contract with GTE. To date, such assistance has encouraged Telecom/Egypt to issue private contracts for provision of pay and mobile telephone service, as well as encouraged their announcement of plans to privatize up to 10 percent of Telecom/Egypt. In general, this contract has strengthened regulation, mergers, and partial privatization by Telecom Egypt, thus directly complementing the privatization goals under DSP.

- Power Sector Support II- Privatization and Regulatory Reform. Since March 1995, USAID has obligated approximately $11.8 million to finance technical assistance to support reform and private sector participation by the GOE's parastatal power authority known as EEA. To date the activity has been successful in encouraging privatization of electric distribution companies. This ongoing RP activity is also directly supportive of the privatization benchmark under DSP.

- Capital Markets Development- This RP, approved in September 1997, will provide some $32 million through September 2001 to increase the efficiency and transparency of the Egyptian capital markets. The work of this RP in supporting increasing volumes in the trading of secondary treasury bonds and fixed rate corporate bonds is directly supportive of DSP's benchmark requiring legislation to develop domestic debt markets, as well as to facilitate primary and secondary markets.

2. Other Donor Activity Related to DSP

Egypt benefits from a multitude of technical and financial assistance from both bilateral and multilateral donors working in many areas of the economy. The following description of other donor activity is limited, however, to the larger donors, and especially those dealing with policy issues similar to those of DSP.

a. The European Union

A European Union agreement with the GOE established the Public Enterprise Reform and Privatization Program (PERPP). It is designed to assist in the facilitation of the reform process of the public enterprise sector through the provision of specialized expert technical assistance. The five-year program is budgeted at 43.0 million Euros that are divided as follows: 25 million are allocated for privatization technical assistance; 9 million for restructuring; 2 million for training; 1 million for technical assistance on special projects; 3 million for the Project Management Unit, 500 thousand for monitoring; and, 2.5 million for contingencies. This project will complement DSP II specific objective dealing with privatization. In addition, the EU has started working on a trade sector policy program. USAID has consulted with the EU team on trade issues in order to establish collaboration during DSP II timeframe.

b. The World Bank (IBRD)

The Bank’s current portfolio consists of 19 projects with loans of over US$ 1.2 billion. Of these, eight are in agriculture (US$ 534 million, much of which is in irrigation); seven are in the social sectors (US$ 415 million); and, four are in infrastructure and the environment (US$251 million). The areas of greatest compatibility with DSP will be in the social sectors--education and health--in future years when these sectors are integrated into the DSP program.

Regarding education and health, the Bank is involved in restructuring through Social Fund projects that would alleviate poverty through public works and loans to small and micro enterprises. A major health sector program with multi-donor participation has recently been implemented.

c. The International Monetary Fund (IMF)

The GOE, with IMF support, successfully completed an economic and financial stabilization program in the mid-1990s. Since then, and for the foreseeable life of DSP II, the activities of the IMF will be limited to its annual consultations on the economy which serve to evaluate its status and progress.

Nevertheless, the IMF is trying to encourage fiscal authorities in Egypt, and around the world, to move forward on a relatively new project of completing a Report on Standards and Codes (ROSC). The ROSC will ultimately be a public document on budget management, the kinds of budget data made available to the public, rules for expenditure management, and related information. Additionally, current Egyptian data reported to the IMF follows a format developed in the mid-1980s and is less transparent, and with less information than the government’s own reporting to parliament on the budget. The Fund is therefore attempting to update and improve the status of General Financial Statistics (GFS) reporting from Egypt.

E. Gender Issues

The consideration of gender under DSP II includes key crosscutting, developmental issues that will allow the full involvement of women in all reform objectives and development activities. Economic reform and growth targeted under DSP II will foster increased incomes for Egyptian households, enhance the role for private sector participation in the economy, and achieve improvements in trade and investments. Gender considerations are well integrated into these reforms since women comprise a substantial proportion of program beneficiaries. The GOE estimates that women currently constitute only 15 percent of the labor force at the national level, and women-headed households represent 20 percent of the families reported as living in poverty. Therefore, DSP II achievements in the form of more productive employment through improved market mechanisms and regulations and the economically rational allocation of resources will have direct positive impacts on women as a group.

In terms of magnitude, the different areas of reform under DSP II may affect men and women differently. These differences will depend on the initial or current status of their relative involvement in the different sectors. However, neither empirical nor theoretical analyses would indicate that any of the reform areas would imply negative bias with respect to gender. Rather, the impacts of the reforms will, at a minimum, be of the same magnitude for both genders. More likely, in relative terms, gains to women could be more pronounced, as their current status of involvement in certain areas (e.g., credit and formal sector employment) is lower than that of men. Simply put, since women are starting from a lower base, their gains will potentially be greater.

The gender-related positive impacts under DSP II will also affect the sustainability of results. Combined with reforms under other SOs, DSP II reforms will be more sustainable because of the improvement in the status of women, both socially (health and education) and economically (employment and business creation).

In an aim to ensure the timely realization and sustainability of the positive impacts of DSP II, two considerations are worth highlighting:

- The positive gender-related impacts of DSP II reforms would not be across the board for all areas of reform. Rather, certain areas could demonstrate partial, or even negative impacts. An obvious example of this is in the area of privatization where jobs may be lost in the short-term. It is, however, a premise of DSP II that the enhancement of the role of the private sector in the economy will be conducive to growth hence, job creation, in the medium and long-term with women getting a share that should over time, increase their current low share in the total supply of labor.

- Supportive institutional and social structures are essential elements for the realization of the full potential impact of DSP II reforms on the status and welfare of women. These will be supported under other SOs and through efforts of the GOE. Examples of these structures are: women's' business associations and advocacy bodies, and training activities targeting women as employees or entrepreneurs.

From the perspective of the individual areas of reform, gender-related impacts would be assessed as follows:

- Liberalizing the International Trade Sector: a more liberal trade sector will encourage traders (both importers and exporters) to engage in activities that are less costly, and based on better calculations of risk and returns. Women, as direct and indirect employees in the trade sector, will achieve enhanced welfare due to job creation and the better availability of goods and services for their families.

- Privatization: as previously mentioned, the direct, immediate impact of privatization could demonstrate negative impacts on the employment of women (through the laying-off of redundant labor). Nevertheless, the more sustainable results will take the form of more productive jobs with the private sector that are essentially associated with higher incomes and the potential of better careers. In the same regard, the encouragement of entrepreneurial spirit in the economy would provide incentives to a certain segment of women to embark on private businesses.

- Fiscal Reform: Egyptian households will gain substantial benefits due to the improvements of fiscal aspects. These shall be specifically realized through an improved taxation system, as well as more efficient and cost-effective public goods and services.

- Financial Sector Reform: Through better and increased access to credit facilities, women will be able to start micro and small enterprises that will generate jobs and incomes.

- Employment Related Laws: This area of reform is indispensable for the encouragement of employers to follow proper employment practices in their respective businesses and organizations. Women have been in a disadvantageous position due to the negative attitudes and practices associated with the shortcomings of employment regulations.

- Competition Regulations, Intellectual Property Rights and Information Technology: Similar to the outcomes of reform in all areas that enhance the private sector activities, this area of reform will have the advantage of providing incentives to a broad-based segment of the business and professional communities in order to actively participate in productive and rewarding economic enterprises. Women are not an exception in this regard, given their relative potential share in the labor market.

- Monetary and Foreign Exchange Policies: Sound policies in these areas are directly conducive to more efficient and cost-effective trade and investment activities, hence positive results will be achieved in terms of job creation, income generation, and enhanced welfare in the Egyptian household sector.

- Enhancing the Rule of Law, Commercial Law and Corporate Governance: By their very nature, women are less inclined to enter into litigation, therefore improved legal and regulatory frameworks for businesses would be instrumental in encouraging women to embark on business activities.

- Promotion of Economic Information, Data Transparency and Dissemination, and improvements in gender-sensitive, macro and microeconomic indicators for improved decision-making process: Women operating on a well-informed basis are less vulnerable to business risks. Also, and on the positive side, accurate and timely data and information would help women take advantage of business and professional opportunities that are potentially more viable.

III. Implementation Plan

A. Activity Management

1. USAID Team Structure, Roles and Responsibilities

The USAID technical office responsible for the design and management of DSP II is the Economic Growth Office, Sector Policy and Privatization (EG/SPP) Division. In addition to the SPP staff, the DSP core team has members from the Strategy Coordination and Support (SCS) Office, Financial Management (FM), and the Legal Office (LEG). Moreover, in the design and management of DSP II policy benchmarks, the team will coordinate with the relevant USAID offices, TA contractors, the US Embassy, and GOE counterparts to come up with a mutual understanding and agreement on the DSP policy reform agenda. Policy formulation and dialogue as well as monitoring and verification of DSP II policy benchmarks will be the responsibility of the DSP team who will work in collaboration with involved USAID offices, the US Embassy, and contractors.

As such, the DSP team will identify a prioritized policy reform agenda that the GOE should pursue to attain its desired economic growth path. Out of this agenda, the team will choose a set of policy benchmarks to include in the DSP II program based on their importance, impact on the economy, and the GOE willingness to implement them. Similar to DSP I, DSP II will be within USAID management capabilities and will not impose a heavy burden on Mission staff. Through the TAPR activity, a Monitoring Plan will be prepared to clearly specify the detailed actions, the value and the means of verification required for each benchmark. Based on this Plan and with the support of the existing USAID contractors, the GOE will submit a comprehensive verification report for all benchmarks before a disbursement can be requested. This will simplify the DSP II disbursement process and USAID management requirements.

2. GOE Role and Responsibilities

The DSP team considers GOE ownership of the DSP II program essential to its success. As such, the team is interacting intensively with senior GOE officials in designing the DSP II policy benchmarks and plans to continue to do so at the implementation and verification stages. On a periodic basis, the DSP team is meeting with the Ministry of International Cooperation (MIC), which is the GOE entity responsible for the coordination and overall management of the program. In addition, the team has started to conduct policy dialogue with various GOE ministries who showed interest in the design of the DSP II policy benchmarks. The team held meetings with senior officials at the Central Bank of Egypt (CBE), the Ministry of Public Enterprise (MPE), the Ministry of Economy and Foreign Trade (MOEFT), and the Ministry of Finance (MOF) to discuss the GOE reform program and possible policy reform benchmarks for the DSP II program. The team also plans to meet with other government ministries to complete the DSP II policy matrix.

Through these initial meetings with GOE ministries, the team was convinced that the GOE is committed to economic policy reform and hence to the overall goal of the DSP II program. Senior officials at the GOE ministries expressed their willingness for implementing policy reform in their respective sectors and for continuing policy dialogue with USAID officials. The team plans to meet regularly with those senior officials to ensure the timely implementation of the DSP policy benchmarks.

Lastly, the principal point of contact between the Mission and the GOE is the DSP Unit (DSPU) of the Ministry of International Cooperation. The DSPU is a coordinating body charged with: 1) supporting the negotiation of, and agreement to, the reforms between the Mission and the GOE, as well as with the appropriate GOE ministries and agencies; 2) collecting necessary information concerning the progress of reforms from the various ministries and agencies, verifying its progress towards achieving the reforms, and reporting on that progress; and, 3) based on the progress achieved, oversees the disbursement process to the appropriate accounts, ministries and agencies.

3. Other Partner Roles and Responsibilities

Private sector businesses, NGOs, and other associations will be our partners in the design and implementation of the DSP II reform agenda. Through meetings, seminars, workshops, and other means of communication the DSP team will seek input from and coordination with those partners in the design and implementation of the DSP II program. Similarly, the team will coordinate its policy reform efforts with the European Union, the World Bank, and other donors through regular donor coordination meetings. The purpose of these meetings is to ensure that the DSP II goals and objectives as well as its policy reform agenda complement rather than duplicate or contradict those of the partners.

B. Acquisition and Assistance Requirements

1. Implementation Letters

Implementation letters (ILs) will be the basis for cash disbursements under DSPII. The purpose of the ILs is to notify the Egyptian counterpart (Ministry of International Cooperation) that the requirements precedent specified in the Grant Agreement have been met. The ILs will specify the requirements for the policy measures that are implemented and the dollar amount attributed to them. The total disbursement dollar amount will be determined accordingly. USAID and MIC representatives will sign the ILs jointly.

Similar to DSP I, ILs related to the use of dollars and local currency will be issued. Also, ILs related to funds disbursements, extending deadlines, and amending the Monitoring Plan will also be issued.

2. Program-Funded Staff Requirements

The implementation of the program will require the efforts of the DSP team. Some members of the DSP team are program-funded. Funds will be made available from TASER to finance program-funded FSNs.

C. Monitoring, Verification, and Impact Assessment

USAID will rely on existing contractual mechanisms to furnish the monitoring, verification, and technical assistance services needed for the program. Technical Assistance will be provided to support:

- The monitoring, verification, and assessment of the effects of the reform on the economy;
- Policy reform formulation and implementation of several sectors;
- Coordination and management of the policy reform; and
- Performance evaluation of the technical assistance contractor(s) and the program intended results.

TASER will finance the activities under a technical assistance contractor to monitor and verify the performance of the GOE in meeting policy benchmarks agreed to in the DSP II Memorandum of Understanding and the attached Policy Matrix and Monitoring Plan. The contractor will also conduct evaluations of the various policy reforms and their effect on the economy based on DSP II targets, specific objectives, and benchmarks, as well as progress towards the USAID's overall goal of, "a globally competitive economy benefiting Egyptians equitably."

