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THOUGHTS ON AN INITIAL PUSH FOR THE INDUSTRIAL SECTOR

EGYPT

THOUGHTS ON AN INITIAL PUSH FOR THE INDUSTRIAL SECTOR

1. This paper is based only on the limited information obtained during the economic mission of April 1972 and on more general discussions held during an Industrial Projects Identification Mission of April 1973.

Comparative Advantages and Prospects

2. The main factors and components for a rapid industrial development in Egypt are: (i) a potentially strong and sophisticated agricultural sector which could provide a market for agricultural inputs and a good base for the manufacturing of agricultural products; (ii) available entrepreneurship and a large semi-skilled labor force; (iii) a good location to serve the European, Mediterranean and Arab world markets; and (iv) good prospects for energy supply including electricity, oil and natural gas.

3. A four phases industrial development could include: (i) an immediate increase in industrial output in selected branches through removal of major bottlenecks in the supply of raw materials and spares to the existing industrial facilities; (ii) reorganization and rehabilitation of obsolete facilities in selected branches; (iii) implementation of the numerous import substitution or export promotion projects whose execution was constrained by the availability of foreign exchange, including a rapid development of small to medium scale industries; and (iv) careful preparation and execution of some major large scale export oriented projects to benefit from Egypt's key location, the availability of energy and industrial land and/or Arab finance (e.g., fertilizer, petrochemicals, steel and electro-metallurgical projects). The last line of action has gained some creditibility and it appears that some joint ventures with foreign firms are being considered by Egypt in this field.

Utilization of Industrial Capacity

4. It has traditionally been reported that industrial capacity in Egypt is under-utilized. The following is a tentative estimate (not yet substantiated by reliable statistics) of capacity under-utilization by branches and a qualitative statement of explanatory factors:

Main Sectors	estimated % of capacity utilized	Most likely factors explaining Capacity Underutilization: Demand	Over Investment	Shortage of raw materials	Spare parts or bottlenecks due to obsolescence	marketing inputs and outputs
Food	60-80%	x		x		x
Milling	60-90%				x	x
Spinning & Weaving	90-100%			x	x	x
Heavy metal transforming	30-50%	x	x	x	x	
Light engineering	70%			x	x	
Building materials	90-100%				x	
Chemical industries*	70%	x	x	x		

* cluding fertilizers.

5. The main factors affecting capacity utilization in some of the major industrial branches are as follows:

a) Food Industries: Supply (including transport and marketing) of basic agricultural commodities. Improvement could stem from better programming in agriculture, increased local demand, and improved planning/marketing for export.

b) Milling Industries: Obsolete equipment and lack of spare parts. Supply of critical equipment (mostly locally manufactured, if constraints in the light engineering industries are removed) should improve capacity utilization in this branch.

c) Spinning and Weaving: Shortage of polyester raw materials (imported) and unreasonably high prices of locally produced rayon; major imbalances in plants and in the sub-sector; largely obsolete equipment; lack of moslem finishing and garment-making facilities and aggressive marketing abroad.

d) Heavy Metal Transforming: Over investment and shortage of raw materials (steel sheets and profiles, non ferrous metals). Increased demand (following regained activity in construction and modernization of transport equipment) combined with imports of billets, steel sheets and other materials should help increase capacity utilization.

e) Light Engineering Industries: Mostly in the private sector, lacks raw materials, components and spares.

Strategy, Policies, Price System and Industrial Finance

6. A notional list of steps Egypt could take--to prepare a development oriented environment in industry, and to capture and mobilize the forces and resources towards such goal--is given below. Actual implementation and the speed of introduction and acceptance of changes in strategy, constitute a more delicate problem.

i) A revised industrial strategy: maximize use of existing capacity; shift emphasis towards light industries; mobilize private sector entrepreneurship in small scale industries; concentrate in the immediate future on industries: serving the construction and transport sector; manufacturing inputs for agriculture and/or processing agriculture products; concentration on short-gestation projects for export-oriented industries.

ii) Assess and reduce the role of physical planning and create conditions for more decentralized investment decisions;

iii) Progressively increase the role of market forces and the price mechanism in clearing markets, to provide yardsticks for investment decisions. Price distortion is such that it would probably be impossible to expose Egyptian industry rapidly to an international patter of prices; identify those branches of industries which are already established but which clearly cannot remain competitive, and work out a second-best solution by protecting those branches, if necessary, by tariff-cum-subsidy schemes.

iv) Organizational set up, decision making and bureaucracy: decentralization of investment decisions and of the implementation of projects, is probably the most important institutional reform Egypt should undertake. The GOI (General Organization for Industrialization) should probably: increasingly rely on capabilities available at the company level for projects planning and implementation; improve its relations with the branch holdings and the companies; and revise the procedures for project execution largely dictated up to now by foreign exchange constraints.

v) Taking of investment and financing decisions at the enterprise level: prepare an interim plan for allowing selected firms to retain some earnings for self-financing and to become increasingly autonomous in their investment decisions (probably a delicate step).

vi) Help revive and promote the private sector activities: free the private sector from enrollment in cooperatives and take full advantage of the existing large entrepreneurship capabilities.

vii) Develop ways and means to use a minimum of economic tools (fiscal policies, taxes, interest rates) to mobilize savings and guide allocation of resources.

viii) Study employment trade-offs between industrial sub-sectors in the process of reorganizing the industry: stabilization (or release) of labor force through modernization of certain industries (notably textiles) vs labor absorption in future booming activities (construction, transport, services, small scale industries.

7. The immediate steps Egypt could take to accelerate the process of industrial growth might be:

i) analyze briefly: the market potentials created for the industrial sector by an increased demand for industrial goods from construction, particularly cement, building materials and metal transforming industries (reinforcing bars, frames, structures); the linkages between better organized agricultural sector and the industrial development, particularly the demand for agricultural equipment (small mechanical equipment like power tillers and pumps) and agricultural inputs (fertilizers and pesticides) and the market for food processing industries. Emergency planning of expansions, rehabilitation in these sectors is vital (and apparently relatively simple) and could be combined with interim import of such goods as necessary pending to projects completion.

ii) rehabilitation of the textiles sector including modernization of equipment, improved marketing locally and abroad, and more appropriate blend of raw materials, and export of better finished goods to European and neighboring countries.

iii) prepare the conditions for a major role to be played by the private sector in the garment and knitwear industries;

iv) mobilize the private sector for small scale industry development and prepare an adequate environment to enable the private sector to react rapidly;

v) improve capacity utilization: in industries constrained by the supply of raw materials (i.e. heavy·metal transforming industries, light engineering industries, food industries) through increased supply of inputs (imported or local); in industries where short gestation and debottlenecking projects might prove to be highly beneficial;

vi) organize a task force for: the preparation of branch blueprints; the formulation and preparation of short to medium term plans for rehabilitation of selected industrial branches; and the preparation of projects feasibility studies.

Bank Role in Assisting Egypt Industrial Development

8. The Bank might help the Egyptian industrial sector regain momentum and might help prepare the ground for a steady growth in Industry through implementation of the following notional set of actions:

i) assist in identifying bottlenecks in key industries and prepare a plan--for selected branches--combining interim import of key raw materials, debottlenecking of segments of the industry and formulation of short gestation projects. Eligible sectors would be textiles, building materials, heavy and light metal transforming industries. A 4-men task force could cover this work in about two months. This work could provide the base for an industrial imports-cum-rehabilitation loan. A notional list of goods is given in the Attachment;

ii) assist in planning/programming of supply of agricultural inputs and program interim imports and local production of fertilizers and pesticides. Priority procurement of fertilizers from Arab countries should be easy to organize;

iii) help formulate policy measures to provide financial means and mobilize private sector skills and entrepreneurship for an immediate development/rehabilitation of small scale industries;

iv) prepare longer term gestation projects (but key to long term development) in Petrochemicals and phosphate rock mining and processing industries. Egypt has comparative advantage in both and foreseen shortages of such commodities in the world, as well as needs of the local industry (plastics for construction, synthetic rubber, and synthetic fibers for textiles; phosphate fertilizers for agriculture and phosphoric acid for export);

v) provide finance (directly or through BOA) for small scale industry development in key selected branches (transport and construction ancillary equipment, textiles, food industries).

Review of Selected Branches and Projects

A. Textiles and Clothing Industry

9. This is a long established sector where local expertise of international calibre is available. Spinning, weaving and finishing operates at full capacity. The sector accounts for 30% of output, 50% of employment and 50% of exports in the manufacturing sector; it is therefore a major segment of industry. The main

problems and constraints are: (i) obsolete machinery--more than 25 years old in many cases--and imbalances at different stages of processing; (ii) acute lack of spare parts; (iii) deficiencies in equipment imported recently from Eastern countries; (iv) use of high-quality high-value long staple cotton in low cost fabrics (underspinning); (v) high cost of viscose rayon because of unreasonable protection for the local rayon company.

10. The main recommendations are: (i) priority sector with good prospects for exports (to convertible-currency countries) and for employment generation; (ii) good potentials for quick returns from investments in rehabilitation and from better programming/marketing; (iii) optimize use of inputs, in particular import polyester staple (to release, with substantial earning, long staple cotton for export); (iv) boost knitting and clothing activities; (v) replace about one-fourth (400,000) of spindles and one-third (9000) of looms; (vi) improve finishing facilities; (vii) local manufacture of textile equipment. The foreign exchange cost of rehabilitation under (v) and (vi) is over US$300 million, to be phased over 5 to 10 years. A Bank mission reviewed the textiles sector in February 1974: Feasibility studies for rehabilitation of four plants (Mahalla El Kobra, Esco, Kafr el Dawar and El Beida) are being prepared.

B. Building Materials (cement, ceramics, bricks, asbestos pipes, tiles, etc..)

11. It is a long established sector with good local expertise and a good raw material base. It is also a key sector for supply of basic materials essential to any major reconstruction effort. Egypt has high comparative advantages and good export potentials to neighbouring Arab countries. The sector operates at full capacity and will probably (particularly in cement) constitute a major constraint for any reconstruction effort, if capacity is not expanded rapidly. The present production of cement is about 4 million tons, of which 1 million exported (value of US$25 million), in 1971/72; there are severe restrictions of supply for local consumption. An additional 3 million tons capacity is foreseen, but no serious financing seems available apart from Tourah project -- to be appraised in March 1974 by the Bank with possible Arab or bilateral co-financing. The projected cement consumption -- even under a low assumption for the reconstruction effort -- shows a shortage of cement in the medium term and the needs for imports at a high foreign exchange cost.

12. Recommendation and action: (i) accelerate investments in this sector in general and particularly in cement; (ii) develop use of petrochemicals products in construction--since wood products are not available and metal products will still have high import component--to build up market for a petrochemical industry; (iii) develop light metal transforming industry for manufacturing of construction components.

C. Petrochemicals

13. Egypt is probably the best location in the Arab world to install a petrochemical industry to serve Egypt and Arab world markets, but also the export markets. Petrochemical products are and will remain scarce in the world and this industry could be set up on the basis of enclave type (or with long term

marketing arrangements) projects. Petrochemical products will be in large demand in a peace-like situation from the textile sector (synthetic fibers), from construction (plastics) and from the transport sector (synthetic rubber).

D. Medium and Light Engineering Industries

14. This is a reasonably well developed segment of the mechanical industry sector. Prospects for further development of castings and machinning industries are large (given labor intensity and good prospects for exports). There are large potentials for the manufacture of: (i) agricultural light implements (power tillers, hand implements, pumps, pipes) essential if agriculture is to be modernized and cropping patterns altered; (ii) construction materials; (iii) transport equipment(notably railways where there is an important market in Europe).

E. Food and Milling Industries

15. This sector has large potentials for both import substitution and exports, particularly to the Arab world, and could develop rapidly if the organization of agriculture and the marketing of agricultural products improve. The main recommendations are: (i) revive the role of the private sector; (ii) improve the marketing and diversify the range of products.

F. Small Scale Industries and Industrial Estates

16. This sector, particularly neglected because of "the build big Syndrome" in the past decade, also has large potential. It includes: a sizeable segment of textiles; most of the footwear, ceramics, and engineering repair industries; the quite large furniture sub-sector; building materials and the important repair shop industries. The base and skills are available and the sector only needs encouragement. The main recommendations are: (i) revive the private entrepreneurship with which Egypt is particularly well endowed; (ii) provide finance for development of small industries; (iii) liberate the sector from cooperative and grouping constraints; and (iv) prepare industrial estates and free industrial zones projects.

G. Steel Manufacturing and Petroleum Refining

17. The status of and the operations in these two industries are unknown. Major work probably needs to be done to complete construction and improve operations. They will probably remain a sensitive sector with consequent difficulties in understanding problems and determining scope for improvement.

H. Heavy Mechanical Industries

18. Rolling and forging industries are operated at an extremely low rate of capacity. Capacity could be better utilized for both local and export needs (to manufacture components for railways equipment, earth moving equipment and commercial vehicles).

EMENA Region
February 22, 1974

Attachment

Notional List of Goods as Part of an Industrial Imports/Rehabilitation Loan

Product	Improve Capacity Utilization in	Induced Effect in the economy
Steel sheets and billets	Rolling and forging	Supply of key profiles for construction industry and components for transport equipment.
Coke/Iron ore	Steel manufacturing	Supply of steel for all mechanical industries
Non ferrous metals	small industries	Construction and sanitary equipment
Pig iron	Castings	Small industries; machinery.
Spares and Machinery for Textiles	Textiles	Exports of textiles products
Spares and Components for Mechanical Industries	Machinery Manufacture	Supply of Agricultural Inputs
Fertilizers and Pesticides	-	General agricultural output
Various chemicals	Textiles	Export of Textile products
Polyester fibers	Textiles	Liberate cotton for export, improve quality of textile goods, create a market for petrochemicals, help export textile fabrics.
Components and spares for:		
a) earth moving equipment and commercial vehicles	-	Construction
b) Tractors and Power Tillers	-	Agricultural Output
c) Electrical equipment for rural electrification	Electrical industries	Agricultural output and rural industries

1. <u>BACKGROUND ON IMF POSITION IN EGYPT</u>

2. <u>NOTE SUMMARIZING REPORTED AID FROM JAPAN, GERMANY, UK AND ITALY</u>

3. US POSITION

N

EGYPT'S RELATIONS WITH THE IMF

1. In 1962, Egypt negotiated a stand-by arrangement with the IMF (SDR 42.5 mil.) based largely on the devaluation of the Egyptian pound (from $2.87 to $2.30) and on domestic credit ceilings. Another stand-by (SDR 40 mil.) was concluded in 1964 obliging Egypt to further credit restrictions.

2. In subsequent years, protracted negotiations were conducted for a new stand-by, but no agreement could be reached. The principal obstacle to such an agreement was the unwillingness of the Egyptian Government to devalue the pound further.

3. Despite continuing disagreements on exchange policy, limited resources were made available by the Fund in 1968 (SDR 40 million), 1970 (SDR 17.5 million) and 1971 (SDR 32 million). These credits were essentially given on the basis of understandings on domestic credit policy although, since 1970 minor steps were also taken by the Egyptian authorities in the direction of stimulating trade with the convertible currency area.

4. In addition, Egypt obtained Fund resources under the compensatory financing scheme (SDR 16 million in 1963, SDR 23 million in 1968 and SDR 47 million in 1973) to offset shortfalls in export earnings.

5. Early in 1973, a new stabilization program was discussed, but the negotiations were discontinued, when Egypt did not follow the devaluation of the US$ in February 1973. They were resumed in June/July 1973 but now a new obstacle emerged: domestic credit expanded rapidly, probably in preparation of the October war, and no policy agreement could be reached.

6. In September 1973, Egypt introduced far-reaching measures to liberalize trade with the convertible currency area, and to base these transactions on more realistic price relations. By adding a premium/surcharge of 50-55% to the official exchange rate ($2.56) the Egyptian pound was effectively devalued to $1.70-1.64. Simultaneously, administrative procedures of purchasing and selling foreign exchange were streamlined. The new exchange regime (parallel market) covers a large number of visible and invisible (tourism, remittances) transactions although major traditional exports (e.g. cotton, rice, textiles) are still excepted. Little is known about the actual functioning of this new system.

7. The next IMF mission is tentatively planned for April 1974. A new drawing may be discussed. Agreement on the use of Fund resources in the first credit tranche (maximum about SDR 32 million) will depend largely on reaching an understanding on domestic credit ceilings.

EMENA Region
February 22, 1974

EGYPT'S POSITION WITH IMF
(SDR million)

Year	Drawings Total (1)	Drawings Reg. (2)	Drawings Comp. (3)	Repayments Total (4)	Repayments Reg. (5)	Repayments Comp. (6)	Drawings Outstanding 1/ (7)	Quota (8)	(7) as % of (8)
1961	10	10	-	13	13	-	50	90	56
1962	67	67	-	10	10	-	107	90	119
1963	21	5	16	2	2	-	126	90	140
1964	25	25	-	12	12	-	139	120	116
1965	15	15	-	29	29	-	125	120	104
1966	8	8	-	28	28	-	105	150	70
1967	-	-	-	-	-	-	105	150	70
1968	63	40	23	69	53	16	98	150	65
1969	-	-	-	24	24	-	74	150	49
1970	17	17	-	9	9	-	83	188	44
1971	32	32	-	11	11	-	104	188	55
1972	-	-	-	45	31	14	59	188	31
1973	47	-	47	9	-	9	96	188	51

1/ End of year.

Annex N

NOTE

REPORTED AID FROM JAPAN, GERMANY, UK AND ITALY

The following summarizes the aid commitments and prospects gleaned from past discussions with the representatives of Japan, Germany and UK in Egypt, as well as from recent press and other reports.

Japan

As part of the debt rescheduling agreement completed in April 1973, Japan provided a commodity loan equivalent to about US$11 million.

Following the Japanese Deputy Prime Minister Miki's visit in December 1973 to Arab countries, including Egypt, Japan is reported to have agreed to provide about $140 million on "soft terms" towards the Suez Canal Expansion Project, to finance contracts which might be placed with Japanese dredging contractors. Apparently, Japanese contractors were the lowest bidders when tenders were opened in 1967 for this project; since then, they have kept on "updating" their 1967 bids.

Agreement to provide another soft loan of $100 million (30 billion yen) has also been reported, to finance commodity imports and for investment imports in the telecommunications, textiles, railway transport and petrochemical fields. Our Tokyo Office advises that an agreement for this amount (50 percent for commodity and 50 percent for project imports) is to be signed in Feb. 22. The terms are 25 years including 7 years grace, at an interest of 3.5 percent per annum.

For over a year, the Japanese had been talking about the possibility of providing a $220 to 240 million loan to assist with the cost of dredging contracts placed on Japanese firms for the Suez Canal Expansion Project. It would seem that, in view of recent petroleum developments, they have now comitted themselves to more or less the same amount, but packaged it in a somewhat different form.

Egypt has also requested Japan to provide a loan of $1000 million over 5 years for development projects. The Japanese reaction is not known.

Germany

As part of the debt rescheduling arrangements negotiated in early 1973, Germany agreed to provide a DM 160 million credit with a 30-year repayment including 10 years grace, at an interest rate of 4 percent per annum. DM 90 million of this is to be used for commodity purchases and is tied to procurement in Germany. The remaining DM 70 million is to be used for capital goods imports on an untied basis. The formal agreement was however signed with fanfare, by the German Economics Minister only in late November 1973.

