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Report to Rep. Lee H. Hamilton, Chairman, House Committee on International Relations: Europe and the Middle East Subcommittee; by Elmer B. Staats, Comptroller General.

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U.S. assistance to Egypt has become a political symbol of evenhanded support among the Middle East adversaries. The economic impact of U.S. assistance depends on Egypt's development of encomic reforms. Findings/Conclusions: The U.S. programs provide long-term benefits through development projects. Short-term balance-of-payment relief is provided through the Commodity Import Program and food aid. The most serious impediment to Egypt's development is its difficulty in mobilizing domestic resources. Egypt's accelerated development program will require it to stretch financial, material, and organizational resources to the limit. This could have a destabilizing effect if development is not accompanied by sound budgetary management. Recommendations: Congress should consider the merits of providing hard currency financing for the local costs of selected projects in the U.S. assistance program for Egypt. The following factors should be considered: (1) the U.S. level of assistance to Egypt is based on political considerations, not on Egypt's economic capacity to accelerate its development program; (2) the economic reforms enacted are expected to fall short in providing the increased savings required to accelerate Egyptian development; and (3) U.S. assistance to Egypt should include projects which will provide long-term benefits. (Author/SC)

REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES

Egypt's Capacity To Absorb And Use Economic Assistance Effectively

U.S. assistance to Egypt has become a political symbol of even handed support among the Middle East adversaries. The economic impact of U.S. assistance depends on Egypt's development of economic reforms.

In response to Egypt's economic situation, the United States, through the Department of State and other Federal agencies, has switched from project funding to commodity funding, has supported the establishment of an Egyptian Consultative Group, and has removed certain restrictions on the Commodity Import Program.

GAO is suggesting that the Congress consider the merits of providing hard-currency financing for the local cost of selected projects in the U.S. assistance program for Egypt.

ID-77-33

SEPTEMBER 15, 1977

B-125010

The Honorable Lee H. Hamilton, Chairman
Subcommittee on Europe and the Middle East
Committee on International Relations
House of Representatives

Dear Mr. Chairman:

Your letter of May 17, 1976, requested that we review U.S. economic and food aid programs for Egypt since their inception following the 1973 Middle East war. Members of my staff had numerous meetings with your office to further define the scope of our work. We also briefed your office several times on the results of our work and provided more detailed information for the Committee to use in its consideration of aid requests for fiscal year 1978.

This report reviews the purpose and effectiveness of U.S. assistance to Egypt from 1974 through late 1976 to determine (1) how assistance levels were established, (2) how projects are designed and implemented, (3) how the U.S. program is coordinated with those of other donors, and (4) the impact of foreign assistance on the Egyptian economy. We examined U.S. policy papers, strategy statements, program documents, reports, correspondence, and other pertinent data and talked with officials of the Departments of Agriculture, State, and the Treasury; the Agency for International Development; and the Egyptian Government. We began our fieldwork in Egypt in October 1976.

We believe that Egypt's capability to absorb and effectively use the substantial amount of economic assistance made available to it by various donors is severely constrained by a number of factors. Financial problems are the major constraints to implementing the development assistance programs, and lack of adequate Egyptian managerial and technical resources to effectively plan, program, and implement development projects has severely hindered progress to date.

We are suggesting that the Congress consider the merits of providing hard-currency financing for the local costs of selected projects in the U.S. assistance program for Egypt. An alternative to this proposal would be to provide a greater portion of U.S. assistance through the Commodity Import Program.

As agreed with your office, we plan to distribute this report to the agencies involved and to other appropriate congressional committees.

As always, we stand ready to render further assistance on the matters presented in this report.

Sincerely yours,

James B. Staats

Comptroller General
of the United States

REPORT OF THE
COMPTROLLER GENERAL

EGYPT'S CAPACITY TO ABSORB
AND USE ECONOMIC ASSISTANCE
EFFECTIVELY

D I G E S T

The United States has important and obvious interests in preserving peace in the Middle East. Strengthening U.S. economic relations with Egypt and with the Arab world is part of these interests. Egypt has moved from confrontation to negotiation as a means of resolving the Arab-Israeli dispute. However, its leaders face acute and massive tasks of rebuilding the Suez area, rehabilitating the economy, and carrying forward the country's develoment.

U.S. aid to Egypt is justified more on the basis of a political symbol of evenhanded economic support for stability in the Middle East than on the capacity of Egypt to absorb and use the available assistance effectively. (See p. 1.)

U.S. assistance increased from $370 million in 1975 to $991 million in 1976, even though U.S. policymakers believed that

--Egypt might not have the capacity to absorb increased project aid and

--the actual impact of this aid on Egypt's economy would depend on Egypt's response to basic economic reforms being discussed with the International Monetary Fund. (See p. 4.)

The Secretary of State has encouraged Egypt to enact reforms and has supported the establishment of the Egyptian Consultative Group, whose purpose is to effectively channel assistance to Egypt. (See p. 22.)

U.S. assistance to Egypt includes development projects, the Commodity Import Program, and

Public Law 480 food aid; for fiscal years 1975-78, a total of $3.2 billion has been approved for these programs. In addition, for calendar years 1975-77, other countries and international organizations have made approximately $7.9 billion in assistance available to Egypt. (See p. 11.)

The U.S. programs provide long-term benefits through development projects. Short-term balance-of-payment relief is provided through the Commodity Import Program and food aid.

Egypt's capability to absorb and use effectively the substantial amount of economic assistance made available to it by various donors is severely hampered by a number of factors. Financial problems are formidable restrictions to putting the development assistance programs into action. Moreover, lack of adequate Egyptian managerial and technical resources to plan, program, and implement development projects has severely hindered progress to date. (See p. 11.)

The most serious impediment to Egypt's development is its difficulties in mobilizing domestic resources. Egypt's accelerated development program will require it to stretch financial, material, and organizational resources to the limit. This could have a destabilizing effect if development is not accompanied by sound budgetary management. (See p. 12.)

GAO suggests that the Congress consider the merits of providing hard currency financing for the local costs of selected projects in the U.S. assistance program for Egypt. (See p. 16.) The following factors should be considered.

--The U.S. level of assistance to Egypt is based on political considerations, not on Egypt's economic capacity to accelerate its development program.

--The economic reforms enacted are expected to fall short in providing the increased savings required to accelerate Egyptian development.

--U.S. assistance to Egypt should include projects which will provide long-term benefits.

Another alternative discussed in this report is to provide a greater portion of U.S. assistance through the Commodity Import Program. The additional imports would generate budgetary resources which could be used to support development projects.

However, at the present time this may not be a viable alternative. In August 1977, the pipeline of authorized but undisbursed Commodity Import Program loans for Egypt exceeded $700 million, so there is some question of Egypt's ability to quickly use the Program to import commodities required in its economy. Therefore, if this alternative is chosen, it would be necessary to ascertain that Egypt could use the additional authorization in a timely manner to generate the local currency required for development projects. (See p. 17.)

The Department of State and the Agency for International Development agreed that Egypt's mobilization of adequate resources for specific projects may be a problem and suggested that local-cost financing be used as an added incentive to obtain Egyptian support for "new direction" projects. (See p. 17.)

The Department of the Treasury stated that increased local-cost financing might have little effect on aid disbursements because of multiple restraints on project implementation.

GAO recognizes that local-cost financing is not a panacea to Egypt's development problems and that improved planning, economic reforms, and coordination are needed. (See p. 18.)

Contents

ABBREVIATIONS

AID	Agency for International Development
CIP	Commodity Import Program
GAO	General Accounting Office

CHAPTER 1

INTRODUCTION

The United States has important and obvious interests in preserving peace in the Middle East and in strengthening its newly developed economic relations with the Arab world. Egypt is an important factor in fostering these relationships.

Egypt has embarked on the road to peace and has moved from confrontation to negotiation as a means of resolving the Arab-Israeli dispute. However, its leaders face the acute and massive tasks of rebuilding the Suez area, rehabilitating the economy, and carrying forward the country's development.

Levels of U.S. economic assistance to Egypt for fiscal years 1975-77 reflect U.S. political desires to demonstrate (1) equitable treatment of Israel and Egypt, (2) support of President Anwar Sadat's policy of moving away from military confrontation with Israel and toward economic development at home, and (3) satisfaction with the progress toward developing the second Sinai agreement.

U.S. aid to Egypt is justified more on the basis of a political symbol of evenhanded economic support for stability in the Middle East than on the capacity of Egypt to effectively absorb and use the assistance available. Aid levels were increased from $370 million in 1975 to $990 million in 1976, even though U.S. policymakers believed that Egypt might not have the capacity to absorb increased project aid and that the actual impact on the economy would depend on Egypt's response to basic economic reforms being discussed with the International Monetary Fund. Moreover, administration officials believed that the United States was not in a position politically to link increased assistance levels to Egypt's movement toward economic reforms, even though reforms were recognized as essential to Egypt's economic recovery.

The composition of fiscal years 1975 and 1976 programs is as follows.

	Loans	Grants	Total
	-------(millions)-------		
Fiscal year 1975:			
Commodity Import Program	$150.0		$150.0
Development programs	44.3	$58.5	102.8
Food aid			
Concessionary sales	104.5		104.5
Donations		12.8	12.8
Total	$298.8	$71.3	$370.1
Fiscal year 1976 and transitional quarter (note a):			
Commodity Import Program	$315.0		$315.0
Development programs	264.0	$216.0	480.0
Food aid			
Concessionary sales	190.8		190.8
Donations		5.5	5.5
Total	$769.8	$221.5	$991.3

a/Transitional quarter includes period from July 1 to September 30, 1976.