Monitoring consists of periodic data collection and analysis based on the benchmarks set forth in the Monitoring Plan. The challenge is to measure the GOE's continuing progress towards achieving the benchmarks in an expeditious and sustained manner. It is also closely linked to the terms of disbursement set out in the Monitoring Plan.

Verification consists of an analysis of progress towards achievement of the benchmarks selected by the GOE under DSP II as reported by the MIC, pursuant to the submission of an annual plan and a biannual progress report. The contractor will verify the information reported.

The impact assessments will measure the impact of implementing DSP I and DSP II on the overall economy. Accomplishment of this task will be measured by the achievement of the various indicators, some of which will be part of the SO 16 IRs. Qualitative and quantitative targets will be subsequently developed. In some cases, this will require baseline information on a benchmark-by-benchmark basis in order to measure before and after results. In this regard, there will be close collaboration between this contractor and the various others USAID-funded units, programs, and activities engaged in similar work. The following indicators have been selected from the Strategic Objective 16 (SO-16) Performance Monitoring Plan (PMP) to measure progress towards the achievement of results of these programs. These are set out in the Strategic Framework of SO 16 and include:

- Non-petroleum exports and imports of goods as a percentage of GDP;
- Progress in WTO compliance;
- Trade weighted average tariffs;
- Liberalization of customs procedures;
- Number and value of privatized law 203 companies, and joint venture firms;
- The lag time for the publication of the national accounts data;
- Selected laws and decrees passed;
- Selected laws and decrees implemented; and,
- Decrease in the ratio of direct tax collections to total tax collections.

In addition, public awareness of policy reform and public relations will be part of this monitoring, verification and impact assessment process.

A mechanism similar to the current Development Support Program Unit (DSPU) will be continued to coordinate and manage the policy reform tasks. A local currency Implementation Letter (IL) will further detail the tasks and functions of this Development Support Program Unit (DSPU). The tasks will include:

- Providing the overall coordination and technical services to ensure synergy among all contractors working on DSP/TASER technical assistance activities.
- Providing key operational, administrative, and financial management support required to acquire DSP/TASER technical assistance.
- Acting as the main link with the DSP II implementing agencies, the Ministry of International Cooperation, and the USAID Sector Policy Division.

Annex 1

Financial Analysis, Budget Tables, and Audits

I. Special Account for Dollar Grant Proceeds

The Foreign Assistance Appropriations Act and USAID policy for Program Assistance and legislative antecedents stipulate that countries receiving Cash Transfer assistance must establish a separate account for the dollar proceeds. USAID will deposit the appropriate dollar amount into an interest bearing Dollar Special Account in a US bank designated by the Central Bank of Egypt. The actual account can be in the US or in Egypt as long as it is in a US bank.

This account will be used solely for the receipt of appropriated dollars for this Cash Transfer program from USAID in accordance with USAID's ESF Cash Transfer Guidance (87 State 32579 dated October 20, 1987 and USAID-issued guidance for Separate Dollar Accounts in STATE 194322 dated June 17, 1990.) The proceeds will not be commingled with funds from any other source, agreement, or assistance. Any interest earned on the account, or redeposit required due to the ineligible use of funds, shall be treated as grant proceeds. In 1994, the Assistant Administrator for the Bureau for Policy and Management approved an exception for Egypt from the requirement of not allowing host countries to retain interest earned on deposits of cash transfers.

A. Uses of Dollar Grant Proceeds

It is anticipated that dollar disbursements will take place upon fulfillment of policy reform benchmarks. The Government of Egypt may use grant proceeds for the following two purposes:

1. Procurement of goods and services from the United States. Examples include bulk commodities, machinery and equipment, capital goods, raw materials, intermediate goods, and other goods and related services. The source and origin of such goods will be USAID Geographic Code 000.
2. Servicing of eligible US Government debt or US Government guaranteed debt in an amount not to exceed 25 percent of the total funds made available under this grant or up to $300 million for the six-year program.

Ineligible uses from the dollar grant proceeds will be the procurement of commodities for military purposes or law enforcement entities, surveillance equipment, abortion equipment, luxury goods, gambling equipment or weather modification equipment. Ineligible uses also include payment of debt for military or law enforcement purposes. In case of ineligible use of funds, the GOE will deposit to the Separate Dollar Account, from its own resources, an amount equal to that released for ineligible use, plus any interest that would have been earned on these funds. The use of Grant funds in dollar amounts is largely pre-determined under this agreement. The determination to require the use of at least 75 percent for commodity procurement is justified because forgiveness of military debt and the rescheduling of economic debt under the Paris Club agreement have reduced Egypt's burden of debt repayment. On the other hand, there is a continuing demand for dollars to finance imports for GOE sectors that no longer receive USAID CIP assistance.

B. Financial Management of Dollar Special Account (Accounting, Monitoring and Reporting)

As stated above, the GOE may use dollars from the Separate Dollar Account for payment of eligible US debt and/or commodities and equipment imported from the US. The systems and procedures used by the GOE for payment of US debt are different from those used for procurement of commodities and equipment. The systems and procedures for these two uses of Dollar Special Account funds are discussed below. Also discussed are the actions required by the Mission to ensure proper accountability and compliance with USAID regulations.

The Ministry of International Cooperation (MIC) will be the primary implementing agency with regard to the allocation of funds. MIC will coordinate all activities among the various GOE Ministries and ensure that the Central Bank properly manages the Separate Dollar Account. USAID will work closely with MIC to ensure adequate systems and procedures are in place to implement this cash transfer program.

The GOE will submit monthly bank statements to USAID. These statements will show the daily activity of the dollar account detailing deposits, withdrawals, and balance. The grant agreement and implementation letters will contain detailed provisions for accounting and reporting of the grant proceeds in conformance with the Separate Dollar Account guidance issued in STATE 194332, dated 06/17/90.

The Central Bank will manage the Dollar Special Account. The Mission has reached a positive determination that the Central Bank is capable of effectively managing the Separate Dollar Account in accordance with USAID requirements. This determination is based on the Central Bank's management of the FY 1989 through 2000 cash transfer separate accounts for USAID programs. The Regional Inspector General/Cairo audit of the FY 89, 90, 91 and 92 cash transfer separate account transactions reported no adverse findings related to the Central Bank's management.

Payment of U.S. Debt-The GOE has adequate procedures in place for managing payments from the Separate Dollar Account for US debt. These procedures require the GOE to maintain records to indicate the amount of debt paid, date of payment, recipient of the debt payment, description of the debt, and evidence of payment.

Payment for Commodities and Equipment Imported from the US-The procedures and systems for using the Separate Dollar Account for procurement of commodities and equipment from the US under the cash transfer mechanism for the first Development Support Program (DSP I) will be applicable for the Second Development Support Program (DSP II). Letters of credit issued by the GOE to procure US commodities should not be less than $1,000,000. The Mission has established procedures for both USAID and the GOE in accordance with the Separate Dollar Account guidance issued in STATE 194322, dated 06/17/90.

The GOE system for accounting, reporting and monitoring dollars used for the purchase of commodities under the DSP I Program approved by USAID, will be used under DSP II. The GOE system will ensure that commodities and equipment procured: (1) comply with source and origin requirements; and (2) clear customs in Egypt. This will be stipulated in an Implementation Letter to MIC to ensure that the GOE complies with the terms of the agreement and USAID requirements.

The GOE system will account for, monitor, and document the eligibility of commodities under this program to ensure the commodities are of US source and origin, and that such commodities have actually entered the country. The accounting books and records will be available for inspection by USAID or USAID's designee for a period of three years following the date of the last disbursement from the Separate Dollar Account. The required documentation, maintenance of records and reporting will be outlined in Implementation Letters between USAID and the GOE.

USAID or its representatives will examine records and documentation at MIC on a quarterly basis or as frequently as deemed necessary by USAID to ensure compliance with the terms of the agreement. USAID may reduce or increase the amount of monitoring depending on the performance of the GOE. Based on the above analysis, the Mission believes that the GOE has the capability to effectively manage the Separate Dollar Account.

II. Local Currency Special Account

The GOE shall establish in the Central Bank of Egypt a separate "Local Currency Special Account" in the name of the Ministry of Finance. Funds deposited to this account will not be commingled with funds generated from other agreements or assistance. The GOE will deposit to this account the local currency equivalent to dollar disbursements made from the Separate Dollar Account for the purpose of commodity procurement. Debt payments will not result in local currency deposits. Therefore, the total expected local currency to be generated will be equivalent to $1.2 billion, minus amounts used for debt payments. Funds deposited in the Local Currency Special Account would not normally earn interest.

A. Deposits and Uses of the Local Currency Special Account (Accounting, Monitoring and Reporting)

1. Deposits of the Local Currency Special Account

Deposits to the Local Currency Special Account will be made in accordance with a repayment mechanism or schedule agreed to between USAID and the GOE. Except as USAID may otherwise agree in writing, the exchange rate applied will be the daily average closing selling rate for transfers as determined by the Free Market Central Chamber for the last business day immediately preceding the day determined for computing local currency deposits. This will be in accordance with the mechanism described in an Implementation letter between USAID and the GOE. The timing and amount of deposits will depend on the type of commodity procured: i.e, whether it is bulk or non-bulk. For bulk commodities, one hundred percent of disbursements made from the dollar account will be deposited in equivalent local currency within thirty days from the date of disbursement. For non-bulk commodities, 25 percent of local currency equivalent to the letter of credit will be deposited within thirty days from the date the letter of credit was issued. The balance of 75 percent will be paid on three equal annual installments with the first installment maturing one year from the issuance date of the letter of credit and over a span of one month. For all types of commodities, cash payment may be made to the Local Currency Special Account if program users so wish or if MIC so determines. Cash payment may be 100 percent of the letter of credit to be paid upon its issuance or 100 percent of each disbursement made from the dollar account or any terms between the bulk commodities and the 25 percent minimum required for non-bulk. The specific repayment mechanism and procedures will be addressed in an Implementation Letter.

2. Uses of the Local Currency Special Account (Specific Assessment)

Funds deposited into the Local Currency Special Account will be programmed in accordance with the Twenty-Second amendment to the initial Memorandum of Understanding regarding the Special Account dated June 30, 1980, or its subsequent amendments and programming documentation. In programming local currency under this agreement, the major portion will be provided as General Budget Support and General Sector Support. The basis for such determination is the General Assessment that determined that the GOE has a rational system of budgetary allocation and expenditures with built-in controls to prevent fraud or diversion of funds. The General Assessment and the 1994 office of Financial Management internal review, which concluded that the GOE could account for local currency programmed as General Budget Support and General Sector Support. The 1992 General Assessment performed by a local accounting firm concluded that the GOE's financial management and accounting systems provide adequate internal management and accounting controls over GOE assets, including local currency generated by USAID programs. The assessment also concluded that the Host Government personnel possessed adequate educational, training, and management capability required to manage GOE resources. In 1995, a General Assessment update was performed to expand the sample and scope of the 1992 assessment to meet the requirement of the 1991 local currency guidance and implement the recommendations of the RIG/A audit report No. 06-263-94-006 dated June 1994. In 1995, in updating the 1992 General Assessment, the Mission assessed the two main Sector Support recipients during that period namely the Ministry of Local Government and the Ministry of Education to determine their technical and administrative capability in managing GOE resources. The 1995 General Assessment update concluded that the GOE budgetary allocation system allows the tracking of local currency from the Special Account to the general fund and from the there to the different sectors or ministries. The Mission has recently completed the General Assessment for 2000 in accordance with USAID supplemental guidance on host country owned local currency (State

204855 dated June 21, 1991). The result of the assessment is positive and the final assessment report will soon be issued.

Policy Determination No. 18 (PD-18) dated July 30, 1991, allows missions to use the Special Account to help reduce a host country's budget deficit provided that the country is implementing an IMF-sponsored stabilization program and/or a World Bank-sponsored public investment program. Under these programs, the domestic money supply and credit ceilings (for both public and private borrowings are firmly established. The IMF stand-by Agreement expired at the end of September 1998. However, the IMF and the GOE have agreed to continue annual consultations relating to the budget deficit. PD-18 states that Regional Assistant Administrator must approve the use of jointly programmed local currency for general budget support. In 1996 and in approving Egypt's new strategy the AA/NE approved the use of generations for general budget support in 96 State 118846. This year however, the Mission is requesting the AA/NE approval for a waiver for the requirement of PD-18 to program local currency generations for GOE general budget support in the absence of firmly established domestic money supply and credit ceilings.

Documentation supporting the Twenty-Second Amendment to the Memorandum of Understanding will discuss the Mission's rationale for providing General Sector Support for each ministry or a GOE entity and that the quality of the overall activity is satisfactory to the Mission. The Mission may also consider providing specific sector support to a project or an activity within the GOE budget. However, due to USAID staff constraints and the intensive accounting, monitoring and reporting requirements associated with this type of budget support, the Mission will limit this method of specific sector support programming to USAID-financed projects.

The GOE budgetary and allocation system are adequate to enable the Mission to program all of the above forms of budgetary support. With regard to the General Budget Support, the GOE provides evidence that the local currency is transferred from the Special Account to the General Fund. This evidence is also considered a performance indicator for providing general budget support.

