

U.S. ECONOMIC ASSISTANCE TO EGYPT: DOES IT ADVANCE REFORM?

HEARING BEFORE THE COMMITTEE ON INTERNATIONAL RELATIONS HOUSE OF REPRESENTATIVES ONE HUNDRED EIGHTH CONGRESS

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THURSDAY, JUNE 17, 2004

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The Committee met, pursuant to call, at 10:53 a.m. in room 2172, Rayburn House Office Building, Hon. Henry J. Hyde [Chairman of the Committee] presiding.

Chairman HYDE. We will now commence with the Committee hearing. The Egyptian economy has often under-performed its peers, despite important natural advantages and massive assistance from the United States and other donors.

Despite that massive assistance, or perhaps because of it, Egypt's economy and political system have largely resisted reform.

This might be a matter of indifference in other parts of the world, but Egypt's longstanding relationship with the United States, its leadership position in the Arab world, its critical location, and its path-breaking peace with Israel, make its development a matter of great concern to Americans.

Which is why we have a massive assistance program to begin with. There are poorer people than the Egyptians, people who are objectively more deserving of our aid if poverty alone were the criterion. It is because of our interest in Egypt's success that we are holding this hearing.

Our assistance is meant to be transforming and not palliative. Yet, Egypt, our second largest aid recipient, negotiates with us about the terms under which it will accept our assistance, and drives a hard bargain.

In the end, it would be fair to say that a combination of geostrategic circumstances and the greater resistance to change in Egypt has made our cash assistance programs, including the Commodity Import Program, of questionable utility in driving reforms. There are no serious reform-involved conditions accompanying \$200 million in yearly CIP (Commodity Import Program) funds, and the record on the \$200 million yearly straight-cash transfer is questionable.

Each year, in exchange for the cash transfer, Egypt is supposed to undertake additional economic reforms. Yet, Administration after Administration has assented to conditionality packages that are remarkably similar to one another.

For example, in the cash that was transferred last week in the supplemental aid package, improved economic statistics were cited as a "quid pro quo." But it turns out that in 1998, we provided cash

to Egypt in return for its agreement to provide the very same statistics.

It is also true that we have provided cash for financial sector reform. Financial sector reform has been identified by the Administration as the most important reform going forward.

It seems to be so important to privatize the state-owned banks in Egypt that we should probably, if necessary, pay yet again to support the same intended result. USAID's consultants have demonstrated the critical role that distorted lending practices play in retarding Egypt's economic reform.

Regrettably, Egypt's financial sector is pursuing coping strategies, which will put the Egyptian economy further and further behind. I congratulate our Administration on its proposal to rework the Egypt assistance program. It ought to be in place in full, and I expect that it will be.

It is critical also that economic progress be matched by a true political opening. We should be of greater assistance in helping Egyptians find their own path forward. The Administration's Egypt program re-work addresses this as well, and it, too, should be put in place with dispatch.

The Commodity Import Program seems to be, for all practical purposes, a second cash grant program that has had almost no scrutiny and has never been specifically authorized, at least in the case of Egypt.

I appreciate the work of the General Accounting Office presented today in preliminary form, and that will help us understand the program, its limitations, and its role, if any, in advancing Egypt's economic transformation.

We will be privileged to hear from two experienced diplomats turned scholars, who can help us understand how we might have an impact through our assistance programs, and perhaps otherwise, on the course of Egypt's economic and political reform.

We will then hear a preliminary view of the General Accounting Office study of the CIP program.

[The prepared statement of Chairman Hyde follows:]

PREPARED STATEMENT OF THE HONORABLE HENRY J. HYDE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS, AND CHAIRMAN, COMMITTEE ON INTERNATIONAL RELATIONS

The Committee will come to order.

The Egyptian economy has often underperformed its peers, despite important natural advantages and massive assistance from the United States and other donors. And despite that massive assistance—or perhaps because of it—Egypt's economy and political system have largely resisted reform.

This might be a matter of indifference in other parts of the world, but Egypt's long-standing relationship with the United States, its leadership position in the Arab world, its critical location, and its path-breaking peace with Israel make its development a matter of great concern to Americans.

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Our assistance is meant to be transforming, not palliative. Yet Egypt, our second-largest aid recipient, negotiates with us about the terms under which it will accept our assistance, and it drives a hard bargain.

In the end, it would be fair to say that a combination of geo-strategic circumstances and the great resistance to change in Egypt have made our cash assistance programs, including the Commodity Import Program, or CIP (a semi-cash as-

sistance program), of questionable utility in driving reforms. There are no serious, reform-involved conditions accompanying \$200 million in yearly CIP, and the record on the \$200 million yearly straight-cash transfer is questionable.

Each year, in exchange for the cash transfer, Egypt is supposed to undertake additional economic reforms.

Yet administration after administration has assented to conditionality packages that are remarkably similar to one another. For example, in the cash that was transferred last week in the Supplemental aid package, improved economic statistics were cited as a "quid pro quo." But it turns out that in 1998, we provided cash to Egypt in return for its agreement to provide the very same statistics.

It is also true that we have provided cash for financial sector reform. Financial sector reform has been identified by the Administration as the most important reform, going forward.

It seems to be so important to privatize the state-owned banks in Egypt that we should probably, if necessary, pay yet again to support the same intended result.

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Today, we will be privileged to hear from two experienced diplomats-turned-scholars who can help us understand how we might have an impact, though our assistance programs and perhaps otherwise, on the course of Egypt's economic and political reform. We will then hear a preliminary view of the General Accounting Office's study of the CIP program.

Let me now recognize the distinguished Ranking Democratic Member, Mr. Lantos, for any comments he may have at this time, after which I will introduce the panel members individually.

Chairman HYDE. Let me now recognize the distinguished Ranking Democratic Member, Mr. Lantos, for any comments that he may have at this time, after which I will introduce the panel members individually. Mr. Lantos.

Mr. LANTOS. Thank you very much, Mr. Chairman, and let me first extend my apologies for having to be on the Floor shortly to engage in a debate on the rule. Mr. Chairman, I want to thank you for convening this important hearing and for your usual thoughtful opening statement.

The United States Congress has appropriated nearly \$60 billion in aid for Egypt since Cairo signed its peace treaty with Israel in 1979. Some \$26 billion of this was economic aid, which is the focus of this hearing.

This assistance program has achieved some important successes over the years, such as helping Egypt to reduce its once soaring birth rate, but Egypt remains a broken society where illiteracy and poverty abound.

On the issues that we must care about today, economic reform and political reform, our assistance program has been largely unsuccessful. The primary reason for this is that the Egyptian regime resists reforms so passionately desired by many of its citizens.

That is why I have joined with you, Mr. Chairman, in writing to President Mubarak to insist that Egypt live up to its obligation to

undertake economic reform before we release any more aid on a cash transfer basis.

Not too many years ago, the late Egyptian diplomat, Tassem Bashier, warned of what he called the mummification of Egypt under the current regime. He was referring to a system so static, so intimidated by the prospect of change and loss of control, that it opposes all reform and change that could bring real prosperity and freedom to the Egyptian people.

It is beyond dispute that our overall aid program is now twisted in a manner that reinforces mummification, and that actually undermines our reformist priorities in Egypt. Since 1999, Mr. Chairman, we have been decreasing our economic assistance to Egypt by \$40 million annually, while religiously adhering to an annual standard of \$1.3 billion in military grant funds.

Our annual military aid to Egypt is now more than twice that of our economic assistance. This is not only a misallocation of priorities, it is a theater of the absurd. Egypt inhabits an enviable strategic environment in which it is at peace with all of its neighbors.

Moreover, that strategic environment has further improved in recent months with Libya's decision to give up its weapons of mass destruction. Exactly where is the threat that justifies Egypt's need for top-of-the-line military technology and warrants such a large annual contribution from our constituents?

The answer is that there is no such threat. Yet, Egypt pursues a vigorous military buildup and very strongly stages military exercises that focus on war with Israel, a neighbor that sees peace with Egypt as the cornerstone of its security.

We have an enormous stake in Egypt's success, Mr. Chairman. We serve Egypt's interests and our own by increasing and improving our support for educational, economic, and political development that effectively contribute to Egypt's stability.

We do the Egyptian people no favor when we sate the appetite of Egyptian generals at the expense of assistance that would promote prosperity and freedom. We can promote both United States and Egyptian interests, first of all, by correcting our mistaken approach to Egyptian foreign aid.