It should be noted that the U.S. program in Egypt is financed with security supporting assistance funds, not development assistance funds. Security supporting assistance funds, which are administered by the Agency for International Development (AID), are used in special situations to further U.S. political and security interests while at the same time supporting the economic stability of recipient countries.

UNITED STATES-EGYPT RELATIONS

In the early 1950s, Egypt under President Gamal Abdel Nasser began to seek unqualified political independence. In 1954, Britain agreed to evacuate its troops from the Suez Canal Zone, and the withdrawal was completed in June 1956.

Egypt's economic growth plans centered on the construction of the high dam at Aswan and the receipt of revenues from the Suez Canal. However, Egypt was unable to finance the dam by itself and turned to the West for aid. After long and difficult negotiations, arrangements were made for a loan to be financed jointly by the United States, Britain, and the World Bank. Then in 1956, Secretary of State John Foster Dulles announced that the United States was withdrawing from the arrangement; in response, President Nasser announced that Egypt would get the needed funds for the dam by nationalizing the Suez Canal.

Following President Nasser's announcement, Egypt's relations with Britain and France deteriorated rapidly. Meanwhile, border frictions between Egypt and Israel increased. In 1956, France, Britain, and Israel launched an invasion of Egypt, but warnings from the United States and the Soviet Union halted it. After the United Nations arranged a cease-fire, British and French forces withdrew from Egypt and Israeli forces were withdrawn from the Gaza Strip.

During 1959 and 1960, United States-Egyptian relations improved. Financial aid agreements were signed in March 1960 providing for the sale of surplus U.S. farm products and for loans totaling $32.5 million for economic development. During fiscal years 1962-65, AID contributed $94.5 million in loans and grants, including $30 million from security supporting assistance appropriations.

Egypt's association with the West deteriorated during 1964 and 1965, while its dependence on the Soviet Union increased. This led to an embargo by the United States on supplies of surplus wheat which were badly needed by Egypt. In fiscal year 1966, U.S. assistance declined to $1.5 million in loans and grants, and in 1967 it fell to $800,000. No U.S. loans and grants were made available to Egypt from the 6-day war in 1967 until 1974, when $8.5 million was provided for canal clearance and minesweeping operations.

The Sinai Accord signed by Egypt and Israel on January 18, 1974--stating that the two parties would resolve their conflict by peaceful means--afforded the United States and Egypt the opportunity to renew full diplomatic relations after a 7-year break. Shortly thereafter, the Egyptian Prime Minister requested U.S. aid, and in March 1974 the Department of State decided to ask the Congress for $250 million for Egypt for fiscal year 1975.

On May 15, 1974, the U.S. Ambassador reported that providing needed commodities to Egypt would help that country to conserve its scarce foreign exchange. Basic replacement parts and industrial and building materials, needed to stimulate the depressed Egyptian economy, could be purchased through freed reserves. Also, Egypt had rapidly improved its relations with the United States over the preceding months and the request for U.S. assistance was as much political as economic. The Ambassador believed that the United States must be responsive to Egypt's request in order to maintain credibility in the development of the new relationship.

LEVELS OF ASSISTANCE

The AID began preparing the fiscal year 1976 program for Egypt in July 1974, when its former Bureau of Supporting Assistance developed guidance for the 1976 program. The guidance, sent to the AID Mission in January 1975, contained an assumption that $300 million, a $50 million increase over the fiscal year 1975 program, would be appropriate to indicate U.S. awareness of Egypt's foreign currency needs and willingness to aid in its development plans.

The U.S. Ambassador communicated the aid levels to the Egyptian Prime Minister. It was hoped that U.S. assistance would not be perceived as the cardinal issue in the two countries' relationship, since the proposed $300-million economic aid level was not comparable with U.S. assistance to Israel and was subject to congressional review.

Egypt's reaction to the $300-million level was negative. The Egyptians believed U.S. assistance to be a symbol of U.S. evenhandedness in the Middle East. Therefore, they pressed for economic assistance equal to that received by Israel, especially since Egypt was receiving no U.S. military assistance.

By March 1975, the Secretary of State believed the fiscal year 1976 aid level must be increased from $300 million to $500 million. A memorandum from the Assistant Secretary, Bureau of Near Eastern and South Asia Affairs, to the Secretary outlined the economic justification as follows.

> "Egypt has a clear need for additional foreign exchange, in part because the civilian economy has been deprived of an adequate level of capital goods and raw material imports over the years and in part because of an over-valued exchange rate, substantial subsidies of consumer goods and internal price controls which have distorted Egypt's economy."

*   *   *   *   *

> "It would be very difficult to increase the level of project aid since good projects will not be available in time for funding. In fact, it will be extremely difficult to find $200 million in adequately developed projects. Therefore, a $200 million increase in the Egypt aid level would have to be handled as an addition to the CIP [Commodity Import Program] program thus increasing it from $100 to $300 million."

The memorandum also noted that Egypt could probably absorb $300 million in U.S. commodities but that the actual impact on its economy would depend on its response to the basic economic reforms being discussed with the International Monetary Fund.

From March 8 to March 23, 1975, Secretary of State Henry Kissinger engaged in a new round of Arab-Israeli shuttle diplomacy. Subsequently, the President ordered a total reexamination of U.S. policy toward the Middle East settlement. This political reassessment increased the level of aid for Egypt to $750 million for fiscal year 1976.

The 1976 level of assistance thus became a symbol of U.S. evenhandedness among the Middle East adversaries. Accordingly, a significant reduction in the level of assistance could be interpreted by the Egyptians as a softening of U.S. support and a negative change in policy. For fiscal year 1977, $750 million in security supporting assistance funds was requested for Egypt, plus $150 million in supplemental assistance under the Public Law 480, title I, food sales program. The Congress approved $700 million in security supporting assistance.

CHAPTER 2

ECONOMIC SITUATION

The January 1977 food riots put into sharp focus the emergency nature of Egypt's economic situation, which in 1976 was characterized by growing balance-of-payments and budgetary deficits. International economists have concluded that, to make progress toward economic recovery, Egypt must enact economic reforms. The Egyptian Government recognizes its problems and has initiated a program of economic reform. In support of this action, the International Monetary Fund approved a $145 million standby arrangement on April 21, 1977.

BALANCE-OF-PAYMENTS DEFICIT

Rising imports and limited exports have caused Egypt's trade deficit to increase from $479 million in 1971 to $2.8 billion in 1975. This deterioration was due in part to the maintenance of an overvalued exchange rate which encouraged imports. (See app. II for balance-of-payments schedule.)

Egypt's imports continue to rise because Egypt does not produce enough food and raw materials to keep up with growth in population and demand and because it requires capital equipment and intermediate goods to implement its development plans. Moreover, Egypt is paying more for its imports because of sharply increased international prices of food, oil, and other essentials. For example, wheat doubled in price from 1972 to 1976. Basic commodities and food account for more than 70 percent of the imports. There are only a few capital goods items, such as automobiles, which can be eliminated. (See app. III for a list of imports.)

In 1971, export earnings ($878.3 million) paid for 85 percent of imports ($1,031.7 million); in 1975 export earnings ($1,402.4 million) paid for only 36 percent of imports ($3,940.6 million). Egypt has begun to export more petroleum, chemicals, and agricultural products but cotton and cotton products accounted for 70 percent of its export earnings in 1971 and 58 percent in 1975. This dependence on one commodity makes export earnings contingent on world cotton and textile markets, which have a very volatile history. (See app. IV for a list of exports.)

Egypt continues to receive large cash payments from Arab countries to help it avert a balance-of-payments crisis. (See app. V.) However, these contributions have not satisfied its foreign currency needs, forcing it to borrow heavily from commercial sources. External debt has increased to $7 billion (plus $5 billion in military debts and other transactions), or well over 5 years of earnings from exports and services at the 1975 level. (See app. VI.) Commercial loans (supplier credits, Euro-currency loans, and bank credit) amounted to $2.2 billion.

Debt-servicing for 1977 is estimated at 37 percent of 1977 exports, well above the 20 percent suggested for developing countries, and debt arrearages had more than doubled by the end of 1976. A policy of reducing the use of private bank credit has been implemented, based largely on limiting new loans to 75 percent of the amounts repaid on old loans.

<u>Exchange rate system</u>

Egypt's complex exchange rate system involves three different exchange rates--official, parallel, and "own."

--At the official exchange rate (one Egyptian pound equals $2.56) the pound is generally held to be overvalued.

--The parallel exchange rate was introduced by the Government in 1973 and established premiums and surcharges above the official rate. The net effect was that, as of June 1976, designated imports and exports could be purchased and sold with an exchange rate of one pound being the equivalent of $1.46 and $1.42, respectively.

--The "own" exchange facility extends the parallel exchange rate to Egyptians abroad who hold foreign currency. Imports of most consumer durables and luxury consumer nondurables in Egypt are made under own exchange regulations. The exchange rate for own exchange imports has ranged from one pound equalling $1.25 to $1.42.

The Government is aware of distortions caused by overvaluations of the Egyptian pound but believes that devaluing the pound would not be appropriate. Its argument is that Egypt's exports include many items, such as cotton and textiles, that are price in-elastic and exported under bilateral trade agreements to Eastern bloc countries, while most imports are necessities which come mainly from countries in which Egypt must use hard currency. Thus, in the short term, the orthodox measure of a devaluation might only worsen the foreign exchange situation.