When providing General Sector Support, Mission will be assured that the local currency has been deposited into the General Fund and that the agreed upon budget allocation to the ministry or budget line item has been made. This is being done through a supplemental budget action whereby the ministry's budget is augmented by the allocation made from the Special Account. Although the local currency looses its identity once deposited in the general fund, the amounts in the supplemental budget action match the approved allocation and the Special Account is identified as being the source of the funds. The supplemental budget meets the reporting requirement of the local currency guidance of budget allocation and expenditures from the General Fund. It also serves the purpose of a program result or performance indicator demonstrating that the ministries' budgets have been increased by certain amounts. In the 1994 internal exercise conducted by the Financial Management office to trace the allocation of funds under general sector support, the GOE was able to provide documentation necessary to support this type of program.

Under the third type of budget support, i.e., 'Specific Sector Support' provided for a USAID financed project, the GOE will provide documentation reflecting budget allocation and disbursement of funds from the general fund to the project or activity. Similar to the General Sector Support programming mode, a supplemental budget action increasing the level of project funding will be made for this type of programming. For each allocation of Specific Sector support, the mission will request reports on the use of funds by the project and that such funds support the project objectives. Specific performance indicators will be developed for each project and will be included in the Mission programming document approving the allocation of funds.

Based on the above and except as USAID may otherwise agree in writing, funds deposited in the local currency Special Account may be used for the following purposes:

(a) Funding USAID administrative costs.
(b) General Budget Support for the GOE Budget.
(c) General Sector Support for particular Government sectors.
(d) Specific Sector Support for USAID-financed projects.
(e) Activities mutually agreed to between USAID and MIC under the USAID Trust Fund (FT 800) Agreement.

Upon mutual agreement between the GOE and USAID, local currency funds may also be used for General Sector Support to those ministries or entities participating in policy reforms under DSP II.

3. Accounting, Monitoring, and Reporting of the Special Account

The MIC shall maintain records with regard to the programming of local currency and make available to USAID or its representative such records for review and audit for the period of the grant and up to three years following the disbursement from the Local Currency Account. Local currency not used for the purposes indicated above will be re-deposited to the Local Currency Special Account from GOE resources. Any unencumbered balances of funds which remain in the Local Currency Special Account upon termination of the program, will be used for such purposes (subject to applicable law) as agreed upon between the GOE and USAID.

The Ministry of Finance (MOF) is responsible for accounting, reporting and monitoring the activity of the Local Currency Special Account. The GOE shall provide USAID with monthly bank statements showing deposits, withdrawals, and balance. The Central Bank will incorporate the summary of deposits, withdrawals and balance of Local Currency and submit them to USAID on a quarterly basis. Details on the frequency and the format of the required reports for funds released from the Special Account as well as the performance indicators for each type of budget support will be stipulated in the amendments to the Memorandum of Understanding regarding the Special Account or in any subsequent programming documents. Even though the Local Currency Special Account is kept in the Central Bank, it is owned and controlled by the MOF. All instructions for opening accounts, issuance of bank statements and their submission to the different recipients are provided by the MOF. From past experience and implementation of previous Special Accounts, USAID believes that the MOF is capable of managing the Local Currency Special Account under this agreement as described in detail in the following section.

B. GOE's Capability to Manage the Local Currency Special Account (Informal Assessment)

The Mission has past experience with the Ministry of Finance in managing the Special Account. The MOF has been responsible for handling Special Account generations and releases since 1985 when a GOE system for monitoring Special Account collections, deposits, and disbursements of local currency was put in place. In October 1988, the MOF established an accounting unit within the Central Loans Department for accounting, monitoring, and reporting Special Account activities. The Mission has verified reports from the MOF on the Special Account unit’s activities on an annual basis.

The Mission will continue to use the system developed for tracking local currency deposits under the current Cash Transfer program to ensure that adequate deposits are being made. Under previous CIP and Cash Transfer agreements, the MOF had exercised a high degree of adequacy in monitoring and reporting Special Account activities. On the few occasions when the Mission had found discrepancies, the MOF was notified and a modified report was issued. Based on the Mission's favorable experience with the MOF, a continuing informal assessment will be undertaken, rather than doing a formal assessment that is prepared solely at one point in time.

The Mission worked closely with the MOF in monitoring Special Account deposits and releases. Under the public sector CIP program, the Mission and MOF have established procedures for Special Account deposits based on dollar disbursements. Monthly reports on CIP dollar disbursements and a schedule of local currency installments were submitted by the MOF on a monthly basis. The Mission verified on a monthly basis the exchange rate applied by MOF and that correct amounts of installments were paid. The Mission also maintained and implemented an accounting system and records to verify adequacy of the MOF's reports and local currency deposits based on bank statements.

In the 1994, internal Financial Management review referred to above under Uses of the Local Currency Special Account adequate reports were submitted by the MOF on the allocation and release of Special Account funds for General Sector Support under MOU amendments number 16 and 17. Reports were verified by both the Mission and RIG/A and found appropriate. The GOE continued to provide the same reports under the subsequent MOU amendments that were subject to audit under the annual Local Currency audits.

Under the private sector CIP the Mission implements a system to verify local banks' compliance to the General Circular No. 1 and MOF monitoring of local banks' performance with regard to local currency deposits. The Regional Inspector General/Cairo audits the local currency generations, including generations from Cash Transfer programs, on an annual basis. The audit objectives were to determine whether USAID/Cairo ensured that the GOE generated, deposited, and reported local currency in compliance with applicable laws, regulations, policies, and terms of the Grant Agreement. Audit reports were issued with no recommendations. Based on this, the Mission assessed as satisfactory the MOF's ability to meet the requirements of the 1991 guidance. The Mission also believes that the MOF is capable of effectively managing the Special Account.

III. Audit

The grant agreement will include provisions requiring audits of the Separate Dollar, and Local Currency Special Accounts in accordance with State cable 194322 dated June 90 and State cable 204855 dated June 91. The RIG/A has been auditing the Local Currency Special Accounts for the past years. Last year RIG/A started auditing the Separate Dollar Account. Funds from the Trust Fund (F.T 800) will be available for audit purposes for both the Separate Dollar Account and the Local Currency Special Account.

IV. Illustrative Budget

Obligation Schedule, by Element ($000)

Element	FY 01 Obligation	Future Obligations FY 02-FY 06	Total Costs
Program Assistance	200,000	1,000,000	1,200,000

Projected Expenditures, by Fiscal Year
And Element ($000)

Element	FY 02	FY 03-FY 06	Total
Program Assistance	200,000	1,000,000	1,200,000

Methods of Implementation and Financing ($000)

Element	Method of Implementation	Method of Financing	Total
Program Assistance	Implementation Letters	Cash Transfer	1,200,000

ANNEX 2

ECONOMIC ANALYSIS

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I. INTRODUCTION

Egypt is an economy well favored by location and a large, educated, entrepreneurial workforce. It has been estimated that there is the potential to achieve sustained GDP growth rates of 6-8 percent per year, or almost double the adjusted growth rates of the last several years. Such faster growth is achievable mainly through policy reforms that allow a significant expansion of participation in private investment and price competition in the domestic economy. Much of the gain would be derived from increased productivity of labor and investment so that they would be accompanied by minimal increases in resource use and environmental degradation. As such, wider participation in private investment and employment activities would improve income distribution through markedly reducing poverty in Egypt.

The Egyptian/USAID Development Support Program (DSP) is based on the premise that altering policy related incentives in the economy will lead to greater growth of GDP, employment and more equitably distributed income. The process of designing the policy content of the Development Support Program (DSP) began with the selection of nine policy issue areas.[1] The intent was to identify policy reforms in at least these areas that will change incentives in order to advance the achievement of the overall goal of SO-16 (Environment for Trade and Investment Strengthened). International experience supports the conclusion that overly intrusive and/or inconsistent government intervention to guide economic behavior adversely affects private productive initiatives, thus reducing growth in the economy.

In light of this, the aim of the DSP is to foster policy reforms that reduce, streamline, and reorient economic interventions so as to improve the incentive atmosphere and stimulate private economic initiatives. Experience in many countries and related analytical work shows that competitive markets will emerge and grow naturally as long as private initiative is not constrained by excessive government interventions. The primary aim of the DSP Policy Reform Program is, therefore to make Egypt's economic incentive system support more private initiative and the emergence of larger, more competitive markets. It is reasoned that an improved, more open incentive system will, over time, result in greater, quicker achievement of SO-16[2]. This will in turn lead to more private, formal sector employment and greater, more equitably distributed GDP growth.

A most important element is altering the incentive system in developmentally favorable ways is changing relative prices and costs, or productive incentives so that production and employment increase and earn more income from productive employment and need less from transfers. In a sense, a government that is unwilling to accept changes in relative domestic costs and prices is unlikely to attain a competitive, productive economy. Frequently the reforms and/or their implementation are viewed as being socially costly. However, the opposite can be the case when reforms increase GDP growth that more than offset these costs.

This paper sets out the conceptual background and some general policy reform prescriptions for the Egyptian economy that support poverty reduction through more rapid employment growth. They are consistent with the natural expansion of trade in domestic and international markets and of private investment and through these, of productive employment. These policy prescriptions form the main general content of the USAID/Egyptian Development Support Program. The remainder of the annex is in two parts. The first sets out the current economic status in Egypt, subdivided according to macroeconomic and microeconomic considerations. The second sets out conceptual backgrounds in the nine policy areas and suggests the general sorts of incentive-based policy reforms that are appropriate for Egypt at this time

II. CURRENT ECONOMIC STATUS

A. Macroeconomic Considerations

1. Overview

This section views developments in macroeconomic aggregates from the perspective of expanding private investment and trade in Egypt. The officially published data for 1999/00 are internally consistent and present a positive picture of macroeconomic developments, including a 6.5 percent real GDP growth rate and low inflation and unemployment. However, there is much questioning of this GDP growth figure in Egypt. Concern is frequently expressed about a ‘liquidity crisis’ and an economic ‘slowdown’. There is talk that a correctly measured real GDP growth rate would be less than 6.5 percent.

Recently, pressure has increased on the LE/$ exchange rate, which was for several years 3.4, but which has risen over the last several months to 3.88. There was also a significant increase in the budget deficit, which was first shown in the revised data for FY 1998/99, but which may actually have begun earlier. This should have caused inflation. However, the inflationary impact seems to have been mitigated by a large buildup of GOE/NIB payments arrears (i.e., payments owed to companies and individuals). At the same time, the CBE has maintained fairly tight constraints on overall credit expansion while accommodating recent credit increases to the GOE-owned SOEs rather than to the private sector. The arrears, tight credit constraints on the private sector, and GOE pressures on businesses to refrain from price increases have held inflation in check but have adversely affected the business and private investment and trade atmosphere.

The increase in private sector demand for foreign exchange, given the tight controls on imports, suggests that there was a speculative shift of savings from Egyptian pounds to foreign exchange in anticipation of devaluation. This was exacerbated by the limited attractive options for domestic savings instruments. This suggests that GOE could alleviate some of the current economic problems by issuing bonds to the private sector to cover the GOE/NIB payments arrears. (Assuming they are willing to accept them.)

2. National Accounts, Employment, and Price Level Developments

Table 1 shows that real GDP growth and investment have been both relatively high and increasing over the last four years up through June 2000. During the same period, officially reported unemployment and inflation have been relatively low and declining.

Table 1: National Accounts, Unemployment, and Inflation

	96/97	97/98	98/99	99/00
1. Real GDP per Capita (LE)	2,884	2,991	3,101	3,232
2. Real Growth Rate	5.3	5.7	6.1	6.5
3. Consumption Share (%)	68	68	68	67
4. Investment Share (%)	14	16	18	20
5. Unemployment Rate	8.8	8.3	7.9	7.4
6. Annual Inflation Rate	6.2	3.8	3.8	2.8

Source: Monthly Economic Digest, MOEFT: Feb. 2001.

While few observers believe the data in Table 1, it is difficult to find an alternative, consistent scenario. The press and many people believe that 1999/00 was a ‘slowdown’ year with a real GDP growth rate of less than 6.5 percent. This would be consistent with a further fall in inflation, to 2.8 percent.

However, many also believe that the 2.8 percent inflation rate is understated, but there are also significant price rigidities in the economy. Prices outside the CPI do not seem to be rising and Egyptians acknowledge that the GOE prevents, through direct intervention or persuasion, price increases in the formal economy, “to protect the poor”. In addition, price increases are not consistent with the slowdown theme. It is possible that there are pockets of unsatisfied demand that threaten to be inflationary, but for the present are not creating pressure on prices.

Following discussions with statisticians, it seems most likely that the nominal GDP figures for 1999/00 reflect two developments. One is slower GDP growth in the **formal** economy and the other is expanded inclusion of elements of the **informal** economy in the national account statistics, without previous years being correspondingly adjusted upwards.

3. Budgetary and Fiscal Matters

Table 2 shows that there was a large increase in GOE capital expenditures (row 2b) and the overall deficit (row 3) in 1998/99, and thereafter. The financing of the large deficit increase was mainly through increased borrowing from the NIB and other public authorities.(rows 4b & 4c). This proved to be a relatively indirect and low-interest/cost way of financing the deficit. Off budget expenditure increases may have actually begun earlier, but only really began to be reflected in revised data beginning in 1998/99.