I intend to do exactly that, Mr. Chairman. I intend to support the Egyptian people by introducing legislation that will phase out our military assistance for Egypt over the next 3 years, transforming the \$1.3 billion in annual gifts to the Egyptian military into assistance for promoting economic and political reform, and improving the quality of life of the Egyptian people.

Mr. Chairman, I look forward to hearing our witnesses' recommendations as to how to improve our economic assistance program, but I have concluded that if we are serious about bringing Egypt into the modern world economically, educationally, and politically, Congress must take the first step. We must show leadership by overhauling foreign aid priorities that are now a quarter-century old, utterly obsolete, and counterproductive. Mr. Chairman, we need a more robust assistance program for Egyptian reform, and a better funded one.

And we can accomplish that simply by recasting our priorities. When we authorize and appropriate funds when we sign the checks, we make a political statement. For too long our statement

to the Egyptian people has been that we care far more about your generals than about your teachers.

I intend to lead an effort to reverse that formulation, and reverse it for both Egypt's sake and our own. Thank you, Mr. Chairman.

Chairman HYDE. Thank you, Mr. Lantos, and without objection, any further opening statements will be inserted in the record at this point in the record.

Today, we are going to hear testimony from three distinguished witnesses. First, we welcome Ambassador Edward S. Walker, Jr., who is the President and Chief Executive Officer of the Middle East Institute.

He has had a distinguished career in government and education, and has served in both the Clinton and current Bush Administrations as Assistant Secretary for Near East Affairs.

He has also served as United States Ambassador to three Middle Eastern countries, including Egypt, and at the United Nations as Deputy Permanent Representative. Ambassador Walker is also an accomplished speaker, known for his even-handed analysis of the Middle East. We welcome you once more, Ambassador.

And we next welcome Dr. Michele Dunne, a Visiting Scholar at the Democracy and Rule of Law Program, at The Carnegie Endowment for International Peace, and Assistant Professor at Georgetown University.

Dr. Dunne worked for the Department of State from 1986 to 2003 in assignments including Director for Near East Affairs on the National Security Staff, as a political officer at the United States Embassy in Cairo, and a member of the Secretary of State's policy and planning staff.

She holds a Ph.D. in Arabic language and linguistics from Georgetown University, and her book, *Democracy and Contemporary Egyptian Discourse*, was published in 2003.

And finally, we welcome Dr. David Gootnick, who has been a Director for International Affairs in Trade at the General Accounting Office since 2001. His current portfolio includes humanitarian aid, development assistance, economic assistance, and global health.

From 1994 to 2001, Dr. Gootnick served as the Director of the Office of Medical Services at the United States Peace Corps. We will ask you to begin, Ambassador Walker, with a summary of your statement, 5 minutes give or take. We won't be inflexible, but your written statement, as well as that of all the witnesses, will be made a part of the record, and we will start with you, Ambassador Walker.

**STATEMENT OF THE HONORABLE EDWARD S. WALKER, JR.,
PRESIDENT, THE MIDDLE EAST INSTITUTE**

Mr. WALKER. Thank you very much, Mr. Chairman, and Members of the Committee. I also want to thank you, Mr. Chairman, for your opening statement and that of Mr. Lantos. You have raised some extremely difficult questions that need to be addressed by this Committee and by the Administration.

I personally welcome the Committee's efforts to review our economic assistance program as administered by the Agency for International Development in Egypt, and to consider its objectives and effectiveness.

Overall, the United States has vested about \$25.5 billion in Egypt's economy. Since the year 2000, by agreement with Egypt, the program has been reduced by about \$40 million each year, so that in fiscal year 2003, funding was at \$615 million. It will level off at about \$475.5 million in the year 2009. The figures, however, do not tell the whole story, for our assistance program was already declining significantly over the years due to inflation.

If we wanted to maintain our program at the level of the 1979 outlay of about \$1.1 billion, by adjusting for inflation over the years, our outlay today would be, I am told, about \$4.5 billion.

The point here is that the impact of our aid dollars has been substantially reduced and our leverage to encourage economic, political, and social reforms equally reduced. I raise this because there is a danger of expecting too much of our aid program.

I also raise it because our resources have declined, and if influence and reform are objectives, then logic would indicate that the scope of our program should have contracted as well.

In short, we should have narrowed our focus so that our remaining programs would be larger and have greater impact. In fact, until the most recent USAID/Egypt program review called for by the House Committee on Appropriations, AID was continuing to cover seven strategic objectives relating to most major sectors of the Egyptian economy and society.

Since our program incorporates a strategic planning cycle, by the end of the 5 years in 2008, we would be stretching a program of \$415 million to cover the seven strategic objectives.

We need to have a better concept of what we are trying to do and what we can possibly do with the resources at hand. Frankly, I don't know what the U.S. objective is. Are we trying to alleviate poverty? Are we trying to build the middle class? Are we fostering upward mobility? When I look at the AID program, I see a Chinese menu: A little of this and a little of that. I don't see a focused program, and I surely don't see the priorities that could make a substantial difference.

Today, we continue to see our AID program in a broader policy context. No matter how much money the AID Director can conceivably have available in today's budget climate, he or she cannot change the pace or direction of reform except at the margins.

What set aside the period of the mid-1990s, when I was Ambassador in Egypt, and when reform by all accounts was in its heyday, was the commitment at the very top of the Administration to reform.

If we are serious about reform, and if we really mean it when we call for democracy and economic and social change, then we cannot leave the problem to our AID Directors or our Ambassadors, or our Assistant Secretaries.

It will take genuine commitment and persistence from the President of the United States and the Vice President, as well as from you gentlemen and ladies in the Congress.

There are two other aspects of the AID program in Egypt that deserve close scrutiny. The program, as it is structured, devotes 30 percent of its funds, or \$200 million, to the Development Support Program (DSP), which is a cash grant in return for meeting negotiated reform targets.

A second \$200 million is directed to the Commodity Import Program, and that leaves about \$200 million for all other programs combined. The DSP grants, although a good idea, have some inherent weaknesses.

One weakness was pointed out by the program review, that the reforms negotiated with the Egyptians covered a wide gamut of issues and thus lost focus. The review recommended focus on one or two key economic reform areas. A good idea.

The second proposal by the review suggests that if outcomes negotiated with Egypt for reforms are not met, then the funds should be reprogrammed to fund other USAID projects in Egypt.

And both of these programs have met resistance by the Government of Egypt, and that raises an important question as to whether or not Egypt is operating under a United States entitlement, or should the program be linked to U.S. interests and objectives.

If a cash transfer is earmarked and obligated as is currently the case and cannot be reprogrammed, then our Ambassador and AID Director have limited leverage in both program design and implementation. In short, whose money is it?

The AID review proposal to permit reprogramming such funds to other AID projects in Egypt would go part of the way to resolving this problem. But AID might also want to look at authority to reprogram such funds to other AID programs in the Middle East as well.

While I was in Egypt, I was a strong advocate of the commodity import. It is a seductive program in that it supports United States business sales to Egypt, establishes supplier relationships with United States companies, and then lets us use the money twice; once for Egyptian firms to buy the products, using low-cost, short-term loans from AID funds, and then again by the Government of Egypt once those loans are paid back.

It is a popular program in Egypt and in the United States. The program review suggests downsizing it to \$150 million by 2009, and that makes sense. However, AID needs to take a hard look at the program. Who does it benefit, and the controls over the Government of Egypt's use of the proceeds.

In this case the money already does belong to the Egyptian Government. One problem with this is that the United States objectives are no longer the guiding principle and allocation process.

In addition, the loans provided to Egyptian businessman tend to be driven more by sales of American products than by AID's reform agenda, not necessarily a bad thing, but not a recognized purpose of the AID program.

AID needs to take a hard look at how this program might be completely restructured and direct it more closely to AID's objectives.

In conclusion, I believe that the AID review has moved the program in the right direction, but that there is further work to do. And part of this work will have to be driven by Congress.

Our objective should be a tighter, more tailored program, which takes account of limited resources. It should not be considered an entitlement, nor should it be seen as a mechanism for enforcing reform.