On the other hand, the U.S. Department of the Treasury advanced the argument that devaluation would have a positive impact on Egypt's balance-of-payment position. In the Department's opinion, foreign exchange prices of Egyptian exports and imports are not likely to be altered by changes in Egyptian supply (of exports) or demand (for imports), so a devaluation would, at most, leave Egypt's foreign exchange situation essentially unchanged. However, the Department theorized that an even more likely outcome would be an improved balance-of-payments position as Egyptian producers increased the volume of their exports and reduced the volume of their imports in response to higher domestic prices.

The Government has recently shifted a large volume of its transactions from the official to the parallel rate, and other shifts are scheduled for 1978. Measures now being adopted will leave 27 percent of imports and 56 percent of exports of goods and services at the official rate and will have some of the economic impact that devaluation would have. The reforms also envisage eventual unification of the parallel and free markets.

FISCAL POLICY

On January 17, 1977, the Egyptain Government unveiled a record $10.16 billion budget and, faced with a potential $2 billion deficit, announced an austerity program consisting of reduced Government subsidies and increased taxes and customs duties. The effect of these moves was severe, raising the prices of wheat, flour, soup, rice, butane cooking gas, cigarettes, and gasoline by as much as 31 percent.

In response to these measures, thousands of workers and students demonstrated in Cairo and other cities. The official Middle East News Agençy quoted the Minister of State for Parliamentary Affairs as saying that the Government was willing to make an "objective reexamination of the price increases in order to spare the working classes." On January 19, faced with the worst riots in 25 years, the Government suspended most of its announced reforms. The remaining reforms entailed budget savings of only about $192 million instead of the initial $716.8 million. The net effect of the remaining savings was depleted further by the approval of additional expenditures totaling $76.8 million.

According to Government estimates, budget revenue is expected to increase by 37 percent, most of it through profits resulting from conversion to the parallel exchange rate. Increased budget expenditures are projected because of industrial subsidies, increased defense expenditures, and increased investment expenditures. In 1977, an overall deficit of $2.8 billion is projected, of which $1 billion is expected to be financed by the banking system. This compares to an initial deficit of $2.1 billion, of which $384 million was to be financed by the banking system. The Egyptians recognized that the resources available to finance expenditures, particularly for investment, have not been sufficient to avoid budget deficits. However, national defense requirements and subsidies to protect the standard of living of the lower income groups prevent greater budget reforms at this time.

Subsidies

Food, particularly wheat and flour, receives most of Egypt's direct subsidies, as shown below.

Subsidies (note a)	1976 budget	Percent of total
	(millions)	
Wheat and flour	$ 552.4	50.9
Maize	77.3	7.1
Edible oil	171.8	15.8
Sugar	54.7	5.0
Other	229.4	21.2
Total	$1,085.6	100.0

a/Excludes fertilizer and indirect subsidies.

If public sector deficits are also considered subsidies, subsidization can be said to have absorbed 30 percent of tax revenues in 1973, 71 percent in 1974, and 65 percent in 1975. Reductions in subsidies will gravely affect the poorer classes, and reform advocates realize that salaries will have to be increased to offset reduced subsidies.

Industrial pricing

During 1976, it cost Egyptian companies approximately 11 percent more to do business because some of their imports shifted to the parallel market, the basis for customs duty valuation changed, prices for some of their imports increased, and wages were increased. The companies, however, were not permitted to raise prices except on the small proportion of output which was free of price controls and on about half of the textile output.

The Government has now decided that industrial prices will be adjusted to cover costs, but over the next year subsidies will be available to permit only gradual price increases. Most of the subsidies are expected to be used for consumer goods. Industrial prices for nonbasic commodities will be determined by the companies, subject to profitability guidelines. Prices for basic commodities will remain under Government control.

NEED FOR MAJOR ECONOMIC RESTRUCTURING

International economists have analyzed Egypt's economy and believe the principal problems to be (1) an exchange rate system that does not promote exports, efficient allocation of external resources, or inflows of foreign capital, (2) failure to carry out price adjustments necessary to prevent large explicit and implicit subsidies, (3) low controlled prices in agricultural and industrial sectors, (4) low interest rate structure, and (5) fiscal policy.

The Egyptian Government recognizes its principal economic problems and has embarked on a program of economic reform. The program's general objectives are set forth, but details need to be clarified. The reforms are expected to be implemented cautiously and slowly in order to prevent a recurrence of the 1977 disorders. The International Monetary Fund approval of a $145 million equivalent standby arrangement on April 21, 1977, could help Egypt to obtain international support.

CHAPTER 3

STATUS OF ASSISTANCE PROGRAMS

U.S. assistance to Egypt includes development projects, the Commodity Import Program (CIP), and Public Law 480 food aid; for fiscal years 1975-78, a total of $3.2 billion has been approved for these programs. In addition, for calendar years 1975-77, other countries and international organizations have made approximately $7.9 billion in assistance available to Egypt.

The U.S. programs provide long-term benefits through development projects. Short-term balance-of-payment relief is provided through CIP and food aid.

Egypt's capability to absorb and effectively use the substantial amount of economic assistance made available to it by various donors is severely constrained by a number of factors. Financial problems are the major constraints to implementing the development assistance programs. Moreover, lack of adequate Egyptian managerial and technical resources to effectively plan, program, and implement development projects has severely hindered progress to date.

DEVELOPMENT PROJECTS

The Egyptian economy requires significant capital investment to achieve increased agricultural and industrial production. Egypt's agricultural production is under the strain of waterlogging and salinity problems and its industrial expansion is inhibited by congested port conditions, breakdowns in communications, need for increased power, and an inadequate transportation system. To address these problems and provide long-term benefits, the United States has provided grants and loans to assist Egypt in improving its infrastructure and increasing agricultural and industrial production. Projects approved during the first 2 years are shown on the next page.

	United States	Other donors	Egypt (note a)	Total
	------------(millions)------------			
Feasibility studies:				
Number 1	$ 1.0	$ -	$ -	$ 1.0
Number 2	15.0	-	-	15.0
	16.0			16.0
Infrastructure:				
Road building	14.0	-	(b)	14.0
Electrical distribution	30.0	-	(b)	30.0
Ismailia power station	98.6	-	61.7	160.3
Grain silo	44.3	-	39.8	84.1
Port of Alexandria	30.8	64.2	56.0	151.0
Helwan and Talka power stations	50.0	-	10.3	60.3
National energy center	24.0	-	8.5	32.5
	291.7	64.2	176.3	532.2
Productive sector:				
Suez cement plant	90.0	-	71.5	161.5
Mehalla textile plant	96.0	-	38.2	134.2
Tile drainage project	31.0	50.0	202.0	283.0
Industrial Development Bank of Egypt	32.0	40.0	(b)	72.0
	249.0	90.0	311.7	650.7
Total	$556.7	$154.2	$488.0	$1,198.9

a/Local currency support converted at $2.56 to the Egyptian pound. In real terms, the value of Egyptian contributions is overstated because of the overvalued exchange rate. If the parallel exchange rate of $1.43 to the pound were used, the local cost contribution would be $286 million.

b/Local currency support will be essential, but no specific amount was identified in the project paper.

Economic and budgetary constraints

Egypt's past performance in mobilizing domestic resources indicates that it will have difficulty in providing budgetary resources to support its accelerating development programs. As indicated in chapter 2, unless Egypt enacts economic reforms to reduce subsidies and consumption to permit it to finance development projects, its economy is expected to continue to decline and ambitious development plans may fuel the fires of inflation. This will affect U.S. projects because, under the terms of most American-Egyptian loan and grant agreements, Egypt must provide the local resources required for the project.

During 1973-76, annual expenditures, not including investment, exceeded annual income, causing the current account deficits. Although the 1976 budget provided for a slight surplus in the current account, Egypt again relied heavily on its banking system to finance investment plans. (App. VII contains details on the Egyptian budget.)

Economic reports have described the gravity of Egypt's problem in mobilizing resources to support investment. These reports indicate that unless Egypt increases domestic savings it can finance its development plans only by borrowing from the banking system. The reports conclude that this occurred in 1974 and 1975 and intensified inflationary pressures.

Preliminary reports on the actual financing of the $2.4 billion 1976 budget deficit, including $2. billion in investments, indicate that the banking system financed $1.3 billion and other domestic sources financed $930.9 million. This compares to a 1975 deficit of $3.4 billion, of which the banking system financed $2 billion, other domestic borrowing financed $906 million, and external borrowing financed $494 million. The 1977 investment plan indicates a continued reliance on the banking system and other domestic borrowing to finance the 1977 deficit and investment program.

More importantly, the impact of deficit financing contributed to increased inflation. After several years of modest price increases, the rate of inflation began to accelerate in 1973. In 1974 and 1975 the urban consumer price index rose by 10 percent, despite the prevalence of controlled items. The inflation would have been even higher without the subsidies on wheat and other essential commodities. Significantly, the rate of increases in the unofficial prices is estimated at 25 to 40 percent each year since the October 1973 war.

To carry out its ambitious development plans, Egypt estimates that domestic savings will have to increase from 6 percent of the gross national product to 15 percent by 1980. Based on past experience, informed sources estimate that domestic savings during 1976-80 will total only one-fourth of the amount required.