Table 2: National Budget and Domestic Debt (LE billion)

	96/97	97/98	98/99	99/00
1. Total Revenues	64.5	68.0	73.3	79.4
2. Total Expenditures (of which)	66.8	70.8	86.0	91.7
2a. Current Expenditures	(53.0)	(54.7)	(60.2)	67.2)
2b. Capital Expenditures	(14.0)	(15.6)	(25.3)	(24.1)
3. Overall Deficit	-2.3	-2.8	-12.7	-12.3
4. Total Domestic Debt-end FY	148.0	160.0	182.0	202.0
4a.Securities (Bonds/Bills)	(90)	(85)	(78)	(78)
4b.GOE-Owed to NIB (net.)	(35)	(52)	(70)	(87)
4c GOE-Owed to Pub. Auth.(net)	(23)	(23)	(34)	(37)

Source: Monthly Economic Digest, MOEFT: Feb. 2001

The increased deficit is a significantly complicating matter for macroeconomic stability. The GOE seems to have relied on a series of non-market, administrative interventions to suppress the inflationary impact of the deficit increase. These apparently included the following: i) informal pressure to encourage price restraints; ii) imposing extra restraints on private sector imports, including raising local currency coverage requirements to 100 percent; iii) using GOE dominance of the banking sector (rather than interest rates) to impose restrictions on credit to the private sector; and, iv) building up GOE accounts payable to the private sector (arrears).[4] The result of these actions is that accommodation to the deficit increase was forced onto formal sector private businessmen and to some extent onto households.

The GOE should not, however, attempt to significantly increase revenues to close the deficit unless it is intended to make the increases in investment expenditures permanent. This would be contrary to the GOE's stated desire to see a relative expansion of private sector activity. Also, greater transfers from abroad will not reduce inflationary pressures unless accompanied by larger BOP trade deficits.

4. Monetary and Financial Developments

It is said that there is currently a liquidity problem in Egypt, but Table 3 (row 3) shows that the problem is more localized in Egypt's formal, 'non-government' sector. The impact of this credit expansion data is difficult to discern primarily because there are no official figures on the size of GOE/NIB arrears to the 'non-government' sector.

Table 3. Percentage Changes in Domestic Credit and Money Supply
(Annual changes; July-June, Percentages rounded)

	Actual					Estimated
	95/96	96/97	97/98	98/99	99/00	00/01
1. Net Domestic Assets	15	14	20	24	13	14
2. Credit to GOE	12	15	15	31	10	14
3. Credit to Non-Govt.[5]	24	24	18	22	13	14
4. Total Liquidity (M2)	10	15	9	12	9	---
5. Velocity (GDP/M2)	1.4	1.3	1.3	1.2	1.2	---

Source: Monthly Economic Digest, MOEFT: Feb. 2001.

Also unclear is how much of the ‘non-government’ sector is truly private and how much are the remaining SOEs and other GOE-owned and controlled institutions. It is likely that SOEs still constitute a large portion of this sector, but they get unknown amounts of their credit from outside of the formal banking system. Whatever the case, row 3 of Table 3 suggests that the private formal economy has experienced either a severe or very severe credit restriction, depending on the size of their holdings of GOE/NIB arrears. It is not clear how these arrears are being handled in the official monetary data.

5. Interest Rate Developments

Table 4 shows that significant interest rate adjustments were not made to help offset the effects of the deficit increase.[6] One would have expected them to rise substantially in order to stimulate private sector saving and crowd out consumer and lower productivity business demands for credit. Instead, administrative interventions and informal pressure seem to have been used to force accommodation to the deficit increase.

Table 4: Domestic Interest Rates (% end of Fiscal Year)

	1996	1997	1998	1999	2000
1. Discount Rate	13.50	12.25	12.25	12.00	12.00
2. Three month deposits	10.50	9.90	9.00	9.14	9.25
3. Bank Loans(1 yr. & less)	15.50	13.20	13.20	12.84	13.11
4. Interbank (CAIBOR)	10.30	8.70	9.10..	11.30	11.10
5. Bill rates (approximate)	10.20	9.10	8.84	8.85	9.00

Source: Monthly Economic Digest, MOEFT: Feb. 2001.

It seems likely that the GOE/CBE avoided the chance to use an indirect, incentive-based policy involving raising domestic interest rates. A possible reason for this is a GOE desire to avoid higher budgetary interest costs. This might explain why the GOE reduced outstanding government bonds and bills following the inflation of the early 1990s and opted instead for financing deficits by borrowing from the NIB (see Table 2, rows 4a, b, and c). It also may explain the sizable but unknown increase in GOE arrears.

A preoccupation with keeping interest rates and deficit financing charges low may reflect a concentration on financial rather than real costs. Alternatively, it may reflect a GOE belief that real rates of return to public sector investments are higher than for domestically financed private investment. Either way, the GOE's approach to financing the budget deficit and the deficit increase resulted in a crowding out of private investment and commercial activity. A more active interest rate policy, e.g., through issuing bonds to the non-bank private sector, would have allowed the private sector to save in ways that are more attractive to them. Such an interest rate initiative would also have relieved much of the pressure on the exchange rate caused by the deficit increase and speculative devaluation concerns.

The arrears buildup may have negative longer-run consequences. One is likely to be higher, risk-adjusted charges for goods and services provided to the government. Another is undesirable uncertainty regarding the intended thrust of economic policy initiatives. Both were unnecessary. The GOE could either swap tradable bonds[7] for the arrears or issue bonds to the non-bank private sector and settle the arrears with cash. Some businessmen in Egypt in fact, suggested the swap approach, and it has been used effectively elsewhere, including in Senegal in the late 1980s.

Given that the arrears are a *fait accompli* the bonds could carry normal interest rates and be exchanged 'at face value' for the arrears. However, private businessmen must be able to trade the bonds in the market in order to solve their liquidity problem and foster a privately initiated bond market. Although this bond-swap approach to the arrears problem will raise budgetary interest costs somewhat, it is much more sympathetic to private sector growth. This will in turn result in greater tax revenues that should cover the larger budgetary interest costs. In addition, private investors will get access to a new, savings instrument.

The budget deficit increase, the GOE/NIB payments arrears, and the severe tightening of credit to private businessmen has disrupted the traditional banker/businessman relationship and its positive influence on the creditworthiness of businesses, who are the client base for the major banks in Egypt. These banks perceive that the creditworthiness of their client base has deteriorated. Businesses cannot receive payments for the arrears and they are encouraged to not raise output prices. On this basis, the banks are reluctant to extend the increases in credit allowed them by the CBE. However, these businesses need increases in subsidized credit to survive without raising prices. The net result is a potentially degenerative situation in which declining business creditworthiness leads to financial problems among the large Egyptian banks.

6. International Trade, Exchange Rate & Foreign Debt Developments

Table 5 (rows 1 and 2) shows a huge disparity between Egypt's high levels of imports and its relatively low levels of exports of tangible goods. This leads to large deficits in the balance of trade (row 3). This deficit is nearly offset by large currency inflows from surpluses of service exports and from transfers from abroad. The result is relatively low BOP current account deficits (row 6) that would be the envy of most other countries with economies the size of Egypt's. At its highest (1997/98), the BOP current account deficit was 2.4 percent of GDP expenditures. In all other recent years, it was a much lower percentage.

Table 5: BOP Accounts, External Debt, and Exchange Rates (US$ B)

	Actual				Estimated
	96/97	97/98	98/99	99/00	00/01
1. Imports	15.6	16.9	17.0	17.9	
2. Exports	5.3	5.1	4.4	6.4	
3. Trade Balance	-10.3	-11.8	-12.6	-11.5	
4. Net Service Exports	6.2	4.7	6.0	5.6	
5. Net Transfers to Egypt	4.0	4.6	4.9	4.7	
6. Balance Current Account	+0.1	-2.5	-1.7	-1.2	
7. External Debt	28.8	28.1	28.2	27.8	27.1*
	1997	1998	1999	2000	June 2001
8. LE/US$ Exchange Rate	3.40	3.41	3.42	3.65	3.88

Source: Monthly Economic Digest, MOEFT: Feb. 2001.
* End of December 2000.

Substantial non-export foreign exchange receipts, and correspondingly low BOP current account deficits, allowed Egypt to use some capital inflows to further retire its external debt (Table 5, row 7), during a period when several major developing countries have been increasing and/or rescheduling it. This is a marked improvement over the late 1980s, when mounting external debt servicing problems resulted in the government undertaking a three-stage rescheduling program beginning in July 1991. Since then, the GOE not only slightly reduced external debt, but also increased international currency reserves from about $12 billion at the end of 1991 to a high of slightly over $20 billion in July 1997. Thereafter, international reserves fell relatively quickly to $14 billion in June 2000 as the GOE defended a LE3.4/$1.00 exchange rate that appears to have been overvalued.

The GOE's defense of an overvalued exchange rate through administrative interventions and sales of $6 billion of foreign exchange is not consistent with incentive-based policy initiatives. The future management of the foreign exchange rate will require the use of more sophisticated policy instruments. It will also require that there be increased price flexibility and fewer obstacles to competitiveness in the domestic economy. To be effective over time, devaluation must be allowed to raise output prices relative to input costs in order to increase the profitability of formal sector production/investment. Governmental price interventions to suppress inflation are not likely to be compatible with the higher output prices needed to increase private business profits and make devaluation effective.

In this context, recent discussions regarding initiating large Euro-Bond debt issues are a matter of concern. Foreign borrowing by governments (rather than Central Banks) should not be used to support the exchange rate. Public sector foreign borrowing may be appropriate in situations involving a significant volume of highly profitable domestic investments and an acute shortage of domestic savings, as reflected in very high, market determined domestic interest rates. However, until markets are liberalized in Egypt, returns to investments will be low and there will likely be excess, or involuntary domestic savings.

At first sighting, the enormous excess of imports over exports would appear to require the adoption of export promotion policies/programs in Egypt. However, the relatively small BOP current account deficits dictate caution. The success of such export promotion programs will, per force, rest on expanded production/investment of the private formal sector. This is precisely the sector that has been forced to forego expansion in order to accommodate the deficit increase. This underlines the importance of further implementation of policies that will make possible more rapid expansion of an increasingly competitive private sector.

B. Microeconomic Considerations

1. Overview

Microeconomics mainly concerns incentives and the structure of factor (labor and capital) and output markets. The actual incentives are the incomes and profits earned by the private owners of these inputs and outputs. Differences in income and profit earnings are determined by differences in prices and costs, which are in turn determined by free markets that represent consumer’s economic preferences. Thus, in a free enterprise economy, free markets determine input and output prices that in turn affect profits, and through them, production and private investment. Different economic structures affect the distribution pattern of incentives differently. In Egypt, there are essentially two sets of these markets, one set for the **formal economy** and one set for the **informal economy**. The structures and incentive (price-cost) patterns in these two markets are very different, as is discussed in more detail in the next section.

This examination of the current microeconomic status of the economy suggests that there are four areas requiring immediate attention:

- One concerns the importance of allowing much greater **ease of entry** in the formal economy in order to stimulate **price competition**. Greater competition will increase productive efficiency and through that lead to higher growth in employment, income, GDP and exports.
- A second is that a primary ingredient in easing private investor entry or participation in the formal economy is faster, more complete, and credible **privatization** and reduced GOE involvement in production.
- A third concerns questions of the **financial viability** of some large financial institutions. This may lead to a need for a balance sheet rescue operation, but it should be done in such a way that moves the banking system toward arms-length relationships between borrowers and lenders and is consistent with the development of new private competing **for profit** providers of financial services.
- Finally, there is the issue of how to expand **trade** (domestic and foreign) in welfare increasing ways. A crucial step is to accept all of the WTO agreements. Beyond this, it is best to recognize that the best way to promote more trade/exports is to reduce intervention and monopoly behavior in the domestic economy, so that competition can flourish and productive efficiency and private investment can grow more rapidly.

2. Structural Characteristics of the Economy: The Formal and Informal Sectors

The factors that have led to the existence of the informal economy in Egypt are particularly relevant to issues affecting the competitiveness of the overall economy. The informal economy in Egypt is very large and very competitive. At about 80-100 percent of the formal economy,[8] it may be the largest in the world. It exists mainly because entry into the formal economy is so difficult and/or costly. It consists of activities that are not legally constituted or licensed.[9] They are unregulated and do not file for or pay taxes. A most important characteristic of the informal economy, quite unlike that of the formal economy, is **ease of entry**; it is open to participation by all. The informal economy has little, if any, legal standing and no direct access to formal sector credit or imports. Because of the way the CBE controls credit extended to buy foreign exchange and imports, informal firms generally do not import directly, but in most instances get their imports from formal firms.

The informal economy in Egypt can play a significant role in liberalization of the formal economy and of trade. At present, the formal economy purchases large amounts of high value added imports from abroad. The imports are of a ‘finished’ nature, by virtue of their content of service inputs from their countries of origin.[10] Given this, Egypt could dramatically increase welfare gains, and improve their distribution, by liberalizing interactions between its formal and informal economies at the same time that it liberalizes trade between its formal and the international economies.

There is considerable price flexibility due to the vigorous competition in the informal economy. Operators there are price takers. Increases/decreases in output demand (e.g., income-induced shifts in demand) stimulate the rapid entry and exit of firms rather than changes in output prices. This too contributes to the competitive nature of the informal economy. Conceptually one can think of the supply curves in the informal economy as being extremely elastic. Because of this, profit margins are small and there is generally much less rent in the informal economy.

In spite of unfettered competition, informal businesses are financially, but not technically efficient. Financial efficiency means that informal businesses are very responsive to changes in prices. They equate all the 'marginals'. Wherever and whenever possible, cheaper inputs are substituted for ones that are more expensive. In particular labor, which is cheap and abundant, is used whenever possible. However, units in the informal economy must stay small to avoid discovery and therefore are unable to realize economies of scale.