Egypt has to take ownership of its own reform program, but we need to continue to stimulate that process. Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Walker follows:]

PREPARED STATEMENT OF THE HONORABLE EDWARD S. WALKER, JR., PRESIDENT,
THE MIDDLE EAST INSTITUTE

Mr. Chairman, Members of the Committee, Ladies and Gentlemen, I welcome the Committee's efforts to review our economic assistance program, as administered by the Agency for International Development (AID) in Egypt and to consider its objectives and effectiveness.

The AID program in Egypt reached its stride in 1979 with a massive infusion of US assistance based on the Camp David Agreement. For most of the period since 1979, until the year 2000, Congress allocated \$815 million to the Egyptian economic assistance program. In addition, supplementals in the early years of \$300 million a year, raised the annual figure to about \$1.1 billion. Overall, the United States has invested approximately \$25.5 billion in Egypt's economy. Since 2000, in agreement with Egypt, the program has been reduced by about \$40 million each year so that in FY 2003 funding was at \$615 million. It should level off at \$407.5 million by 2009. The figures, however, do not tell the whole story. For our assistance program was already declining significantly over the years due to inflation. If we wanted to maintain our program at the level of the 1979 outlay of \$1.1 billion, adjusting for inflation over the years, our outlay today would be around \$4.5 billion. Another way of looking at it is that the purchasing power of the current program in 1979 dollars is a little over \$150 million and that does not buy a whole lot. In terms of Egypt's non-recurring expenditures in 1979, that is excluding salaries and so forth, the AID infusion was equal to about two thirds of Egypt's discretionary budget at that time. Today the program hardly makes the chart.

The point here is that the impact of our AID dollars has been substantially reduced and our leverage to encourage economic, political and social reforms equally reduced. I raise this because there is a danger of expecting too much of our AID program. I also raise it because our financial resources have declined; so, if influence and reform are our objectives, then logic would indicate that the scope of our programs should have contracted as well—in short, we should have narrowed our focus so that our remaining programs would be larger and have greater impact. It might also dictate that we should have created a consortium of donors, who annually contribute about \$2.3 billion, to leverage common reform interests.

In fact, until the most recent USAID/Egypt program review called for by the House Committee on Appropriations, which called for greater focus of our program, AID was continuing to cover seven strategic objectives including: Trade and Investment; Competitiveness; Utility Services; Environment and Natural Resources; Health and Planned Families; Governance; and Education. Since our program incorporates a five-year strategic planning cycle, by the end of the five years in 2008, we would be stretching a program of \$415 million to cover the seven strategic objectives.

The review was a solid effort to change the nature of our program to meet the resources available. But it has some of the same problems of diffusion that previous programs suffered from. The recommendations of the program review call for a reduction in the number of strategic objectives to four areas including 1. Democracy and Governance, 2. Economic Reform, 3. Education, and 4. Health. They also call for emphasis within these programs on the number of individuals reached at the "grassroots level." These would be noble objectives if we were talking about a program of \$4.5 billion. But how much impact can a \$407.5 million program have when it is spread out over so many areas and is designed to focus on the "grassroots level"? With 23 million Egyptians living below the poverty line, even if the entire AID authorization was directed to the "grassroots" and alleviation of poverty, we would still only be spending a little over \$1.75 per impoverished Egyptian per year. But of course the bulk of the Egyptian program does not and will not go to the "grassroots."

We need to have a better concept of what we are trying to do and what we can possibly do with the resources at hand. Frankly, after reading the literature, I don't know what the US objective is. Are we trying to alleviate poverty? Are we trying to build the middle class? Are we fostering upward mobility? Are we trying to improve our image? Are we trying to create jobs, any jobs, or are we trying to create jobs that fulfill expectations? Is our objective 100% literacy and if so why, in a largely subsistence economy? When I look at the AID program, and even the Program

Review, I see a Chinese Menu—a little of this and a little of that. I don't see a focused program and I surely don't see priorities that could make a substantial difference. We should not forget, that what happens in Egypt with about 23% of the total Arab population in the region, has a profound effect on other Arab countries. If Egypt sincerely embraces reform, it becomes far easier for others to follow in its wake.

I was in a meeting two days ago with a number of Egyptians considering the reform process. Each of them, in one way or another, highlighted the failure of Egypt to build a large and vibrant middle class as the principal roadblock to economic and political reform. In fact, these Egyptians said that the gap between the wealthy and the poor was widening and the middle class was declining. I am not a development theoretician. And I know how many acolytes there are for literacy programs, grass-roots programs and small and micro-enterprise lending. When I was Ambassador in Egypt, I was a strong advocate of women's literacy and small and micro-enterprise programs as being important to the long term development of Egypt. But I think we have to ask the question if such programs have any realistic prospect of making a significant contribution to reforming the economy. We also have to ask if it would not make more sense to concentrate on those reforms that would have the greatest impact on economic growth and upward mobility in the society. In Egypt, because of legal, financial, bureaucratic and cultural limits, it is very difficult for micro-enterprises to break through into significant mid-level business enterprises. The development of medium-sized businesses might be a better focus for our programs.

The reform agenda, according to the AID submission to the Committee of May 18 notes that "The greatest threat to domestic stability results from popular frustration with recent economic performance and a persistent lack of economic opportunity." The AID report points out that over one third of the population lives below the poverty line—i.e. 23 million people. At the same time real unemployment is running at between 12 and 25 percent. The Egyptian economy has to generate from 750 to 800 thousand new jobs each year, far more than they have been generating in recent years.

As I indicated before, our AID is not significant enough alone to leverage the Egyptian government toward reform. There is a tendency to look at the \$25.5 billion expended and to suggest that the AID program has been a failure. That is not fair. Good people working for good objectives are running our program. And a lot has been accomplished. Without AID, we would probably long since have seen the emergence of a virulent hostile political environment which would work against our military and political interests.

But today, we need to see our AID program in a broader policy context. No matter how much money the AID director can conceivably have available in today's budget climate, he or she cannot change the pace or direction of reform except at the margins. And from my own experience, no matter how active a part our Ambassador plays politically, his or her contribution will be limited. What set aside the period of the mid-nineties, when I was Ambassador in Egypt, and when reform, by all accounts, was in its heyday in Egypt, was the commitment at the very top of the Administration to reform. Al Gore, through the Gore-Mubarak partnership, with its Presidents' Council of business leaders from both countries, made the difference. The current Administration has not put that kind of commitment into the reform program in Egypt and the results are predictable. If we are serious about reform and if we really mean it when we call for democracy and economic and social change, then we cannot leave the problem to our AID Directors or our Ambassadors or Assistant Secretaries. It will take genuine commitment and persistence from the President and the Vice President, as well as from the Congress.

There are two other aspects of the AID program in Egypt that deserve close scrutiny which the Program Review highlighted. The program as it is structured devotes about 30% of its funds, or \$200 million to the Development Support Program (DSP) which is a cash grant in return for meeting negotiated reform targets. A second \$200 million is directed to the Commodity Import Program. That leaves about \$200 million for all other programs combined. The DSP grants, although a good idea, have some inherent weaknesses. One such weakness was pointed out by the Program Review—that the reforms negotiated with the Egyptians covered a wide gamut of issues and thus lost focus. The Review recommended focus on "one or two key economic reform areas." A second proposal by the Review suggests that if outcomes, benchmarks and timelines negotiated with Egypt for reforms are not met in a reasonable time, then the funds should be reprogrammed to fund other USAID projects in Egypt.

Both of these proposals have met resistance by the Government of Egypt. And that raises an important question as to whether Egypt is operating under a US entitlement or the program is linked to US interests and objectives. If the cash transfer

is earmarked and obligated, as currently is the case, and cannot be reprogrammed regardless of agreement on a serious reform agenda or performance on implementation, then our Ambassador and AID Director have limited leverage in both program design and implementation. In short, whose money is it? I cannot speak for the current situation, but I can assure you that when I was Ambassador negotiating the DSP reform programs, I erred on the side of moderating our objectives to ensure that the Government would be able to carry out the required reform programs in a reasonable time frame. In effect, I pulled our punches. I did not want Congress to be forced into the position of facing a large pipeline of earmarked but unspent funds that could result in returning the funds to the US Treasury. I felt that the impact on our bilateral relations would be severe and this would damage the successful initiative undertaken by Vice President Gore. The AID Review proposal to permit reprogramming such funds to other AID projects in Egypt would go part of the way toward resolving this problem, but AID might also want to look at authority to reprogram such funds to other AID programs in the Middle East as well.