It is understood that during negotiations, Germany gave a "gentleman's undertaking" that as soon as this credit was committed by Egypt, it would be ready to negotiate a similar credit.

In July and September 1973, when IDA was exploring the possibility of Germany co-lending for the Talkha Fertilizer and Tourah Cement projects, Egypt advised that they intended to commit the German monies quickly for other projects. It is however reported that the Egyptians have been slow in allocating and committing these monies, not because of the lack of projects, but because of the Government's hesitation in sorting out project priorities.

UK

In mid-1973, UK announced that it had agreed to provide credits totalling £10 million to be used over a 5 year period for priority projects. The credit is for a 25-year repayment period, including 7 years grace, at an interest of 2 percent per annum. About £3 million had already been committed by June 1973.

UK officials also advised the Bank staff "confidentially" at the time, that UK would like to see a £3 million a year "disbursement level" reached by fiscal 1975 and a "higher figure" thereafter, which would enable UK to increase its level of lending to Egypt.

Italy

As part of its debt rescheduling arrangement, Italy agreed in late 1972 to provide a loan equivalent of $48 million to Egypt for commodity and capital purchases tied to procurement in Italy. Italy however has not direct aid program for any country. However, to provide "aid", the Government usually arranges for either of the four Government-owned Italian Banks (IMI, ICHIPU, Medio Banco and IFI Banco) to give agreed amounts at concessional rates to developing countries. The difference between the "bank terms" which these banks charge, and the "aid terms" provided to the countries, is "subsidized" by the Italian Government under an internal Italian arrangement. However, with a subsidized interest rate and insurance premium charges, Italian monies could end up with an effective cost of about 6 percent, and have a maximum repayment period of 15 years.

It might be noted that before Egypt accepted the Arab Fund's offer to co-finance the Talkha Fertilizer Project with IDA, Italy was quite keen to help with as much as $45 million on these terms, but on the basis of tied procurement.

It might also be interesting to recall that in early 1973, Italy was actively exploring the possibility of interesting the European Common Market countries in forming a consortium, which would provide $500 million annually as aid to Egypt for development, war rehabilitation, Suez Canal expansion and similar purposes, if Egypt could defuse the middle-east conflict. It is believed that except for Germany, not much interest was evinced by other European countries at that time, and the proposal was quietly dropped.

EMENA Region
February 22, 1974

OPERATIONAL STEPS ON SUEZ CANAL/CANAL ZONE REHABILITATION MATTERS

1. Mr. Davar's January 1974 Report on December 1973 Mission.

2. Suez Canal

   (a) Mr. Davar's January 16 Memo - Approach through an Exploratory Mission.
   (b) Messrs. de Man/Elliott's February 11 Memo - Exploratory Mission's Findings.
   (c) Messrs. Votaw and Davar's February 15/14 Memos - Recommending Clearance/Reopening Project.

3. Canal Zone Rehabilitation
   Mr. Wyatt's February 1 Memo - Preliminary Proposals for Bank Activity.

O

Annex O

OFFICE MEMORANDUM

TO: Mr. Gregory B. Votaw

DATE: January 8, 1974

FROM: A. J. Davar

SUBJECT: Egypt: Report on Mission

I have already reported verbally to Mr. Benjenk and you on the highlights of discussions last month in Egypt. Pertinent matters discussed on ongoing projects have been reported on separately. This memo essentially reports on matters arising from the October 1973 hostilities, the Egyptian thinking about the role the Bank could play in future and the directions in which we might consider helping that country. The subject is a difficult one with many intertwining considerations, on which views and advice should be solicited within the Bank before distilling a course of action. Therefore, the comments made herein are more in the nature of thinking aloud to test the wind and obtain the benefit of your reactions and those of others in the Region.

2. I met a number of ministers and officials including Deputy Prime Minister Dr. Hegazy, Sayed Marei, Agriculture Minister Zaki, Reconstruction Minister Osman and the Suez Canal Company Chairman Mashour (the last two at the specific request of the Finance Ministry). An interesting highlight was a visit arranged for me to the war zone and the Canal cities of Ismailia, Qantara and Port Said, to appreciate the extent of the rehabilitation needs of that war-devastated region. Besides reconstruction of those parts of these cities destroyed by bombing in the 1967 and 1973 hostilities, these cities will need substantial investments to rehabilitate damage caused by disuse and to restore public utilities, to stimulate the rehabitation and economic activities in them.

Political Situation

3. In February 1973 when Sadat also assumed the prime ministership, we analyzed from his previous record as an astute master politician who carefully plans his moves and countermoves in advance, that this step presaged "unorthodox" measures in 1973, to break the middle eastern deadlock. The October 1973 events apparently were that step. Since then, instead of skeptical cynicism, Sadat now enjoys immense popular support. With the backing of War Minister Ismail (former Chief of Army Intelligence), Sadat also retains the army's support. Almost all cabinet ministers are technocrats, with unquestioned loyalty to him.

4. As mentioned in my verbal reporting, having accomplished his objective of breaking the middle eastern deadlock, Sadat was expected to relinquish, in early 1974, the prime ministership to a trusted lieutenant. That would enable him to devote primary attention to larger questions of war and peace and Arab unity, leaving the prime-minister to attend to the running of the country and achieving Sadat's goal of Egypt's economic resurgence. It was anticipated that the person selected would be one who enjoyed enough Arab confidence to continue to

marshal Arab monies for Egypt's economic development, and who was known to be US or western-oriented-to provide another clear signal of Sadat's intention to increasingly look in that direction in future. The choice was therefore between Sayed Marei and Hegazy. Last night, the latter was nominated.

Bank's Role in Egypt

5. During discussions, Hegazy, Sherif Lotfy and others pressed the point that while Egypt appreciated the continuation of $40 to $50 million of soft IDA funds for economic development, this level of aid was going to be hardly meaningful or one of impact at a time when (a) Egypt was looking forward to the rehabilitation of its war-devastated areas and a reconstruction of its economy and (b) there was likelihood of a significant inflow of Arab monies for this purpose. They indicated that things had not yet jelled sufficiently on the peace question, to discuss the magnitude of Egypt's overall needs (but which would be large) and possible Bank contribution towards it. They however believed that, in principle, the Bank should now be prepared to reconsider the level and type of assistance it could provide, since that would determine the future role it could play in Egypt. The Egyptians would indeed like the Bank to participate, both technically and financially, to a significant extent in their country's development. $40 to $50 million of IDA monies each year would hardly give the Bank a chance, much less leverage, to play a constructive role or one of impact in this exercise. In fact, Lotfy ventured that if Bank Group participation was to be pegged around this level, it might not be worthwhile for Egypt and IDA to expend the substantial manpower needed to prepare Bank Group projects; from the Egyptian viewpoint, it would then be wiser to have no more than two projects a year and let IDA provide more monies for each of them from its $40 to $50 million ceiling. The saved Egyptian manpower could be used to prepare other projects for financing sources which were available and whose demands for project preparation were not as taxing as the Bank's. However, the Egyptians appreciated the meticulous work that Bank projects entailed, and were prepared to put it in the necessary effort from their side, for a meaningful and substantial Bank Group program.

6. To get a feel of the current situation, I solicited their thinking on what the Bank could do, keeping in mind the mutually familiar constraints, including limited IDA availabilities and Egypt's severe debt service and creditworthiness aspects -- both of which had so far deterred consideration of Bank lending. What the Egyptians have in mind is that if the IDA allocation cannot be increased, it should be increasingly blended with Bank financing. The way they see the situation is as follows. Now that peace moves have been initiated, Egypt is determined to achieve its goal of an economic resurgence, for which it will need foreign exchange over and above what it hopes to obtain from Arab sources; in the medium-term, it would be unrealistic to expect a transfer of resources from defence expenditures towards development; therefore, in order to meet its development aims, Egypt has to continue to borrow the required additional

monies on hard-terms from commercial banking or suppliers' credit sources, as it has been doing; this, in the medium-term, would indeed further vitiate its debt service problems; however, if as a development institution, the Bank is concerned about Egypt's debt-service burden, it should consider helping to alleviate that burden; Bank-financing having a 20 to 25-year repayment period including 4 to 5 years grace and a 7.25% interest, would aggravate the debt burden less than available hard sources of financing; to the extent that Bank monies are blended with IDA's, Bank terms would be softened While no specific figures were mentioned, a total of up to $200 million a year, inclusive of about $50 million from IDA, was hinted at.

7. They did not expect that this level of financing could be obtained only through the modicum of some Bank "enclave projects", such as for the Suez Canal and export-based industrial projects like urea or phosphatic fertilizers, petrochemicals, etc. (Egypt would welcome Bank involvement in such projects at the most propitious time.) It was suggested that if the Bank was worried about Egypt's debt-service capacity and repayment of the monies it lends, we might consider channelling Bank financing not merely for projects which build-up the country's economic base, but more for those which expands Egypt's productive capacity and that, for earning foreign exchange. In this connection, besides the possibility of (i) a fruit/vegetable production, processing and marketing project (essentially for export), and those for cash or import-substitution crops or (ii) import-saving industrial projects such as fertilizer, sponge iron etc., Hegazy, Mohamadain and Lotfy again pressed for a program loan, if we so desire, for at least selected export-earning industrial sub-sectors such as food/leather processing, textiles, or electronics/engineering. They would be even prepared to consider a program loan initially, for maintenance of spares for such sub-sectors, on the understanding that Egypt would provide (from other bilateral monies) licences to these sub-sectors to import raw materials and semi-finished goods. They concede that existing industrial capacity might be underutilized because of other constraints such as lack of power, trained workers, etc.; but according to them, all evidence suggests that the paramount constraint which is making the country lose between 12 to 14% of its potential for production and halving the potential growth rate of the industrial sector, is the lack of foreign exchange for current imports of raw materials, semi-finished goods and maintenance spares. If we were prepared, the Egyptians would be prepared to analyze the requirements in depth with the Bank, as well as permit the reviews of the sub-sectors. Hegazy would also welcome help to initiate both the masterplanning of Cairo and Sinai, studies on regional development to reduce pressures on Cairo and create bases of economic activity in other areas in Egypt, besides projects that may result from such masterplans or studies. Some of the interesting project possibilities explored are summarized in the Annex. But the point was repeatedly made that it was through projects and program lending which helped with Egypt's physical and economic reconstruction, that a dynamic and meaningful impact could be made by the Bank, at this critical juncture in Egyptian and middle eastern history. That implied Bank-IDA, not mere IDA lending.

8. I took the tack that the Bank was appreciative of this line of thinking and I would raise the matter within the Bank. However, I was also confident that the Egyptians were equally appreciative of certain basic principles which the Bank had to take into account as a "trustee" of international monies provided to it for development. I tactfully inquired with both Hegazy and Marei, whether in the circumstances, Egypt might not be considering steps, which would help restore its international creditworthiness and open the door for Bank and western bilateral aid, and perhaps also enable Egypt to obtain commercial bank credits on terms more favorable than it obtains today. One obvious avenue was to alleviate Egypt's critical debt-service problem in the next 5 years, by channelling available Arab aid to pay off maturities for the next 3-5 years, on debts to at least major western creditors. Another alternative, politically more difficult, might be to consider if some Arab donor countries like Kuwait or Saudi Arabia might not provide co-guarantees along with Egypt, for Bank or similar financing. Hegazy felt that time was not yet ripe politically, for either possibility; Marei was more positive and indicated that he would raise the possibilities with Sadat and others in the Cabinet.

Financing of the October Hostilities

9. At this point of time, it is difficult to obtain "hard information" on this subject. However, in my discussions with Hegazy and Lotfy, I inquired about the medium-term implications on debt-servicing and resource mobilization reulting from (i) the substantial USSR arm supplies in October/November, and (ii) the current expenditures of the October hostilities. The response was understandably guarded. The indications were that there were no adverse implications on debt-service, since USSR wanted, and was paid in, cash essentially by Algeria, Kuwait and Saudi Arabia. The current expenses are being shared by Egypt, with Saudi Arabia, Libya and the Emirates. The figure which has maximum credence in diplomatic circles is about $920 million for the arms supply. Daily military expenditure in the first 4 weeks of the hostilities is being placed at between LE5 to 7 million ($13 to 18 million). Despite stringent new tax measures taken by Hegazy in early October, even the present lower level of daily military expenditure (being placed around LE3 million) is likely to strain Egyptian resources.

10. However, in late August/September, significant remittances were made by Saudi Arabia, Libya, Kuwait, etc. Of this, about $60 million was applied as down payment for the purchase of $180 million worth of Australian wheat; the balance is to be paid off as an 18 months credit. While from the short-term viewpoint, the balance of payments on current account may not be critical, Lotfy projects that after accounting for the Khartoum Agreement payments, there will have a deficit at the end of 1973 of over $200 million. He anticipates that the current account deficit will continue to increase in the next two years to over $300 million, because Egypt's earnings from higher cotton prices will be more than offset by the higher prices (resulting from international inflation and currency changes) for Egypt's capital and recurrent imports and more important, continuing massive wheat purchases.

Post-war Reconstruction and Economic Development

11. On the other hand, the October hostilities has given rise to an Arab decision (at the recent Algiers summit meeting, followed by the Arab Finance Ministers meeting in Cairo) to bolster the economies, and make investments in the industrial and other sectors vital for the economic rehabilitation, of "the front-line countries of Egypt and Syria." The Egyptians have been provided and are anticipating substantial Arab aid. One manifestation was the financing arrangement, completed while I was in Cairo, for $400 million required for the SUMED pipeline: $200 million (essentially towards local costs) by Egypt, $60 million each by Saudi Arabia, Kuwait and Abu Dhabi and $20 million by Qatar.

12. Another is an investment company, established with an initial capital of $250 million, by Egypt, Saudi Arabia, Kuwait, Sudan, Abu Dhabi and Qatar. Sayed Marei is actively involved in the proposal. It will promote agriculture, agri-business, agro-industrial and transport investments initially in Egypt and Sudan. Amidst great publicity, Hegazy went in early December on a 24-hour trip to Riyadh and returned with an initial Saudi investment of $125 million in this company. Incidentally, when I met Sayed Marei (together with the Agriculture Minister) he requested me "to convey personally to Messrs. McNamara and Benjenk that Egypt would like to offer the Bank an opportunity to help this company, as well as future projects that it will undertake." Its activities however were not clearly explained, and at my request, Marei promised to send materials to the Bank "after a month or two, when details can be revealed." According to him, its first venture will be the establishment of a corporation to produce wheat over 1 million acres in Sudan for export to Egypt and the Gulf and for "cash crops" in about 40,000 acres in Egypt. Other future ventures are expected to include sugarcane and sugar production, processing of agricultural produce, establishment of urea and nitrophospatic fertilizer plants and eventually, the undertaking of the Jongli irrigation scheme.

13. Another proposal, still under wraps, is the use of the Arab-European banking consortium (UBAF) to invest Arab capital abroad, and from earnings from these investments -- supplemented by monies that the consortium can raise from European banks -- the financing of development projects in Egypt, Syria and other Arab countries through another investment company. Lotfy privately indicated to me that he was leaving the Government by February to manage UBAF. (Since Hegazy has just been made Prime Minister, I would not be surprised if Lotfy if held back.)

14. Available evidence suggests that if Arab aid continues to be provided in future, it is likely to take the form of increasingly organized funding rather than dispensations as ad hoc grants, as has hitherto been the case. This aid is being provided for political considerations, on the heels of the first manifestation of Arab unity ever achieved on this scale. What is not clear is, whether once the current uniting cause is won, will the feeling of collective responsibility to use surplus Arab monies for the development of less fortunate Arab countries, last? Even if it does,

can this feeling be systematically organized, coordinated and more important, continued on a long-term basis? Already, Libya is at odds with Egypt over Ghaddafi's pique at not being consulted before the October hostilities. He wrote a blistering "open letter" to Sadat in late November, which his own Revolutionary Council repudiated 3 days later. This was followed in early December by the closing down, lock, stock and barrel, of the Libya mission in Cairo without prior notice to Egypt. What this implies for the proposed Libya-Egypt merger, is anyone's guess. The general expectation however is that in the near-term future, Libya will continue to provide ad hoc grants to Egypt as it has so far done, because of Arab pressure.

15. There is no evidence of other bilateral aid, except the Japanese offer (in mid-December) of a $220 million in soft loan for the Suez Canal (to finance dredging by Japanese firms) and promise to help with petro-chemical, textiles and railway investments. The Suez Canal offer is merely a highly-publicized reiteration of Japan's interest, expressed over a year. As regards bilaterals such as Germany, Italy or UK (who are politically well-disposed towards Egypt), they have not offered any new aid for reconstruction, nor do their Cairo embassies expect any in the near future.

16. At the same time, the monies required for the physical rehabilitation of the war-damaged Canal Zone, the opening and expansion of the Suez Canal and reconstruction of the Egyptian economy per se, will be massive and long-term. Substantial investments are likely to be needed first, to prod peace negotiations towards a final settlement; for instance, before talking peace substantively, Israel is already pressing for commitments to reopen the Suez Canal and rehabilitate the cities on the Canal's West Bank; the Egyptians want to expand these cities also to its East Bank, besides resuming agriculture in Northwest Sinai. While one wants a larger geographical area to be covered than the other, the objective of both is the same, viz. to have populations and economic activities in these areas -- which might provide some deterrent to future aggressive activities by either party. Larger investments will be required, as and after the peace settlement is reached, e.g. for the Suez Canal expansion, the development of Sinai, tunnels beneath the Canal linking its West and East banks, regional development, training of human resources and investments in almost all sectors of the economy.

17. Anticipating the future, Sadat established a new Ministry of Reconstruction headed by Mr. Osman in November. He was Chairman of the Arab Contracting Company, which completed construction of the Aswan Dam ahead of schedule. The Ministry is specifically charged with the responsibility for the Canal Zone reconstruction, construction of four tunnels (first at Ismailia) linking the West and East Banks, establishment of a Free Zone industrial estate at Port Said, formulating and implementing master plans for Sinai development and Cairo's future development (including the sorely-needed water supply/sewerage and urban transport facilities), regional development and creation of satellite cities to stabilize Cairo's current growth. A Scandinavian firm has been in Egypt

since mid-November, studying the feasibility of the "tunnel proposal"; consultants are being selected for the master planning of Cairo and Sinai; Egyptian engineers are working on plans to reconstruct the Canal cities -- physically and economically. The Minister's back of the envelope estimate for all this is between £E 2 to 3 billion, over a 5 to 8 year period.

18. This figure is over and above that required for the immediate, as well as the long-term, reconstruction of the economy. It would not be prudent for Egypt to mount rehabilitation plans of this magnitude without first quickly boosting Egypt's capacity to increasingly mobilize its own resources for them; one short-term way might be to help it to utilize its existing unutilized agricultural and industrial potential, constrained by shortages of essential current inputs because of foreign exchange scarcities. The extent of these needs, merits expeditious analysis.