With regard to the formal economy, particularly the state-owned enterprises, there are major issues in respect to the efficiency of resource allocation and use. It is for this reason that the government has assigned a high priority to the privatization of SOEs. An objective of policy makers in Egypt, as in many other countries, is that privatization policies must be designed carefully in order that public sector monopolies are not replaced by private sector quasi monopolies. It is important that free entry and exit become the norm and that competition policy encourages firms to innovate and introduce new cost saving and quality enhancing production processes.

Much of Egypt's formal economy is characterized by a lack of both financial and technical efficiency. Major reasons are the difficulties of freedom of entry and exit and little price competition in formal output or factor markets. Output prices are often adjusted to costs rather than the other way around[11]. The formal economy has been dominated by public enterprises, or by a relatively few influential, non-competing private businessmen. In essence, much of the formal economy has primarily public sector investment or private investment that is negotiated with the GOE.[12]

As with public sector investments, many of these private formal sector investments are relatively large, vertically integrated investments. Their establishment has often involved negotiations with the government involving the special benefits that the government may provide and the costs that must be borne, or the conditions private investors must accept in order to operate in domestic output markets. Private investors often operate in protected or quasi monopoly/oligopoly settings. This primarily means that they, like the public enterprises, often can adjust to shocks by changing output prices rather than by changing production processes in order to raise productivity and lower per unit costs.[13] Because of this, many are technically inefficient by international standards.[14] High levels of vertical integration mean that economies of specialization are rare. In this setting, the entry of new competing enterprises has often been seen as duplicative and wasteful rather than as desirable in terms of encouraging price competition and technical innovation.[15]

Many of the new investments by existing businessmen inhibit the entry of new investors and the enlargement of the investor pool, as well as increased competition. Although this may change, a small pool of businesses currently undertakes most of the large private investments in Egypt. This monopoly/oligopoly structure of much of the formal economy means that many formal economy supply curves are inelastic. Without informal GOE pressures, increases in aggregate demand may stimulate price rather than output increases. For this reason, there is the potential for excess profits and the presence of large amounts of rent in the formal economy.

The evolution of Egyptian policy will require a comprehensive review of current policies relating to the existence of state monopolies, exclusive production and import rights, commercial policies, restrictions on FDI, and rights of establishment of service providers.

3. Trade in Goods & Services, the WTO, and Trade Support Services

In referring to trade expansion, economists treat domestic and foreign trade as being substantially equivalent. If the expansion of a country’s international trade comes about in a welfare enhancing way it will, except in unusual cases, be accompanied by an expansion of domestic trade and an improvement in domestic productive efficiency. These results are inherent in the demand and supply analysis that underlies, among other things, the WTO trade agreements.

The trade analysis underlying the WTO agreements is based on the fundamental assumption that international trade occurs when domestic prices adjust to international markets in ways that create excess supplies in local markets. For example, excess supply (and exports) occur when the adoption of an international price raises the local price above its local equilibrium level. This price increase restricts domestic demand (consumption) and expands domestic supply (production) to create the excess supply that is exported. This one event, if accompanied by increased production or imports of equal, offsetting value, will be welfare enhancing. This underlies the importance of creating an economy characterized by easy entry of new producers and competitive pressures on existing suppliers to increase efficiency because of price signals. As shown by the experience of other countries, it is this rapid responsiveness in a competitive setting that leads to overall increases in employment and reductions in poverty.

Two points are crucial about this example of trade liberalization or acceptance of all of the WTO agreements:

- One is that the price increase is a market-derived one that is credible. Producers know that they can sell increased amounts of output at the new higher price.
- Second, the expansion of output is the result of increased competition in domestic markets. This increased competition results from the ease of entry and a larger number of investors and the improvements in productivity that the increased competition causes.

A devaluation of the exchange rate will affect exports in the same way as the above example of implementing WTO agreements. That is, as long as there is freedom of entry and relatively strong price competition in the domestic economy, devaluation further raises the relative prices of domestic traded output. This in turn can stimulate increases in domestic production, employment, incomes, and exports. However, without such competition, the domestic currency price of traded output will not rise relative to non-traded output (This relative price change is the actual ‘real’ devaluation.) and the beneficial results of the price increase will not occur.

III. BACKGROUND AND REFORM POSSIBILITIES IN NINE POLICY AREAS[16]

A. Improvements in Export Orientation and the External Trade Balance

1. Overview

Economists talk about **free trade**. Politicians talk about **fair trade**. The difference between the two is essentially the role played by governments and the WTO. In the theory of free trade, there is no government and no WTO. Based on this theory, trade liberalization essentially means reducing and finally eliminating government economic interventions altogether. The argument that trade liberalization will inevitably increase welfare is among the most compelling and widely held by free market economists in the world. Indeed, the welfare benefits of full trade liberalization can be enormous, primarily because of the impact that trade liberalization can have on domestic production.

The trade liberalization that has been tried so far by Egypt (e.g., tariff and NTB reductions) has not been as effective as desired, mainly because it has not significantly altered relative prices nor increased competition and productive efficiency in the domestic economy.[18] As a result, the policy changes that have occurred so far do not seem to have changed producer/investor behavior. The limited nature of price competition and of free entry and exit in the domestic economy have kept trade liberalization measures from having the beneficial impact on economic growth that otherwise would be possible.

The WTO was established to prevent predatory behavior that increases one country's welfare by transferring it from abroad. In essence, the WTO establishes the rules of free trade. This means that if GOE follows WTO principles in expanding Egypt's trade and welfare, there will be a net gain in Egypt's welfare, along with an increase in world welfare rather than a transfer of welfare from other countries to Egypt. That is, there will be **trade creation**, rather than **trade diversion**. It is fortuitous that the WTO, established to prevent predatory behavior that increases welfare at the expense of others, is now mainly engaged in convincing governments to stop adopting policies that reduce their own welfare. The basic WTO premise is that when countries agree to WTO principles they also agree with each other. There are four main WTO principles:

- First, treat all foreign trade equally, regardless of the country of origin.
- Second, treat internal trade the same as foreign trade.
- Third, reduce trade barriers to WTO approved levels (i.e., to the same levels as all other countries).
- Fourth, eliminate NTBs so that all countries use only (the same levels of) tariffs for protection and revenue.

Egypt is furthest along in implementing the first but has made much less progress in accomplishing the others. The equal treatment of domestic and foreign trade will become increasingly important as removal of NTB's on foreign trade progresses. It is possible that Egyptians tend to see compliance with WTO agreements as mainly benefiting foreigners. It may require a significant effort in capacity development and institutional strengthening to establish the necessary understanding of the potential requirements and domestic benefits of compliance with WTO agreements as well as to develop the ability to put them in place. Defraying the related costs and providing technical assistance in this regard would be fruitful areas for donor assistance.

At this stage, major progress on trade liberalization is likely to come by increasing the speed and extent of compliance with WTO agreements, rather than as part of other international trade initiatives. Thus, for example, even when Egypt engages in discussions/negotiations regarding joining in free trade areas it should be in the context of increasing compliance with WTO agreements, rather than as a substitute. In addition, the major immediate focus should be on reducing NTBs. These are particularly costly in Egypt because the GOE is still the sole provider of many Trade Support Services (TSS) and due to the Egyptian approach to import standards. TSSs are mostly provided under competitive conditions by private investors in other countries. Reducing NTBs in Egypt entails both GOE agreement to comply with WTO obligations (e.g., on customs inspections, valuations and standards applications and on IT, IPR, and others.) and the privatization of trade support services.

The provision of trade support services should be done in a way that encourages private investment and competition. If done properly, the private provision of trade support services will improve the domestic economy in at least four ways.

- First, trade support services will be more efficiently provided in more user-friendly ways, thus lowering trade-related costs.
- Second, GOE budgetary costs for training for and providing more modern, efficient TSS will be reduced/eliminated.
- Third, private, small scale, service investment opportunities will be increased.
- And finally, the increased private investment will increase productive employment and wage bills.

In support of this the GOE should develop an investment and privatization strategy that would inventory the public assets at all sea and air ports that could be privatized and identify the priorities for their transfer to the private sector. In addition, consideration should be given to transforming the involved public authorities such as the Civil Aviation Authority and the Cairo Airport Authority into economic units. As part of this effort the need for new regulatory approaches to oversee the expanded private sector role will need to be assessed.

2. Standards

The current Egyptian system of standards constitutes one of the largest non-tariff barriers to trade in Egypt. It is largely inconsistent with the obligations of WTO/TBT in a number of respects that will also be problematic for membership in the Euro Med free trade area. Direct and indirect additional costs of the existing system are estimated to range from 5 to 90 percent, depending on the industry. This affects importers supplying the domestic market as well as exporters who need imported inputs. The current system mixes quality standards with safety standards, involves multiple centers of responsibility, lacks transparency, and has a high compliance cost. In this area, the government has made substantial progress in addressing the sampling procedures for testing. The next phase of reform needs to involve: 1) a comprehensive review of current standards and related laws and decrees that underlie the current system; and, 2) the development of a new system that is compliant with WTO agreements.

Further reform of the Egyptian tariff system is desirable to facilitate simpler and more transparent custom processing and reduce competitive distortions caused by high and randomly distributed effective rates of protection. There are four suggested methods to restructure the Egyptian tariff system. These are:

- Concertina- The highest tariffs would be reduced to 30 percent and the lowest ones would be raised to 10 percent.
- Two Tier- Infant industries and industries with export potential would be taxed at one lower rate and all other imports at a uniform higher rate.
- Uniform- A single tariff rate would be established that would maintain existing tariff revenues.
- Transitional- An initial two-tier system would evolve toward a uniform tariff over a specified period of time.

An initial approach would be for the government to develop a five-year reform plan for tariff system that would have as its first objective achieving a two-tier system.

3. Export Promotion, Subsidies, and the Administration of WTO Trade Rules

The removal of NTBs, through the adoption of international/WTO conventions and procedures, and by increasing the role of private, competing TSS providers should reduce GOE costs and the amount of GOE administration associated with international trade. These reductions in the GOE’s role in international trade will be partially offset by some required new GOE initiatives relating to export promotion (subsidies) and international trade remedies such as dumping and retaliation.

Careful compliance with the WTO agreement on export promotion (subsidies) and trade remedies will stimulate increased competition and productive efficiency in the domestic economy. Doing so will result in trade creation (domestic and foreign) rather than trade diversion. The resultant increased productive efficiency, along with increased domestic competition, will lower output costs and prices, thus increasing trade. In WTO language, ‘green’ (internationally acceptable) subsidies stimulate trade creation, while ‘red’ (internationally prohibited) subsidies cause trade diversion.

According to WTO convention, there is a presumption of a subsidy, and a trade welfare loss, when the external price of traded output is below its domestic price equivalent. In addition, there is a presumption of subsidization when certain incentives are not extended to all producers but are reserved for certain (e.g. exporting) producers. As a generalization, the WTO makes no distinction between differing producing sub-sectors (e.g., between agriculture and industry).[19] The only general type of acceptable subsidy is an infant industry one, although when applied in practice this encompasses two general forms. A true infant industry subsidy cannot be a recurrent one. Instead it must be a lump sum, or once-and-for-all grant. In addition, the test of ‘infant’ producers is a productive efficiency one.[20] It is that once they start operations, these firms should experience increases in productivity or falling per-unit costs purely because of more and more production. That is, once started because of an infant industry grant, per-unit costs must decline over time purely because of continued/expanded operation.

As applied in practice, this dictum has resulted in acceptance of two types of subsidies as being welfare increasing. One is making lump sum grants available to all investors who want to start businesses that have ‘infant’ attributes and prospects. Such subsidies must be accompanied by reductions/removal of government economic interventions that restrict entry and exit and competition.

Subsidies that offset government-imposed distortions are frowned upon.[21] Such subsidies have been found to be very difficult to accurately calculate and are subject to enormous abuse. As a result, the WTO has endorsed removing the distortions rather than trying to offset their impact with subsidies. The other is to help defray the infant, or startup, costs of emergent private suppliers of trade support services in general and of international marketing services in particular. These too, would necessarily be accompanied by reductions in GOE-implemented NTBs.

Once again, the presumption is that the subsidies will be lump sum or once-and-for-all grants rather than recurrent transfers. There is a presumption that these services are privately provided. In general, they are provided by the public sector in Egypt. This means that even if subsidized, their provision is likely to be too slow, costly, and ineffective. Allowing private initiative to take over and develop them would be better than the GOE providing invisible subsidies through continued monopolization of these services.

The above suggests that export promotion is a crosscutting issue that will involve several ministries. To comply with WTO agreements, export promotion should be focused on improving productive efficiency and price competition in the domestic economy. In infant industry cases, the subsidy can be explicit, although it should be a lump sum one with no prior limitations on its disbursement. For most, however, the ‘subsidies’ would be implicit, and in the form of removal of cost increasing interventions and/or of barriers to entry (competition).

Finally, there is a need for the GOE to foster efficient growth in the trade-remedy adjudication process. This will involve some relatively substantial startup costs and considerable recourse to international legal and economic expertise. It is an area where international aid donors can make a significant contribution.