While I was in Egypt, I was a strong advocate of the Commodity Import Program. It is a seductive program in that it supports US business sales to Egypt, establishes supplier relationship with US companies, and then lets us use the money twice—once for Egyptian firms to buy the products using low cost short term loans from AID funds and then again by the Government of Egypt once those loans are paid back. It is a very popular program in Egypt and in the United States with its beneficiaries. The Program Review suggests downsizing it to \$150 million by 2009 and this makes sense. However, AID needs to take a hard look at the program, who it benefits, and the controls over the Government of Egypt's use of the proceeds. My recollection is that this is not a program that incorporates a great deal of conditionality. The Egyptian Government is relatively free to allocate the proceeds to various ministries and programs with loose AID oversight but little AID direction. In this case the money does already belong to the Egyptian Government. One problem with this is that US objectives are no longer the guiding principal in the allocation process. In addition, the loans provided to Egyptian businessmen tend to be driven more by sales of American products than by AID's reform agenda, not a bad thing, but not a recognized purpose of the AID program. AID needs to take a hard look at how this program might be restructured to sustain its popularity but direct it more closely to AID's objectives.

In conclusion, I believe that the AID Review has moved the program in the right direction but there is further work to do. And part of this work will have to be driven by Congress. Our objective should be a tighter more tailored program which takes account of limited resources. It should not be considered an entitlement, nor should it be seen as a mechanism for enforcing reform. Egypt has to take ownership of its own reform program, but we need to continue to stimulate that process. The AID program should only be seen as one element in a much broader effort at the highest levels of the US government to help alleviate a growing problem of discontent and potential instability in the region.

Chairman HYDE. Dr. Dunne.

**STATEMENT OF MICHELE DUNNE, PH.D., VISITING SCHOLAR,
THE CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE**

Ms. DUNNE. Mr. Chairman and Members of the Committee, thank you for inviting me to testify. Having worked on democracy assistance to Egypt during assignments in the Government and then observed them from outside the Government, I welcome the opportunity to present my thoughts to you.

With your permission, I will focus primarily on the impact of American assistance on the prospects for political reform versus economic reform. First, I believe that democracy assistance to Egypt can be effective only as part of a coherent policy strategy, including active engagement with the Egyptian Government on the structural changes in law and practice that political reform demands.

The U.S. Agency for International Development's programs have helped to build Egyptians' ability to participate in a democratic system, but not their opportunity to do so.

For example, several years of assistance to non-governmental organizations has strengthened Egyptian skills in running their organizations, but has not helped change restrictive laws that keep civil society groups from operating freely and practicing advocacy effectively.

Modest, bottom-up pressure of the sort that can be generated through democracy programs alone will not force an unwilling governing elite to share power, nor are the amounts of assistance under consideration enough to persuade them.

Second, the United States Government should raise the relevant issues in private discussions with the Egyptian Government at senior levels, and reinforce them with public statements on the need for reform in Egypt and throughout the region.

Recent steps by the Administration in this regard have been important factors in opening up political space in Egypt for discussion of reform. President Bush raised the issue of political reform with President Mubarak for the first time at their April 2004 summit in Crawford, in preparation for which President Mubarak hosted a meeting of Egyptian and Arab civil society activists, who issued a refreshingly frank and thorough statement of needed reforms.

Regarding public statements, despite the undeniable resistance among many Egyptians to the United States as the messenger of democracy and reform, nonetheless the public message has resonated among a broad spectrum of activists—Islamists, and leftists, as well as liberals—who have long advocated reform and are now coming forward with their own ideas.

In planning a coordinated strategy of policy engagement and assistance programs, it is important to be honest and clear about the current political situation in Egypt. The Egyptian Government has shown a willingness to modernize certain institutions, for example, the judiciary, and is now allowing discussion of liberalizing aspects of political life. It has not, however, shown any intention to democratize, by which I mean giving the Egyptian people the right and ability to change their Government.

All of the United States democracy assistance programs so far, and most under contemplation now, aim at modernization and liberalization, which can certainly improve people's lives in Egypt, but do not necessarily lead to democratic transformation.

I think it is important to keep in mind that that would be a further step that could eventually happen, perhaps when the governing elite decides that it can no longer resist strong internal pressure for change, or as a result of visionary leadership.

Although Egypt is not necessarily on the cusp of democratic transformation, it is important to keep political reform on the public and private bilateral agenda in the coming few years when Egypt is likely to face a leadership succession, as well as parliamentary elections.

While the United States cannot and should not try to force change in Egypt, it can use the significant influence that it possesses to help shape the environment in which Egyptians will make important decisions about their future.

The United States should be realistic about how much its assistance can achieve, but at the same time be determined to spend American funds only on programs that stand a real chance of aid-

ing political liberalization with a view toward eventual democratization.

I have some specific recommendations. First, the United States should concentrate in the policy dialogue, and in programs on issues that Egyptians themselves have identified as critical to political reform: Lifting emergency laws; revising laws on forming political parties and regulating non-governmental organizations; forming an independent electoral commission and monitoring bodies; and amending the Egyptian constitution to provide for direct election of the President, term limits, and redistribution of power from the executive to the legislative and judicial branches.

The United States should make major program commitments only in areas where the Egyptian Government has demonstrated the will to reform, for example, the judiciary, or in these other critical areas where the United States is prepared to work hard on persuading the Egyptian Government to open up.

I recommend we retain enough flexibility in the assistance program to be able to respond to opportunities or challenges that arise. As I mentioned, the political situation in Egypt, I think, is going to be changing over the next few years, and we should be able to respond to that.

So I recommend avoid committing all the funds to large, multi-year projects. The United States should carve out funds that can be disbursed by the U.S. Government directly to Egyptian or non-Egyptian organizations, with Egyptian Government agreement only to general program guidelines.

As I am sure that the Committee is aware, currently all of the funds and all of the programs must be approved by the Egyptian Government.

And the United States should seek alternative destinations for funds, as Ambassador Walker also mentioned, should the United States and Egyptian Governments be unable to agree on meaningful programs for democracy assistance.

Finally, it helps to recall that Egypt is for the Egyptians, and all of the important decisions ultimately belong to them. At the same time, the United States' influence in Egypt is not neutral, and should be used in the service of regional peace and internal reform, which I see as the two overarching issues that face Egypt and the Middle East today. Thank you for your attention, and I welcome any questions.

[The prepared statement of Ms. Dunne follows:]

PREPARED STATEMENT OF MICHELE DUNNE, PH.D., VISITING SCHOLAR, THE
CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

Mr. Chairman and Members of the Committee, thank you for inviting me to testify. Having worked on democracy assistance to Egypt during assignments at the U.S. Embassy in Cairo and National Security Council staff and then studied the issue from outside government, I welcome the opportunity to present my thoughts to you. With your permission, I will focus primarily on the impact of American assistance on the prospects for political (versus economic) reform.

First, democracy assistance to Egypt can be effective only as part of a coherent policy strategy including active engagement with the Egyptian government on the structural changes in law and practice that political reform demands. The U.S. Agency for International Development's programs have helped to build Egyptians' ability to participate in a democratic system, but not their opportunity to do so. For example, several years of assistance to non-governmental organizations has strengthened Egyptians' skills in running their organizations, but has not helped

change restrictive laws that keep civil society groups from operating freely and practicing advocacy effectively. Modest bottom-up pressure of the sort that can be generated through democracy programs alone will not force an unwilling governing elite to share power, nor are the amounts of assistance under consideration enough to persuade them.

Second, the U.S. government should raise the relevant issues in private discussions with the Egyptian government at senior levels and reinforce them with public statements on the need for reform in Egypt and throughout the region. Recent steps by the American administration in this regard have been important factors in opening up political space in Egypt for discussion of reform. President Bush raised the issue with President Mubarak for the first time at their April 2004 summit in Crawford, in preparation for which Mubarak hosted a meeting of Egyptian and Arab civil society activists who issued a refreshingly frank and thorough statement of needed reforms. Despite the undeniable resistance among many Egyptians to the United States as the messenger of democracy and reform, the public message has nonetheless resonated among a broad spectrum of activists—Islamists and leftists as well as liberals—who have long advocated reform and are now coming forward with their own ideas.