19. Besides the above, investments will be needed to open and expand the Suez Canal. According to the Company's Chairman, (i) the cost estimated last year for clearing and restoring the Canal to its 1967 capacity, is likely to be about £E40 million and (ii) that of a 2-phased project to expand and deepen it -- first to accommodate vessels up to 175,000 tons (3 years) and then up to 270,000 tons (3 years thereafter) -- an additional £E300 million. While estimates for both (i) and (ii) are being redone on the basis of current prices, he expects them to work out to between £E420 to 450 million. The Chairman concedes that the proposed SUMED pipeline (which will now undoubtedly be constructed) will reduce the Canal's earnings; but the tradeoffs still have to be studied. His Company's estimates suggest that if the Canal tariff is maintained at close to the 1967 level, tanker and cargo traffic would find the Canal route cheaper than the longer Cape route, and the available traffic would be substantial enough to make the expansion project a financially attractive proposition. According to the Chairman, besides the aforementioned Japanese interest, Yugoslav and German dredging companies had offered to arrange bank credits at 8.5 to 9% interest on relatively short 7 to 8-year terms. While he did not anticipate much difficulty in arranging monies on such basis, he believed that financing on terms more favorable to Egypt and his Company could be arranged, with the Bank's financial and technical lead. He recapitulated Mr. McNamara's interest in 1969 in opening the Canal, recalled the possibility of providing Bank financing on the "enclave project" principle discussed with Mr. Benjenk in 1971, and hoped that the Bank would still be willing to play a role on that basis. In my subsequent discussions, Hegazy also indicated that as peace negotiations advanced, Egypt hoped that the Bank would help with the Suez Canal projects. I indicated that, in principle, the Bank should be prepared to play a role.

The Bank's Future Role

20. Financing of this magnitude for Egyptian development is clearly beyond the pale of Egyptian resources alone. The expectation that Arab largesse will continue for years to come, looms large in current Egyptian

thinking. However, one cannot altogether rule out the possibility that after the present political motivations abate, the desire to provide such largesse may also abate. One possible hedge against this, might be the institutionalization of the Arab aid to countries like Egypt at this point of time when the feeling of collective Arab responsibility is strong and the desire to provide aid exists. Another is to organize, coordinate and harness this aid now, for meaningful and viable development proposals designed on a scale, with precision and within the timeframe required for the development of Egypt's economy and those of similarly placed poorer Arab countries.

21. One possible approach would be to continue our posture to help Egypt through an IDA program at levels currently visualized, consider helping with the Suez Canal project as an enclave proposal and continue with our current programs in Syria and other poor Arab countries. This is a low-risk, sound and traditionally conservative Bank approach. It might however cost us an opportunity to have any significant impact in Egypt and the Arab world and helping to meaningfully shape their development. In the long-term, it might also deny us a chance of marshalling surplus Arab resources for the development of the Arab world, and hopefully other member countries.

22. On the other hand, an extraordinary opportunity exists for the Bank to play a unique role in harnessing Arab aid towards immediate objectives mentioned in para. 20 above. Egypt and other countries are aware of the quality of Bank projects and the objectivity with which it plans and implements them. Knowing this, the response might be favorable, if the Bank took the initiative by offering assistance in organizing the embryo Arab development investment corporations, and in conceiving, planning and helping to formulate sound development projects (for Egypt and other Arab countries) for which these corporations could channel Arab aid. A similar role could be played for organizing the Suez Canal expansion. With the Arabs, greater respect towards the Bank might be engendered by taking the initiative and making them react to it, rather than our reacting to any such proposal which an Arab country might advance. Bank's involvement in this manner might also provide western bilaterals with an added incentive to participate in such development projects in Egypt.

23. It would be futile to hope that the Bank's initiative would be readily accepted by Egypt or the Arab donor countries without significant Bank financing and on the basis purely of technical assistance. Besides enclave projects, ways and means will need to be explored and found, to provide at least a hard blend of Bank and IDA monies. Larger involvement will obviously call for human and fiscal resources far above what we have so far committed in the Middle East. Whether we opt for our current policy, or for taking an initiative, there are bound to be criticisms, with political overtones. However, the opportunity is unique to assume a role of responsibility and impact in mobilizing available Arab aid for the effective economic development of Egypt and other poor countries, in a region whose economic and political stability is becoming increasingly important to all our member countries.

Possible Approach

24. Taking account of the needs, opportunities and long-term advantages to the Bank, the Middle Eastern region and Egypt, I would recommend that serious consideration should now be given in the Bank to the following:

(a) Whether the Bank should take the initiative to offer its help to institutionalize the embryo Arab investment corporations and with the formulation of key development projects through which such corporations, the Bank and others could channel aid to Egypt and poorer Arab countries;

(b) A fresh policy review at senior levels should take place, and avenues explored, to channel Bank financing for Egypt's rehabilitation and reconstruction programs through a hard blend of Bank-IDA monies, besides the "enclave" project approach;

(c) A positive decision to play a catalytic financing role, besides a technical one, for projects to expand the Suez Canal;

(d) Initiation of a review with the Egyptians regarding the extent of foreign exchange requirements needed in the next 2 years, to boost the economy through the use of existing unutilized industrial, agricultural and transport potential (as we did in Nigeria and Bangladesh), and the extent of Bank Group monies that could be provided, along with those of interested Arab and bilateral donors, for this purpose;

(e) If a decision is taken to move ahead on the aforementioned four matters, a visit by Messrs. McNamara and Benjenk would ensure both long-term relational impact and positive response by Egypt and Arab donors concerned to our proposals. A more cautious approach would be for them to visit first and obtain a feel of the situation and possibilities, before taking these decisions.

(f) While decisions on the above matters are being taken, the Bank should now begin reviewing with the Suez Canal Company the technical, economic and financial basis of their proposals; these matters can be time consuming, and much is to be gained by commencing this work as soon as possible; should the Bank ultimately decide not to help with financing of the Canal, our association with the review would be valuable "technical assistance" to Egypt and the Company;

(g) Review whether in principle, the Bank Group should do program lending for current imports needed by selected export-oriented industrial sub-sectors; if a decision is taken to channel some Bank lending to Egypt, program lending could include raw materials, semi-finished goods and maintenance spares for these sub-sectors; if the decision is to limit our role to IDA lending only, it could cover only maintenance spares.

(h) The next economic mission to Egypt (tentatively March) should include a person with urban planning/regional development expertise, to review the possible approach and arrangements for initiating the masterplanning of Cairo and regional development studies for Sinai, Aswan and/or other key regions proposed by Egypt; we should be prepared to explore with Egypt the best possible source of financing and to act as executing agents for these exercises.

(i) Steps should be initiated in the next 2 to 3 months to advance proposals (including arrangements for project preparation) for fruit/vegetable production and marketing, technical/vocational education, industrial estate at Port Said and reconstruction of public utilities for the Canal cities; we might need to consider an engineering credit, at some stage, for the latter two proposals.

Attachment

cc: Messrs. Benjenk, Wapenhans, Karaosmanoglu, Maiss, Armstrong

ADavar/te

POSSIBLE FUTURE PROJECT PROPOSALS FOR IDA LENDING

(1) Agricultural Credit for Fruit/Vegetable Production and Marketing: The proposal was tentatively identified by the Thompson mission last year, and is of interest to Egypt. Appropriate areas for production will need to be carefully selected. Possibilities mentioned by the Agriculture Minister were Fayum and Anchas for fruits and Giza Qualabiya or Menoufia for vegetables. The proposal might include provision of credits for necessary equipment and facilities to (a) farm cooperatives and orchard/farm owners for increasing production of quality fruits and vegatables; (b) a major cooperative who would purchase this production, grade and process it, market inferior production domestically and export better grades directly to Europe in refrigerated truck-trailers from Alexandria. Proposal has potential not only for export earnings, but rural employment and increase in rural earnings. Since many ministries/organizations will be involved, Government prefers to achieve maximum coordination in project preparation by setting up a team under the Finance or Industries Ministry's leadership, who would work with IDA staff help.

(2) Textiles Rehabilitation: Modernization/rehabilitation of selected 3 to 4 textiles/garment manufacture complexes, e.g. Mahalla. Monies could be channelled to them through BOA. Alternately, a second BOA credit could include some additional financing for other dfc activities, but its major component would be for these textiles rehabilitation projects. The Industries Minister is extremely keen, and sets high priority on it, since textiles/garments constitute one of Egypt's leading exports and the project has employment potential. He indicates that a team is preparing a proposal for IDA. He however pressed strongly for the TORs (promised to him last July), for a sub-sector analysis and preparation of a proposal to a level which would facilitate IDA appraisal, latest by December 1974. He wants to avoid a situation where his team would do work which IDA might later find redundant, thereby delaying early lending for the project.

(3) Industrial Program Credit, for import of raw materials, semi-finished goods and/or maintenance spares to utilize capacity in export-oriented food, textiles, leather and engineering/electronic industries. (Idea expanded in the main memo.)

(4) Sponge-Iron Manufacture: Proposal is to set up facilities to produce sponge iron using Abu Kheir natural gas and Bahria ironore (which will need upgrading from 51 to 62 ore content). Benefits might lie in (a) reduced production cost of sponge iron, now based on imported scrap (whose prices are escalating) and coke and (b) foreign exchange savings resulting from eliminating these imports. Egypt believes that even if some high-grade Indian ironore (under barter) is imported to upgrade and beneficiate the low-grade Bahria ore, the proposal would still be financially viable and an attractive saver of foreign exchange.

(5) Port Said Free Zone Estate: Proposal is to set up an industrial free zone estate to promote the establishment by foreign entrepreneurs, of industrial manufacture "in bond" for export and/or warehouses, for distribution and packaging of goods for North and East African and Arab markets, as in the Free Zones in Panama or Singapore. The proposed location exploits Port Said's ideal location for such a facility; laws providing (over) liberal tax incentives for the establishment of such activities in free zones in Egypt, exist since 1971. Besides its potential for attracting investment capital to Egypt and foreign exchange earnings, the proposal forms part of an attempt to create economic activity in the Canal cities. It will need analysis of what foreign investors will come for, besides creation of an efficient and promotion-oriented authority to run the free zone, and design and engineering.

(6) Water/Sewerage Rehabilitation for all or any of the Canal Cities of Ismailia, Port Said and Suez: As part of the rehabilitation of these three cities and to promote rehabitation and economic activity in them, provision of this basic infrastructure would be most meaningful. Road, housing and other social services could be contributed by Egyptian, Arab and bilateral capital. If the Bank desires an increased posture, our financing could include some of these other investments also.

(7) Technical and Vocational Education: Egypt has engineers and graduate skills, but serious shortages of semi-skilled and skilled level personnel in trades, vocations, industry and agriculture, and those at lower supervision levels in these sectors. Government therefore gives high priority to the revamping of the educational system and expansion or creation of new training facilities so that such shortages do not, in the medium-term, restrict Egypt's economic activity. A longer-term objective is to earn foreign exchange by "export" of skilled manpower and stimulating worker remittances, a la Yugoslavia, Turkey, etc.

(8) Urea Fertilizer Production, using Abu Kheir natural gas; alternately, manufacture of phosphatic fertilizers from low-grade and "contaminated" phosphate deposits. Government indicates that Japanese and French firms are interested and there may be a possibility of developing this as an entirely export-oriented project on the "enclave" principle.

(9) Agriculture Credit, for selected high-value cash crops or for increasing production in selected regions. Although Egypt has well-established credit institutions, credit is currently available either on a short-term basis on crop liens, or at best on 2 to 3 year-terms. Government is very interested.

(10) Agro-Industries: Provision of credits to existing or new facilities for packing, canning, juicing, etc. Has potential for creating employment, adding value to agricultural production and export earnings, particularly to the Gulf and African countries.

(11) Regional/Rural Development, in a selected area such as Aswan, by providing assistance for agricultural production or processing, marketing, rural roads, water supply, education, etc. Proposal could

be made to result from regional development studies proposed in the main memo.

(12) Cairo Urban Project: The master planning of Cairo, also proposed in the main memo, could lead to proposals for reducing growing pressures on Cairo (UN lists it as the world's 7th most populous city), including creation of satellite townships, restructuring Cairo or development of other areas.

(13) Tourism: With the prospects of restoration of peace, this foreign exchange earning and employment absorptive sector, has potential. (U.S. Hotel chains particularly, are showing increasing interest in Egypt.) Proposal could include coastal development west of Alexandria.

EM1DA
January 8, 1974

Annex O

Mr. M. P. Benjenk (thru Mr. G. B. Votaw) January 16, 1974

A. J. Davar

EGYPT: Suez Canal

1. In my memorandum of January 8 to Mr. Votaw, I recommended that pending a decision on whether or not the Bank should finance the Suez Canal proposals, we should now begin reviewing with the Suez Canal Company, the technical, economic and financial basis for these proposals. My impression is that the Company has developed a substantial data base and completed the technical/engineering work, but that weaknesses may lie essentially in their economic and financial analyses of these proposals. In any event, if the Bank were to play some financing role, we would require a satisfactory proposal from all aspects. This could be a time consuming matter and therefore much is to be gained by commencing the work as soon as possible. Should the Bank ultimately decide not to help with the financing, or the Egyptians decide not to approach us for it, a meticulous and detailed review and analysis of all aspects of the Suez Canal proposals would in any case be helpful to Egypt and the Company, before they consider implementing those proposals themselves.

2. In these circumstances, until the Bank takes a decision about its financing role, I would suggest the following approach:

(a) Dave Elliott will be in Cairo from January 27, to join the Railway Project mission currently in the field. We could take advantage of his presence to advance matters with the Government and obtain a feel of the amount of the detailed work done so far for the Company and gauge the manpower required to review this work in depth along with the Company Officials to ascertain the extent, if any, of additional work required to be done.

(b) After he makes this determination, the next step would be to mount a Bank mission later in February to do the said in-depth review in Cairo, and establish a concrete plan of action for any additional analysis or data that may be required. I would, however, be surprised if this step can be completed without at least a 3-man team, consisting of a ports engineer, economist and financial analyist, working in Egypt for about three weeks. Chances are that a larger mission may be entailed.

(c) It is only after this in-depth field review of existing data, material and analyses, that one can draw up a realistic plan of action for any additional work required. It is quite possible (although I believe the chances to be slender) that the Company has done much work to a level that would be satisfactory to international financing agencies. By the time this review is completed by mid or late March, we might be in a position of making a decision as to whether we would want to play a financing role in the Suez Canal projects. Should we decide otherwise, we might still want to provide technical assistance to Egypt and the Company by arranging for proper consultancy studies, and additional technical, financial or economic analysis on satisfactory terms-of-reference, helping to supervise such work, etc. We may even like to consider providing some assistance for financing such consultants, although this possibility need not loom large in our thinking at present.

3. Should the above-mentioned approach meet with your approval, I would suggest that either Mr. Votaw or I should telephone both Dr. Lotfy and Mr. Mashour (Chairman of the Suez Canal Company) this week about Mr. Elliott's visit, and adopt the following line: At this stage, the Bank would be prepared to help in viewing the work so far done on the Suez Canal proposals, without commitment on the Bank's part to play a role in financing them or on Egypt's part to involve the Bank in these proposals. Based on this understanding, the Bank was prepared to assist with a thorough review of the technical, economic and financial work done by the Company, and advise on and assist with vetting the analyses, obtaining any additional data, etc., which Egypt would need to have in any case, irrespective of whether the Bank was involved financially with these projects. If ultimately both sides decide that the Bank should play some financing role, such a review and analysis would in any case be a necessary adjunct for our involvement. Substantial time can be saved and effective Bank help given, by commencing this work together from now. If Egypt and the Company were agreeable, the Bank would be prepared to send Mr. Elliott to commence the discussions, and review and follow-up with a subsequent mission in February on the lines outlined in paragraph 2 above.

4. Do you agree? If so, we can work out the details, indicating manpower needs etc., with Messrs. Wapenhans and Elliott.

5. Dave Elliott leaves on his mission on Friday, January 18. I therefore believe it would be useful if a decision on the approach suggested in this memorandum could be taken before his departure.

Cleared in substance with & cc: Mr. D. Elliott

cc: Messrs. Wapenhans, Armstrong, Karaosmanoglu

AJDavar:js

Annex O

OFFICE MEMORANDUM

TO: Mr. G. Wyatt

DATE: February 11, 1974

FROM: P. C. de Man and D. C. Elliott

SUBJECT: EGYPT - Suez Canal
Exploratory Mission

INTRODUCTION

1. This report summarizes our discussions in Cairo with the Ministry of Finance, the Suez Canal Authority (SCA) and the General Petroleum Authority between January 31 and February 6 concerning the Government's plans for reopening and expanding the Suez Canal and constructing the SUMED pipeline.

REOPENING OF THE CANAL

2. Following the disengagement agreement with Israel and the withdrawal of Israeli forces from the Suez Canal Zone, the Government has decided to reopen the Canal as soon as this can be technically realized. These works will be undertaken in two phases: (i) immediate reopening; and (ii) restoration of the Canal to its preclosure condition.

3. For phase (i), the following steps are envisaged:

(a) removal of mines, bomb shells, etc. by the Navy in cooperation with the Corps of Engineers. These works have already started and are expected to be completed by March/April 1974;

(b) removal of major obstacles (shipwrecks, etc.). The SCA is presently negotiating a price for these works with a consortium of a U.S. contractor, the U.S. Navy and a joint venture of a Dutch, German and Yugoslav contractor. It is expected that the contract for these works will be signed by the end of February. Estimated costs are about US$8 million equivalent;

(c) removal of minor obstacles (small ships, vehicles, etc.) by the SCA in force account in cooperation with the Navy;

(d) repair of damaged revetments and vital workshops by the SCA in force account; and

(e) procurement of necessary floating and field equipment, navigation aids and communication equipment.

The SCA estimates that steps (b) through (e) will be completed in about six months which means that the Canal could be opened to traffic by about September of this year.

4. After completion of phase (i) and reopening of the Canal, only minimum facilities will be available for navigation, communication, maintenance and repair and further works under phase (ii) comprise:

- rebuilding of offices, workshops, signal stations (10 in total) and houses for employees;
- reconstruction of service roads;
- procurement of communication and navigation aids.

In addition, further workshop equipment and tools, and floating equipment will have to be acquired.

5. Cost estimates provided to the mission are tentative. It is now estimated that phase (i) will cost LE 18 million (US$45 million). The Government is about to sign an agreement with the Kuwait Fund for a loan of 10 million Dinar (US$33 million) to cover the foreign exchange requirement of this phase. The remainder will be provided by the budget.

6. Phase (ii) is estimated to cost LE 51.5 million (US$130 million) broken down as follows:

	LE(Millions)		
Civil Works	Local	Foreign	Total
Revetments and Dredging	4.5	2.0	6.5
Service Roads	(8.0)	n.a.	8.0
Buildings and Workshops	3.8	1.4	5.2
Repairs to Employees Housing (800)	2.6	0.6	3.2
Fresh Water Supply	1.2	0.8	2.0
	20.1	4.8	24.9
Materials			
Workshop Material and Tools	1.4	1.8	3.2
Navigational Aids and Communications	0.2	3.2	3.4
Floating Craft	1.0	16.5	17.5
Vehicles and trucks	0.3	2.2	2.5
	2.9	23.7	26.6

No contingency allowances have been included in the estimates and the foreign component of some of the items appears low.

7. Equipment would be obtained by one of three methods:

(i) direct quotation -- where standardization is necessary;

(ii) direct procurement -- for urgent needs (e.g. a second hand dredger); or

(iii) international competitive bidding.

It is believed that the majority of the equipment would fall in the latter category.