Because U.S. projects had not entered the implementation stage to a major degree at the time of our review, the effect of budgetary constraints on the progress of these projects could not be evaluated. Project implementation cannot begin until certain predisbursement conditions are met by the Government of Egypt. At December 31, 1976, these conditions had not been met on most development projects, including the grain silo project for which unusually long delays had developed. When these projects do enter the implementation phase, they will require budgetary support from the Government of Egypt. Implementation of infrastructure projects, such as drainage and grain silos, will depend on direct funding by the Government of Egypt. For other projects, such as the Mehalla textile and Port of Alexandria projects, budgetary resources are to be generated from operating profits. In the latter cases, the Government will have to forego dividends during the project period if adequate local resources are to be available for project implementation.

Need for improved planning and coordination

When U.S. assistance levels were set for Egypt, the Department of State realized that the program would have to overcome another constraint--a shortage of planned projects. Sound development planning was limited because there was little coordination among Egyptian ministries responsible for planning, approving, financing, and executing development projects. During our review, we determined how projects were selected and became part of the Egyptian budget.

We found that Egyptian implementing ministries were aggressively promoting their respective development projects. The Agency for International Development evaluated these proposals on their technical and economic merits, basing its evaluations in most cases on studies made by U.S. consultants. These studies were financed under feasibility grants and were made during a relatively short time frame. The implementing ministries either operated independently or through the Ministry of Economy and Economic Cooperation, which is responsible for securing foreign currency from donors and which acts as a focal point for donor countries and signs agreements. Neither the implementing ministries nor the Ministry of Economy and Economic Cooperation had coordinated their activities with the Ministry of Planning, which develops Egypt's 5-year development plan, nor the Ministry of Finance, which prepares the annual budget for cabinet and parliament.

An official of the Ministry of Finance informed us that the Ministry had only begun to address the Government's commitment to provide local resources for these new projects during the next 5 years. He said that requests for budgetary support in 1976 were significantly greater than the Ministry could handle. The Government decided to give priority to the United States and other donors which had provided foreign currency for special projects; it anticipated imbalances between sectors as a consequence of this decision.

An official of the Ministry of Planning stated that Egypt's ongoing projects committed more local resources than were available and that priorities based on international commitments had reached a level beyond Egypt's capacity to fulfill. In the past, similar conditions forced Egypt to abandon some projects before they were finished because new projects had preempted the bulk of expenditures required for old projects.

The planning of individual projects has also suffered from a lack of coordination among the implementing ministries responsible for important elements of the project. For instance, a recent report on Egypt's energy plan by consultants to an international organization noted the need for improved coordination among the Ministries of Electricity, Petroleum, Irrigation, and Industry and among their planning groups at the working levels. The study indicated that improved coordination would reduce Egypt's energy cost by helping it take greater advantage of its hydropower and natural gas resources. Specifically, the study suggested that the locations of three power stations planned for Ismailia and Suez be shifted to take advantage of flared and/or unused natural gas. The study estimated that $700 million could be saved over a 10-year period by using flared gas and by exporting the oil that would be required to fuel planned power stations.

The shortage of planned projects accentuated the need for improved coordination among donors and the Egyptian Government in selecting projects. We observed that shortages led to competition among those donors for projects involving highly advanced technology. Three proposed projects, for example, were aborted by the United States because they were awarded to other donors. In one case, the United States had planned to finance a Suez power station from fiscal year 1977 funds. However, the Ministry of Electricity informed AID that it had reached agreement with the Governments of Germany and Austria for the construction of a 300 megawatt thermal power station in the Suez city area. In place of this project, the Ministry suggested that the United States consider financing a second Suez power station and this is currently being considered for the fiscal year 1978 program.

Local-cost financing

We believe that the most serious impediment to Egypt's development is its difficulties in mobilizing domestic resources. Egypt's accelerated development program will require it to stretch financial, material, and organizational resources to the limit. This could have a destabilizing effect if development is not accompanied by sound budgetary management. Donors have offered attractive projects which Egypt has accepted. However, the implementation of these projects requires Egypt to provide resources that are presently beyond its capacity to generate.

One solution would be for the United States to provide a greater proportion of project costs. This would differentiate from the projects so far approved by committing the United States to finance not only the cost of equipment and services purchased from the United States but also to cover some of the local costs of the project. Thus, the foreign exchange in excess of the amount required for project imports would be available to the Government of Egypt.

The dollars exchanged for pounds would become free foreign exchange and might not be tied to U.S. procurement. The Congress, as pointed out in the Department of the Treasury's letter of June 6, 1977 (see app. IX), has heretofore encouraged the tying of U.S. aid to U.S. procurements and untying it would be a significant change. On the other hand, the Congress has approved untied cash grants for budgetary support when there were overriding considerations. The following special considerations pertain to Egypt.

1. The U.S. level of assistance is based on political considerations, not on Egypt's economic capacity to accelerate its development program.

2. Economic reforms so far enacted are expected to fall short in providing the increased savings required to accelerate Egyptian development.

3. U.S. assistance to Egypt should include projects which will provide long-term benefits.

We believe that the Congress should consider the merits of providing hard-currency financing for the local cost of selected projects in the U.S. assistance program for Egypt. In considering this matter, the question may arise as to whether the United States should use Egyptian pounds held by the U.S. Treasury rather than provide free foreign exchange. The United States held the equivalent of $179 million in Egyptian pounds as of June 30, 1977. It must be recognized that these holdings represent a claim on Egyptian resources and their use would only add to the inflationary spiral of the economy and reduce the amount of resources available to the Government of Egypt.

A second alternative would be to provide a greater portion of U.S. assistance through CIP, as was done in February 1977. The additional imports would generate budgetary resources which could be used to support development projects. However, at the present time this may not be a viable alternative because Egypt has not been able to use the amounts already authorized to date. In August 1977, the pipeline of authorized but undisbursed CIP loans exceeded $700 million, so there is some question as to Egypt's ability to quickly use the CIP for imports of commodities required in the economy. Therefore, if this alternative is chosen, it would be necessary to ascertain that Egypt could use the additional authorization in a timely manner to generate the local currency required for development projects.

The Department of State and AID agreed that Egypt's mobilization of adequate resources for specific projects may be a problem in the future. (See app. VIII.) They suggested that local-cost financing not be restricted to capital projects but also be used as an added incentive to obtain Egyptian support of "new direction" technical assistance activities, such as family planning. We believe that AID's suggestion for local-cost financing of new direction projects is appropriate, because these projects are less capital intensive and require a greater proportion of local currency to foreign exchange.

State and AID indicated that they were addressing the need for local currency and for developing criteria on the circumstances and types of projects for which AID should supply local financing. Furthermore, AID informed us that its 1979 congressional presentation will include proposed projects involving local-cost financing.

The Department of the Treasury stated that, given the multiple constraints to project implementation, an increase in local-currency financing might have little effect on AID disbursements. Nevertheless, we believe that local-cost financing as well as improved development planning, economic reforms, and better coordination among Egyptian ministries and donors should be considered.

Other development constraints

Even if Egypt can make substantial progress in mobilizing domestic resources and improving coordination among Egyptian ministries and donors, implementation of development projects must overcome additional constraints. For example, the Suez cement plant, Ismailia power station, and Industrial Development Bank of Egypt will require the assemblage of competent managerial staffs. This will be a difficult task because of Egypt's shortage of managerial talent. Egyptians have recognized this to be the case, citing the fact that many qualified persons are working in other countries where salaries are much higher. Egypt also recognizes the need to increase its construction capacity and has stated that construction capacity has been a bottleneck in development efforts, particularly for infrastructure projects. It considered this constraint as possibly even more important than the scarcity of funds.

COMMODITY IMPORT PROGRAM

AID justification of CIP to the Congress stated that:

> "This program is needed in order to provide equipment parts, and material required for effective utilization of domestic industry and for the increasing productivity of the agricultural sector. Increases in domestic production will enable the general population to purchase more of the essential goods required for everyday life thus improving their level of living."

During the first 2-1/2 years of renewed U.S. assistance, CIP disbursed about $186.3 million, and a pipeline of over $718 million has been developed. The status of the program at August 26, 1977, is shown below.

Loan agree- ment	Date of agreement	Total	Solici- tations	Awards	Amount disbursed	Percent disbursed
		-----------(millions)---------				
1	Feb. 13, 1975	$ 80.0	$ 80.0	$ 80.0	$ 65.6	82
2	June 30, 1975	70.0	70.0	68.6	43.6	62
3	Dec. 18, 1975	100.0	96.0	92.6	29.9	30
4	May 22, 1976 (note a)	150.0	127.0	120.3	17.8	12
5	Sept. 30, 1976	65.0	30.6	20.5	0	0
6	Mar. 3, 1977	440.0	202.0	143.8	29.4	7
		$905.0	$605.6	$525.8	$186.3	

a/Agreement was initially for $50 million and was increased by $100 million by amendment on July 22, 1976.

Allocation of funds to capital equipment

In allocating CIP resources in Egypt, U.S. policy-makers were concerned that the United States would receive few political b nefits if the money was spent entirely for quickly consumed goods and supplies rather than something long-lasting, tangible, having developmental impact, and, above all, "visible." Food and other consumables are short-lived, move quickly through the economy, and leave little lasting notice or impact. The U.S. Ambassador insisted as a matter of policy that roughly half of the imports be capital equipment, including buses ($46 million), trucks and trailers ($10 million), and grain loaders ($3 million). The rest of the loan was spent for such conventional commodities as tallow, tinplate, and the like.