B. Enhancement of Competition and its Regulations[22]

1. Overview

In the 1970s and 1980s, when economic planning was considered promising, a primary approach to development involved stimulating the growth and regulation of monopoly firms and guiding private sector investment. It was thought that planners could control prices in such a way that monopolists would not restrict output but would produce the same level and distribution of GDP as a perfectly competitive free-market ‘twin’. It was also thought that government planners could better identify sectors for private sector investment than private investors. This led to the sanctioning of regulated monopolies as a development tool and a significant public sector effort to influence private sector investment. As part of this approach to development, the ability of investors to start up new, competing businesses, so called ‘freedom of entry’, was restricted and/or controlled in many countries.

Foremost among the theoretical economic benefits expected from this regulated monopoly approach was the expected achievement of economies of scale so that firms would be highly efficient. In addition, it was thought that regulated monopolies would earn greater, more concentrated internally generated investment funds or profits. These would be easily available to finance yet more large, monopoly investments. There were administrative benefits that were anticipated as well. It was also expected that it would be easier for governments to collect taxes from a small number of large companies.

There is still substantial belief in Egypt that the GOE should decide for significant sub-sectors what investments are needed, despite the fact that this approach has not been particularly successful anywhere in the world. Much of the Egyptian formal sector is protected and not very efficient or profitable. A relatively small group of businesses receive most of the new credit and make most of the new investments, thus inhibiting entry of new investors and competition. It is for this reason that so few people own so many different businesses.

The earlier comparative description of the formal and informal economies as well as the above discussion demonstrates two important points. One point is the extreme importance of **ease of entry and exit** for fostering price competition. There is fierce price competition in the informal economy because it is so easy to start new businesses. Supply is relatively elastic so that price controls are not necessary. Price competition in the formal economy is very uneven, due in part to the extent of GOE ownership and the difficulties that new investors face when trying to initiate competing investments with either SOEs or the larger existing private businesses. In general, supply elasticities are much lower in the formal economy. This tends to rationalize price controls.

The other point relates to the extent to which competition in the formal economy is encouraged by GOE. There seems to be a view that a large number of competing firms is duplicative and wasteful[23], at least in 'important' sub-sectors. There seems to be a belief that direct GOE regulation of monopolies will more efficiently control prices and profits than will competition. Given this, the GOE's approach has often been to administratively limit the number of private firms and regulate their prices and profits, at least in key sub-sectors.

The draft competition law proposed by MOEFT[24] contains 42 articles in eight chapters. It aims at addressing the legislative gap that should be filled in order to promote a competitive domestic market, encourage foreign investment, and provide the prerequisites for globalization. Chapter one mainly sets out exemptions from coverage of the law with a fair amount of GOE discretion in this matter. Chapters two and three define and delineate the meanings of anti-competitive activities and dominant positions. Other chapters deal with permissible and non-permissible GOE activities (mainly with respect to traded items), mergers and acquisitions of firms with a combined capital of over LE 50.0 million, the establishment of an implementing Cabinet agency for protecting competition, and penalties for prohibited behavior. The penalties described are legal rather than economic in nature, consisting of fines and jail terms. Conspicuous in its absence is the breaking up of monopoly firms so that they become separate competing entities. It is also unclear if private parties who feel aggrieved can initiate court actions under the law against alleged monopolists.

In this setting, it is important that the new Competition Law be complemented by structural changes that will facilitate easier entrance and exit of private businesses and freer price movements.

The superiority is in three dimensions that are of major concern to the GOE.

- One is that increased competition will cause formal sector **employment to rise**, if labor markets are allowed to adjust.
- A second is that more competition will cause **labor productivity and wages to rise**.
- The third benefit of increased competition in formal sector firms is a marked increase in welfare enhancing trade, including **increased exports**.

It is important to appreciate the fact that enhanced competition brings about these benefits, even though it is not yet theoretically understood why it happens.[25] Up until about fifteen years ago, it was felt that competition mainly did a better job than regulators of keeping prices and profits from rising. However, an increasing number of total factor productivity (TFP) studies make it clear that greater competition increases TFP or productive efficiency and **lowers real output costs and prices**. Increased TFP tends to lead to higher wages while lower output prices lead to increased production, employment and sales, including exports. These increases in employment, wage bills and exports do not come from special government-led promotion programs, but from the effect that increased competition has on reducing costs and raising competitiveness and output levels.

The WTO sanctioned intellectual property rights (IPR) agreement deals with the international acceptance of patents, copyrights, etc. These are time-bound exemptions or exceptions to competition laws. The economic issues giving rise to them are important. They allow the temporary earning of monopoly profits to finance research and development or technological innovation. These agreements may appear to be welfare reducing for Egypt if viewed from a static, short-term rather than dynamic, medium-term viewpoint. As the Egyptian economy becomes more open and competitive, the GOE accession to the IPR agreement should stimulate significant private, welfare enhancing investment involving foreign/Egyptian partnerships.

The information technology agreement (ITA) will also work significantly to Egypt's advantage if accompanied by more liberalization and competition (ease of entry) in the domestic economy. This is particularly the case if direct access to IT imports is enlarged. The agreement is a sector-specific application of WTO principles. In general, this specificity is frowned on. However, because IT has raised productivity so dramatically across all other productive sectors in other countries, there is compelling reason for its early liberalization. Of note is the impact of IT agreements on increasing the productivity of service providers. Given this, an IT agreement could have a significantly beneficial impact on incomes and productivity in the informal economy.

2. Labor Utiliztion and Productivity [36]

The two most fundamental problems in Egypt are the underemployment of labor, or the low average number of hours worked per week, and low average and marginal labor productivity. Together these explain the bulk of Egypt's poverty problem as well as its work/leisure incentive problems. Increases in labor productivity and the number of hours worked per household would significantly reduce the level of poverty. Official data give too positive a picture of the amount of employment, especially in terms of the number of hours worked. Were it not for the informal economy, the extent of the unemployment would probably be destabilizing. In addition, there is hardly any official mention of the problem of low labor productivity, even though raising it significantly would be the single most important benefit of a policy reform effort.

The latest CAPMAS figure for the size of Egypt's workforce 15.6 million people in 1999 (16 million in 2000) and implies a workforce of 24 percent of the estimated population of 65 million. This is low, given the fact that Egypt's population age profile shows a large bulge of potential workers in their teens, twenties and thirties.

A rule of thumb is that the workforce for populations with normal age distributions is about 33 percent of the population, or 21.4 million in the case of Egypt. However, given the age distribution of Egypt's population, the workforce could well be near 40 percent of the population or about 26 million. A different CAPMAS figure is that the workforce is 17.3 million, when women engaged in subsistence agriculture are not counted. The number of these women is generously estimated to be 6 million[37], which would bring this estimate to about 23.3 million or between the World Bank estimate of 22.3 million and the ILO estimate of 23.8 million[38].

The official unemployment rate, with unemployment being defined as those wanting to work but who have not worked in the previous week, has been declining. It was 8.3 percent in 1997/98 and 7.4 percent, or about 1.5 million people in 1999/00.[39] This latest figure implies a workforce of 20.2 million people. Use of the 40 percent figure mentioned above (26 million) implies that this figure of 20.2 million is most probably 6 million too low. This would give a 'gross' unemployment rate of about 28.8 percent (adding 6 million to the 1.5 'actively seeking work' to get gross unemployment of 7.5 million and then dividing 7.5 million by 26 million).

The most fundamental economic problem in Egypt is the low productivity of labor; due mainly to overstaffing and poor work incentives. Studies rank the productivity of Egyptian labor as very low. Egyptian labor is given a number of 47 where 1 is the highest labor productivity rank and 50 is the lowest.[40]

Given this, it is no wonder that family earnings are so low for most Egyptian households. This has implications for Egypt's work/leisure incentive system, particularly the number of those seeking work, and for the size of the student population beyond the basic educational level. The opportunity cost of being a student, beyond the basic educational level is also very low. This means that the educational system will, as it currently is, experience considerable pressure from 'students' who are enrolled simply because they cannot find work for more than a few hours a week, for very low wages. Unfortunately, it is also the case in these circumstances, that the incentive to learn is low, given that there is a weak relationship between expertise and wages.

National planners have traditionally reasoned that significant increases in investment will raise the number of hours worked to 'full employment' levels. Conceptually this can be argued, but it has not worked in practice. A major reason is that increases in public sector, or government 'credit-pushed' private investment have been accompanied by continued low labor productivity.

The lessons of international experience with economic reform are that both employment and labor productivity increase with increases in private sector price competition.[41] In Egypt, this argues strongly for reducing public sector crowding out of private investment through privatizing SOEs and reducing GOE investment expenditures. In addition, removal of barriers to free investor entry and exit is critically important. Finally, reforms must aim at ensuring, through deregulation and enforcement of competition policies, that price competition flourishes among a growing number of private producers/investors.

C. Improve the Efficiency of Resource Allocation

Privatization can accomplish two important things. It can reduce the GOE's role in production and, depending on how its done, it can contribute to liberalization of the economy. Ultimately it should result in the transfer of some of the responsibility for economic decision making to a diverse set of competing private entrepreneurs. As it is currently conducted, privatization may not be contributing to liberalization to the extent that is desirable. There is a major focus on the revenue that privatization brings to the budget. This causes the process to be too carefully scripted and is only slowly reducing GOE control over the economy. More significantly, the current process does not appear always to be an arms-length one that would occur in liberalized asset markets. Instead, it can often be seen as resembling a process of negotiating rights to produce, or quasi monopoly rights, as well as selling productive assets.

Significant improvement of the formal economy in Egypt would be enhanced through more rapid privatization. This could also be a keystone initiative for reacting appropriately, from a demand management perspective, to the budget deficit increase. Assuming primarily domestic sales, privatization would, like domestic bond issues, reduce the inflationary pressures that are currently being suppressed through non-market means.

Privatization could also foster liberalization in at least three significant economic areas.

- One is to stimulate the formation of competitive asset markets in which productive assets are evaluated and traded according to free market principles.
- A second is to improve productive efficiency, both in the firms being privatized and, through increased competition, in their respective sub-sectors.
- The third is to reduce moral hazard problems, or the extent to which individuals look to the GOE rather than themselves to produce economic output.[26]

The undeveloped nature of asset markets (and of effective bankruptcy procedures) makes investment and banking activities both more difficult and risky for private Egyptian entrepreneurs than they would otherwise be. This in turn offsets efforts to stimulate more private investment. Egypt's privatization process is not now providing an impetus for the formation of free asset markets primarily because each privatization is treated as a unique, carefully scripted event rather than as a standard market-like, potentially repetitive transaction. Uniqueness is reinforced because the slow, deliberate pace of privatization allows each event to be treated as a discrete one. Part of the slowdown in the pace of privatization relates to the decreasing attractiveness of the remaining firms. This suggests that liquidations or the sale of the more productive assets of these firms should become more important components of the privatization process.

D. Improvements Fiscal Policy and Public Debt Management

The Egyptian Government has indicated it intends to strengthen the budgetary process. A 1973 Budget Preparation Law (53/1973) is still applicable, but affects things only slightly. Its age and the advancing sophistication of fiscal activities suggest that the relevance of the Law is slight. Because there is a vast array of Treasury accounts into which revenue can be placed and out of which expenditures can be dawn, normal budgetary control and accounting procedures are of reduced relevance. To date, controls are weak and accounting and reporting procedures are lacking.

Given this budgetary situation much will have to be developed before Egypt can have a precise, well-implemented fiscal policy. However, because government leadership has similar, somewhat conservative fiscal policy views, Egypt has an understood fiscal policy stance, but without much in the way of normal fiscal controls to implement it.

Regardless of the nature of fiscal policy, it is the case that the current budgetary procedures cause macro and microeconomic problems that need addressing to encourage private formal sector investment and trade. In managing the substantial increase in the deficit at the end of the 1990s, the GOE seems to have relied mainly on non-market interventions to suppress inflation.

There were policies that the GOE might have adopted that are consistent with greater economic liberalization and improved longer-term private sector growth prospects. Primary among these would be to sell bonds to the private sector. This would be an important reform thrust of the DSP reform program. Had the GOE speeded the pace of the relevant DSP I reforms, such bond sales would have been a much more welfare increasing policy option for the GOE.

Two microeconomic problems stand out with respect to budgetary procedures. One relates to the uneven incentive effects of the tax system. The standards by which to judge the incentive effects of tax systems, involve doing an assessment assuming revenue neutrality.[27] That is, abstracting from concerns about the deficit by asking the question, "given the most recent year's tax revenues, can the same amount be raised through tax reforms that improve development incentives?" The overriding principle is to shift taxes from private business and investment (capital) and onto consumption expenditures. Doing so will cause domestic output prices to rise relative to the prices of inputs or the costs of production.

This reform principle implies that countries should first introduce a General Sales Tax (GST) and then raise tax rates and tax collections on consumption expenditures (i.e., on consumers) in order to be able to reduce taxes on and tax collections from private producers/investors. Egypt has already introduced a GST, but the management of increasing taxes and prices paid by consumers must be carefully introduced and explained to the public.

In fact, the logic of raising taxes on consumers, and lowering them on private producers/investors is that this will increase formal sector private investment, employment, and worker incomes. This can lead to the poor having access to jobs and earned income rather than having to depend on transfers. In addition, since it is supposed to be a revenue neutral tax reform, consumers should be as well off as before in terms of net consumption expenditures, but better off in terms of increased savings. In short, increasing the GST while reducing taxes on producer/investor profits and inputs helps solve a poverty problem by increasing employment, rather than spreading a stagnating amount of price-related transfers to a growing number of poor.