8. We were asked whether the Bank would be prepared to participate in phase (ii) for which no financing has been assured so far. On the basis of the information so far obtained, it appears that the Bank could participate in this financing, and it is recommended that an appraisal mission be scheduled as early as possible and a special team should be established to process this project in the shortest possible time.

EXPANSION OF THE CANAL

9. The SCA has been conducting a number of studies on the supply and demand pattern for Middle East oil and on the growth and composition of the world tanker fleet and has concluded that, in order to continue to have a major share in the oil transport for the Arabian Gulf to Western Europe, the Canal should be enlarged to accommodate tankers of up to 200,000-270,000 dwt, fully loaded. The detailed engineering for these plans has already been prepared by the Engineering Department of the SCA. The SCA wants to implement this plan immediately after the Canal has been restored to its pre-closure capacity, and envisages a two-stage construction. The first phase, requiring about three years, would increase the capacity of the Canal to about 150,000 dwt tankers and is estimated to cost about US$755 million with a foreign exchange component of US$205 million. Bids for dredging work on three sections of the Canal for this first phase were opened in 1967 on the same day the war started. Since then, the lowest bidder, a Japanese firm, has regularly updated its price on the basis of the cost of living index and recently the Government of Egypt has received a proposal from the Japanese Government for a loan to finance these works (about US$140 million foreign exchange component) provided the Japanese firm will be awarded the contract.

10. We were asked whether the Bank would be interested also to participate in the financing of this project and we pointed out that before this could be considered a detailed economic analysis (which so far has not been made) should be undertaken which should not be restricted to the Canal, but also look at other possible transport alternatives. We referred to the recent decision by the Government to go ahead with the SUMED pipeline (para. 11) and pointed out that, first of all, an integrated study of the oil transport market and alternative solutions to accommodate the oil traffic should be made. After some deliberations, we tentatively agreed that the Bank should send a mission of experts to review the plans for expansion of the Canal and

the adequacy of the project preparation studies and to advise on the scope of any further studies. This same team could carry out the appraisal mentioned in para. 8. SCA will make suitably qualified staff available to work with the mission and, in view of other commitments, asked for the mission to be sent by about mid-March.

PIPELINES

11. At the same time that the Suez Canal Authority is making plans both to reopen the Canal and later to deepen and widen it, a pipeline is being built which will also carry oil from the south to north transiting Egypt. We met with engineer, Ramzy El Leithy, who is Chairman of the Petroleum Authority of the Government. He gave us the following information. An award is due to be signed this week to Bechtel for $345 million to construct a pipeline consisting of two 42-inch pipes together with necessary storage facilities and off-shore loading facilities. In addition to the contract, which is a turnkey contract of $345 million to Bechtel, a further $55 million will be spent on other works. So far, financing is assumed to cost a total of $400 million with Egypt producing $200 million and other Arab states the rest. The foreign exchange component is in the neighborhood of 50%. Egypt, for its part, intends to borrow the foreign exchange and has been approached by EXIM and Chase Manhattan and foresees no problem in raising money for this project. The Petroleum Authority estimates that within two years they will have a capacity of 40 million tons and, shortly thereafter with the completion of the second pipeline, 80 million tons of oil a year. Four types of crude will be transported through the lines and there is a possible expansion later on which would take the total capacity up to 120 million tons a year. The total capacity in the first phase of 80 million tons a year has already been allocated to suppliers who have agreed to transport that amount on a take or pay basis. The tariff is a flat rate and the average tariff is a little less than $2 per ton. This compares with somewhere around $1 a ton previously charged for transit through the Suez Canal.

FINANCING

12. Unlike the financing for the pipelines which has been reasonably well assured, that for the Suez Canal is far from so. A first budgetary allocation of LE 15 million has now been made by the Government and the Government, in turn, has obtained 10 million Kuwaiti Dinar from the Kuwait Fund. These funds are expected to be sufficient to enable the Authority to clear the Canal to its minimum position so that shipping can start to pass through, and it is estimated that this phase will last approximately six months. Thereafterwards, a further LE 50-55 million will be needed to replace equipment and to set up workshops and navigation aids in place. No funds have yet been allocated for this nor has there yet been any firm plan as to where the money is to come from. The Suez Canal Authority hoped that the Bank might be able to help in financing part of the costs of this phase.

CONCLUSIONS

(i) It appears that the plans and cost estimates are still in a very preliminary stage and can only be taken as orders of magnitude. They need checking.

(ii) There appears to be a complete lack of coordination between the two Authorities presently in charge of oil transport. Prima Facie, this may affect the timing of the expansion of the Canal more than the expansion itself as, on present indications, it appears that both pipelines and the Canal have a role to play.

RECOMMENDATIONS

(i) The Bank should send a mission in mid-March and obtain first class people for it.

(ii) If we decide to participate in phase (ii) of the reopening, then the mission should try to also appraise this project.

ACTION

13. We should inform SCA about the timing and composition of the mission.

cc: Messrs. Benjenk, Wapenhans, Votaw, Davar, Jaycox, Karaosmanoglu, Hendry, Eccles, Finzi

PCdeMan/DCElliott:lt

OFFICE MEMORANDUM

Annex O

TO: Mr. Munir P. Benjenk, Vice President, EMENA (through Mr. Votaw)

DATE: February 14, 1974

FROM: Adi J. Davar, Division Chief, EM1DA

SUBJECT: EGYPT--Suez Canal Clearance and Reopening Project

1. The key points which emerge from Messrs. de Man and Elliott's February 11 report on their mission are the following:

(i) to reopen, and restore efficient navigation in, the Suez Canal to its pre-June 1967 capacity, a total investment of about \$175 million is required (\$45 million to clear the Canal and \$130 million to provide the minimum equipment/facilities for operating it efficiently);

(ii) the foreign exchange component of this investment would be about \$78 million, \$18 million for the "clearance" and \$60 million for equipment/facilities;

(iii) against this, the only foreign exchange financing which Egypt has in hand, is \$33 million from Kuwait. (Reported bilateral offers like Japan's, appear to be tied to the Canal's expansion, and not to its clearance and operations.) It is not quite clear whether the Kuwaiti financing is available for both the foreign exchange and local costs of the "clearance" (total cost of which is \$45 million), or it can be used to finance the foreign exchange cost of both the "clearance" and equipment/facilities also required for an efficient operation of the Canal at its pre-June 1967 level.

2. The above factors are new elements in the picture. The Egyptians had previously indicated that all financing required for the "clearance" and resumption of navigation in the Canal, had been taped down. I have sympathy with de Man's and Elliott's recommendation that the Bank Group should consider playing a financial role in the project for the clearance and reopening of the Canal ("the Project"), quite apart from the future role we might like to play in subsequent projects to expand the Canal to accommodate large tankers.

3. In taking a decision in this matter, the under-mentioned constraints and alternatives need to be recognized:

(i) The Egyptians are aiming at reopening the Canal for navigation by about September 1974. To enable international traffic to take full advantage of the reopened Canal, equipment/facilities required for its efficient operation, will need to be procured and be in place in as short a time as possible thereafter (by February/March 1975). Therefore, the time available to process a Bank Group project would be quite short. International bidding for equipment/facilities which we may wish to finance, will need to be initiated quickly, so that orders can be placed in time to ensure a rapid delivery within the time-frame involved.

(ii) The foreign exchange required for the project is high. If the $33 million Kuwaiti loan is to be used only towards financing the total cost of the "clearance," then the foreign exchange required for the purchase of equipment/facilities would be in the region of at least $60 million. If Kuwaiti monies could be used to finance the foreign exchange component of both the "clearance" and the purchase of equipment/facilities, even then, the foreign exchange required would be $45 million ($78 million less than $33 million). Either amount would be too high to be accommodated within the total of $65 million IDA funding earmarked for lending to Egypt in FY75.

(iii) The alternative would be to consider providing a Bank loan sufficient to cover whatever is ultimately determined to be the foreign exchange for the project, after ascertaining for what the Kuwaiti monies are to be used. The question which will then arise is, whether the decision to provide Bank financing to Egypt should be deferred until the issue of Egypt's creditworthiness for Bank monies (not expected to be completed until March) is reviewed, or we can take a decision at this time to provide a Bank loan, by treating the project as an enclave project.

(iv) Should we decide to provide only IDA financing for the project, then $20 million could be made available in FY75 by dropping the Telecoms Project (the other FY75 projects that we expect to lend for, would be Railways II -- $25 million and Tourah Cement -- $20 million). In this event, we shall have to seek joint partners (preferably limited to one or two only) who could finance specific portions of the project, within the given time constraints. At this stage, the following seems to me (and Mr. Elliott) to be the most attractive alternative, if Egypt agrees to it:

(a) the Kuwait Fund finances the foreign exchange cost of the "clearance" ($18 million) plus that of all civil works ($13 million) indicated in para. 6 of de Man's and Elliott's report;

(b) Elliott advises that "floating crafts," having a foreign exchange component of approximately $40 million, are likely to be obtained from Germany even after international competitive bidding; it would therefore make sense to try and persuade both the Egyptians and the Germans to finance this project component from the existing German credit (DM 70 million) or from a new credit which the Germans have promised to negotiate quickly with Egypt as soon as the said DM 70 million credit is fully committed;

(c) workshop materials and tools, navigational aids and communications equipment, vehicles and trucks (foreign exchange: $18 million), as also the economic feasibility studies and initiation of detailed engineering for the expansion (foreign exchange: $2 million) of the Suez Canal, could then be covered by a $20 million IDA credit.

(v) Irrespective of what the Bank Group decides to finance, we will have to appraise the Clearance and Reopening Project as a complete package, in order to make a sensible economic and financial analysis.

(vi) It should be recognized that Egypt is unlikely to earn additional foreign exchange as a result of the project. Even if a sufficient volume of tanker and cargo vessel traffic goes through the reopened Canal (quite likely), and the Suez Canal Authority earns a net revenue of $250 million a year after servicing the new borrowings undertaken to implement the project, a net revenue of this magnitude will only replace about $250 million which Egypt has been annually receiving from Saudi Arabia, Kuwait and Libya under the 1967 Khartoum Agreement.

4. The effects of the Bank Group's involvement with the Suez Canal Clearance and Reopening Project on our relationship with Egypt and the Arab world at large, are likely to be both salutory and significant. We would also be helping Egypt by providing financing, which it does not now have for the project. If Egypt borrows monies from commercial banks or uses suppliers' credits, the terms would be harder than the Bank's and add further to Egypt's debt service burden. If it succeeds in obtaining bilateral financing, the project could become more expensive, because of tied procurement. Besides, by involving ourselves with the Suez Canal at this time, we could also help Egypt by providing objective technical assistance for the Suez Canal expansion projects, and lay a base for their sound and timely implementation.

5. Taking the pros and cons into account, I would recommend consideration of the following:

(i) as de Man and Elliott propose, a mission should be sent in mid-March to try and appraise the project;

(ii) provide about $60 million Bank financing for the project, on an enclave basis; and

(iii) in the event we cannot find ourselves doing (b) at this time, at least $20 million should be provided in FY75, by dropping the Telecoms Project. This less attractive proposal will obviously need discussions with the Egyptians and also exploration with Kuwait and Germany to see if they will join IDA, on the lines elaborated in para. 2(iv) above.

Cleared with and cc: Mr. D. Elliott
cc: Messrs. Wapenhans, Votaw, Wyatt, Finzi, Karaosmanoglu (o/r), de Man (o/r), Armstrong (o/r),

ADavar/sjw

OFFICE MEMORANDUM

Annex O

TO: Mr. Munir Benjenk

DATE: February 15, 1974

FROM: Gregory B. Votaw

SUBJECT: EGYPT - Suez Canal

1. Attached please find Adi's comments and recommendations on the deMan/Elliott report (also attached).

2. Briefly summarized, we recommend acceptance of the deMan/Elliott recommendation that a mission go to Egypt in mid-March to appraise the $130 million equipment facilities project for restoring Canal to efficient operation on the pre-1967 scale.

3. Such intervention at this time would have several advantages:

a) It would facilitate financing of the equipment package on appropriate terms by providing an independent authoritative evaluation of the Suez Canal Authority's plans. Except for about $15 million of Kuwait money, we know of no offers to cover the $60 million required in foreign exchange to complete these works, let alone $70 million additional required to cover local costs.

b) It would put the Bank in a position immediately to take an active role in evaluating much more costly plans for enlarging the Canal work SCA proposes to accomplish in five or six years beginning 1975. Equally, it would place the enlargement program into the larger perspective of urban-industrial Regional development throughout the Canal zone and provide the Bank with an opportunity to be an active partner not only in the reconstruction of canal cities (for which Gavin has organized a reconnaissance mission that is ready to move on three weeks' notice) but also in planning the longer-term regional development program.

c) In addition to the benefits of Bank technical evaluations and assistance in fund-raising, there are obvious public relations benefits to be derived from early visible participation by the Bank staff in all of these important programs.

4. I view the Bank's financial role largely as a catalyst for other sources of finance, given the magnitudes involved. Because of our historic relationship with SCA, we are in a particularly strong position to play this role.

a) As far as the $130 million is concerned, I recommend the mission go in March without our taking a final decision on size or terms of a Bank/IDA financial contribution. I would be prepared to take a portion of the $65 million IDA allocation (FY75) for this purpose if it became necessary; but, as you know, there may be a break-through in the evaluation of Egypt's creditworthiness before any such decision is necessary. We should, of course, be clear that some Bank/IDA contribution will be available, hopefully in combination with suitable other bilateral funds (e.g., German as Adi suggests in para. 3(iv)(b) or Arab), if needed.

b) For the larger programs of (i) Canal enlargement, (ii) Canal cities reconstruction and (iii) urban-industrial-regional development in the Canal zone, I would recommend serious consideration of an Indus Fund type operation, should Egypt request the Bank to play such a role.

c) The enclave approach strikes me as a last resort. I conceive Canal revenues as a major factor in the re-evaluation of Egypt's overall debt-servicing capacity, which is part of the ongoing creditworthiness study undertaken in connection with the forthcoming CPP. To the extent that we mortgage those revenues for particular purposes we may limit Egypt's total borrowing capacity. Restoration (and probably) enlargement of the Canal is so important that I would recommend enclave financing rather than nothing; but it might be premature to opt for that approach at this early stage. However, "enclave financing" for the Canal is so safe a fallback position that it supports the recommendation that we should proceed to make definite plans for a mid-March appraisal without further delay.

5. Needless to say, the bigger issues involved can only be decided after McNamara's forthcoming talks with President Sadat. But I believe we should be prepared at those talks to show a willingness to play a very much larger longer-term role than as a quick contributor to the very urgent requirement of $130 million.

6. In the interest of speed I am sending this note directly to you, but I have discussed these ideas in general terms with Bill and believe he agrees with them. Indeed, from his account of the unexpected talks on these subjects in Kabul, it seems we have all been thinking independently on very similar lines.

cc: W. A. Wapenhans
N. Horsley/O. Maiss
A. Davar
A. Karaosmanoglu (o/r)
G. Wyatt
D. Elliott
U. Finzi

GBVo-taw:jw

Annex O

Mr. Munir P. Benjenk, Vice President, EMENA Region February 1, 1974

Gavin Wyatt, Acting Director, EMENA Projects

EGYPT - Suez Canal Region Rehabilitation
Preliminary Proposals for a contingency
plan for Bank activities

1. Following your request we carried out a preliminary review of the implications of a possible request from the Egyptian Government for some assistance from the Bank Group in the rehabilitation and development of the Suez Canal Region.1/ We consulted with the EMENA CPI Department, with the relevant EMENA Projects Divisions, with the Transportation and Urban Projects Department and with the Telecommunications Division (Public Utilities Department). In particular, the subject was reviewed during an exploratory meeting at Division Chiefs level attended by Messrs. Davar, Fateen, Finzi, Howard, Le Moigne, Russell, Sathar (Telecommunications), Singh (Urban) and myself on January 28, 1974.

Rehabilitation and Development Plans for the Suez Canal Region

2. As reported in Mr. Davar's mission report of January 8, 1974, we have indications that the Egyptian Government intends, in parallel with the re-opening of the Suez Canal, to rehabilitate the cities of Suez, Ismailia, Quantara and Port Said and gradually restore civilian life in the whole Suez Canal Region. In addition, the Government is considering an expansion of these cities on the East Bank of the canal, resumption of agriculture in Northwest Sinai and a general regional development effort in the area, to be later expanded to the Sinai. For this purpose, among others, a new Ministry of Reconstruction has been established in November, 1973. The Minister is Mr. Osman, former Chairman of the Arab Contracting Company (which successfully carried out construction of the Aswan Dam and is engaged in other major civil engineering works in the Arab world). The Ministry is specifically responsible for the Canal Zone reconstruction, construction of four tunnels (first at Ismailia) linking the West and East Banks, establishment of a Free Zone industrial estate at Port Said, and formulating and implementing master plans for Cairo, Sinai and other regions in Egypt. A Scandinavian firm has been in Egypt since mid-November, studying the feasibility of the proposed tunnels; Egyptian engineers and town planners are working on plans to reconstruct the Canal cities -- physically and economically. A first back-of-the envelope Egyptian estimate of the cost of the projects involved is of the order of $5 billion, over a period of 5 to 8 years.

3. A preliminary attempt to evaluate the implications of these plans on the Egyptian economy and to examine possible ways of financing them is being made in connection with the preparation of the Country Program Paper. This note does not address itself to the question of the type of financial assistance that the Bank Group could give to Egypt in relation to the above projects. This is only a first attempt to speculate on what projects might

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1/ A tentative feeler was verbally made by the Egyptian Government to Mr. Davar in Cairo in December, 1973.

be suitable for Bank involvement (if the Bank Group were to agree to channel additional funds to Egypt beyond the current IDA allocation) and to determine how best we can make a rapid response to any request from the Government for assistance in rehabilitation and reconstruction.

Possible projects and Technical Assistance activities

4. The rehabilitation of the four cities, let alone the surrounding region, and the overall development of the area, is a huge task. The required financing will have to be added to the requirements of the immediate reconstruction and long-term development of the Egyptian economy. The Bank Group contribution, although important for all the aforementioned objectives, is likely to be modest in relation to the total financing required. Therefore, projects and technical assistance activities in which the Bank may become involved in furtherance of these objectives, including the Suez Canal Region rehabilitation, should be carefully chosen in order to maximize the benefits to Egypt's reconstruction and development effort and the impact of the Bank's work. We also have to recognize that the rehabilitation of the Canal Zone does not imply that everything is to be done at once, but rather that physical reconstruction will be planned to accommodate a gradual, albeit speedy, restoration of life and economic activity in that region.