A consequence of this allocation of CIP funds to the acquisition of capital equipment rather than to consumables was to substantially delay the expenditure of funds because of the need for special supplemental Egyptian budgetary approval and the use of more time-consuming bidding procedures and technical specifications. For example, loan agreement 1, which included $10 million for trucks, was signed February 12, 1975; at November 1, 1976, the truck allocation was unspent and had been extended to September 1977.

Thus, CIP could have been more effective in easing Egypt's balance-of payment problems and could have had a greater impact on Egypt's short-term economy by providing more raw materials and intermediate goods rather than capital equipment.

In February 1977, the United States shifted $190 million of assistance from capital development projects to the Commodity Import Program and eliminated the requirement that half the Program be used to purchase capital equipment. Although an increased flow of commodities could act as a disincentive to Egypt to enact economic reforms, we believe these actions have made the program more responsive to Egypt's short-term needs.

CONCESSIONARY WHEAT SALES

The United States provided Egypt with 650,000 metric tons of wheat in 1975 and 1 million metric tons in 1976 through concessionary wheat sales under Public Law 480 to help relieve its balance-of-payments problems. The wheat is financed under dollar loans repayable in 20 years.

Title I of Public Law 480 contains a provision (called the usual marketing requirement) intended to ensure that commodities sold on concessional terms do not interfere with normal international trade. The requirement establishes the quantities the recipient country must import commercially with its own foreign exchange from the United States and/or other customary free world suppliers. The requirement for Egyptian wheat purchases was raised for the 1976-77 supply period from 2.2 million to 2.6 million metric tons by the European Economic Community (the Common Market) and other principal supplier countries, including the United States. Thus, Egypt must purchase 2.6 million metric tons from its traditional suppliers before it is eligible for Public Law 480 purchases.

Because of its serious balance-of-payment problems, the Government of Egypt has attempted to persuade the European Economic Community to reduce the marketing requirement for the 1977-78 supply period from 2.6 million metric tons to 1.6 million.

With respect to Public Law 480 concessionary wheat sales, the Department of State and AID stated that they support Egypt's attempt to have the usual marketing requirement reduced and are helping Egypt to prepare and present sufficient data to support a reduction.

The Department of Agriculture stated that it was considering a significant reduction in the usual marketing requirement and that the establishment of the actual marketing requirement will take into account the Egyptian economic situation and internationally agreed procedures governing usual marketing requirements as well as the Egyptian commodity supply and stock situation. (See app. X.)

CHAPTER 4

IMPROVEMENTS MADE IN

THE MANAGEMENT OF EGYPTIAN DEVELOPMENT

The Government of Egypt has instituted changes designed to improve the planning and implementation of its economic development. These changes include support for an Egyptian-donor consultative group and the appointment of a Deputy Prime Minister for Economic Affairs to coordinate the activities of Egypt's principal ministries.

CONSULTATIVE GROUP

Egypt, the World Bank, the International Monetary Fund, the United States, and other donors have been actively discussing Egypt's economic policies and development, including the need for a consultative group composed of representatives of Egypt and the donors. Such a group could provide the factual and analytical material the participants need to make a balanced assessment of Egypt's progress; difficulties encountered; prospects and priority needs; and, where appropriate, how the group's members could contribute to development efforts. After several postponements, the first meeting of the consultative group was held in Paris on May 11 and 12, 1977.

The Department of State and AID provided the following information on the participants and achievements of the meeting.

> "* * * the first meeting of the Egypt Consultative Group chaired by the World Bank was held in Paris May 11-12, 1977. In addition to the United States, participants included Canada, France, West Germany, Iran, Italy, Japan, Kuwait, the Netherlands, Saudi Arabia, the United Arab Emirates, the United Kingdom, the African Development Bank, the Arab Fund for Economic and Social Development, the Commission of European Communities, the European Investment Bank, the OPEC [Organization of Petroleum Exporting Countries] Fund, the UNDP [U.N. Development Programme], the Gulf Organization for Development of Egypt, the International Monetary Fund, the International Finance Corporation and the Islamic Development Bank.

"The Consultative Group meeting provided an important forum for all donors of consequence to discuss issues associated with Egyptian development and financing requirements. 1/ Accordingly, the Consultative Group meeting, we believe, was a vital step in improving the coordination process. The GOE [Government of Egypt] delegation was exposed to wide-ranging concerns of its donors, encouraging the Egyptians to take economic reform efforts seriously. The meeting required the GOE to focus sooner than it might otherwise have on planning priorities and elicited promises of continuing attention to the planning process."

IMPROVED COORDINATION

In October 1976, the U.S. Ambassador, recognizing the need for greater coordination among ministries, met with high Egyptian officials to discuss implementing U.S. projects more promptly. Shortly thereafter, the Government of Egypt announced the appointment of a Deputy Prime Minister for Economic Affairs with responsibility for coordinating the major cabinet departments concerned with preparing and implementing Egypt's development program. The Department of State and AID noted that:

"This office has aggressively pursued its responsibilities and is becoming a focal point for sorting out Egyptian project priorities. At its direction the Ministry of Planning has developed a statement of the GOE's medium term development strategy. It has compiled a list of projects to be implemented by a number of ministries that will be given priority for foreign donor financing and GOE local support."

During the consultative group meeting, State also expressed its belief that development planning and project implementation should be more closely coordinated. At the meeting, the Deputy Prime Minister mentioned the Government of Egypt's plans to establish a Supreme Investment Authority to review potential investment, identify donor participants, and ensure the availability of local resources to support those projects.

1/The agenda included discussions on Egypt's economic reform and growth objectives, type and volume of external assistance required, the government's investment program, and Egypt's private sector.

CHAPTER 5

MONITORING AND CONTROL OF ASSISTANCE PROGRAM

The Departments of State and Agriculture and the Agency for International Development have several methods of reviewing the vast program in Egypt, including:

--Reports and statements of the Egyptian Government which are required by various U.S. laws and by agency regulations.

--Monitoring of program activities by U.S. agency personnel.

--Internal audits and inspections by various U.S. agencies.

EGYPTIAN REPORTS AND STATEMENTS

Egyptian reports are required for almost all U.S. assistance programs and cover a wide range of controls. Typically, loan or grant agreements establish conditions precedent to disbursement and terminal dates for commitment and disbursement. Progress and shipping reports are required on a quarterly basis and copies of bid documents and contracts are required as they are created. Egypt (and any other recipient country) is required to maintain records for AID's inspection showing the receipt and use made of AID-financed goods and services, nature and extent of solicitations of prospective suppliers, and bases of awards of contracts to successful bidders.

Egypt is also required to report on receipt, distribution, and use of food received under Public Law 480. This is done primarily by use of quarterly reports which show Egypt's progress in complying with the usual marketing requirement and export restrictions. Egypt also submits an annual report which discusses the uses made of Egyptian currency arising from sales of wheat and other commodities.

MONITORING BY U.S. PERSONNEL

Onsite monitoring and oversight by U.S. personnel is possibly the most effective program control. One phase is "end-use reporting," which occurs when an AID employee goes to a project and verifies the existence and use made of the material or equipment. Early in the program, because of limited staff and heavy workload, AID/Cairo was not able to do this on a systematic basis. However, the AID Auditor General had an audit staff in Egypt during September and October 1976, and it prepared end-use reports, on a test basis, for approximately $22 million or 33 percent of the commodities shipped as of August 31, 1976; only minor discrepancies were reported.

AID/Cairo's staff has grown considerably from early 1974 and was recently increased to 68 positions, which should enable it to more effectively meet its monitoring and oversight responsibilities.

INTERNAL AUDITS AND INSPECTIONS

The internal auditors and inspectors of AID and State (AID Auditor General, the Inspector General of Foreign Assistance, and the Inspector General of Foreign Service) have issued reports on local-currency funding of the American University of Cairo, refugee assistance, child-feeding programs under title II of Public Law 480, Suez Canal clearance and reconstruction, and the Security Supporting Assistance Program in Egypt.

Congress of the United States
Committee on International Relations
House of Representatives
Washington, D.C. 20515

May 17, 1976

Mr. Elmer Staats
Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Staats:

The Special Subcommittee on Investigations would like the General Accounting Office to undertake a study of United States economic and food aid programs for Egypt since their inception following the 1973 Middle East war.

In particular, we would like a GAO assessment of the purpose and the effectiveness of the programs, how projects are being picked, how project designs are formulated, why further stress is not being given to population and health programs and other programs emphasized in Congressional reforms of economic aid programs, how and to whom funds are obligated, how efficient programs are, the extent of Egypt's need for concessional food aid and the degree to which you feel some aid funds are being diverted from intended uses or are wasted.

My staff consultant, Mike Van Dusen, is available to talk with you about this proposal, and he can be reached at 225-3345. I would hope that this project would be available in time for consideration of aid requests for Fiscal Year 1978.

With best regards.