At present only about 30 percent of GOE tax revenue is collected via the GST.[28] Another 30 percent comes from business profits taxes and another 40 percent comes from other indirect taxes, e.g., on imports and inputs. In an ideal system, more revenue would come from the GST and income tax and the remainder of the tax revenues would come from something like an ‘excess profits/capital gains tax’ or a tax on super normal profits. Profits would be calculated using very liberal (rapid) depreciation rates. In such a system, there would be absolutely no exemptions from the GST for any consumption expenditures on final goods or services. However, the GST would be steeply graduated, with low tax rates on basic needs and very high tax rates on luxury goods and services.

The other fiscal policy problem relates to the high cost but low real value of public sector output provided through the budget. The GOE provision of these public goods and services can be direct (e.g., education, etc.) or indirect through GOE purchases or contracting out. It is assumed that problems with GOE purchases can be ameliorated by efforts to change and strengthen GOE contracting and purchasing procedures. These problems, that is, the high cost but low quality and value of publicly provided services requires significant improvements in what is called ‘Public Expenditure Management’ (PEM).

The high cost and low real value of directly provided government services results from two, inter-related fiscal problems. One, a PEM problem, is an imbalance in the current budget between (very high) expenditures for public sector employment (civil service wages and salaries, Chapter I of the National Budget) and very low expenditures for the goods and services they need to perform their jobs (Chapter II). Public servants do not have the money to buy the goods and services (e.g., textbooks, petrol, etc.) needed to do their jobs properly.

The other problem relates to poor public sector work incentives. It derives from the view that the GOE must be the employer of last resort in the formal economy. The lack of non-GOE job opportunities in the formal economy has led to excessive government employment and a steady deterioration of work incentives and public sector worker productivity.

Solutions to this problem involve the GOE publicly avoiding the employer-of-last- resort role in favor of stimulating more private sector investment and employment. In Egypt stimulating more private sector employment need not begin with employment-specific fiscal policy initiatives. Instead, the GOE’s first initiatives could involve both increasing the credibility and effectiveness of free-market oriented fiscal/monetary/stabilization policies, and relatively massive economic liberalization/deregulation to enable expansion of private market and formal sector investment. Until and unless these initiatives are credibly completed, it will be both costly and ineffective to initiate specific fiscal programs targeted at increasing private sector employment.

The final dimension of fiscal policy to be considered is the GOE’s approach to managing its domestic and foreign debt. Until the establishment of the Debt Management Unit, GOE’s debt management policy was unclear. Ever since Egypt's May 1991 foreign debt rescheduling, senior economic leaders in Egypt have vowed not to increase, and if possible to reduce foreign debt. From then until now it has done pretty much as it has promised, although the GOE is currently considering issuing bonds in the Eurobond market.

Regarding domestic debt, the absence of free domestic debt markets is a legacy of the GOE's past economic policies. In this case, freely operating debt or bond markets would enable market determined rather than GOE controlled interest rates. It would also loosen the GOE's influence over the banking sector and commercial credit. In the past, GOE deficits were apparently financed mainly through government bond and bill sales to banks, but amounts outstanding have not changed appreciably since 1993/94. Instead, deficits, including the recent dramatic rise, have been mainly financed through steep increases in GOE borrowing from the NIB and other public economic authorities. Much of these funds were, in turn, derived from pension funds and insurance companies. This approach to financing deficits will not effectively crowd out excess aggregate demand in a way consistent with greater economic liberalization and with encouraging more private sector investment and trade in the longer-term.

E. Enhancing and Streamlining Financial Sector Reform and its Regulations

The financial sector can provide financial services that contribute greatly to GDP growth. Traditional reasoning used to be that financial services were mainly needed to provide inputs or financing for investment and production. That is, that increasing financing volumes and lowering costs would **indirectly** increase GDP by fostering investment and production. However, throughout the world, this has not proved to be an effective approach. Financing targeted for investment has gone astray and ended up financing consumption, particularly of imports.

A different view, supported by recent analysis[29], is that encouragement of growth in the financial sector also **directly** increases GDP by making it easier for households to save, and through the provision of services that enable consumption smoothing. The demand for all of these rises with income. In this view, investment and production can be 'pulled up' by growth in (income elastic) consumer demand for financial services. Of considerable importance to this latter view is the significant impact on employment and wage growth that accompanies expansion in the breadth and volume of financial services.

The existing Egyptian financial sector is underdeveloped. It is significantly owned and controlled by the GOE and has a heavy focus on servicing public sector financial demands. In some respects, it is a quasi-government instrument that is not well suited to providing the breadth and volumes of financial services desired by private businesses and consumers.

It is important that rapid growth in private, ‘for profit’ financial services be encouraged so that new institutions can cater to credit demands ‘around the edges’ of the current formal sector client base. This approach assumes that a large number of competing, financial service providers will find solutions to financial sector problems as they go along. It follows from this that solutions to the balance sheet problems of the major existing financial institutions in the formal economy should be compatible rather than at odds with rapid growth ‘around the edges’.

An approach to reforming financial sectors that are sliding into insolvency that is frequently followed stresses heavy treasury/central bank/IFI involvement in resolving financial insolvency (balance sheet) problems coupled with subsequent privatization of the ‘rescued’ institutions.[30] This approach has not been particularly successful. A major reason is that, even with privatization this approach, by itself, does not change the sector’s oligopoly structure, or its client pool. Instead, moral hazard problems have persisted and have led to the re-occurrence of balance sheet problems in a number of countries. Indeed, the Egyptian banking sector was restructured ten years ago because of previous problems of this nature and also relating to the rescheduling of foreign debt.

It may be that the best strategy involves stabilizing the publicly owned institutions while removing constraints to the rapid growth of competing, privately owned financial institutions. Following this, the public sector financial institutions can be restructured and privatized. The alternative, to focus initially on reforming and then privatizing the existing public sector financial institutions may not stimulate development of the sorts of financial services demanded by modern private businessmen and consumers.

There is also good potential for increasing the beneficial impact on the economy of the insurance and pension systems. Currently, although the size of the insurance sector is very small on an international comparison basis, entry barriers for new firms are high. Not only are the capital requirements for establishing a new insurance company quite high, but EISA has the authority to decide whether it is convenient for a new company to enter the insurance sector. Since nationalization in the 1960s, very few new companies have entered the market. The government’s view has been that the market is saturated and if any new companies wish to enter, they should buy all or part of one of the state-owned companies. Egypt’s regulatory framework has been one of market control, rather than the promotion of competition while monitoring solvency.

The government has recently adopted a reform plan for the insurance sector that will have a substantial beneficial impact on the contribution of this sector to the economy. The implementation of the plan should be a priority for implementation.

F. Liberalization of Foreign Exchange and Monetary Policies[31]

Egypt has used a fixed LE/$ exchange rate as a nominal anchor to support stabilization efforts. However, there are a variety of administrative controls on access to credit and foreign exchange and nominal interest and exchange rates are probably too low to balance the supply and demand for credit and foreign exchange. There are also a variety of restrictions on imports. This leads to the existence of excess domestic demand for (domestic shortages of) tradable goods and foreign exchange to be held as savings. If the GOE did not also control many domestic prices, the domestic costs of tradable output would rise, thus stimulating more domestic production, trade, and employment. To a large extent it is, therefore, the GOE's desire to keep domestic prices low, in order to protect consumers, that interferes with growth in GDP and employment, which would benefit the poor. This political issue is at the core of several of the economic policy issues that the government is addressing.

The Egyptian data does not show inflation or stagnation, but it is generally believed that both are currently problems. It is possible that inflation is suppressed by GOE efforts to persuade producers to keep prices down. This could lead to something that might be called a 'monetary overhang'.[32] The data also do not show stagnation. It is possible that formal sector growth has declined sharply, but that the official GDP growth figures overstate overall growth by increasingly expanding coverage of informal economic activity and including it in current economic statistics without comparably adjusting upward the data for previous years.

The GOE influences the prices and availability of foreign exchange and the allocation of domestic credit through its control over key institutions in the financial system. The result is that excess demand is not removed through price and cost adjustments in the formal economy. In particular, it prevents the prices of tradable output from rising relative to the prices of non-tradable output. This price adjustment, which is the 'real devaluation', is needed for greater growth in GDP and exports.

The primary rationale for these GOE price interventions is to prevent inflation, which devastated the Egyptian economy in the early and mid 1990s. The GOE's influence over many tradable output prices is implicit rather than explicit. This system, though not an 'arms-length' one, has kept inflation rates low while enabling reported GDP growth rates of about 5-6 percent for the past several years.

There are three types of reform initiatives that are consistent with a continuation of these implicit controls over tradable output prices and profits. Two are considered under Enhancing Competition above. They involve policies that lead to an intentional lowering of input prices and the expansion of the number of firms producing tradable output. The third, more suitably discussed here, is the role that liberalized interest rates and the creation of asset markets can have in stabilization and improved efficiency. Such liberalization involves selling GOE bonds to the private sector through brokers. These brokers would create bond markets by breaking down the bonds into sizes that are of interest to purchasers.

Bond sales will help absorb monetary overhangs (suppressed inflation)[33]. In addition, issuing a diverse set of debt instruments would stimulate the development of privately operated domestic financial markets and services. The current economic situation suggests that it is very important to put in place the institutional and regulatory framework needed to successfully issue a broad array of debt issues to private businesses and consumers. These would include government, infrastructure and industrial/banking bonds, as well as mortgages. The primary purpose of the issues would be to foster market development, although the GOE could also thereby raise more revenues in a non-inflationary way.

G. Enhancing the Business Environment and Investment Opportunities[34]

It is useful to distinguish between behavioral changes that are **induced**, through alterations in economic incentives and those that are **mandated** through laws, regulations, and decrees (All of which are hereinafter called 'laws'). Many of the behavioral changes anticipated under DSP I and II are likely to be most efficiently induced through alterations in price and cost incentives. However, there are exceptions involving amending laws and/or the administration of them. In DSP, concerns about the rule of law mainly relate to how Egypt's present laws and the administration of them reduce the actual and prospective profitability of private investment and commercial activity. Concerns about corporate governance mainly relate to how to insure that greater corporate profits are accompanied by increased, rather than reduced social welfare.

The present legal system, comprising both the laws and their administration is dominated by the GOE and not well suited to rapid expansion of efficient, private economic activity. The system's main problems are that it is very time-consuming and costly to use. Furthermore, this time-cost element, or interest forgone, is not recognized in legal settlements. It can be used to intrude capriciously into legitimate economic activity and is seen as lacking transparency. It can also be a hindrance to the expansion of private commercial activity.

The government has made progress in identifying approaches to improving the **administration of justice** through pilot programs. Progress has been made in judicial reform, both procedural and substantive, as well as in improving the court system's administration, legal research, case management, and documentation.

In one of the pilot areas, the time for case resolution has decreased nearly 50 percent.

As part of the pilot program, a trainer of trainers program was carried out for judges. This program focused on upgrading knowledge of commercial law, introduced alternative dispute resolution approaches, and built capacities in governance-oriented issues. During DSP II, this foundation should be used to train additional judges and replicate the pilot activities throughout the country.

In addressing issues of legal reform, it is important to consider the implications for the huge 'illegal' informal economy in Egypt. Independent measurements find it to be approximately equal in size to that of the formal economy[35], yet it seems to function without a formal legal system. The vibrancy of the informal economy suggests that the best legal system reforms, from the viewpoint of faster economic development, would be those that allow/encourage a unification of the formal and informal economies without reducing the value of output in either.

A successful legal system reform should envelop the informal economy in a way that encourages it. It is likely that this rules out a completely GOE dominated and controlled reform of the legal system. Instead, it suggests that GOE sanction, and even encourage, the expansion of privately provided legal services and accept a process of codification of what works rather than what should work. Sanctioning the expansion of private legal services entails codifying and GOE acceptance of legal outcomes arrived at privately. However, encouraging the expansion of legal services might require some government support for the infrastructure needed by a growing number of private legal service providers.

Corporate governance issues apply mainly to companies where ownership and management are separate. In such circumstances, principal/agent problems can arise because of the slow or incomplete transmission of information or the differential treatment of minority shareholders. Without a good and timely information flow, managers can behave in ways detrimental to owners' and creditors', as well as society's welfare. Without adequate protection of minority shareholder rights, equity ownership will be seen as being excessively risky. It is generally held that pursuit of the dual goals of profit and long-term net worth maximization will maximize the welfare of both owners and society. Devious managerial or majority owner behavior, involving asset striping, transfer pricing (where profits are shifted out of the firm), or not paying creditors can reduce real profits, net worth, and owner and social welfare.

There are two approaches to solving such principal/agent problems, one legal, and the other economic in nature. Both entail clearly establishing expectations regarding managerial and majority owner practices. The economic approach involves designing salary incentive schemes that induce behavior that maximizes owner (and societal) welfare. The legal approach is to direct managers and majority owners, through corporate laws, codes of conduct, and principles regarding acceptable practices.

The two complementary approaches to deal with this issue are first, to improve in-firm incentives as a contribution to solving corporate governance problems. To be effective this approach also requires considerable competition in capital markets so that poorly performing managers are quickly exposed. The second approach is to prescribe appropriate behavior through re-drafting old, or drafting new laws, codes, and regulations. This approach requires a separate administrative or implementing system and a well-functioning legal system that is independent both from government and corporate influences.

During DSP II, an initial strategy for reforming corporate governance in Egypt could include the following:

- Create a joint public/private sector working group to draft a code of best practices for corporate governance for Egyptian companies.
- Draft a uniform company's law based on international best practices.
- Define the role of the public and private sectors in improving corporate governance.
- Develop a training program for directors in basic corporate governance.