5. On the basis of the above criteria, the following projects and technical assistance activities appear to have, prima facie, the best potential for Bank Group involvement:

a. Public Utilities Rehabilitation in Suez, Quantara, Ismailia, Port Said. The project would cover power, water supply and sewerage, and aim at meeting the demand for these services only in the immediate and medium-term future. No detailed information is available in the Bank at present on the status of public utilities in the cities and in the region; however, substantial rehabilitation works, including perhaps the reconstruction of power transmission lines and/or generating equipment, are likely to be needed.

b. Railways Rehabilitation. Egyptian Railways indicated to Mr. Davar in December that the tentative cost estimate for the rehabilitation of railways facilities in the Suez Canal Region and in Northwest Sinai might be of the order of $25 million, including track replacement and additional rolling stock needed. Mr. Elliott, who is at present in Egypt with some of his staff, has been instructed to explore with the Government the possibility of including railways rehabilitation for the period 1975/1976 in the Suez Region in the Railways II project, for which an appraisal is scheduled in March.

c. Telecommunications Rehabilitation. Rehabilitation of telecommunications facilities in the Suez Region could be included in the proposed telecommunications project for FY 1975. This project will consist of a time slice (1975-

1977) of a longer telecommunications improvement program. Once again, only those investments that can be made in that time frame in the Canal Region would be included. Timing of appraisal (possibly April 1974) is, however, still under discussion with the Egyptian Government.

d. Urban Planning. Reconstruction of the four cities gives an opportunity to redevelop them according to modern and rational planning criteria, even if some of the physical reconstruction work has to be commenced almost immediately, to further the objective of gradually rehabilitating them. Although Egypt is said to be well equipped with town planners, the Bank might be able to assist if the Government so wishes, possibly through an engineering credit which will be processed either as a separate operation or attached to the Public Utilities Rehabilitation project (item a. above).

e. Studies for the Establishment of a Port Said Free Zone Industrial Estate. Creation of free zone facilities where foreign investors could establish either industrial units for exports "in bond" or warehouse distribution facilities, as in Panama or Singapore. Little information is available, except that Egypt promulgated legislation for free zones and tax incentives for investors. If a viable project can be prepared, it would not only contribute to the resumption of economic activity in the Canal Region, but earn scarce foreign exchange for Egypt.

f. Suez Zone and Northwest Sinai Regional Planning. A major regional planning effort will be needed. Although too little information is at present available on Government's intentions, the Bank should be ready to assist, possibly through an engineering credit, which could finance the necessary study and preparation of initial projects identified by it. The credit could also include financing of studies for the proposed Port Said Free Zone Industrial Estate (item e. above).

Very little information seems to be available in the Bank on the above projects. However, the relevant Project Divisions are now collecting and reviewing whatever data is available as a preparatory step for the reconnaissance mission discussed below. They are also considering the staff implications of such a request in order to minimize delay in our response.

Proposed Action

6. The first step, if a formal Government request is received, would be to mount a reconnaissance mission. The mission should preferably consist of a member of the Programs Department staff, a power engineer, water and sewerage engineer, and a highways engineer. Subject to further clarification of Government's intentions, a telecommunications

expert and an urban planner might be added. We aim to dispatch such a mission within three weeks of a decision being reached by the Bank to respond to the request.

7. I agree with Mr. Davar that a letter along the lines of the enclosed draft, should be sent to the Egyptian Government to indicate the Bank's readiness to assist as soon as an official request is received.

8. As none of the above activities are included in the FY1974 Budget and estimates for FY75, a special budgetary allocation will be needed and because of the need to provide a rapid response which precludes recruitment of additional staff it will almost certainly cause some delay in processing of other projects in the FY74-75 lending programs.

Cleared with and cc: Mr. Davar

cc: Messrs. Votaw, Karaosmanoglu, Eccles
Wapenhans (o/r)
Haynes, Hendry, Finzi
Fuchs, Jaycox, Rovani
Fateen, Howard, Le Moigne, Russell, Sathar, Singh

UFinzi/GWyatt:sgp

Enclosure

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

1818 H Street, N.W., Washington, D.C. 20433, U.S.A.

Area Code 202 · Telephone - EXecutive 3-6360 · Cable Address - INTBAFRAD

NOT SENT SINCE OVERTAKEN BY INVITATION FOR MR. MCNAMARA'S VISIT TO EGYPT.

DRAFT LETTER

MAKE TWO OFFICIAL COPIES

ADavar/te
February 1, 1974

His Excellency
Ahmed Osman
Minister for Reconstruction
Cairo, Egypt

Dear Mr. Minister:

I would like to thank you for the very cordial reception and hospitality which you extended to Mr. Davar during his visit to Cairo last month. The visit which you arranged for him to Ismailia, Qantara and Port Said was most useful in providing firsthand feel for the extent of the war damage caused to these cities in recent years and the magnitude of the efforts that will be needed to rehabilitate them as well as Port Suez. Mr. Davar has also reported on his discussions with you on how the rehabilitation efforts could be approached, and on the future economic development of the different regions in Egypt. He also discussed these topics with His Excellency Deputy Premier Dr. Abdel Aziz Hegazy, and Dr. Sherif Lotfy of the Ministry of Finance and Economy.

From Mr. Davar's report I understand that your Government proposes to carry out a program for the reconstruction of the four canal cities, according to master plans being prepared by Egyptian engineers. Such an undertaking will require substantial inputs of capital and is planned to take a few years to complete. The first steps, which you plan to start immediately, include the repair and rehabilitation of essential infrastructure such as water, sewerage, power and telecommunications facilities, housing, roads, a tunnel connecting the West and East banks of the Canal, etc. The restoration of this infrastructure will provide the nucleus for the resumption of economic activities in these cities and a gradual rehabilitation of these cities and the Suez Canal Region.

I am pleased to inform you that in principle, the Bank Group would like to assist Egypt in taking some of these first steps. We realize that substantial financing will be required to complete even these first steps. However the effort is so massive, that besides your country's own resources, I am sure that your Government will be marshalling financial assistance from other Arab and friendly bilateral sources. Keeping this in mind, as well as the limitations of the Bank Group's resources, we would be willing to consider helping by providing some assistance in the following directions:

(a) rehabilitation of the water, sewerage and power facilities in some or all of the four Canal cities, with the objective of meeting the demand for these services in the immediate and medium-term future;

(b) rehabilitation of some of the railway transport infrastructure (including track renewal and additional rolling stock) under the Railways II project; as you might know, this project is proposed to be appraised in March/April this year and will cover investments to be made between 1975 and 1977 under the Egyptian Railway's 5-Year Modernization Program;

(c) provision of telecommunication facilities to meet the immediate and medium-term demand for telecommunication services in these Canal cities; these could be included under the Telecommunications Project, which will cover investments to be made between 1975 and 1977 as part of your country's long-term Telecommunications Improvement and Expansion Program; we hope to be put in a position to appraise this project, around April/May this year;

(d) assistance in the future urban planning of these four cities, even though we realize that some of the physical reconstruction work has to be commenced immediately towards your Government's objective of commencing rehabilitation in these cities as soon as possible;

(e) assistance in mounting a regional planning effort for the Suez Canal and Northwest Sinai Region, with the objective of providing a blueprint as to how and with what investments economic activity can be fully restored in this Region.

Should this approach be of interest to your Government, we would, as a first step, hope to send a Bank mission in March/April to review the situation at first hand and see how these proposals could be quickly advanced to a stage when they can be considered for Bank Group assistance. I shall look forward to receiving your Government's reaction, at your earliest convenience. It would greatly facilitate the work of such a mission, if you could send us, preferably before the mission visits Egypt, whatever technical data that is available about the existing water, sewerage and power facilities in these Canal cities, your Government's evaluation of the extent of the damage caused to these facilities and proposals however tentative, for their rehabilitation. It would also help, if we could also receive similar background information about your urban development plans and available technical data regarding the railway transport and telecommunications facilities that your Government believes will be required in the medium-term future for this Region.

I believe that another proposal that you, and later Dr. Lotfy, suggested to Mr. Davar, as a means of stimulating economic activity in the Canal Zone, was the establishment of a Free Zone Estate at Port Said. We are aware that legislation pertaining to free zones and tax incentives for foreign investors, have been promulgated by your Government in the last two years. Once again, I am pleased to inform you that in principle, the Bank Group would be willing to consider processing the Port Said Free Zone proposal further. However, as you and Mr. Davar discussed, one of the first steps that will need to be taken, is to establish the magnitude of the foreign interest in establishing facilities in that Free Zone estate, determine whether such investments might be made for industrial units which would produce industrial goods "in bond" for export or for warehousing and distribution facilities, or for both, as in Panama and Singapore. While this is being established, the most appropriate site for Port Said Free Zone will have to be located and work commenced on the preliminary site and engineering studies, design of infrastructure and buildings and estimation of capital and operating costs. It will also be necessary to work on creating an authority which would both promote and manage that Estate. With a view to developing the proposal further, it would be most helpful if you could send, at your early convenience, whatever background material or analysis your Government has prepared on this particular subject. This will again enable us to have sufficient information on which to base a preliminary analysis, before a Bank Group mission visits Egypt to discuss the matter further and review the appropriate steps for shaping it into a technically and economically sound investment proposal.

You discussed with Mr. Davar the Government's intention to finalize a sound Master Plan for Cairo's future development (including the establishment of satellite cities) to stabilize its future growth and relieve the current population and economic pressures on that city. An inter-related solution connected with Cairo, were studies as to which viable regions in Egypt, such as Aswan, Sinai and areas west of Alexandria, should be developed, with what priorities and through what strategy and investments. I understand that when Mr. Davar met with Deputy Prime Minister Hegazy, the latter also saw considerable advantage in initiating work in the very near future on these matters, particularly on the regional development studies. As Mr. Davar mentioned to you, the Bank's last Economic Mission to Egypt (April 1972) also addressed itself to this problem and had recommended that this was indeed the right direction in which your Government was looking. As Mr. Davar mentioned to Dr. Lotfy, we are tentatively planning our next economic mission to Egypt for the spring of this year. It would be fruitful if this mission could also review in detail, the proposal to finalize a Master Plan for Cairo and initiate regional development studies of selected regions, discuss what actions may be taken by Egypt to commence work on them and the role which the Bank might play in these studies and future investment proposals that might result from them. If this timing is convenient, I shall arrange for urban and regional development experts to participate in this economic mission.

I shall look forward to receiving your early reactions to the proposals included in this letter and to receiving the available background materials which I have requested.

In view of their interest, I am sending copies of this letter to His Excellency Deputy Prime Minister Hegazy, as well as to Dr. Sherif Lotfy of the Ministry of Finance and Economy.

Sincerely yours,

M. P. Benjenk
Vice President
Europe, Middle East and North Africa Region

Copy to: His Excellency
Abdel Aziz Hegazy

Dr. Sherif Lotfy

Cleared in substance with and cc: Messrs. Wyatt/Finzi, Fuchs (particularly paras. 5), Singh (particularly paras. 3 and 6)

MACRO-ECONOMIC AND CREDITWORTHINESS ASPECTS

1. February 1974 Mission Report - Preliminary Thoughts on Macro-economic and Creditworthiness Issues.

2. Mr. Karaosmanoglu's February 21 Memo - Preliminary Thoughts for Bank Program.

3. Mr. Cizauskas' February 21 memo - Possible Approach for Organizing International Rescheduling of Egypt's Debts.

P

OFFICE MEMORANDUM

TO: Mr. Munir P. Benjenk, Regional VP, EMENA

DATE: February 22, 1974

FROM: Attila Karaosmanoglu, Chief Economist, EMENA AK (Revised version of Memorandum dated February 19 on the same subject)

SUBJECT: Report on Mission to Egypt: Preliminary Evaluation of Macro-Economic and Creditworthiness Issues

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1. I arrived in Egypt with Mr. Armstrong on February 10, 1974; I left Cairo on February 17, 1974. Mr. Armstrong will continue his contacts and discussions through the remainder of the month.

2. The primary objective of our visit was to obtain up-to-date information about the Egyptian economy and to begin to identify ways in which it could become creditworthy. Partly because reliable data are scarce, I conclude that it would be prudent to think of building up Egypt's creditworthiness in stages. I recognize that there may be a need for substantial external reconstruction and development financing before the Bank could consider the country fully creditworthy. However, I believe that, the actions recommended in Part E of this memorandum would represent sufficient justification for substantial external financing, which itself would set the stage for further improvements in performance and creditworthiness. How

3. I propose in the following parts of this memorandum to describe the salient aspects of the present administrative and economic situation, then to discuss the creditworthiness question, and finally to set forth my recommendations for Bank action.

A. The Present Situation

4. Seven years of ever-increasing military expenditures, with investments and other civilian expenditures being treated basically as residuals, plus a heavy burden of debt service on both long- and short-term loans, have brought the Egyptian economy to an extremely difficult position. How much

5. Top secret status has been given to much economic information. The restricted availability of these data to a very limited number of people, has created serious difficulties, as many inconsistencies or errors remain unnoticed, and coordination of policy making has been seriously hindered.

6. A long-term plan prepared and presented to the cabinet in 1972 was never adopted. Our mission was given for the first time general tables of this Plan, which in view of drastically changed circumstances, now have limited value. But it was indicated to us that the investment figures (at least totals) in this year's budget basically reflect the Plan figures for 1974.

7. Minister Hegazy (who used to be a professor of accounting) has changed the budget presentation to look like the ledger of a business enterprise. The budget, which is made publicly available, is difficult to use as a decision-making document or as a basis for economic analysis.

8. The fiscal year was changed to the calendar year at the beginning of 1973. As a result, many statistical series (including national accounts) are not available on a continuous basis after the 1971/72 fiscal year, ending June 1972. People at central decision-making points are not fully informed about the behavior of the economy in 1972 or 1973. Dr. Sherif Lotfy, upon my insistent questioning, gave his impression for the change in GDP in 1973 (in current figures) as "maybe around 4%". This could mean a stagnation or actual decline, in real terms. Preparations for the war of October 1973 were reflected in a large increase in the money supply, inflation, and pressure on the balance of payments, but on the whole the economy seems not to have suffered very much from the war itself. There was a reduced availability of some commodities, but no particular economic hardship and little new physical damage to the economic infrastructure outside the immediate war zone.

9. The latest balance of payments figures available from the Central Bank are those on current account for the first nine months of 1973. The unavailability of the capital account, plus significant price changes during the last three months of the year, also diminish the value of that document to some extent.

10. We were given during this visit, for the first time, extensive information from the 1973 and 1974 Foreign Exchange Budgets. This appears to be a real instrument of policy, but it seems to be available in full to only a very small group of members of government and civil servants; it is available to a somewhat larger group in the form of summaries. Magnitudes shown in this budget have little resemblance to balance of payments figures (as prepared by the Central Bank) or to foreign trade figures (as prepared by the Customs). Despite its several inconsistencies, I believe that the Foreign Exchange Budget is the policy instrument through which most allocation decisions are made, directly or indirectly. Some of the inconsistencies in the information given to us appear to stem from a non-systematic effort to eliminate defense-related information. But most of the inconsistencies, I am afraid, are attributable to inefficiencies and other errors resulting from secrecy and a lack of critical review.

11. President Sadat does not appear to have (i.e., our enquiries did not turn up any indication that he has) an economic brain trust to develop economic strategies, to formulate alternatives or to review options in the area of economic policy. Nor does he appear to have a staff to keep tabs on an economic bureaucracy which often seems to have lost sight of political directives and long-term economic objectives. I seriously doubt that even now -- several months after the end of hostilities -- a serious effort has been launched to formulate a strategy for effecting the transition from a wartime to a peacetime economy. There is much vague talk of "opening the economy" and of "liberalization" and of "reconstruction". But the planning of an economic program appears to be on as piece-meal and short-term a basis as ever, and few tangible actions have yet been taken.

12. There is a clear and present need to prepare a new development plan. Since 1967, uncertainties about war precluded the formulation and implementation of medium-term plans, and the Ministry of Planning has had little voice in the Government. Once peace is secured, it will be urgently necessary to strengthen the planning apparatus. A conscientious effort to broaden the accessibility of data among government agencies would greatly help to improve the quality of information and analysis.

13. There is a present danger that the new Ministry of Reconstruction could become an empire unto itself, with massive projects under its aegis going ahead without coordination in a macro framework for the economy as a whole. The Minister is a successful builder-businessman. We do not know whether he fully appreciates the importance of fitting his program into the larger national framework, especially since his Ministry plans to administer a $7 billion investment program over the next five years -- equivalent to more than has been spent for investment in the entire economy over the past six years.

14. The only indication of an approach being taken to the formulation of "global strategy" is the announced intention to create three Boards to advise the Office of the Presidency in the fields of: (i) Production and Economy; (ii) Services and Social Development; and (iii) Education, Technology and Science. However, since these Boards are intended to include a representative cross-section of society, it may be doubtful how useful they will be as systematic formulators of consistent objectives or policies.

15. The formation of a new government, which had appeared imminent through much of January, now appears to have been postponed indefinitely -- or until after the last Israeli soldier has been evacuated from the occupied territories. A change which took place during our mission was the formation of an "independent" Agency for Arab and International Economic Cooperation, headed by Dr. Sherif Lotfy. Dr. Lotfy described the primary function of his Agency as "leading the liberalization (in the sense of opening up) of economic policies, with a special emphasis on facilitating inflows of Arab capital and assistance from other sources".

16. Deputy Prime Minister Hegazy emphasized to me the point that Egypt's economic performance over the past six years had to be seen in the context of a heavy war effort, but that the future now offered a prospect for significant transfers of resources from military to civilian purposes. More specifically, he suggested that perhaps as much as 50% of current military expenditures (estimated at nearly $2 billion) might become available to the civilian economy and for development purposes.

B. Problems of Creditworthiness
Savings, Investment and Growth

17. As I mentioned earlier, recent national income data are not available. But the actuals for the 1973 foreign exchange budget (which was given to us on a strictly confidential basis) show that imports of capital goods in 1973 declined to a mere U.S.$230 million (less than 10% of total commodity imports, or less than 3% of GNP). This level of imports reflects a serious disinvestment in most sectors. The 1974 Foreign Exchange Budget has an allocation of U.S. $726 million for investment goods imports, while the 1974 Government Budget has a total allocation of U.S. $1331 million for investment.

18. This implies that 55% of total investment would consist of imported capital goods -- a proportion which *a priori* seems far too high -- but we were not able to obtain data on the projected composition of investment goods imports. The budgeted investment in 1973 of about US$1020 million was only partially implemented. The 1974 budget assumes that national income will increase 6.6% at current prices (5.9% at constant prices) and that there will be a 1.8% increase in employment. The 1974 budgeted investment figures include part of the Sumed pipeline costs and one large Arab financed poultry project (possibly with IFC participation), but do not include allocations for reconstruction activities.

19. Some marginal measures are being taken to improve tax collections. Egypt is currently a fairly highly taxed society. Consequently, the main increments to public savings will have to come from reallocations from the defense budget and from improved profitability of the public enterprises.

20. As noted above, there is talk about liberalization or opening up of the economy, including through easing price controls, but few tangible actions have been taken yet. Establishing some free zones in the Suez area and in Cairo (after the examples of Shannon or Singapore) to attract foreign capital is also a subject being considered seriously, but it will take some time before any results can be obtained. A law passed for this purpose was found inadequate by a team of UNDP experts, and some changes will need to be made in the law before any large-scale free zone operations are likely to start.

21. The indigenous private sector is small and limited in scope. Any "liberalization" will need to start by establishing some competition between existing public enterprises, and by a systematic decontrol of prices. In other words, an intelligent program in the direction of creating a "socialist market economy" may enable the Government to create an investment climate conducive to the encouragement of Arab or other direct foreign investment (mainly in new enterprises), and to stimulate a greater role for the local private sector. Unless determined steps are taken also to change the monolithic nature of the General Organizations controlling different sectors, Egypt cannot go very far with a meaningful "liberalization". (Dr. Lotfy is keenly interested in getting advice on such matters, especially on the terms and conditions which should be granted to foreign investment, and in early March Professor Mason will go to Egypt under Ford Foundation auspices to begin such a dialogue.) I am making arrangements for Mr. Bela Balassa to go to Egypt next month to advise on the structure of protection appropriate to Egypt, and we may wish to locate other experts to follow up on discussions Belassa and Mason initiate.