Third, in planning a coordinated strategy of policy engagement and assistance programs, it is important to be honest and clear about the current political situation in Egypt. The Egyptian government has shown a readiness to modernize certain institutions—for example, the judiciary—and is now allowing discussion of liberalizing aspects of political life. It has not, however, shown any intention to democratize, by which I mean giving the Egyptian people the right and ability to change their government. All of the U.S. democracy assistance programs so far, and most under contemplation, aim at modernization and liberalization, which can certainly improve people's lives but do not necessarily lead to democratic transformation. Such transformation could eventually happen when the governing elite decides that it can no longer resist strong internal pressure for change, or as a result of visionary leadership.

Fourth, although Egypt is not necessarily on the cusp of democratic transformation, it is important to keep political reform on the public and private bilateral agenda in the coming few years, when Egypt is likely to face a leadership succession as well as parliamentary elections. While the United States cannot and should not try to force change in Egypt, it can use the significant influence it possesses to help shape the environment in which Egyptians will make important decisions about their country's future.

Fifth, the United States should be realistic about how much its assistance can achieve, but at the same time be determined to spend U.S. funds only on programs that stand a real chance of aiding political liberalization with a view toward eventual democratization. Specific policy recommendations include:

- Concentrate in the policy dialogue and in programs on issues that Egyptians themselves have identified as critical: lifting Emergency Laws, revising laws on forming political parties and regulating non-governmental organizations, forming an independent electoral commission and monitoring bodies, and amending the constitution to provide for direct election of the president, term limits, and redistribution of power from the executive to legislative and judicial branches.
- Make major program commitments only in areas where the Egyptian government has demonstrated the will to reform, or critical areas where the U.S. government is prepared to work hard on persuading the Egyptian government to open up.
- Retain enough flexibility in the assistance program to be able to respond to opportunities or challenges that arise; i.e., avoid committing all the funds to large, multi-year projects.
- Carve out funds that can be disbursed by the U.S. government directly, with Egyptian government agreement only to general program guidelines.
- Seek alternative destinations for funds should the U.S. and Egyptian governments be unable to agree on meaningful programs.

Finally, it helps to recall that Egypt is for the Egyptians, and all of the important decisions ultimately belong to them. At the same time, the United States' influence is not neutral, and should be used in the service of regional peace and internal reform, the two overarching issues that face Egypt and the Middle East today.

Chairman HYDE. Thank you, Dr. Dunne, for an excellent statement, and now Dr. Gootnick.

STATEMENT OF DAVID B. GOOTNICK, DIRECTOR, INTERNATIONAL AFFAIRS AND TRADE, U.S. GENERAL ACCOUNTING OFFICE

Mr. GOOTNICK. Mr. Chairman and Members of the Committee, thank you for the opportunity to be here today to discuss GAO's ongoing work on the private sector Commodity Import Program in Egypt.

This program, managed by USAID, seeks to foster a competitive private sector in Egypt, and to assist United States exporters. Since 1986, Congress has appropriated roughly \$3.1 billion to this program.

In 1998, the United States and Egyptian Governments agreed to reduce U.S. economic assistance by roughly 50 percent to \$407 million by 2009. This projected reduction is shown on the slide to my left, this and subsequent graphics are reproduced in my written statement.

First, traditional project assistance shown in white on the graphic focuses on private sector development, health, education, and the environment. Shown in orange, the cash transfer program, as mentioned by Ambassador Walker, provides funding to the Government of Egypt conditioned on Egypt's achievement of specific reforms.

The CIP, shown in blue, provides loans to Egyptian importers of United States goods, and through loan repayments provides funding to the Government of Egypt.

Today I will focus on three issues. First, Egyptians' importers use of the Commodity Import Program. Second, the use of funds generated by the repayment of CIP loans; and third, factors that affect CIP's ability to foster a competitive private sector in Egypt.

By way of background, the flow of CIP transactions are shown in the slide on my right. AID provides funds to U.S. banks to pay exporters that sell goods through the CIP.

Egyptian importers obtain loans from Egyptian banks, who assume credit risk for that loan. On repayment, the banks transfer the local currency to a special account at the Central Bank of Egypt.

Now to GAO's observations. First, regarding Egyptian importers' use of the CIP. In fiscal years 1999 to 2003, about 650 Egyptian firms used the CIP to import \$1.1 billion in United States products. For importers that used the program, CIP supplies needed access to foreign currency. During our fieldwork, United States officials, as well as Egyptian importers and banks, consistently reported that there is insufficient hard currency to meet private sector demand.

For importers, key additional features of this program include a fixed exchange rate and a grace period on loan repayments. In a recent survey, half of CIP importers said that the program helped increase their production capacity, and one-third said that it increased employment.

However, two-thirds said that they would have imported U.S. goods without this program.

Second, regarding the use of funds generated by the repayment of CIP loans, USAID and Egypt's Ministry of Foreign Affairs jointly determined the uses of this local currency.

As shown in the slide on my left, funds enter the special account from two sources; the cash transfer program, and CIP. Between 1999 and 2003, about three-quarters of the CIP funds supported Egypt's general and sectoral budgets.

Also, AID uses about 6 percent of these funds toward its operating expenses in Egypt, and roughly 9 percent support AID projects, studies, and evaluations. Congressional Committees have encouraged AID to use these funds for specific projects, such as building a new campus for the American University in Cairo.

Finally, let me outline four factors that affect CIP's ability to foster a private sector in Egypt. First, reforms, such as reduction in government subsidies, lower tariffs, and privatization of state-owned enterprises, which began in the early 1990s, have stalled in recent years.

This has created a climate not conducive to private enterprise. Because CIP funding to the special account is not tied to reforms, some United States officials have suggested that the CIP may ease reform pressures on the Egyptian Government.

Second, the Egyptian Government's inconsistent exchange rate policies have contributed to foreign currency shortages, and have hampered the business environment in Egypt.

Third, Egyptian banks are reluctant to provide loans to entrepreneurs. Egyptian banks generally provide CIP loans, and indeed any loans, only to well established customers with sufficient collateral and a proven track record.

Fourth, because the program is not designed to reach Egypt's large informal economy, its ability to develop a competitive private sector is limited. Informal businesses make up more than 80 percent of Egypt's entrepreneurs.

In conclusion, Mr. Chairman, while the CIP provides benefits to program participants and supports the Egyptian Government's budget, various factors limit its ability to foster a competitive private sector in Egypt.

In this context, it is important that policymakers continue to evaluate whether this program is the most effective means to support economic growth and private sector development in Egypt. Mr. Chairman, this concludes my statement. I will be happy to answer the Committee's questions.

[The prepared statement of Mr. Gootnick follows:]

PREPARED STATEMENT OF DAVID B. GOOTNICK, DIRECTOR, INTERNATIONAL AFFAIRS
AND TRADE, U.S. GENERAL ACCOUNTING OFFICE

GAO United States General Accounting Office
Testimony
Before the House Committee on International
Relations

For Release on Delivery Expected
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FOREIGN ASSISTANCE
Observations on USAID's
Commodity Import Program
in Egypt

Statement of David Gootnick, Director
International Affairs and Trade Team



Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our ongoing work on the Commodity Import Program (CIP), a component of U.S. economic assistance to the Arab Republic of Egypt. U.S. policy objectives in Egypt include supporting the country's economic growth and development and strengthening its investment environment. The CIP is intended to further these objectives by fostering a competitive private sector in Egypt, in addition to assisting U.S. exporters. The program, managed by the U.S. Agency for International Development (USAID), enables Egyptian firms to obtain loans with favorable financing terms to import U.S. goods. The Egyptian government and USAID use importers' loan repayments for budget support and operating expenses, respectively, among other activities. Since 1992, Congress has appropriated at least \$200 million per year for the CIP.

In 1998, the United States negotiated a reduction in its economic assistance to Egypt, including the CIP, through fiscal year 2009. In this context, you asked us to examine the extent to which the CIP contributes to the Egyptian private sector's growth and development. Today, I will discuss (1) program participants' use of the CIP and the Egyptian government's and USAID's use of program funds and (2) factors that have affected the CIP's ability to foster a competitive private sector in Egypt.