Sincerely yours,

Lee H. Hamilton
Chairman, Special Subcommittee
on Investigations

LHH/dm

APPENDIX II

BALANCE OF PAYMENTS, EGYPT

	1971	1972	1973	1974	1975
Monetary Items			(millions)		
A. Exports	$1,034.2	$ 911.3	$1,021.1	$1,690.2	$1,568.7
Imports	-1,512.8	-1,440.8	-1,694.4	-3,508.9	-4,329.2
Trade balance	-478.6	-529.4	-673.2	-1,818.7	-2,760.4
B. Receipts (income)	221.6	345.5	428.7	717.6	1,081.6
Payments (outgo)	-333.5	-337.8	-421.8	-546.5	-800.8
Net services	-111.9	7.8	6.9	171.1	280.8
C. Total, trade & services (A & B)	-590.5	-521.7	-666.3	-1,647.6	-2,479.6
D. Unrequited transfers (grants, etc.)	333.9	330.3	744.6	1,318.1	1,078.5
E. Current balance (C & D)	-251.2	-191.4	78.3	-329.5	-1,401.1
Non-Monetary Items					
F. Medium and long-term capital, net	31.6	145.3	-82.3	-200.6	404.5
G. Other	2.8	-7.7	-10.1	-12.0	-26.9
H. Total (E, F, & G)	-216.8	-53.8	-14.1	-542.1	-1,023.9
I. Credit from IMF	24.3	24.2	-	-	-
J. Overall balance (H & I)	$ -192.5	$ -29.6	$ -14.1	$ -542.1	$-1,023.5

Source: Agency for International Development

GAO note. Converted at 1975 rates of exchange; totals may not add due to rounding.

APPENDIX III

EGYPTIAN IMPORTS (note a)

	1971	1972	1973	1974	1975
	----------------	----------------	(millions)	----------------	----------------
Fuels:					
Crude petroleum (note a)	$ 33.3	$ 28.4	$ 9.2	$ 3.1	$183.6
Petroleum products (note b)	28.1	24.8	7.9	23.0	8.2
Coke and coal	10.2	0.8	0.8	34.0	75.0
	71.6	54.0	17.9	60.2	266.8
Raw materials:					
Food:					
Wheat	150.0	107.0	141.1	596.0	545.3
Maize	2.8	6.1	6.4	68.3	69.4
Sesame	2.8	4.4	3.8	13.0	6.4
	155.6	117.5	151.3	677.3	621.1
Non-food:					
Tobacco	20.5	25.1	28.1	28.9	52.5
Wool	8.2	13.3	11.3	17.1	16.1
Other	20.2	14.6	15.6	30.7	51.5
	48.9	53.0	55.0	76.7	120.1
	204.5	170.5	206.3	754.0	741.1
Intermediate commodities:					
Animal fats and vegetable oils	58.9	78.6	42.2	118.5	346.1
Various chemicals	60.2	70.1	60.2	158.2	254.2
Scrap metals	25.3	16.1	11.5	26.6	38.6
Iron and steel	58.6	67.6	55.3	120.1	260.6
Dyes and coloring	13.3	13.3	10.0	24.3	47.1
Wood	26.4	55.6	28.9	74.2	127.2
Paper and paper products	28.4	30.2	26.1	79.1	140.3
Fertilizers	14.6	9.7	23.3	75.0	95.0
Electrical products	7.7	7.9	6.6	24.6	52.7
Rubber and rubber products	11.3	14.8	11.5	14.6	34.8
Oils and wax	9.4	13.8	9.2	13.6	23.3
Other	69.9	56.1	52.4	80.6	163.8
	384.0	433.9	337.4	808.4	1,583.9
Capital goods:					
Automobiles	68.6	69.4	50.7	69.6	247.8
Other transportation	20.2	17.7	41.5	70.9	32.8
Textile machinery	22.8	27.9	29.4	30.2	49.4
Electrical products	22.8	20.0	21.0	29.4	66.6
Earth-moving equipment	4.3	8.4	14.0	15.1	38.4
Other	70.4	55.8	46.1	103.4	231.2
	209.1	199.2	202.7	318.7	666.1

	1971	1972	1973	1974	1975
Consumer goods:	(millions)				
Durables:					
Automobiles and motorcycles	$ 23.0	$ 9.2	$ 16.9	$ 75.5	$ 77.3
Radio and television	8.7	7.2	6.1	12.0	15.1
Other	7.2	7.2	6.9	11.0	33.8
	38.9	23.5	29.9	98.5	126.2
Non-durables:					
Wheat flour	28.2	19.5	27.1	74.5	119.0
Sugar	-	-	-	67.3	105.7
Tea	11.3	13.3	9.7	16.6	32.2
Coffee and cocoa	4.6	1.3	2.0	5.1	10.0
Meat, fish, and poultry	13.6	17.7	17.1	27.9	58.4
Beans and lentils	1.5	5.4	1.8	7.9	37.6
Medicines	6.9	9.2	6.9	8.7	17.4
Disinfectants and insecticides	18.7	26.1	31.7	55.3	85.2
Paper and paper products	7.6	4.3	5.4	10.7	33.8
Other	30.9	22.5	28.2	41.4	57.1
	123.4	119.3	130.0	315.6	556.5
	162.3	142.8	159.9	414.1	682.7
Total	$1,031.7	$1,000.4	$ 924.4	$2,355.5	$3,940.6

a/ Data based on Egyptian customs records, so differ from balance-of-payments figures based on exchange control records. Does not include "own exchange" imports, which include most consumer goods and many other final products. The own exchange system, started in 1974, allows Egyptians who have been living abroad to bring back household effects, including two automobiles a year. Professional people and owners of businesses living abroad may also bring back equipment needed for their professions or businesses. Statistics on the own exchange operation are almost totally lacking, but it is believed these consumer goods are often sold once they arrive, thereby using up a considerable amount of domestic savings.

b/ Petroleum imports considered to be seriously understated.

Source: Government of Egypt.

GAO note: Converted at 1975 rate; amounts may not add due to rounding.

EGYPTIAN EXPORTS (note a)

	1971	1972	1973	1974	1975
	(millions)				
Fuel (note b):					
Crude petroleum	$ 5.1	$ 52.0	$ 94.4	$ 61.2	$ 59.1
Petroleum products	2.3	7.6	20.0	67.8	73.5
	7.4	59.6	114.4	129.0	132.6
Raw materials:					
Raw cotton	448.0	414.7	491.3	714.5	514.5
Rice	62.7	56.3	66.8	101.6	61.7
Fresh onion and garlic	15.6	17.4	32.0	27.4	24.0
Dehydrated onion and garlic	3.6	1.3	3.8	6.1	5.1
Oranges	23.0	12.3	40.4	28.4	47.4
Potatoes	5.1	8.2	17.0	15.1	8.2
Groundnuts	6.1	4.3	3.8	6.4	6.9
Other	12.3	17.7	22.3	22.5	32.2
	576.5	532.2	677.4	922.1	700.2
Semi-finished products:					
Cotton yarn and waste	95.7	116.2	123.1	173.8	171.8
Essential oils	2.6	3.8	9.2	14.8	15.6
Other	14.8	12.5	18.7	30.7	39.9
	113.1	132.6	151.0	219.4	227.3
Finished goods:					
Textiles	71.7	78.8	81.4	112.4	127.0
Sugar	15.9	3.6	10.5	23.8	36.3
Footwear	9.5	10.2	14.8	20.9	36.3
Leather goods	5.1	7.2	5.6	7.2	13.0
Chemicals	13.0	26.4	11.8	12.0	31.5
Alcoholic drinks	9.2	11.0	13.3	11.0	17.9
Furniture	7.4	5.9	6.4	9.5	9.7
Books and periodicals	3.8	6.9	4.1	7.9	11.5
Cement	15.1	9.5	11.8	6.1	3.1
Other	30.5	34.0	34.3	37.4	55.8
	181.2	193.5	194.0	248.3	342.3
Total	$878.3	$918.0	$1,136.9	$1,518.8	$1,402.4

a/ Data based on customs records, so differs from balance-of-payments figures which are based on exchange control records.

b/ Petroleum exports are considered to be understated in both customs and exchange control records.

Source: Government of Egypt.

GAO note: Converted at 1975 rate of exchange; totals may not add due to rounding.

OTHER DONOR ASSISTANCE

Program assistance	Calendar Years 1975	1976	1977
Countries:	-------(millions)-------		
Saudi Arabia	$ 863	$ 640	$ [a]192
Kuwait	656	237	[a]168
United Arab Emirates	277	150	[a]72
Qatar	114	75	[a]48
Iran	320	-	-
Gulf Organization for the Development of Egypt (note b):			
Direct loans	-	-	1,750
Guarantee	-	-	250
Other	491	56	28
	2,721	1,158	2,508
Project assistance			
Countries:			
Germany	73	97	84
Iran	23	-	-
Italy	-	-	20
France	23	(c)	(c)
Japan	50	40	125
Netherlands	5	10	11
Sweden	3	(c)	(c)
United Kingdom	6	(c)	(c)
European Community	7	(c)	204
Belgium	(c)	(c)	5
Saudi Arabia	50	126	(c)
International Monetary Fund	30	144	144
World Bank	132	95	150
United Nations	31	-	(c)
	433	512	743
Total	$3,154	$1,670	$3,251

a/Estimated

b/Includes Saudi Arabia, Kuwait, United Arab Emirates, and Qatar. Organization initially established to provide project aid, but has converted funds to program assistance.

c/Not available

Source: Agency for International Development

OUTSTANDING EXTERNAL PUBLIC DEBT
AS OF SEPTEMBER 30, 1976 (note a)

	Principal		Interest	Arrears	Principal and Interest Payment Schedule	
	Total	Disbursed			Oct.-Dec. 1976	1977
Convertible Currencies	(millions)					
Official loans	$3,973.6	$1,886.2	$449.0	$ 81.1	$ 15.7	$ 114.2
Rescheduling agreement	199.0	199.0	75.9	-	.4	44.4
Euro-currency loans	226.0	226.0	76.7	-	22.9	38.7
Supplier credits	660.0	611.0	-	168.5	91.7	199.1
Official deposits	1,942.3	1,942.3	281.8	4.6	62.2	1,104.4
	7,000.9	4,864.5	883.4	254.2	192.9	1,500.8
Clearing Currencies	1,188.6	805.8	69.6	3.1	51.0	123.3
Total	$8,189.5	$5,670.3	$953.0	$257.3	$243.9	$1,624.1

a/ Does not include bilateral payments liability, foreign deposits with Egyptian commercial banks, liabilities under compensation agreements, and military debt.