22. There are some "project lists" available, and we were given assurances that a large number of projects could quickly be made ready for financing with external assistance. We have not had an opportunity to evaluate the worth of these lists, but our initial judgment is that Egypt should not have an "absorptive capacity" problem in the usual sense. However, we know from our own experience that finalization of specific projects is likely to take several months, and we learned that Egypt has been very slow to allocate and disburse German project aid, not because of a lack of projects, but because of the Government's inability to sort out its priorities. Some major projects currently under construction include the Helwan Iron and Steel complex and an aluminium plant -- both Russian-financed.

23. A danger for the economy now is a too-heavy emphasis on reconstruction-type projects which would increase the overall capital-output ratio. Especially insofar as external assistance comes not as grants but as loans, it would increase the already high burden of the external debt, without contributing to the export potential of the economy.

C. Balance of Payments Performance

24. Serious inconsistencies between the balance of payments, foreign exchange budget and foreign trade figures hinder intelligent policy planning and decision making. Dr. Lotfy was unable to provide answers to many of our questions related to such inconsistencies. For several years now, every time an IBRD or IMF mission visits Cairo, it is told that the administration will soon do something about this situation. But nothing has been done so far.

25. The 1974 foreign exchange budget makes provision for the utilization of about 1/3 of the excess capacity estimated to exist in 1973; Dr. Hegazy quoted a figure of ₤E 260 million for the total value of production foregone in 1973 as a result of excess capacity. When we compared the actuals for 1973 and the budget figures for 1974, there were enormous increases (exports 79%, imports 33%, and imports of invisibles 74%, etc.) which could not easily be explained by price changes. We could not obtain satisfactory answers to our questions about the bases for these figures.

26. The recovery of Sinai oil fields (current production 120,000 barrels per day) and an expected increase in production from the El Morgan oil fields (when the present operation of building up pressure through water injection is completed) will provide significant additions to Egypt's export receipts. Data were not made available during my visit, but Mr. Armstrong expects to obtain these projections next week.

27. The Egyptians hope that the Khartoum assistance will continue for some years, even after the Suez Canal is opened. We have been told by several foreign observers that there has been a sudden increase in the number of visiting businessmen and representatives of aid agencies (Eastern and Western) in Egypt. This influx has already created extremely optimistic expectations about the potential inflow of capital which may follow. The Government also appears to be optimistic about its prospects for increasing both commodity exports to, and invisible earnings from, Arab oil-producing countries. Saudi Arabia recently abolished its bans on imports from Egypt and on Saudi tourist travel to Egypt.

28. Although it is too early yet to assess the probable effects of all these changes, there may be a danger that the Egyptian administrators have a more optimistic outlook than the situation warrants -- that they will sit back and wait for the foreign capital to rush in and make things happen. Despite our very frank discussions, no one we met would venture to guess the likely size and conditions of Arab -- or other -- investments in Egypt.

D. External Debt and Debt Management

29. Egypt's external debt situation is the most difficult aspect of its creditworthiness problem. We were given this time a table showing total external debt and the composition of debt payments and rollovers in 1973 and 1974. All of these data were labeled top secret, we were requested to treat them as such (see attached tables). We were also given some new explanations about the mechanism of payments of Eastern bloc debts. (See my separate note on this subject.)

30. There were serious inconsistencies (probably more attributable to inefficiency than to efforts to disguise) in the figures for debt payments and new borrowings in 1973. Total payments of short and long-term debt in 1973 (according to the actuals of the Foreign Exchange Budget) amounted to ₤E 457.2 million (US$1197 million). Some of these, of course, were payments in the nature of rollovers, both short and long term. The data on the financing of the deficit in 1973 showed a banking facility use of ₤E429.4 million (US$1086 million). Normally, this entry should be no more than the sum of payments of total banking facilities (₤E149.4 million), increases in the total outstanding banking facilities in the year (₤E58.9 million), and possibly increases in reserves (₤E102.4 million) amounting to ₤E309.7 million, in all. We could not get an answer other than "obviously this must be wrong". I am describing this detailed example to give a flavor of the actual data situation.

31. According to the 1974 foreign exchange budget (see attached table), payments on short and long-term debt for the year are projected to ₤E544.5 million (about US$1400 million). The external debt table (see attached) shows payments (obligations) amounting to ₤E465.5 million in 1974. The breakdown on these payments is as follows: Bankers facilities ₤E123.1; Arab deposits in Egyptian banks ₤E95.7; debts to Arab countries ₤E7.5; suppliers credits and medium-term loans to Eastern countries ₤E101.1; and IMF credits ₤E5.3. Of the total, some ₤E312.7 (or two-thirds) are more or less automatically rolled over. Most of the repayments on rescheduled debt (₤E22.4) also automatically create new credit coverage, while the IMF credits may also be considered as rollovers in another sense. This leaves a net need of about ₤E130 million (US$333 million) to pay the debts on due dates. This debt burden, added to the projected new borrowings that will be needed to finance a large current account deficit, clearly suggests that without a major debt rescheduling operation, it may prove very difficult to save Egypt from a continuation of its past hand-to-mouth foreign exchange situation. Some have surmised that massive capital inflows from Arab sources may alone be sufficient to solve the problem. However, this optimistic projection may overlook the likely composition of Arab investment and terms on Arab capital.

On the one hand, a large proportion of the Arab capital which does become available is thought likely to be invested in real estate, which will assist Egypt's debt-servicing capacity only in the year of purchase. And on the other hand, even the oil-rich Arab states may not make their funds available on particularly soft terms. Libya, for example, has reportedly been charging 8% on its "deposits" in the Egyptian Central Bank.

32. On the matter of debt rescheduling, Dr. Lotfy took the position that the time would not be ripe for this until a peace settlement were concluded. He felt the matter to be untimely and "too political" at the present time. When I asked what he then suggested was required to make Egypt creditworthy for Bank loans, he acknowledged that Egypt needed a "breathing space" of three or four years but suggested that this take the form of import credits amounting to US$500 million a year. There is apparently no precise basis for the $500 million figure (other than his "being optimistic for the future of Egypt"), which is offered as an "order of magnitude" estimate to be refined only when a real prospect of such aid emerges.

E. Possible Bank Action

33. The mission's initial balance of payments projections, based upon fairly optimistic assumptions about future improvements in Egypt's economic performance, suggest that large current account deficits over the medium-term are likely to be the concommitant of Egypt's achieving a fuller utilization of existing capacity and undertaking a major investment program. Over the medium-to-longer term, Egypt has promising prospects for non-traditional manufactured exports, petroleum, phosphates, tourism, workers remittances and other foreign-exchange earning exports, so that with improved economic management the country should become creditworthy for loans which do not require servicing for at least several years. But unless there is a special action among the main creditors aimed at making Egypt creditworthy (instead of waiting until Egypt somehow becomes creditworthy), there may be difficult times ahead.

34. Two stages may be considered to help Egypt become creditworthy and enter into a path of sustained growth.

(1) Stage I could be designed to capitalize on the increased present interest in Egypt of the main Western creditors. There are numerous signs that most of them (U.S., Germany, Japan, Italy, the U.K.), are increasing their aid to Egypt in one form or other (enclave projects, import loans, increased insurance coverage, etc.). At this stage, the Bank may take the leadership by asking Egypt and its Western creditors (and possibly the oil producers) if they wish to participate in an *ad hoc* Consultative Group (or aid symposium) to coordinate three types of operations: Yes

(i) to foster a large import program (through commodity loans) for two or three years, to provide necessary inputs for a fuller utilization of industrial and agricultural capacity;

(ii) to reschedule debt through a two year moratorium if such a moratorium were accepted (to provide time to negotiate a longer term rescheduling), it would immediately release very large amounts of foreign exchange for commodity imports and investment. Repayments on civilian debts (other than bank credits) in the two years 1974 and 1975 will call for £E521 million (of which £E175.6 million is to East Bloc countries). A good part of this should be covered in such a moratorium, if Eastern countries agree to a parallel operation;

(iii) to help to ensure that economically justifiable projects (either under construction or of very high priority) are completed quickly.

The conditions for these operations in Stage I on the part of Egypt should be to:

(i) improve economic and social data and make them available;

(ii) prepare a new development plan which puts the reconstruction and other development needs and potentials into a consistent financial and policy framework; and

(iii) prepare and implement policies improving the efficiency of the public sector.

(2) Stage II would involve the application of more strict creditworthiness criteria, with the selection and financing of projects in the context of a program which is neither too ambitious (thereby creating new difficulties) nor too conservative (thereby failing to use the full development potential of the country).

35. Sometime this Spring it seems inevitable that Bank management will have to decide whether or not the Bank wishes to play a leading role in this operation -- which may amount to an undertaking as demanding as the initiation and management of a major Consultative Group. I do not see, at this stage, any other creditor, nor Egypt herself, taking the necessary initiatives to set up the well-programmed operation that is required. The danger in the absence of an action group -- especially at the early stages -- is a waste of resources through a series of uncoordinated investments, and also possibly through unnecessary competition among creditors for the choice of better projects. I do not know whether the Egyptians would want to have such an operation organized. They in fact may not be very enthusiastic about the idea. But I think it is worth considering. WDs

cc: Mr. Knapp
Mr. Votaw (cleared with)
Mr. Wapenhans
Mr. Davar
Mr. Maiss
Mr. Armstrong (cleared with)

E G Y P T

Exchange Rates

Official Exchange Rate effective from February 1973

£E 1 = $ 2.56

Official Exchange Rate effective before February 1973

£E 1 = $ 2.30

Official Exchange Rate applied to (full) calendar year 1973 flows

£E 1 = $2.53

Incentive Exchange Rate effective February 1973

Buying rate: £E 1 = $ 1.61

Selling rate: £E 1 = $ 1.54

FOREIGN EXCHANGE BUDGET

FOREIGN EXCHANGE BUDGET
1973-1974
(£E millions)

	1973 Actual	1974 Estimate	Increase %
A. Current Receipts (1+2)	518.4	788.1	52.0
1. Exports (Agr. and Ind.)	369.7	660.0	78.5
2. Invisibles (incl. savings and tourism)	148.7	128.1	- 16.1
B. Current Payments (3+4)	999.0	1346.6	34.8
3. Imports	951.4	1263.7	32.8
4. Invisibles	47.6	82.9	74.2
C. Global Financing Requirements	937.8	1104.0	17.7
Deficit on current transactions (A-B)	480.6	558.5	15.6
Settlement of obligations	457.2	545.5	19.3
D. Source of Financing	1040.2	1000.2	
Banking Facilities	439.4 1/	200.0	-119.7
Supplier Credits	163.3	356.5	118.3
Other 2/	437.5	443.7	1.4
E. Surplus or Deficit Financing	+ 102.4	- 103.8	

1/ Including some wheat facilities

2/ Including Khartoum Agreement, Special Drawing Rights, Cotton financing, Cash loans, Donations and Utilization of bilateral payments agreements ceilings.

FOREIGN EXCHANGE BUDGET, 1974
(£E millions)

	Free Currencies 1974	Bilateral 1974	Total 1974
A. RESOURCES			
Agricultural Exports	175.0	234.5	409.5
Industrial Exports	75.5	110.9	186.4
Invisible Receipts	33.4	9.7	43.1
Arab Support	115.0	-	115.0
Total	398.9	355.1	754.0
Savings	50.0	-	50.0
Tourism	35.0	-	35.0
Total of Resources	483.9	355.1	839.0
B. EXPENDITURES			
1. Obligations	401.1	143.4	544.5
2. Commodity Imports			
Consumer goods	346.5	65.1	411.6
Intermediate goods	335.8	235.2	571.0
Capital goods	229.2	54.4	283.6
Total	911.5	354.7	1266.2
3. Invisible Payments			
Governmental	15.6	11.6	27.2
Non-governmental	43.0	6.0	49.0
Total	58.6	17.6	76.2
4. Monetary Parallel Market	15.0	-	15.0
Total of Expenditures	1386.2	515.7	1901.9
C. DEFICIT (A-B)	900.6	160.6	1061.2
1. Commodity Imports Financing			
Banking facilities	200.0	-	200.0
Suppliers Facilities			
Consumption and intermediate	60.0	-	60.0
Wheat facilities	80.0	-	80.0
Investment	186.0	34.4	220.4
Total Suppliers Facilities	326.0	34.4	360.4
Without payment petroleum imports	35.0	-	35.0
Commodity imports from 1973 resources	20.0	-	20.0
Total Commodity Imports Financing	581.0	34.4	615.4
2. Advance Finance of Cotton	25.0	-	25.0
3. Bilateral Payments Agreements	-	85.0	85.0
Total	606.0	119.4	[illegible]
Deficit	- 296.3	- 41.2	- 337.5
Other Receipts			
Arab support	62.0	-	62.0
Petroleum support	110.0	-	110.0
Total	172.0	-	172.0
Net Deficit	- 124.6	- 41.2	- 165.8

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FINANCING OF THE DEFICIT
(Actuals) 1973
(LE million)

	Free Currencies	Bilateral	Total
Bank credit facilities	429.4	-	429.4
Suppliers	144.4	18.9	163.3
Imports from 1972	32.5	2.4	34.9
Barter and Others	3.6	-	3.6
IMF compensatory finance	22.2	-	22.2
Bilateral swing limits	-	107.1	107.1
SDR's	6.4	-	6.4
Deposits	25.0	-	25.0
Prefinancing of Cotton	3.9	-	3.9
Abu Dhabi credit	4.1	-	4.1
IMI	12.2	-	12.2
Grants	130.1	-	130.1
Others	2.3	-	2.3
Total	816.1	128.4	944.5

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FINANCING OF THE DEFICIT
1974

	Free Currencies	Bilateral	Total
Banking facilities	200.0	-	200.0
Suppliers credits	326.0	34.4	360.4
Imports from 1973	20.0	-	20.0
Bilateral swing limits	-	85.0	85.0
Pre-financing of cotton	25.0	-	25.0
Petroleum support	145.0	-	145.0
Arab support 1/	62.0	-	62.0
Net deficit	124.6	41.2	165.8
Total	902.6	160.6	1063.2

1/ Other than Khartoum Agreement which is shown among export receipts as it compensates Suez Canal earnings.

EXPORTS - FOREIGN EXCHANGE BUDGET

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EXPORTS 1973

Estimated and Actual 1/

(in £E millions)

Commodity	Est. 1973 Budget Free	Est. 1973 Budget Bilateral	Est. 1973 Budget Total	Actuals for 1973 Free	Actuals for 1973 Bilateral	Actuals for 1973 Total
Cotton (raw)	50.8	98.5	149.3	58.0	113.0	171.0
Rice	7.5	20.2	27.7	4.8	17.2	22.0
Onions (Fresh)	4.4	2.3	6.7	3.9	4.2	8.1
Potatoes	3.5	0.7	4.2	2.2	1.6	3.8
Others (agricultural)	4.0	10.0	14.8	4.3	14.9	19.2
Total Agricultural Exports	70.2	132.5	202.7	73.2	150.9	224.1
Indust. Exports						
Cotton yarn & textiles	14.9	55.0	69.9	15.5	50.3	65.8
Crude oil & oil prods.	11.5	5.5	17.0	10.9	4.4	15.3
Engineering goods	1.8	7.0	8.8	0.8	2.5	3.3
Chemical indust.	0.8	4.5	5.3	1.1	6.9	8.0
Food indust.	2.9	9.5	12.4	4.4	8.2	12.6
Building materials& refractories	2.5	3.0	5.5	3.2	1.0	4.2
Private sector & cooperatives	2.2	16.0	18.2	2.8	28.5	31.3
Others	0.9	9.4	10.3	2.0	3.1	5.1
Total Industrial Exports	37.5	109.9	147.4	40.7	104.9	145.6
GRAND TOTAL AGRIC. & INDUSTRIAL	107.7	242.4	350.1	113.9	255.8	369.7

1/ Estimated according to foreign exchange budget at beginning of year.

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INVISIBLES RECEIPTS 1973

Estimated and Actual 1/

	Estimates			Actuals		
	Free	Bilateral	Total	Free	Bilateral	Total
Invisibles Receipts						
Maritime transport	2.9	2.0	4.9	2.4	0.1	2.5
Interest & profits	4.7	1.3	5.0	4.7	1.6	6.3
Tourism & remittances (savings)	33.5	10.0	43.5	102.2	-	102.2
Other invisibles	21.4	5.5	26.9	29.5	8.2	37.7
TOTALS	62.5	18.8	81.3	138.8	9.9	148.7

1/ Estimated according to foreign exchange budget at beginning of year.

NOTE: Increase in actuals due to

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FOREIGN EXCHANGE BUDGET 1974

Agricultural Exports

Commodity	Quantity (Thousand tons unless otherwise specified) Free	Bilateral	Total	Av. Ton Price (£E) Free	Bilateral	Value (£E millions) Free	Bilateral	Total
Cotton (1000 Bales)	384	458	842	355	440 (per bale)	135.7	203.0	338.7
Rice	150	50	200	140	180	21.0	9.0	30.0
Fresh Onions	65	35	100	71	95	4.6	3.3	7.9
Potatoes	85	20	105	60	65	4.9	1.3	6.2
Fresh Garlics	3	10	13	150	170	0.4	1.7	2.1
TOTAL						166.6	218.3	385.0
Fresh Vegetables	9.1	10.9	20.0	110	130	1.0	1.4	2.4
Citrus	50.0	150.0	200.0	40	80	2.0	12.0	14.3
Groundnuts	10.0	1.0	11.0	180	250	1.8	0.2	2.0
Flax	3.0	3.5	6.5	150	112	.4	.4	.8
Other								
Total						8.3	16.2	24.5
GRAND TOTAL						175.0	234.5	409.5

FOREIGN EXCHANGE BUDGET 1974

(£E '000)

Industrial Exports	Free	Bilateral	Total
Cotton Yarn & Textiles	24,695	55,490	80,185
Non-Cotton Textiles	1,500	5,400	6,900
Building Materials and Refractories	310	1,501	1,811
Food Industry Products	6,980	9,568	16,548
Engineering Industry Products	5,692	7,204	12,896
Metallurgical Industry Products	165	8,684	7,029
Chemical Industries Products	669	2,017	2,686
Private Sec. & Cooperative Prod.	2,643	18,357	21,000
TOTAL	42,654	106,401	149,055
Crude Oil & Products	30,829	2,515	33,344
Other Industrial Products	2,050	1,950	4,000
GRAND TOTAL	75,533	110,866	186,399

NOTE: The proceeds of the free currency industrial exports goes to the resources of the collateral foreign exchange market except oil and products, cotton yarn and cotton textiles.