We analyzed data on trends in the use of the CIP during fiscal years 1999-2003, as well as the results of a USAID-sponsored 2003 survey on the CIP's impact. (We determined that these data were sufficiently reliable for our analysis.) We also collected and analyzed documents describing program operations and outcomes. In addition, we interviewed officials from USAID and other government agencies; Egyptian government officials; representatives of Egyptian companies and banks; and experts for development in Egypt. (See app. 1 for a more detailed description and methodology.) We performed our work between January and May 2004 in accordance with generally accepted government auditing standards.

Summary

The CIP provides loans to Egyptian importers of U.S. goods and, through the loan repayments, supplies local currency (Egyptian pounds) to the government of Egypt. During fiscal years 1999-2003, about 650 Egyptian firms used the CIP to import \$1.1 billion in U.S. products from approximately 670 U.S. exporters. Two-thirds of respondents to a 2003 USAID survey said that they would have imported U.S. goods without the program, half said that the CIP helped increase their firm's production capacity, and one-third said that it helped increase their firm's employment levels. The program gives Egyptian importers access to the

foreign currency they need to finance U.S. imports; it also provides them a fixed exchange rate and interest-free loan repayment grace periods. In addition, USAID offers several incentive programs—for example, for importers in Upper Egypt—that extend the loan’s grace period for qualifying Egyptian firms. USAID and the Egyptian government jointly determine the uses of local currency from loan repayments, based on an annual memorandum of understanding. From 1999 through 2003, about three-quarters of CIP-generated local currency supported Egypt’s general budget and the budgets of various government ministries, and about 15 percent supported USAID-administered activities and operating expenses in Egypt.

Despite the positive results reported by some CIP users, various factors appear to have limited the CIP’s ability to foster a competitive private sector in Egypt. First, the slow pace of the Egyptian government’s economic reforms has created a climate not conducive to private enterprise. According to a senior USAID official, there are also concerns that the CIP may have reduced pressure on the Egyptian government to speed economic reforms. Further, the government’s inconsistent foreign exchange policies have hampered firms’ ability to do business in Egypt and limited the extent to which the CIP can relieve the country’s foreign currency needs. For example, a private sector representative estimated that the private sector requires about \$15 billion in foreign exchange annually; however, the CIP provides less than 2 percent of this amount. In addition, because of the recent economic slowdown and the increased risk of nonrepayment, Egyptian banks have been reluctant to provide loans to entrepreneurs. Egyptian bank officials stated that they generally provide CIP loans only to well-established customers with proven credit. Finally, because the program is not designed to reach firms in Egypt’s large informal economy, which comprises 80 percent of the country’s businesses, its ability to foster a competitive private sector has necessarily been constrained.

Background

The U.S. government’s economic assistance in Egypt focuses primarily on partnering with the Egyptian government to promote economic growth and development. This support has three core components:

- Traditional project assistance, managed by USAID, focuses on, among other things, private sector development, health and education, and the environment.
- The Development Support Program, or “cash transfer program,” provides assistance funding conditioned on the Egyptian government’s achievement of specific reform goals.

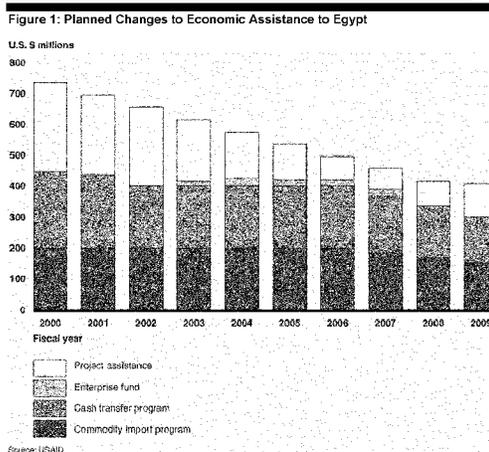
The CIP supplies financing to Egyptian private sector importers of U.S. goods and funding to the Egyptian government that is not specifically conditioned on any reforms.

Between 1975 and 1986, the CIP funded only public sector imports. In 1986, USAID established a private sector CIP, providing foreign exchange to finance imports of capital and noncapital goods¹ from the United States. Since 1986, the CIP has facilitated more than \$3.1 billion in loans to the private sector for the purchase of U.S. exports. In 1991, USAID ended the public sector CIP.

In 1998, the U.S. and Egyptian governments agreed to reduce U.S. economic support from \$815 million to \$407 million per year in fiscal year 2009.² Annual CIP appropriations are projected to remain constant until fiscal year 2007 and decline to \$150 million by fiscal year 2009 (see fig. 1).

¹Capital goods (e.g., construction equipment) are used to produce other goods or services. Noncapital goods include raw materials (e.g., plastics) and intermediate goods (e.g., air conditioner compressors).

²The planned changes also include establishing an enterprise fund—an independent corporation authorized by the U.S. Congress that primarily makes loans to, or invests in, businesses in which other financial institutions are reluctant to invest. As of May 2004, the United States had not established a fund in Egypt, although USAID funding was set aside for this purpose.



CIP transactions have two main components (see fig. 2 for a depiction of the CIP transaction flow).

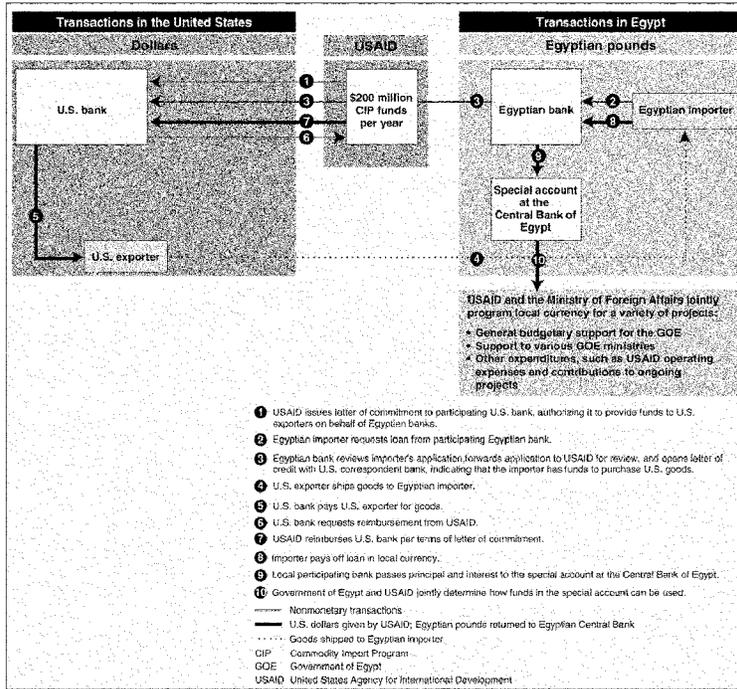
- First, USAID issues letters of commitment to participating U.S. banks (nine as of 2004). These letters authorize the banks to pay U.S. exporters that sell goods through the CIP. After the goods are shipped and the exporter provides the required documentation, the U.S. bank pays the exporter and requests reimbursement from USAID.
- Second, the Egyptian importer seeks a loan, denominated in Egyptian pounds, from 1 of 31 participating local banks (27 private and 4 public), which assumes the credit risk for the loan amount. The importer must document a reasonable

number of bids and certify that the goods are new and unused; made in, and shipped from, the United States; and consistent with the U.S. government's list of eligible commodities.³ Before the Egyptian bank issues a letter of credit authorizing the transaction, USAID again reviews the application. Regardless of whether the importer repays the loan, the local bank is required to send the net proceeds⁴ in Egyptian pounds to a special account at the Central Bank of Egypt.

³Eligible commodities include capital and intermediate goods and raw materials. Ineligible commodities include military and surveillance equipment and luxury goods. USAID also generally prohibits the importation of bulk grain commodities, such as wheat and corn. See U.S. Agency for International Development, *Commodity Eligibility Listings*, rev. ed. (Washington, D.C.: 1988).

⁴According to USAID, Egyptian banks have not defaulted on any loan repayments to the Central Bank of Egypt. The net proceeds equal the loan principal plus interest, minus the local bank's administrative costs, which vary between 2 and 4 percent depending on the type of commodity purchased.