Source: Agency for International Development

APPENDIX VII

GOVERNMENT OF EGYPT BUDGET

	1973	1974	1975 Prelimi-nary	1976 Budget
	--------	--------(millions)	--------	--------
Receipts:				
Central government:				
Taxes on income and profits	$ 411.6	$ 451.6	$ 581.9	$ 677.9
Taxes on property	42.7	54.5	44.8	60.9
Taxes on goods and services	488.2	500.0	546.0	674.3
Customs duties	525.0	592.4	1,020.7	1,211.1
Other taxes	109.3	149.8	199.9	171.8
Fees	49.6	50.4	59.6	70.4
Miscellaneous	148.8	198.4	152.2	147.2
	1,775.6	1,997.1	2,605.1	3,013.6
Local government revenues	153.6	167.7	161.5	212.7
Public economic sector:				
Transferred profits (note a)	350.7	540.2	532.4	921.6
Investment financing (note b)	325.1	317.4	232.9	384.0
	2,605.1	3,022.4	3,531.9	4,531.9
Expenditures:				
General public services	420.9	456.9	533.2	876.1
Defense	722.9	778.2	748.5	862.2
Education	375.8	417.3	510.2	597.2
Health	189.2	207.9	241.9	190.2
Community and social services	7.2	10.5	13.0	72.2
Economic services	111.1	123.6	149.5	160.2
Local governments	130.8	155.1	204.8	249.8
Subsidies	480.0	1,249.8	1,578.7	1,495.0
	2,437.9	3,399.3	3,979.8	4,502.9
Current account surplus (deficit)	167.2	-376.9	-447.8	29.0
Other expenditures:				
Investment expense	-1,154.5	-1,446.4	-1,738.2	-2,560.0
Emergency fund	-378.9	-87.0	-586.2	-875.5
Overall deficit (amount to be financed)	-1,366.2	-1,910.3	-2,772.2	-3,406.5

APPENDIX VII

	1973	1974	1975 Preliminary	1976
	-------------	(millions)	-------------	
Method of financing:				
Domestic borrowing:				
Social insurance and pension funds	$ 573.1	$ 626.9	$ 647.5	$ 742.2
Savings certificate	97.2	109.8	128.0	107.5
Postal savings	25.5	45.8	43.5	40.9
Jihad bonds	33.2	4.8	25.6	-0-
Banking system	468.4	803.5	1,638.4	1,435.8
Other	38.3	79.1	20.4	-0-
	1,235.[illegible]	1,669.9	2,503.4	2,326.4
External borrowing	130.5	240.4	268.8	1,080.1
Total	$1,366.2	$1,910.3	$2,772.2	$3,406.5

a/Mandatory transfers under legal requirement that 65 percent of net profits after tax and depreciation be transferred to the treasury.

b/Resources generated internally by public authorities and public economic organizations to finance part of their investments; associated expenditure included in "investment expenditure." An alternative presentation would exclude this provision from both receipts and expenditures, which would affect current account but not overall deficit.

GAO note: Converted at 1976 rate of exchange; amounts may not total due to rounding. Figures may not agree with amounts used in text of the report because updated figures were used as they became available.

Source: Ministry of Finance, Government of Egypt.

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

AUDITOR GENERAL

JUN 16 1977

Mr. J. Kenneth Fasick
Director, International Division
General Accounting Office
441 G Street N.W.
Washington, D. C. 20548

Dear Mr. Fasick:

We have appreciated the opportunity of discussing the draft GAO report on "Need for Restructuring U.S. AID to Egypt to be more Responsive to Egypt's Needs" with representatives of the GAO to clarify certain points and present additional information and data. The attached joint State-AID comments pertain to each of the recommendations and to several issues in the order in which they occur in the draft report.

We are also providing pertinent information on the meeting in Paris on May 11-12 of the Consultative Group for Egypt under the leadership of the World Bank.

Those sections of the draft report which were marked as classified have now been declassified by the Department of State and AID.

We request that the attached comments be taken into account in preparation of the final report or included as an appendix to the report. If you should have further questions, please let us know.

Sincerely yours,

Harry C. Cromer

Harry C. Cromer

Attachment: a/s

Comments of the Department of State and A.I.D. on GAO's Draft Report, "Need for Restructuring U.S. Aid to Egypt to be More Responsive to Egypt's Needs"

The following joint State-AID comments are presented in the sequence in which the recommendations and discussion of certain issues appear in the draft report.

Commodity Import Program

(See GAO note 1, p. 42.)

The draft report states on page 14 that a "reason for the limited rate of disbursement is that the Government of Egypt's procurement procedures do not correlate with AID's competitive procurement regulations." While GOE and AID procurement procedures differ as the GAO outlines on pages 16-18, this has not been an especially significant factor in holding down the rate of disbursement. The report should note that a more important factor is the lack of Egyptian familiarity with U.S. equipment and technical standards. Until the resumption of diplomatic relations in 1974 Egypt had been relatively isolated from U.S. commercial suppliers and, consequently, Egyptian equipment users were not acquainted with modern U.S. technology and its products. Once those became available to them under the CIP, it is understandable that the Egyptians needed to learn more about equipment available from the U.S. and the standards for its construction and operation. AID has recognized this problem and has addressed it by bringing Egyptian procurement technicians to the United States to allow them to see equipment using new U.S. technology available for CIP financing. This has helped speed up the development of technical specifications and we plan to continue bringing Egyptian technicians to the U.S. as required for this purpose in the future.

(See GAO note 1, p. 42.)

APPENDIX VIII

(See GAO note 1, p. 42.)

The draft report notes on page 19 that in February, 1977, $190 million was shifted from capital projects to the Commodity Import Program. At that time the requirement that at least half of CIP funds be used to finance capital equipment was removed. We are prepared to review this earlier requirement in the future during consideration of new CIP programs, (See GAO note 1, p. 42.)

Food AID -- Usual Marketing Requirements

(See GAO note 1, p. 42.)

(See GAO note 1, p. 42.) In order to help address its serious balance of payments situation, the GOE has undertaken discussions with the EC with the aim of reducing its UMR for the FY 77/78 supply period from 2.6 million metric tons. We support this effort and are assisting the Egyptians by helping prepare and present sufficient data to support a reduction.

(See GAO note 1, p. 42.)

Selection of Projects for Financing

(See GAO note 1, p. 42.)

Coordination of Development Plans

With regard to Egyptian measures to ensure greater coordination of development plans and project management, on page 30 we suggest that the report take note of actions the GOE has recently taken. In November 1976, a Deputy Prime Minister for Economic Affairs was appointed with responsibility for coordinating the four major cabinet departments concerned with the preparation and implementation of Egypt's development program. This office has aggressively pursued its responsibilities and is becoming a focal point for sorting out Egyptian project priorities. At its direction the Ministry of Planning has developed a statement of the GOE's medium term development strategy. It has compiled a list of projects to be implemented by a number of ministries that will be given priority for foreign donor financing and GOE local support.

In terms of GOE organization to quicken the implementation of approved projects, the Deputy Prime Minister for Economic Affairs has played a major role in obtaining rapid People's Assembly ratification of the FY 1977 CIP loan. He directed that the Ministry of Economy control the allocation of CIP funds among the various GOE ministries so that all funds could be programmed by virtually the same time the loan was signed, and he also insured that loan conditions precedent were rapidly met. To expedite the use of those funds he directed the Ministry of Economy to use import licensing controls to ensure that commodities being purchased from the U.S. on commercial terms are shifted to CIP funding.

During the Consultative Group meeting in May, 1977, we again raised our concern that greater coordination of development planning and project implementation activities should take place. At that time, the Deputy Prime Minister mentioned the GOE's plans to establish a Supreme Investment Authority to review potential investment projects, identify donor participants, and ensure that local resources to support those projects are available.

We are encouraging the World Bank to establish a permanent IBRD representation in Cairo to assist in improving coordination among donors and in their dealings with individual GOE ministries. Furthermore, at the recent Consultative Group meeting it was agreed that smaller groups of donors would meet occasionally in Cairo with the GOE to follow through on questions of project priority and selection.

In summary, we have continued to urge the GOE to improve coordination with Egyptian ministries responsible for financing and planning Egypt's economic development, have identified a number of means to accomplish this, and have urged these measures on the GOE.

(See GAO note 1, p. 42.)

Project Implementation/Monitoring

(See GAO note 1, p. 42.)

APPENDIX VIII

(See GAO note 1, p. 42.)