FOREIGN EXCHANGE BUDGET 1974

Invisibles (Revenues)

	Free	Bilateral	Total
Maritime Transport	5,100	1,700	6,800
Transit Trade	150	-	150
Insurance	200	50	250
Interest & Profits	6,200	1,800	8,000
Others	21,700	6,200	27,900
TOTAL	33,350	9,750	43,100
Tourism & Grants	35,000	-	35,000
Savings (Egyptians Working abroad)	50,000	-	50,000

IMPORTS - FOREIGN EXCHANGE BUDGET

CONFIDENTIAL 3.1

COMPARATIVE LISTS OF IMPORTS OF SELECTED ITEMS

([illegible] millions)

Item	1972 Fixed Quotas Volume '000 Tons	1972 Fixed Quotas Free Currency	1972 Fixed Quotas Bilateral	1972 Fixed Quotas Total	1972 Actual Volume '000 Tons	1972 Actual Free Currency	1972 Actual Bilateral	1972 Actual Total	1973 Fixed Quotas Volume '000 Tons	1973 Fixed Quotas Free Currency	1973 Fixed Quotas Bilateral	1973 Fixed Quotas Total	1973 Actual Volume '000 Tons	1973 Actual Free Currency	1973 Actual Bilateral	1973 Actual Total	1974 Quotas Requested Volume	1974 Quotas Requested Free	1974 Quotas Requested Bilateral	1974 Quotas Requested Total	1974 [illegible] Volume	1974 [illegible] Free	1974 [illegible] Bilateral	1974 [illegible] Total
1. [illegible]																								
[illegible]	2,100	62.0	–	[illegible]	2,100	61.9	–	61.9	2,300	181.1	–	181.1	2,300	205.5	–	205.5	2,600	294.0	–	294.0	2,500	260.0	–	260.0
Flour	201	18.2	–	[illegible]	201	[illegible]	–	[illegible]	525	37.5	–	37.5	[illegible]	30.5	–	[illegible]	200	27.0	–	27.0	200	25.0	–	25.0
Maize	100	3.0	–	3.0	118	2.5	–	2.5	170	6.7	–	6.7	165	13.1	–	13.1	[illegible]	26.2	–	26.2	250	[illegible]	–	[illegible]
[illegible] Oil	140	11.1	9.4	[illegible]	124	[illegible]	6.2	[illegible]	120	41.6	4.1	45.7	125	38.1	4.2	42.3	100	45.9	5.4	51.3	200	35.8	13.8	49.6
[illegible] Fats	10	0.1	1.2	[illegible]	9	[illegible].02	1.2	1.2	15	2.0	0.6	3.2	12	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible] Fats	80	5.9	1.2	[illegible]	80	[illegible]	1.1	[illegible]	86	11.3	0.8	12.1	86	14.0	1.2	15.2	84	16.3	[illegible]	16.5	84	14.6	3.4	18.0
Coffee	5	1.5	–	[illegible]	5	1.3	–	[illegible]	5	2.5	[illegible]	2.5	5	[illegible]	–	2.4	[illegible]	3.3	–	3.3	6	3.0	–	[illegible]
Tea	27	0.9	9.5	[illegible]	25	[illegible]	7.7	[illegible]	28	1.5	10.5	11.9	26	0.9	8.4	9.3	28	–	11.8	11.8	28	–	11.8	11.8
Lentils	16	–	1.4	1.4	16	–	1.4	1.4	25	2.0	[illegible]	4.7	15	1.5	[illegible]	[illegible]	25	2.0	3.0	5.0	10	1.3	[illegible]	[illegible]
[illegible]	16	–	1.3	1.3	16	–	1.3	1.3	17	2.2	1.2	3.4	18	1.4	2.4	3.8	20	2.0	2.0	4.0	20	2.0	2.0	4.0
[illegible]	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	50	3.2	3.3	6.5	25	–	3.3	3.3
Other Supply Goods	–	5.3	20.4	[illegible]	–	7.7	18.3	26.0	–	11.1	21.8	32.9	–	15.0	20.0	35.0	–	33.9	37.9	71.8	–	17.7	32.2	49.9
2. Fertilizers & [illegible]																								
[illegible] ([illegible])	1,600	5.5	4.5	[illegible]	1,435	5.6	4.0	9.0	1,700	20.0	5.0	25.9	1,700	17.1	7.5	24.6	2,300	52.5	6.0	58.5	1,900	32.6	6.0	38.6
Pesticides	–	10.8	0.3	11.1	–	10.6	0.1	10.7	–	12.5	0.3	12.8	–	15.6	0.4	[illegible]	–	20.4	0.3	20.7	–	13.5	0.3	13.8
Seeds	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	1.8	–	1.8	–	1.5	–	1.5
Iron & Timber																								
Iron Rod	120	3.5	2.5	6.0	120	3.3	4.2	7.5	120	6.2	2.9	9.1	90	4.6	1.6	6.2	165	16.8	3.0	19.8	120	9.4	5.0	14.4
Timber ('000 m^3)	230	0.5	10.0	10.5	283	0.4	12.5	12.9	–	0.7	15.6	16.3	–	0.3	1.6	1.9	50	7.6	22.8	30.4	430	2.8	27.0	29.8
Wood for Furnit.	–	2.5	3.5	6.0	–	2.2	4.0	6.2	–	3.0	6.0	9.0	–	4.6	1.5	[illegible]	–	7.6	2.4	10.0	–	4.0	6.0	10.0
Crude Oil & Products																								
Crude Oil	–	3.7	13.3	[illegible]	–	6.8	7.3	14.1	–	22.3	4.2	26.5	3,030	17.4	4.3	21.7	4,050	47.7	12.7	60.4	4,050	29.4	6.5	35.9
Oil Products					–	12.6	4.9	17.5	–	7.9	6.1	14.0	–	6.3	0.5	6.8	–	13.7	30.5	44.2	–	7.5	[illegible]	[illegible]
Drugs & Pharmaceuticals	–	10.1	9.5	19.6	–	8.6	4.2	12.8	–	13.9	6.0	19.9	–	13.9	6.3	20.2	–	28.1	7.6	35.7	–	13.0	6.0	19.0
Paper for all [illegible]	–	4.3	5.9	10.2	–	3.7	6.9	10.6	–	4.3	6.7	11.0	–	3.4	7.4	[illegible]	–	9.9	11.2	21.1	–	5.9	11.2	17.1
Tyres	–	3.1	1.5	4.6	–	3.1	3.2	6.3	–	3.5	4.0	7.5	–	2.0	2.6	4.6	–	4.7	4.6	11.3	–	4.0	4.0	8.0

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IMPORTS 1973

Item	Estimated 1973	Licences Issued	Letters of Credit Opened
Consumption Goods			
Wheat	181.1	320.7	313.2
Flour	37.7	32.9	30.5
Tea	11.9	12.9	9.3
Edible Oils	45.7	48.6	42.3
Medicines & Dairy products	7.0	5.2	5.2
Other consumption	30.8	30.9	26.6
TOTAL	314.2	451.2	427.1
Intermediary goods			
Tobacco	8.7	13.7	9.6
Paper & News Print	4.4	11.7	7.0
Tops (wool)	7.5	6.0	4.6
Iron & Iron Sections	16.5	19.8	19.8
Chemicals & Dyestufs	16.7	24.6	16.4
Spareparts	24.5	51.7	42.7
Crude Oil & Products	42.8	40.4	36.6
Fertilizers	25.9	44.5	39.9
Insecticides	12.8	17.5	16.5
Medical Supplies	12.8	15.1	14.9
Others			
TOTAL	401.7	502.2	438.0
Investment Goods	161.7	91.2	91.2

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WHEAT ESTIMATES FOR 1974

Made in October 1973

A. Requested by the Ministry of Supply

1000 Tons	
3,695	Total Needs
- 680	Existing Stocks (January 1, 1974)
- 215	Local Production
- 895	Total Available
2,800	Requested Imports

B. Ministry of Finance Estimates

3,675	Total Needs
- 450	Local Production
- 735	Stocks (January 1, 1974)
2,490	Requested imported
2,500	Approx.

FERTILIZERS - 1974

'000 tons

A - Estimates of Ministry of Agriculture

2,988	Total Needs (15.5% Nitrogenous)
- 680	Local Production
2,308	Imports Needed

B - Estimates of the Ministry of Finance

2,600	Total Needs
- 680	Local Production
1,920	Imports
1,900	Approx.

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IRON AND TIMBER (For Housing) - 1974

Iron

	Quantity (Ton)	Value (£E '000)		
		Free	Bilateral	Total
	120,000	9,400	5,000	14,400
Timber (Requested by Ministry of Housing)				
M^3	400,000	2,003	18,500	20,500
	Approved by Ministry of Finance			
M^3	480,000	2,750	27,000	29,750

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Development of Waiting-Room

During Period Nov. 1972/Nov. 1973

		(£E millions)
November	1972	63.5
December	1973	62.0
January	1973	65.4
February	1973	62.2
March	1973	49.3
April	1973	47.0
May	1973	46.0
June	1973	37.0
July	1973	37.0
August	1973	32.0
September	1973	40.0
October	1973	46.0
November	1973	49.8

(Mostly applies to consumer and intermediary goods.
This is waiting-room at Central Bank - applies to free currency only.
These figures are after all papers, clearances, authorizations made; this is what the Central Bank "does not have" to hand over.)

TRADE AND BALANCE OF PAYMENTS

Balance of Payments Estimates

(In Millions of Egyptian Pounds)

	Jan,Sept.1972	Jan.,Sept.1973 (x)
- Current Transactions:		
1- Proceeds :		
Exports (xx)	278.0	295.7
Insurance (xxx)	0.1	0.2
Shipping	4.4	4.1
Suez Canal Dues	-	-
Interest,Dividends & Other Revenues	8.9	45.6
Tourism & other Receipts	51.0	85.4
Total	342.4	431.0
2- Payments :		
Imports (xx)	399.1	413.4
Film Rentals	0.5	0.2
Other Commercial Payments	8.5	13.5
Insurance (xxx)	1.1	0.7
Shipping	5.9	4.7
Interest,Dividends & Other Revenues	26.4	33.4
Tourism Transfers	6.7	14.4
Govt. Expenditures	21.6	17.0
Other Payments	14.6	32.5
Total	484.4	529.8
A- Current Transactions Account	- 142.0	- 98.8
B- Transfers	+ 93.7	+ 96.7
Balance	- 48.3	- 2.1

(x) Primary Extimates .

(xx) Include Transitional Trade .

(xxx) Excluding Imports & Exports .

Petroleum Balance of Payments
(Value in I000 Pounds)

			I97I	I972	I973	I974
I.	Imports:					
	a)	Crude Oil	I7756	I9053	22573	35939
	b)	Petroleum products	25628	I7949	I36I4	I78I9
		Total Imports	43384	37002	36I87	53758
2.	Exports:					
	a)	Crude Oil:				
		Free	II23I	7855	3528	64I5
		Sinai	-	-	-	-
		Clear	I4795	3369	4I78	I570
		Total	26026	II224	7706	7985
	b)	Petroleum products	3I67	6797	I2946	25359
		Total Exports	29I93	I802I	20652	33344
3.	Balance (2 - I)		-I4I9I	-I898I	-I5535	-204I4

Source: The General Organization for Petroleum

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Imports & Exports
by Commodity Groups
and Currency Areas

4.3

Groups of Commodities	Imports								Exports								Difference	
	1972				Jan - Sept 1973				1972				Jan - Sept. 1973				1972	Jan-Sept. 73
	Conv. Currency	Clearing	Other	Total	Conv. Currency	Clearing	Other	Total	Conv. Currency	Clearing	Other	Total	Conv. Currency	Clearing	Other	Total		
Agricultural & Food Comm.	77.2	[illegible]	0.2	109.7	84.0	24.2	-	108.2	64.7	[illegible]	4.9	250.8	63.[illegible]	[illegible]	0.I	174.[illegible]	+ 14[illegible].I	+ [illegible]
Yarn & Textile Industry	4.9	10.7	2.2	17.8	7.5	5.3	-	12.8	14.1	68.8	0.2	83.I	11.8	37.6	-	49.4	+ 65.3	+ 36.6
Mining & Building materials & refractories Industrials	0.8	I.[illegible]	0.I	2.I	1.3	I.8	-	3.I	2.7	I.4	I.6	5.7	2.[illegible]	[illegible]	-	3.4	+ 3.6	+ 0.3
Petroleum & Fuel	I7.0	I5.3	-	32.3	I0.6	6.5	-	I7.I	4.7	8.4	0.8	I3.9	3.8	0.7	-	4.5	- I8.4	- I2.[illegible]
Chemicals	46.4	27.I	0.2	73.7	40.3	I6.7	-	57.0	I.I	5.9	0.3	7.3	I.I	4.I	-	5.2	- 66.4	- 51.8
Others	[illegible]	205.[illegible]	[illegible].0	29I.7	53.5	I18.8	I.I	I73.4	6.3	31.4	3.5	41.2	2.2	I0.9	-	I3.I	- 250.5	- I60.3
Others not-specified	-	-	-	-	23.6	I8.0	0.2	41.8	-	-	-	-	7.2	38.I	-	45.3	-	+ 3.5
Grand Total	230.4	288.2	4.7	523.3	226.8	I85.3	I.3	413.4	93.6	297.I	II.3	402.0	92.5	203.I	0.I	295.7	- 335.3	- II7.7

PB.N.

EXTERNAL DEBT

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FOREIGN EXCHANGE BUDGET
1974
Breakdown of Obligations

	£E Million	US$ 1/ Millions
Bank Credit Facilities (Short Term)	234.0	599.0
Suppliers Credits from Western Countries	117.0	299.5
Suppliers Credits from Eastern Countries	61.0	156.2
Public Obligations (IBRD; IMF, Rescheduled debt)	40.0	102.4
Others	92.5	236.8
Total	544.5	1393.9

1/ Dollar conversion at £E 1 = $2.56

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FOREIGN EXCHANGE BUDGET 1973

Breakdown of Obligations

	£E millions		$ millions 1/	
	Budgeted	Actual	Budgeted	Actual
Bank Credit Facilities (Short term)	146.2	148.4	370	375
Suppliers Credits from Western Countries	113.5	115.4	287	292
Suppliers Credits from Eastern Countries	46.0	44.5	116	113
Public Debt Obligations (IBRD, IMF, Rescheduled Debt)	61.1	58.3	155	147
Others	103.4	90.7	262	229
TOTAL	470.4	457.2	1190	1156

1/ Dollar conversion at £E 1 = $2.53 (average for 1973)

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EXTERNAL DEBT, DEC. 31, 1973

5.4

In £E millions ($ millions in parentheses)

	Convert.	Non-Convert.	Total
Medium and Long-Term			
Gov't loans (western, not rescheduled)	75.3 (193)		
Rescheduled loans	153.4 (393)		
Eastern Block loans		322.2 (825)	
Arab loans (gov't)	108.7 (278)		
IBRD	10.5 (27)		
Western suppliers' credits	133.9 (343)		
Arab suppliers'credits	7.7 (20)		
Eastern suppliers' credits		154.7 (396)	
Sub Totals	489.5 (1254)	476.9 (1221)	966.4 (2474)
Bilateral Agreements, Special Accounts, Deposits, & IMF			
Bilateral agreements & Special Accts.		227.4 (582)	
Deposits (Arab)	120.2 (308)		
IMF	59.1 (151)		
Compensation Agreements	4.8 (12)		
Short-Term (banks)	194.4 (498)		

SUMMARY
(in $ millions)

	Convert.	Non-Convert.	Total
Medium and Long Term Loans	$ 1,254	1,221	2,474
Bilateral Agreements	-	582	582
Arab deposits & IMF	459	-	459
short term(banks)	498	-	498
TOTAL 1/	$ 2,211	1,803	4,014

1/ Does not include $ 12 million compensation agreements.

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Bilateral and Special Accounts 1/

	(£E millions)
31/12/71	191.8
30/ 6/72	143.7
31/12/72	165.8
30/ 6/73	199.6
31/12/73	227.4

1/ Net outstanding debits (within swing limits) on accounts where Egypt is net debtor; does not include few accounts for which Egypt is net creditor.

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Banking Facilities

	(£E millions)	(US$ millions)
31/12/71	96.1	221
30/ 6/72	98.9	227
31/12/72	135.5	312
30/ 6/73	101.0	259
31/12/73	194.4	498

PLAN - BUDGET, INVESTMENTS, PROJECTIONS

1973-1982 Plan

Projected Growth Rates of Output by Sector

(%)

	1973	1974	1975	1976	1977	72-77	77-82	72-82
Agriculture	2.8	3.4	3.6	3.7	4.1	18.9	22.0	45.1
Industry & Oil	5.6	7.4	8.5	9.2	9.9	47.7	66.5	145.9
Industry	6.0	5.9	6.5	7.3	8.7	39.5	60.0	123.2
Oil	0.7	28.3	32.2	27.4	19.0	159.1	114.4	455.3
Construction	13.2	8.5	3.1	10.2	13.1	48.8	48.9	135.0
Electricity/Power	5.5	4.6	29.2	15.4	6.7	75.4	57.5	176.3
Total Commodity Sectors	4.8	5.5	6.4	6.9	7.4	34.4	45.2	96.0
Transp./Commun.	5.3	6.9	29.3	44.5	4.8	120.3	44.4	218.0
Trade & Finance	4.8	7.0	6.7	7.4	7.4	37.9	45.7	100.9
Total Distribution Sectors	5.0	6.9	15.6	23.7	6.0	70.2	45.0	146.8
Housing	1.4	1.5	1.7	2.4	3.1	10.6	29.2	42.9
Public Utilities	4.9	5.4	6.6	7.6	8.3	37.4	53.8	111.4
Social Development Services	6.3	6.2	6.1	5.9	5.8	34.2	41.5	89.9
Total Services Services	5.5	5.6	5.5	5.5	5.5	30.8	40.2	83.3
Grand Total	5.0	5.7	7.5	9.2	6.6	38.6	43.8	99.8

Source: 1973-1982 Plan.

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1973-1982 PLAN

Projection of GDP at Factor Cost

(constant 1972 prices)

Sector	Base Year 1972	1973	1974	1975	1976	1977	1982
Agriculture	768.5	790.0	817.0	846.6	877.6	913.8	1,115.0
Industry & Oil	622.2	657.0	705.4	765.7	836.2	918.8	1,530.0
Industry	579.7	614.2	650.5	693.1	743.7	808.7	1,294.0
Oil & Prod.	42.5	42.8	54.9	72.6	92.5	110.1	236.0
Construction	114.0	129.0	140.0	144.4	159.1	180.0	265.0
Electricity/Power	45.0	48.1	50.3	65.0	75.0	80.0	126.0
Total Commodity Sectors	1,550.0	1,624.1	1,712.7	1,821.7	1,947.0	2,092.6	3,039.0
Transport & Commun.	163.5	172.1	183.9	237.8	343.7	360.2	520.0
Trade & Finance	253.8	266.0	284.5	303.5	326.0	350.0	510.0
Total Distribution Sectors	417.3	438.1	468.4	541.3	669.7	710.2	1,030.0
Housing	122.5	124.2	126.1	128.3	131.4	135.5	175.0
Pub. Utilities	12.3	12.9	13.6	14.5	15.6	16.9	26.0
Social Development Services	700.4	744.2	790.7	838.7	888.4	939.8	1,330.0
Total Services Sectors	835.0	881.3	930.4	981.5	1,035.4	1,092.2	1,531.0
Grand Total	2,802.8	2,943.5	3,111.5	3,344.5	3,344.5	3,895.0	5,600.0

Source: 1973-1982 Plan.