Figure 2: Flow of CIP Transactions



CIP Assists Egypt's Private Sector and Supplies Funds to the Egyptian Government

The CIP provides favorable financing to importers of U.S. goods and, through the loan repayments, supplies funds to the Egyptian government. From fiscal years 1999-2003, about 650 Egyptian firms used the CIP to import just over \$1 billion in U.S. products from approximately 670 U.S. exporters. The program gives Egyptian importers access to foreign currency at fixed exchange rates⁵ and offers varying interest-free grace periods and repayment periods, as well as incentive programs that extend the grace periods. To ensure that all transactions comply with CIP rules and regulations, USAID has established several management controls. USAID and the Egyptian government mutually determine the uses of the local currency from CIP loan repayments, which are held in a special account at Egypt's Central Bank.

CIP Financing Assists Egyptian Importers and U.S. Exporters

In fiscal years 1999-2003, approximately 650 Egyptian firms used the CIP to import \$1.1 billion worth of U.S. products.⁶ Midsized to large firms⁷ accounted for 75 percent, or about \$850 million, of CIP transactions. During this period, an average of 90 new Egyptian importers used the CIP each year; the average and median loan values were \$300,000 and \$153,000, respectively (CIP loans can range from \$10,000 to \$8 million). Egypt's industrial sector accounted for about two-thirds of CIP loans, with most of the remaining loans used for agriculture, construction, and health care equipment imports. During fiscal years 1999-2003, commodities imported by Egyptian businesses included items such as computer systems, diesel engines, hydraulic pumps, irrigation equipment, and chick incubation systems. In addition, according to USAID, approximately 670 U.S. exporters from 43 states, plus the District of Columbia and Puerto Rico, used the CIP to export to Egypt in fiscal years 1999-2003.

In a 2003 USAID-sponsored survey, 66 percent of Egyptian importers surveyed said that they would have imported U.S. goods without the CIP.⁸ However, 49 percent of survey respondents said that the CIP helped increase their firm's

⁵The exchange rate is fixed at the Egyptian bank's rate at the close of business the day before the bank issues the letter of credit.

⁶Sixty-four percent of the importers were end-users, 23 percent were traders, and 12 percent were both end-users and traders. The remaining one percent did not identify themselves as belonging to either category.

⁷According to the Organization for Economic Cooperation and Development, midsized to large firms as those with 50 or more employees. More than 90 percent of Egyptian companies have fewer than 50 employees, according to Egypt's Ministry of Foreign Trade.

⁸Development Associates, Inc., *Impact Analysis Study: U.S./Egypt Commodity Import Program* (Cairo, 2004).

production capacity and 32 percent said that the program helped increase their firm's employment levels. The importers surveyed reported that they used the CIP chiefly because of three program features—the fixed exchange rate, interest-free grace periods, and the ability to repay loans in Egyptian pounds. Although three-quarters of the U.S. exporters surveyed indicated that they would have exported goods to Egypt without the CIP, almost half said that the CIP helped their firm increase its exports to Egypt.

CIP financing helps Egyptian firms obtain from Egyptian banks the foreign currency loans needed to import goods. Representatives of several Egyptian firms told us that the CIP had helped them procure part or, in some cases, all of the foreign currency they needed for U.S. imports. Foreign currency can be difficult to obtain because, according to bank officials we interviewed, Egyptian banks often receive more requests for foreign currency loans than they can accommodate. In addition, Egypt's Central Bank instructed banks in 2003 not to make foreign currency loans unless their clients are able to repay the loans in foreign currency.

The financing terms that the CIP offers Egyptian importers depend on the type of commodity and how and where it will be used. Under the program's standard terms, USAID allows participating Egyptian banks to extend the interest-free grace period to traders and end-users⁹ for noncapital goods for up to 2 and 4 months, respectively; for capital goods, the grace period may be extended for 9 and 18 months, respectively. Egyptian importers can take 6 months to 8 years to repay their loans after the grace period ends. The terms of CIP loans have been adjusted in response to changes in demand for the CIP. For example, when demand for the program has been high, USAID shortened the duration of the interest-free grace period to reduce distortions of the commercial trade finance market.¹⁰

USAID also offers three incentive programs extending the interest-free grace period to Egyptian firms that (1) are increasing their exports, (2) invest in Upper Egypt, or (3) invest in environmentally friendly equipment. According to USAID, during calendar years 1999-2003, about 12 percent of CIP's resources (\$133 million) supported imports by firms that qualified for these programs. Over the last 5 years, nearly half of all loans related to the special incentive programs,

⁹Traders resell the goods to other Egyptian firms. End-users are producers or manufacturers that process or use the imported goods.

¹⁰In August 2002, USAID shortened the duration of the interest-free grace period for noncapital goods from 6 months to 2 months for traders and from 9 months to 4 months for end-users.

or \$60 million, went to importers who increased their exports, \$45 million went to Upper Egyptian importers, and \$28 million went to importers of environmentally friendly equipment.

Officials from USAID's Office of the Inspector General told us that the percentage of fraud in the CIP is relatively low given the high volume of transactions in the program. To ensure that the CIP complies with the agency's rules and regulations, USAID uses a series of management controls. These include site visits and physical checks to ensure that goods are used for their intended purpose, as well as posttransaction reviews to detect overpayment for imported goods and noncompliance with program requirements. USAID conducts 25 end-use checks in Egypt annually to ensure that commodities purchased through the program meet these requirements—for example, that goods are used promptly for their intended purpose. Importers who have not complied with CIP requirements have been debarred from the program for 3 months to 3 years. According to USAID officials, seven importers have been debarred from the CIP since 1999. In addition, USAID requires that U.S. suppliers refund overcharges for transactions in which goods were not made in and shipped from the United States. From 1999 to 2003, USAID obtained 120 refunds totaling about \$4.7 million.

Egyptian Government and USAID Jointly Determine Use of the Special Account

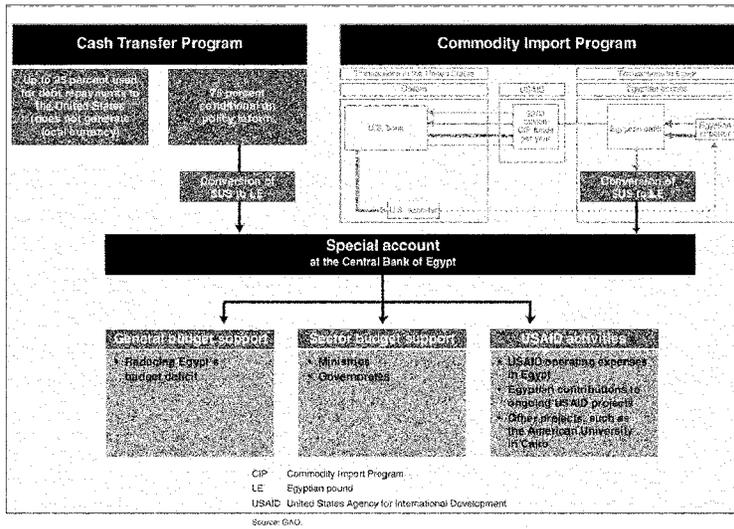
In an annual memorandum of understanding, USAID and Egypt's Ministry of Foreign Affairs jointly determine how much of the local currency for the repayment of loans in the special account will support Egypt's general and sector budgets and USAID's activities. (See fig. 3 for a depiction of the account's funding flow). The special account comprises multiple discrete accounts for the CIP as well as for the cash transfer program.¹¹ For planning purposes, these are considered one large account, but USAID and the Egyptian Foreign Affairs Ministry can track the funding to a CIP or cash transfer deposit from a prior year. Although the Foreign Assistance Act and the annual memorandum give USAID a

¹¹The cash transfer program receives an annual appropriation of \$200 million. The government of Egypt may use up to 25 percent of cash transfer appropriations, or about \$50 million, to support its budget deficit (this portion does not generate local currency). Egypt must use the remaining 75 percent to import U.S. goods. However, this funding is conditional on Egypt's completing comprehensive economic reforms agreed to by USAID and the Egyptian government. Once USAID has certified that the government has met these conditions, the agency transfers additional dollar disbursements to the government, which uses the funds to purchase U.S. goods. The Egyptian government must then deposit into the special account Egyptian pounds equivalent to the dollar value of the cash transfer.

role in determining the uses of the funds in the account, the local currency belongs to the Egyptian government.¹²

¹²For example, see P.L. No. 108-199, 118 Stat. 178-79, and USAID implementing guidance, *Automated Directives System*, sections 624.3.2 and 624.3.3. These provide that host country-owned local currency generated through the Foreign Assistance Act (including the CIP) must be deposited into a separate account and not commingled with funds from other sources. As may be agreed by USAID and the foreign government, the local currency may be used only for project or sector assistance activities, debt or deficit financing, or the administrative requirements of the U.S. government.