Organization of Consultative Group

On pages 41 and 42 the draft report should be updated to reflect the fact that the first meeting of the Egypt Consultative Group chaired by the World Bank was held in Paris May 11-12, 1977. In addition to the United States, participants included Canada, France, West Germany, Iran, Italy, Japan, Kuwait, the Netherlands, Saudi Arabia, the United Arab Emirates, the United Kingdom, the African Development Bank, the Arab Fund for Economic and Social Development, the Commission of European Communities, the European Investment Bank, the OPEC Fund, the UNDP, the Gulf Organization for Development of Egypt, the International Monetary Fund, the International Finance Corporation and the Islamic Development Bank.

The Consultative Group meeting provided an important forum for all donors of consequence to discuss issues associated with Egyptian development and financing requirements. Accordingly, the Consultative Group meeting, we believe, was a vital step in improving the coordination process. The GOE delegation was exposed to wide-ranging concerns of its donors, encouraging the Egyptians to take economic reform efforts seriously. The meeting required the GOE to focus sooner than it might otherwise have on planning priorities and elicited promises of continuing attention to the planning process.

On page 44 the draft report asserts that Egypt's present inability to mobilize adequate resources will affect the implementation of AID-financed projects. This should be stated hypothetically since Egypt has been able so far to provide the local resources to support AID-financed projects.

(See GAO note 1, p. 42.)

The final paragraph on page 47 should be revised to note the fact that the first meeting of the Consultative Group was held May 11-12, 1977. During that meeting considerable attention was given to Egyptian plans to prepare a detailed medium term development plan outlining priority areas for investment that would be tied into the country's overall economic strategy statement.

(See GAO note below.)

We welcome this GAO suggestion since we agree that GOE mobilization of adequate resources for specific projects may be a problem in the future. We believe, however, that local currency financing should not be restricted only to capital projects; for example, we can foresee circumstances in which the provision of local currency may be required as an extra incentive to obtain Egyptian support of "new directional" technical assistance activities. A family planning project possibly would be such an activity.

The AID Mission has addressed the need for local currency financing in its country strategy statement and is developing criteria on the circumstances and types of projects for which AID should supply local currency financing. We will be considering the Mission's recommendations during our review of the budget submission and are prepared to take action accordingly to ensure that adequate local cost financing is available as required for implementation of projects jointly undertaken by the GOE and AID.

GAO note: We suggested that local-currency financing be approved for selected projects.

In conclusion, we wish to compliment the GAO team on the constructive approach with which it has carried out the review with State and AID in Washington, with our Embassy and USAID Mission in Cairo, and with the Government of Egypt.

GAO notes:

1. The deleted comments pertain to matters omitted from or revised in final report.
2. Page references in this appendix refer to the draft report and may not correspond with the page numbers in the final report.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

JUN 6 1977

Dear Mr. Lowe:

I have reviewed the latest draft of the GAO report on "The Need for Restructuring U.S. Aid to Egypt to be More Responsive to Egypt's Needs," and found it to be a useful description and analysis of our aid program in Egypt and the range of possibilities for restructuring it. In your letter of transmittal, you requested Treasury Department comments. I hope the following comments will be helpful.

Your proposal for financing local currency costs of selected U.S. capital development projects (p.48) raises a number of important policy concerns.

First, there exists some doubt as to whether the rate of project aid disbursements in Egypt would be significantly accelerated by the U.S. financing of the local currency costs. As your report notes, disbursement rates have also been slowed by other factors, such as lack of coordination among Egyptian ministries responsible for executing projects, lack of planned projects in sufficient numbers, shortages of on-site AID staff, the long lead times involved in project implementation, lack of qualified Egyptian managerial staffs, and differences between U.S. and Egyptian procurement practices. Given these multiple constraints on the rate of aid disbursement, it seems quite possible that an increase in local currency financing might have little effect.

Secondly, your proposal envisages providing U.S. dollars to generate additional local currency (pg. 46a). At present Egypt is an excess currency country. The provision of foreign exchange to cover local currency expenses may run counter to the intent of Section 612 (b) of the Foreign Assistance Act. This section requires the U.S. to make maximum utilization of U.S.-owned foreign currencies to carry out USG programs in an excess currency country. What is the statutory basis for your recommendation on local currency financing? (See GAO note below.)

GAO note: Section 612(b) of the Foreign Assistance Act of 1961, as amended, appears to permit use of dollars rather than U.S.-owned foreign currency in an excess-currency country when the reason for the use of such dollars is certified in each case by the appropriate administrative authority (22 U.S.C. 2362(b)).

Thirdly, the proposal raises additional issues related to whether the foreign exchange provided the GOE to purchase local currency would be in any way tied to U.S. procurement or specific commodity lists as is the case with the current CIP program. While the Treasury does not favor tying to either source or kind of import, untying part of the Egyptian SSA program would represent a significant departure from procurement practices Congress has heretofore encouraged. We would not wish to see a decline in support in Congress for our program to Egypt because of this proposal.

It may be that financing mechanisms could be found to overcome these difficulties. However, they should be specifically addressed in the GAO report if this recommendation is to receive serious consideration.

Finally, in your discussion of the deterioration in Egypt's balance of payments situation on pages 8 and 9, it would be helpful if you pointed out that this deterioration was due in part to the maintenance of an overvalued exchange rate which encouraged imports. Also, I did not find convincing the argument advanced on page 10 that a devaluation would worsen Egypt's foreign exchange position. The foreign exchange prices of Egypt's exports and imports are not likely to be altered by changes in Egyptian supply (of exports) or demand (for imports). In these circumstances, a devaluation would at worse leave Egypt's foreign exchange situation essentially unchanged. However, an even more likely outcome would be an improvement as Egyptian producers increased the volume of their exports and reduced the volume of their imports in response to higher domestic prices.

My staff has already provided your office with more detailed comments on specific parts of the report which I will not repeat here.

Once again, allow me to compliment you and your staff for a most interesting presentation.

Sincerely,

C. Fred Bergsten
Assistant Secretary for
International Affairs

Mr. Victor L. Lowe
Director, General Government Division
United States General Accounting Office
Washington, D.C. 20548

GAO note: Page references in this appendix refer to the draft report and may not correspond to the page number in the final report.

United States Department of Agriculture
Office of the General Sales Manager
Washington, D.C. 20250

MAY 27 1977

Mr. Henry Eschwege, Director
Community and Economic Development Division
U.S. Government Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

We are responding to your letter of March 31 to Secretary Bergland requesting the Department of Agriculture's comments on the GAO draft report, "Need for Restructuring U.S. Aid to Egypt to be more Responsive to Egypt's Needs."

Before addressing the specific portion of this report which falls within the Department's area of interest, we would like to make two general comments. It would have seemed more appropriate for a United States entity to review this subject from the point of view of enhancing effectiveness in meeting U.S. needs and interests as well as those of Egypt. We also note that the report focuses extensively on economic problems, such as inflation and balance of payments difficulties, but does not address the population growth rate problem at all.

(See GAO note)

we do recognize the severe economic problems now facing Egypt. Several food aid donors, including the United States, are currently reviewing the appropriate level for usual marketing requirements. Since such requirements are established by more than one food aid donor in accord with internationally recognized FAO Principles of Surplus Disposal, they are the subject of concern to several donor countries as well as Egypt. To really have an effect on the Egyptian economic situation, it is necessary for all donors to establish similiar usual marketing requirements; since in practice, the highest one established by a donor country is the quantity Egypt must purchase commercially.

At present we are considering a significant reduction in the usual marketing requirement to provide some balance of payments relief to Egypt. We are fully aware of the problem addressed by GAO in this report. Establishment of the actual UMR levels will take full account of the Egyptian economic situation, internationally agreed procedures governing usual marketing requirements, as well as the Egyptian commodity supply and stock situation. We would like to point out that reducing or waiving a usual marketing

GAO note: The deleted comment refers to matters omitted from or revised in final report.

APPENDIX X

Mr. Henry Eschwege 2

requirement does not, in itself, provide any balance of payments relief. The significant factor is the food import requirement of Egypt and how such requirement is met. Egypt will either have to purchase commercially the required quantity or it must be supplied by food aid donors.

The decision that really affects the Egyptian economy is the level of food aid which is provided by the various donors. Such level, of course, must ultimately be decided in the overall context of food aid needs of all less developed countries and the financial and commodity availability of international food aid.

Sincerely,

PRINCIPAL OFFICIALS RESPONSIBLE FOR ACTIVITIES DISCUSSED IN THIS REPORT

	Appointed
DEPARTMENT OF STATE	
SECRETARY OF STATE:	
Cyrus R. Vance	Jan. 1977
Philip C. Habib (acting)	Jan. 1977
Henry A. Kissinger	Sept. 1973
ASSISTANT SECRETARY, BUREAU OF INTERNATIONAL ORGANIZATION AFFAIRS:	
Samuel W. Lewis	Dec. 1975
AGENCY FOR INTERNATIONAL DEVELOPMENT	
ADMINISTRATOR:	
John J. Gilligan	Mar. 1977
John E. Murphy (acting)	Jan. 1977
Daniel S. Parker	Oct. 1973
DEPARTMENT OF THE TREASURY	
SECRETARY OF THE TREASURY:	
W. Michael Blumenthal	Jan. 1977
William E. Simon	May 1974
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS:	
C. Fred Bergsten	Mar. 1977
Gerald L. Parsky	Feb. 1976
DEPARTMENT OF AGRICULTURE	
SECRETARY OF AGRICULTURE:	
Bob Bergland	Jan. 1977
John A. Knebel	Nov. 1976
Earl L. Butz	Dec. 1971

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