H. Laying the Foundation for Civil Service Reform

The civil/public service in Egypt is overstaffed and underpaid, with weak professional incentives. However, it wields political influence that can lead to resisting efforts to reform it. Because of this, civil service reform will be very difficult unless reforms in other economic areas are successful. If other reforms are successful, public sector employees can willingly leave the civil service for better jobs elsewhere. A particular requirement is that significant increases occur in employment and wage (labor productivity) prospects in the private formal sector. Without these, it will be difficult to reduce the number and raise the per-worker productivity and compensation of civil servants.

It is generally agreed that both government agencies and many businesses, particularly SOEs, are heavily overstaffed. Many civil servants can position themselves to inhibit or facilitate business activity. This leaves them in a position to collect gratuities and allows them to do things slowly and inefficiently. As with the classic definition of negative marginal productivity, it is likely that overall economic productivity and output would rise, perhaps significantly, as the number of redundancies of public servants, even if on full pay, increases. The main problem is that the civil service has acted as an employer of last resort. This has caused enormous over-employment in the civil service and, as the rate of net public sector hiring has fallen, increased transition times in the public educational system. It has also led to excessive expansion of civil servant functions.

Reforms in three main areas are called for:

- First, the amount of civil service administrative activity and the number of authorized civil service positions should be rationalized/reduced to decrease the number of civil servants required.
- A second reform would be to achieve a significant reduction in the number of publicly paid workers, even without similar reductions in the public sector wage bill. This will allow those who remain to receive higher wages, preferably increasingly linked to performance.[42]
- And finally, the issue of civil service performance and malfeasance, including bribe taking must be addressed.

The lessons from other countries are that these performance and malfeasance problems only disappear when they are addressed both indirectly, e.g., through reform of salary schedules, as well as directly.[43] It appears that it is necessary to institute direct, positive incentives for improved performance and penalties for poor performance. In addition, there will be a need for special investigative units to ferret out corruption. They must be imbued with sufficient power and stature so that their findings result in the imposition of penalties, including dismissal.[44]

During the DSP II period, an initial step that would help lay the foundation for needed reform of the civil service would be the collection of information on existing public services. This could include such key characteristics as service time, use of resources, quality of user experiences, and formal and informal costs. In addition, the potential for contracting out public services could be assessed based on international experience.

I. Promotion of Data and Information Transparency and Dissemination

In Egypt, the needs of researchers, entrepreneurs and policymakers for timely and accurate economic data clash with a low priority assigned to the public release of such data. Frequently, relatively comprehensive and accurate data are collected but not released publicly. Sometimes, even their existence is unknown outside of a small group of officials. Alternatively, data may be poorly defined and explained and/or collected/published in non-standard ways.

Given the importance that is attached to freely accessible, easily understandable, and accurate information, the lack of it in Egypt is costly. For one thing, rumors substitute for facts.[45] For another, the selective provision of information conveys monopoly privileges. It also prevents the use of data that is obtained unofficially for analysis that is to be made public. And finally, when the credibility of the published data is suspect, people feel free to make capricious ‘adjustments’ whenever it appears advantageous. In the end, these problems with Egyptian data raise costs by fostering inappropriate decisions by policymakers, businesses, and researchers.

The following examination of issues surrounding the widely questioned 6.5 percent 1999/2000 real GDP growth rate demonstrates some of the problems associated with the collection and dissemination of data. While it is generally considered too high, even though it is the official but provisional figure issued by the Ministry of Planning[46], it is based on surveys of the **nominal** value of production of visible (formal and informal) enterprises, including farms. These survey results are inflated by including estimates of the nominal value of invisible, formal sector (e.g., licensed) services. There is official recognition that these estimates omit or under-report the value of informally provided services in the education, health, business, and trade and transport sectors. Some provisional attempts to expand coverage of estimates for these are being made, but most fundamentally, the design and conduct of the next five-year standard survey will be changed to specifically cover these informal services. Although it is likely that this 6.5 percent figure passed an IMF financial consistency check, it is also possible that lower real GDP growth rates would also pass that check, as long as prices not covered by the CPI rose at faster rates than the CPI.

In any event, there have been independent estimates suggesting that Egypt’s 1999/00 real GDP growth rate was below 6.5 percent suggesting a ‘slowdown’ compared to the 6.1 percent official growth rate recorded for 1998/99. Indeed, the press has adopted the slowdown theme, which is consistent with the declining inflation rate. The problem is that people tend to believe these independent estimates and in the press more than they believe the official data. A lack of transparency regarding what the data are, how they are collected, and what they mean is a major part of the problem.

In addition, there is a lack of awareness, even within the present statistical apparatus, of the need in a more global economy for timely publication of well explained, internationally standardized data. Educating existing statistical staff to appreciate and perform these new informational functions is likely to be only marginally effective. Many are already performing other functions.

Probably more effective would be to establish a new institution, within the statistical apparatus, charged with increasing the publication of, and access to user-friendly statistical information. Such a new institution, perhaps called the Statistical Policy Unit (SPU) is currently under discussion. Its main focus would be to improve the standardization of data and statistical transparency. It should embrace the transparency precedent that ‘a release to one is a release to all’. Such a SPU would probably require new staffing and re-training in order to standardize data definitions and outputs, and inventory and broadly (probably electronically) publicize both the availability of data series and the data itself.

ENDNOTES

[1] The nine areas are: (1) Improving the Export Orientation and External Trade Balance; (2) Enhancing Competition and Regulations; (3) Improving the Efficiency of Resource Allocation; (4) Improving Fiscal Policies and Debt Management; (5) Enhance and Streamline the Financial Sector and its Regulations; (6) Liberalize the Foreign Exchange Rate and Monetary Policies; (7) Enhance the Business Environment and Investment Opportunities; (8) Lay the Foundation for the Reform of the Civil Service; (9) Promote Data Transparency and Dissemination.

[2] Recent findings suggest that internal and international trade usually rise together. That is, that except in extractive and enclave industries, expanding international trade involves a companion expansion of internal trade. See, Ceglowski, Janet. "Has Globalization Created a Borderless World?" in Globalization and the Challenges of a New Century: A Reader, edited by Patrick O'Meara, Howard D. Mehlinger, and Matthew Krain, Bloomington, IN: Indiana University Press, 2000, pp.101-111.

[3] Guesses of the size of these arrears have ranged from a low of LE 5 billion to a high of LE 25 billion.

[4] This includes NIB and SOEs.

[5] One hears that businessmen have occasionally been charged 17% to 19% for credit. The data in Table 4 don't show this. However the main point is that CBE didn't raise interest rates to allocate significantly reduced credit that was available to the private sector. Instead, GOE or GOE owned banks appear to have administratively allocated the credit cutbacks.

[6] It would be better if the bonds are bearer bonds.

[7] Schneider, Friedrich and Dominik Enste. "Shadow economies around the World: Size, causes and consequences." (IMF working paper ; WP/00/26) International Monetary Fund, Fiscal Affairs Department, February, 2000. This study says Egypt's informal sector is 80% of its formal economy.

[8] Hernando De Soto's work in Egypt through ECES.

[9] Much better would be for the imports to be of the low value added, input variety that go first to the informal economy for further processing and then to the formal economy as inputs to their outputs.

[10] For instance, many Egyptians believe that the devaluation of the LE/$ exchange rate will result in domestic price increases rather than reductions in the volumes of imported inputs or expansion of exports.

[11] The IMF RED presents rough estimates of the fixed investment/GDP ratio. This was about 19% in the last two years, but because GOE transfers to NIB and NIB expenditures are not effectively netted out, this figure contains double counting as well as being subject to other errors. In addition, there are no separate figures for private investment. In an earlier RED, the IMF estimated that purely private sector investment, excluding investment by public corporations, was estimated at 4% of GDP.

[12] To understand the beneficial role that price/cost shocks can have in a competitive environment see Eric J. Bartelsman and Mark Doms, "Understanding Productivity: Lessons from Longitudinal Microdata." JOURNAL OF ECONOMIC LITERATURE, Vol38, (Sept. 2000, pp. 569-594).

[13] A common argument is that capital utilization is limited by lack of imports. However, if Egyptian enterprises operated at international levels of efficiency, they could expand capacity utilization and profits by importing in order to expand exports.

[14] The English language EGYPTIAN GAZETTE of May 2, 2001, p. 7 contains an article with the following quote by Saeed Abdul-Khaliq, undersecretary in MOEFT. "Copycat economy [presumably duplicate investments] means wasting resources that could be directed to other areas more vital to the national economy." The article goes on to say, "He shared the view that repeating the same types of investments meant that supply would exceed demand, ending in slow sales and sell offs (liquidations). This entails less profits in both the medium and long terms." There have been also press clippings suggesting that some government officials consider more private banks and insurance companies to be similarly superfluous.

[15] This is based partially on: Hassan Selim, "DSP II: Major Objectives and Policy Analysis." Feb./Mar. 2001:

[16] Egyptian businessmen tend to say that NTBs, not tariffs are the binding problem. A tariff reduction mainly means they have to pay more for GOE-provided trade services, so their gross import costs end up being the same.

[17] There are several legal loopholes however.

[18] As is the test for trade creation.
[19] An exception to this is that certain tax rebates for exports are permitted/encouraged.
[20] This is based partially on: F. Shaker, "The transformation of the Egyptian Labor Market." 11/12/00, 8 pp.: Author Unknown, "Labor and Civil Service Reforms." 11/14/00, 14 pp.: Mervat Fikry, "Civil Service Reform in Egypt." 12/9/00, 34 pp.: Mervat Fikry, "Concept Paper: Child Labor Issues and Influence on Exports." 4/28/01, 48 pp.
[21] See footnote 19 above.
[22] Apparently there is a separate proposed law drafted by the Ministry of Home Supply.
[23] See Eric J. Bartelsman and Mark Doms, op. cit.
[24] Moral hazard problems between governments and their citizens lead to reductions in private initiative. At first the government may rise to the occasion and supplement personal initiatives. This leads to an intensification of the moral hazard problem as citizens' expectations increase and their personal effort declines. Eventually the government can no longer expand further, but moral hazard prevents the re-emergence of personal initiative. Instead rationing, or informal activity takes over.
[25] Lyn Squire and Zmarak Shalizi, Lessons of Tax Reform. World Bank, 1991:Washington, DC.
[26] Taxes represent about 65% of GOE revenue, with the rest (LE 24 b or about $ 7 b) being mainly transfers from abroad. All these percentages are for FY1997/98.
[27] Ross Levine, "Financial Development and Economic Growth: Views and Agenda" JOURNAL OF ECONOMIC LITERATURE, June 1997, vol. 35 Issue 2, pp. 688-726.
[28] Gerard Caprio, Jr and Robert Cull, Bank Privatization and Regulation for Egypt. Distinguished Lecture Series 15, Published in August 2000 by ECES, Cairo, Egypt.
[29] Two background papers relevant to this are: Hassan Selim, "DSP II: Major Objectives and Policy Analysis." (pp. 4-6), Feb/Mar., 2001 and Robert Myers, "DSP2:Note 2. The Liquidity, Exchange & Interest Rate Problems in Egypt" October, 12, 2000.
[30] Indeed, the velocity of money has fallen, although only very slightly.
[31]It should noted that more rapid privatization will also help sop up excess private sector demand.
[32]This is based partially on: Ali Kamel, "Corporate Governance Report-DSP II Design," 11/13/00; and, USAID/CLDP, "Statement of Work- Commercial Law Development," 6/10/1997.
[33] See footnote 12 above.
[34] This is based partially on: F. Shaker, "The transformation of the Egyptian Labor Market." 11/12/00, 8 pp.: Author Unknown, "Labor and Civil Service Reforms." 11/14/00, 14 pp.: Mervat Fikry, "Civil Service Reform in Egypt." 12/9/00, 34 pp.: Mervat Fikry, "Concept Paper: Child Labor Issues and Influence on Exports." 4/28/01, 48 pp.
[35] Private correspondence with Dr. Ragui Assaad.
[36] These different CAPMAS, World Bank and ILO figures are cited on p. 14 of a draft entitled , "Jobs, Employment and Labor Markets in Egypt," dated July 30, 1999 and done by Checchi-Louis Berger International, Inc.
[37] This 1.5 million is in the Egyptian Gazette, May 2, 2001, page 7.
[38] Ibid, p 31.
[39] Eric J. Bartelsman and Mark Doms, "Understanding Productivity: Lessons from Longitudinal Microdata." JOURNAL OF ECONOMIC LITERATURE, Vol38, (Sept. 2000, pp. 569-594).
[40] At present, the amounts of supplementary payments not linked to performance are reported to be a very large portion of total civil service income.
[41] There is a significant debate over this. Susan Rose-Ackerman (Corruption and Government: causes, consequences, and reform. Cambridge, U.K.; New York: Cambridge University Press, 1999) covers the debate but takes a minority view that appropriate wage structures will ameliorate corruption.
[42] Daron Acemoglu and Thierry Verdier, "The Choice Between Market Failures and Corruption." AMERICAN ECONOMIC REVIEW, Vol. 90, No. 1 (March 2000), pp 194-211.
[43] See "About rumors ….." The Egyptian Gazette (English), April 25, 2001, p. 1
[44] The Ministry of Planning gathers these data on nominal GDP and its components in order to establish the latest base year for the Plan. It makes some of the data available to other ministries for publication. There are a lot of other data that are not made available to the public, however.