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Production of Major Export and Import

Crops in 1971/1973 and Expectations for 1974 and 1977

(in 1,000 m. tons)

Crops	1971	1972	1973	1974	1977
Cotton (lint)	510	514	495	513	610
Rice (paddy)	2534	2507	2274	2599	2938
Winter onions	283	276	230	272	340
Peanuts	33	30	26	36	38
Potatoes	451	595	778	800	900
Vegetables*	4719	4758	4776		
Citrus fruits	883	825	923	950	970
Wheat	1729	1616	1837	2147	2220
Corn	2342	2417	2507	2705	3024

* excluding potatoes

DISTRIBUTION OF INVESTMENTS BY SECTORS 1974

(Amount in L E.000)

Sectors	Administration	Authorities	Organizations	Funds	Total 1975	Total 1974
I. Agriculture & Irrigation	5470	25555	54856	13	60124	81894
2. INDUSTRY, Petroleum & Minning	80	I3284	I93080	—	137537	206444
3. Electricity	—	6000	I2000	6—	22650	I8000
4. Transportation & Communication	9I6	47850	61935	—	90I63	II9701
5. Supply & Internal Trade	27	23	3I4I	—	3300	3I9I
6. Finance, Economy & Foreign Trade	467	90	4007	—	2393	4564
7. Housing & Construction	II200	I5006	5800	—	38450	32006
8. Health & Social Services	4480	556	I430	—	7365	6466
9. Education, Research & Youth	II900	2I08	—	—	27540	I4008
I0. Culture & Puplicity	I27	I873	—	—	2000	2000
II. Tourism	50	—	I950	—	I800	2000
I2. Defence, National Security & Justice	9262	531	—	434	2000	I0227
I3. Sovereignty Services	959	—	—	—	46I	959
I4. INSURANCE	425	II5	68	—	235	608
I5. Local Governments (Autonomous Finance)	4377	—	—	—	6I85	4377
S. T O T A L	49740	II399I	338267	447	396323	502445
• Alexandrec, Transport Org.	—	—	—	—	2000	I000
Services Industrial Councils	—	—	—	—	3200	3000
Not distribuited	—	—	—	—	30977	I3555
T O T A L	49740	II399I	338267	447	432500	520000

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TOTAL ESTIMATES OF 1974 BUDGET

Resources. ~~REVENUES~~	1973	1974	changes	USES	1973	1974	changes
T.1: Soverignty Revenues	617.1	730.3	+113.4	T.1: Wages	541.2	597.5	+ 56.3
T.2: Current Revenues & Transfers	1696.6	2430.8	+734.2	T.2: Current Expenditures & Transfers	1772.4	2563.8	+791.4
T.3: Different Capital Revenues	280.2	638.1	+ 57.9	T.3: Investment Expenditures	432.5	520.0	+ 87.5
T.4: Loans & Credit Facilities	339.3	387.8	+ 48.5	T.4: Capital Transfers	487.1	505.9	+ 18.8
Total	3233.2	4187.2	+954.0	TOTAL	3233.2	4187.2	+954.0

STRICTLY CONFIDENTIAL

SUMMARY

FOREIGN EXCHANGE BUDGET 1973

	(£E Millions)		
	Free Currencies	Bilateral	Total
Total Resources	373.3	265.7	639.0
Total Expenditures	1,097.0	394.1	1,491.1
Deficit	-723.7	-128.4	-852.1
Total Capital Inflow (incl. short-term)	826.1	128.4	954.5
Surplus (change in reserves)	102.4	-	102.4
Original Budget Estimates as of Beginning of Year			
Total Resources	292.0	261.2	553.2
Total Expenses	905.6	481.5	1,387.1

EGYPT: NORMATIVE PROJECTIONS OF BALANCE OF PAYMENTS, 1974-78
(£E millions)

Exports	1973 Base	1974	1975	1976	1977	1978	Assumptions
Agricultural exports	224	230	238	245	253	261	Approximate Plan growth from 1973
(of which Cotton)	(171)	(175)	(181)	(185)	(191)	(195)	Cotton prices from Bank Guidelines; assume decline in rice prices just offset by rise in other agricultural export prices.
		[300]	[276]	[272]	[269]	[268]	
		[355]	[333]	[332]	[331]	[334]	
Industrial exports (not including oil)	132	138	154	175	192	209	"Catching up" to Plan targets by 1977 prices inflated by general index (Guidelines)
		[149]	[178]	[212]	[245]	[281]	
Petroleum exports	15	16	26	31	37	43	Guideline prices - (includes Egypt's share only).
		[51]	[83]	[106]	[135]	[168]	
A. Total Commodity Exports	371	384	418	451	482	513	
		[555]	[594]	[650]	[710]	[783]	
Tourism	35	40	50	60	70	85	Arbitrary volume - reach 1966 volume in 1976. Prices increasing 5% annually.
		[42]	[55]	[70]	[85]	[109]	
Other invisibles	47	49	51	53	130	140	Arbitrary volume - Sumed volume fixed, no price adjustment; 6% price annually other invisibles. Sumed as net revenues not included on payments side.
(of which Sumed)	(-)	(-)	(-)	(-)	(75)	(80)	
		[52]	[57]	[63]	[144]	[160]	
Suez/Khartoum Transfers	119	120	120	120	120	120	
Workers Remittances and other transfers	67	100	125	150	175	200	Arbitrary volume; prices at index of international prices.
		[108]	[144]	[182]	[224]	[269]	
B. Total Invisibles and Transfers	268	309	346	383	425	545	
		[322]	[376]	[435]	[573]	[658]	
C. Total Current Receipts (A and B)	639	693	764	834	977	1058	
		[871]	[970]	[1085]	[1283]	[1441]	
Imports							
Consumption and intermediate goods	865	983	1032	1084	1138	1195	Volume growth above Plan at 5% annually: 1974 from Foreign Exchange Budget, import substitution in petroleum products, especially prices-inflated by international index.
		[983]	[1100]	[1212]	[1338]	[1476]	
Investment goods 1/	91	189	184	212	237	275	Volume growth for 74-78 as in Plan for 73-77 (i.e. one year lag) - price rise as above. 1/
		[205]	[205]	[257]	[303]	[370]	
D. Total Commodity Imports	956	1172	1216	1296	1375	1470	
		[1188]	[1305]	[1469]	[1641]	[1846]	
E. Invisible Payments (not inclu. debt service)	78	80	84	88	95	98	
		[84]	[92]	[102]	[116]	[125]	
F. Total Current Expenditures (D and E)	1034	1252	1300	1384	1470	1868	
		[1272]	[1397]	[1571]	[1577]	[1971]	
Current Account Deficit — 1973 Prices	395	559	536	550	493	510	
Current Prices	[395]	[395]	[427]	[486]	[474]	[530]	
$ Current Prices	$1011	$1011	$1093	$1244	$1213	$1357	

1/ 1974 investment based on 40% of £E 520 million forecast of total investment; presumed to include perhaps £E 40 million for Sumed; £E 38 million for Suez clearing; another £E 36 million for renovation; new projects but not major Suez Canal zone reconstruction: 1975 takes £E 160 million as new base, including Sumed but not Suez. Up 15% volume, 7% prices; 1976 15% volume, 5% prices; 1977 no Sumed, volume up 12%, prices 5.3%; 1978 volume up 16%, prices 5.2%.

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Annex P

OFFICE MEMORANDUM

TO: Mr. Wapenhans, Acting Vice President, EMENA DATE: February 21, 1974

FROM: A. Karaosmanoglu, Chief Economist, EMENA AK

CONFIDENTIAL

SUBJECT: EGYPT - A Program for the Bank

1. I proposed a two stage program to bring Egypt into a credit-worthy position in my memorandum to Mr. Benjenk, dated February 19, 1974. I now had a little more time to put together a few more facts and observations which may be useful in the consideration of the proposal. I should emphasize, however, that these are still tentative suggestions which could be developed with more rigorous analysis.

2. The following may be an appropriate check-list of questions to be answered:

- Urgency of the situation;
- Possible size of an imports program;
- Benefits that could be obtained from a grace on the amortization of the external debt (moratorium);
- Actions required by Egypt;
- Possible variations of the proposal.

Urgency of the Situation

3. Egyptian administrators now consider the economic prospects for Egypt much more optimistically than they have in several years in the past. The assumptions in their Government budget about the growth in 1974, which I referred to in my memo mentioned above (6.6% in current prices, 5.9% in constant terms) is a good indication of the present mood. They also seem to be overly optimistic about the possibilities of shifting resources from military to civilian use. They, in fact, may hope to muddle through with improved opportunities for additional assistance from Arabs and the West. But, in the last few years, the maturities of the external debt have shortened and terms hardened so much that unless special measures are taken, mammoth annual operations of bilateral debt rollovers will keep economic policy makers too busy to take full advantage of new development possibilities for Egypt. The following simple table may give an indication of the nature of the external debt squeeze.

	£E.million		US$	
	Actuals 1973	Budget 1974	Actuals 1973	Budget 1974
Foreign Exchange Revenues	639.0	839.0	1,616.7	2,147.8
External Debt Repayments	457.2	544.5	1,156.7	1,396.5
Debt Service Ratio (%)	71.5	64.9	71.5	64.9
Deficit to be covered (including grants other than Khartoum Agreement)	944.5	1,061.5	2,389.6	2,717.4

4. The Government program for 1974 assumes that 1/3 of the unutilized capacity in industry will be utilized. A fuller utilization of capacity would require a larger import program and would increase the deficit. On the average the effect on Egypt of the recent price increases is moderate. Their wheat import bill is expected to increase in 1974 by US$140 million over 1973. But the expected increase in their raw cotton exports alone is about US$430 million. Increased oil prices do not affect Egypt adversly either. In fact in two or three years time, expected production increases and the return of Sinai oil fields may change the situation very favorably. The important question is how can one shift Egyptian economic policy and expectations from day to day uncertainties and considerations to economic development in circumstances of peace. The immediate development potential that needs to be put in use in Egypt now relates to creating the atmosphere and conditions for direct foreign investments (basically Arab but including others), quickly adding to hotel capacities to fully benefit from increased tourism demand which is not being fully met, and increasing the production of some raw materials which command high prices in the world markets (phosphates and petroleum). To fully utilize these possibilities, in addition to a reorientation of policies, the economy needs to be rescued from the pressure of shortages emanating from the balance of payments difficulties.

Possible Size of the Import Program

5. It is possible to try to identify the size of the import program from the deficit in the balance of payments or from the imports side of the foreign exchange budget. According to the foreign exchange budget, in 1974, even if Egypt can successfully get (in addition to Khartoum payments) a total of about US$530 million grants from the other Arabs and about an equivalent of US$350 million from bilateral sources (as they have budgeted), they will have to find finance in convertible currencies amounting to US$1,665 million, which include:

	US$ million
1. Banking Facilities	512.0
2. Suppliers credits for:	
a) consumption and intermediate goods	153.6
b) wheat facilities	204.8
c) investment goods	476.2
3. Uncovered Deficit	319.0

6. The import program calculated from the balance of payments deficit may vary from a level of about US$300 million up to about US$680 million excluding the Banking facilities. The budgeted volume of imports from the convertible currency area (consumer goods US$887 million and intermediate goods US$860 million) suggest the easy possibility of formulating rather large import programs, should the financing become available. Needless to say these magnitudes are based on Egyptian figures and projections and are used here to give the rough orders of magnitude. They will need to be scrutinized later by our analysis.

Benefits that could be obtained from a grace on the amortization of the external debt (moratorium)

7. Our Program Division with the help of the DPS has been working on various alternatives for a debt rescheduling exercise on the basis of the external debt data that had been supplied to the Bank within the normal reporting framework. It is at this point too early to draw serious conclusions from the work carried out so far. Undisputable facts are that:

- the short and long term debts in convertible currencies constitute a major portion of the total civilian obligations (55%, US$2,211 million out of a total US$4,014 million);

- the maturities of the Egyptian debt are very short. 61.2% of total convertible currency debts are due for repayment in 1974 (42.2%), and 1975 (19.0%), (US$933 million and US$421.4 million respectively).

At this point, without more detailed information both from Egypt and the creditors, it is difficult to estimate accurately how much relief could be obtained from a grace on amortization. Much will depend on the degree of insurance coverage at the creditor end and the structure of the short term debt. As long as the political uncertainties in the Region continue, it may be difficult to convince the creditors to agree to long-term rescheduling operations. But a two year initial grace to work out the details of the terms and conditions of rescheduling would be extremely useful.

Actions required by Egypt

8. I had suggested in my earlier memo that Egypt should:

a) improve economic and social data and make them available;

b) prepare a new development plan which puts the reconstruction and other development needs and potentials into a consistent financial and policy framework; and

c) prepare and implement policies improving the efficiency of the public sector.

I think three more conditions need to be added to this list and these are:

1. to undertake parallel negotiations with the Eastern European countries for a similar relief operation;

2. to produce a transitional program for stage one including immediately needed policy changes on prices, foreign trade policies, institutional changes, etc.

3. to change the practice of treating civilian expenditures as residuals and to identify certain amounts to be spent for civilian purposes (current and investment) to be financed by domestic savings.

Possible Variations of the Program

9. My starting point is that there is a policy decision to increase operations in Egypt which will require the use of some IBRD money. Using IBRD money immediately raises the question of creditworthiness, for which in the short term analysis (we were able to make during my mission to Egypt) there is no comforting answer. A longer term projection, Mr. Armstrong undertook to prepare in Egypt if he is supplied necessary data, may give a more optimistic picture. One possible approach may be to use IDA funds (if and to the extent they are available), and a portion of the funds which may be obtained from the oil producing countries in the first stage. The use of IBRD money at this stage may be limited to financing of enclave projects such as the Suez Canal. One has to be careful, however, in defining the amounts of projects that could be financed through enclave arrangements in order not to create a situation parallel to the Eastern European Debts.

10. One possibility to consider is the likely attraction for the creditors of financing the reconstruction and development of the Suez Canal zone. If there is enough interest to do it on grant terms or very easy terms, one could think of tying the Suez Canal operation to a balanced development of other projects in Egypt to ensure a coordinated approach to the problems of development and reconstruction and also to avoid an excessive burden of debt service. The possible leverage that can be obtained through the offer of development of the Suez Canal zone can thus be used to indirectly influence the formulation of a consistent development and reconstruction plan for project preparation, i.e. help in persuading Egypt to undertake the required action discussed above.

cc: Messrs. B. Knapp
M. Benjenk
G. Votaw
A. Davar
R. Armstrong

Annex P

OFFICE MEMORANDUM

- CONFIDENTIAL -

TO: Mr. Attila Karaosmanoglu, Chief Economist, EMENA/VP DATE: February 21, 1974
HROUGH: Mr. Wouter Tims, Director, EPD
FROM: Albert C. Cizauskas, EPDIE ACC

SUBJECT: Egyptian Debt

1. You asked me to set down those steps which I believe would be necessary or at least desirable to initiate international action possibly leading to a multilateral debt rescheduling for Egypt.

2. First of all, I believe it would be necessary for Egypt to take the initiative in seeking, either directly or through the good offices of another party (perhaps the Bank), a meeting of all her creditors, both East and West, to consider the possibility of debt relief within a multilateral context. It would be important for Egypt to stress, among other things, her desire to honor in full all her obligations without default, but that to do so on present schedules and with envisaged available resources would depress investment and consumption to unacceptable levels for some time to come. Egypt might also point out that prospective changes in her position would favor more rapid economic growth and repayment of past obligations provided the burden of existing indebtedness, assumed under very different circumstances, were alleviated. This is substantially the message conveyed by both Ghana and Indonesia to their creditors in 1966. The U.K., at Ghana's request, convened Ghana's Western creditors; mainly at the initiative of the U.S., initially the Japanese and then the French chaired a Western creditors' group (the so-called "Paris Club") to which the USSR was invited but declined. Egypt should be prepared to submit at such a meeting as fully documented and detailed a report as possible on all its external debts.

3. The creditors could then be asked for a period of grace on the amortization of the external debt (it might be more prudent not to speak in terms of a "moratorium") during which a balance-of-payments assessment would be made of Egypt's present and prospective capabilities of discharging its debt obligations while maintaining a reasonable rate of growth. To this end, the report would recommend such debt relief as would be compatible with the results of the assessment. The period for the preparation of the study should be reasonably brief, perhaps 6 months. The study would also examine the structure of Egypt's debt, including such important matters as which debts are private and which are public, which have been rescheduled and which not, and which debts if any might be exempted from rescheduling. In multilateral debt reschedulings, only public debt-- official loans and private credits insured by creditor governments-- has been rescheduled, while private debt uninsured by creditor governments has been generally excluded. In the Indonesian rescheduling of 1970, about $2.1 billion of public debt (as defined above) of more than 180 days' maturity contracted prior to July 1, 1966 (the so-called "Sukarno" debt) was rescheduled. This represented the bulk of the entire external debt up to that date. If I recall correctly, private debt uninsured

by the creditors amounted to about $100 million for which Indonesia undertook separate arrangements (although some creditors insisted successfully on the inclusion of part of the unguaranteed private debt in the rescheduling arrangements). The rescheduling, by the way, included debt service payments previously rescheduled, thus setting a precedent.

4. In the cases of Ghana and Indonesia, an interim period of roughly six months ensued after the first meeting of creditors during which debt data were assembled and ideas of how to treat the debt were considered. Contractual interest was charged during this period but capitalized for later payment. In Egypt's case, this too might be done, or, if not too great a burden, such interest might be paid as due as an indication of Egypt's good intentions.

5. Successive annual reschedulings were arranged for Indonesia in 1967, 1968 and 1969 which provided total balance-of-payments relief on the "Sukarno" debt, as fully 100 percent of the principal and contractual interest due in these years were rescheduled and "moratorium" interest capitalized for later payment. It was not until 1970 that the "Sukarno" debt was rescheduled on the terms mentioned above.

6. In the Indonesian case, a study of the longer-term debt outlook leading to the 1970 agreement was assigned to a German banker-- Dr. Abs-- whose international repute and objectivity enabled him to make far-reaching proposals which, with some changes, were accepted. I would think a case for Egyptian rescheduling might also best be made by an individual of international stature. He would be under obligation neither to Egypt nor to the creditors and so his recommendations would carry weight. He could be assisted by a staff of "experts" from the Bank and Fund, as in the Indonesian rescheduling.

7. The emphasis of any such study would be the restoration-- and maintenance-- of Egyptian creditworthiness. This was the all-pervasive theme of the Abs' report on Indonesia. Payment and/or capitalization of contractual interest on all existing debt during the interim period of a debt assessment, the setting of some cut-off point (perhaps the October, 1973 war) after which new credits would be serviced on schedule, and Egypt's declaration that it would not renege on any existing debts, could be important elements in such a restoration.

8. I think it would also be essential for Egypt to indicate-- without becoming specific-- that it wished to treat all creditors on an equal and non-discriminatory basis. It would be up to the debt assessment to spell out how and for which categories of debt this would be attempted.

9. Other suggestions were advanced in my memo of February 8th to Bob Armstrong, a copy of which was sent to you.

10. With regard to the status of the U.S.-Egyptian debt bilateral, I have asked my contacts in State for information which they said would be forthcoming.

cc: Messrs. Votaw, Director, EMENA-CPI
Saxe, Chief, EPDIE
Davar, Chief, EMENA-1A

ACC/mas