Figure 3: Egyptian Government's Special Account



For fiscal years 1999-2003, about three-quarters of the CIP-generated funds from the special account were used for general and sector budget support to help reduce Egypt's budget deficit. In addition, USAID used about 6 percent of CIP-generated funds in the special account for some of its operating expenses.¹³ USAID also used about 9 percent of this local currency to finance various projects, technical and feasibility studies, evaluations, and assessments, among

¹³In fiscal year 2003, about 89 percent of USAID's \$14.5 million in total operating expenses in Egypt were paid for with CIP-generated funds.

other things; the remaining 8 percent covered other disbursements such as refunds for cancelled transactions. Over the years, congressional committee reports have encouraged USAID to use funds from the account to support specific projects, such as the construction of a new campus for the American University in Cairo.¹⁴ Table 1 lists examples of activities funded with CIP-generated funds from the special account during fiscal years 1999-2003.

Table 1: Examples of Projects and Activities Supported by CIP-generated Funds from Egypt's Special Account, Fiscal Years 1999-2003

Fiscal year	Type of support/ recipient	Total funding (nominal dollars in millions) ^a	Purpose
1999	Sector Support/Ministry of Health	10.3	Equip medical centers and public hospitals, as well as the National Center for Liver and Communicative Diseases
2000	USAID Activity/Egyptian Center for Economic Studies	14.4	Ensure the steady flow of resources to sustain the center's operations
2001	Sector Support/Ministry of Communications and Information	10.1	Train new graduates in information technology and programming, purchase equipment and vehicles
2002	Sector Support/Ministry of Public Enterprise	7.7	Fund (1) studies related to restructuring failing companies, (2) leadership training for these companies, and (3) a technical office in the ministry
2003	USAID Activity/American University in Cairo	34.2	Construct a new campus

Source: Government of Egypt, Ministry of Foreign Affairs.

^aConversions from Egyptian pounds to U.S. dollars for fiscal years 1999-2003 were calculated with the annual average exchange rate (see International Monetary Fund, *International Financial Statistics*, January and May 2004).

¹⁴H.R. Rep. No. 106-254, 106th Cong., 1st Sess. 35-36 (1999).

Several Factors Limit CIP's Ability to Strengthen Egypt's Private Sector

Various factors have limited the CIP's ability to foster a competitive private sector in Egypt. First, the CIP has been operating in a policy and economic climate not conducive to business activity. Although the government of Egypt took steps, beginning in 1991, to shift from a centrally planned economy to one more hospitable to private enterprise, the pace of reforms slowed in the late 1990s. For example:

- *Subsidies and government spending.* The budget deficit as a percentage of gross domestic product declined from more than 17 percent in the early 1990s to 3 percent at the end of the decade. However, the deficit subsequently increased steadily, reaching 6.3 percent in 2002-2003. The Economist Intelligence Unit forecasts that Egypt's budget deficit will widen to about 7 percent in fiscal years 2004 and 2005, mainly because of subsidies to protect citizens from price increases and slow private sector economic activity. According to the State Department, Egypt's real gross domestic product growth slowed from nearly 6 percent in fiscal year 1999 to roughly 3 percent in fiscal year 2003, and the private sector's share of this growth fell.¹⁵

Tariffs and custom duties. In the early 1990s, Egypt agreed with the World Trade Organization (WTO) that it would abide by multilateral trade rules and liberalize its trade policies. Accordingly, by the end of the 1990s, Egypt reduced the maximum tariffs for most imports from 50 percent to 40 percent¹⁶ and lifted a ban on fabric imports, among other actions. However, many high tariffs persist—for example, on products related to the automobile and poultry industries and on some textiles. The full implementation of the Egyptian government's WTO commitments is expected to take several more years.

State-owned enterprises. The Egyptian government's pace in privatizing government-owned enterprises also slowed. According to Egypt's Ministry of Public Enterprise, 191 of more than 300 state-owned enterprises were privatized between 1993 and 2002. Although the number of entities privatized each year increased from 6 in 1993 to a high of 32 in 1998, it steadily declined to 6 in 2002. According to a September 2003 U.S. Embassy report, two privatization transactions took place in the first quarter of 2003.¹⁷

¹⁵According to Egypt Ministry of Foreign Trade data, the private sector's share of GDP has remained stable at about 70 percent since 2000.

¹⁶Egypt also reduced its 40- and 35-percent tariff rates to 30 percent.

¹⁷Embassy of the United States of America, *Economic Trends Report: Egypt, September 2003* (Cairo: 2003).

Further, according to a senior USAID official, there are concerns that the CIP may have eased pressure on the Egyptian government to speed the pace of economic reforms. Although the \$200 million that the CIP brings into the country is relatively small—roughly 0.3 percent of the gross domestic product—the funds generated by the program represent, on average, 4.2 percent of the government’s budget deficit in the last 5 years. Because CIP funding is not tied to specific conditions, the funding may ease the government’s resource constraints without requiring it to reform.

A second factor affecting the CIP’s ability to strengthen the private sector has been the perceived inconsistency in the government’s foreign exchange policy, according to several U.S. government studies and a senior Egyptian economist. For example, between 2000 and 2003, the government devalued the Egyptian pound several times; in 2003, it announced that it was adopting a free market exchange rate but subsequently continued to try to support the value of the pound. These actions have undermined the confidence of foreign and domestic investors and contributed to the persistence of a parallel “black” market for foreign currency and to foreign currency shortages, hampering firms’ ability to do business in Egypt. In this context, the CIP can provide only limited relief to the country’s foreign currency needs. A representative from the Egyptian Chamber of Commerce stated that the private sector requires about \$15 billion in foreign exchange annually, but the CIP supplies less than 2 percent of this amount.

A third factor limiting the CIP’s effect on the private sector has been Egyptian banks’ hesitancy to provide financing. Because of experience with bad loans, the recent economic slowdown, and the resulting increased risk of nonrepayment, Egyptian banks are reluctant to finance entrepreneurial activity, according to the Economist Intelligence Unit. Egyptian bank officials told us that they generally provide CIP funds to firms they deem creditworthy, usually well-established customers with proven credit records. Further, officials at one bank indicated that the bank is moving away from corporate lending in general, including use of the CIP, to concentrate on “less risky” activities such as consumer lending.

Finally, the CIP’s impact on the private sector has been constrained by Egypt’s large number of informal businesses, which the program is not designed to reach. These businesses, which make up more than 80 percent of the country’s 1.4 million firms, generally have no access to formal sources of credit such as the CIP, because they are unable to use their assets as collateral for loans. Until broader reforms bring the informal sector into the legal and economic mainstream, the CIP’s ability to foster a competitive private sector in Egypt will likely remain limited.

In conclusion, Mr. Chairman, while the CIP provides benefits to program participants and supports the Egyptian government's budget, several factors have affected its ability to foster a competitive private sector in Egypt. In this context, it is important that policymakers continue to evaluate whether this program offers the most effective means to achieve U.S. policy goals in Egypt. This completes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

**Contacts and
Acknowledgments**

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Appendix I: Objectives, Scope, and Methodology

At the request of the Chairman of the House International Relations Committee, we examined the Commodity Import Program (CIP) in Egypt. For fiscal years 1999-2003, we analyzed (1) program participants' use of the CIP and the Egyptian government and USAID's use of program funds and (2) factors that have affected the CIP's ability to foster a competitive private sector in Egypt.

To determine the CIP's goals, we examined the U.S. Agency for International Development's (USAID) Congressional Budget Justifications for this timeframe. We reviewed various laws and congressional reports that mentioned the CIP as part of the overall mandate for economic support funds to Egypt, and we also reviewed applicable international agreements. We spoke with representatives from the Department of State, the Department of Agriculture's Foreign Agricultural Service, and the Department of Commerce's Foreign Commercial Service. We also reviewed and analyzed applicable USAID regulations, program documentation and descriptions, as well as USAID-sponsored reports and analyses. In addition, we interviewed USAID officials in Washington, D.C., and Cairo and Alexandria, Egypt, and officials of the Egyptian ministries of Foreign Affairs and Finance. We obtained from the Egyptian Ministry of Foreign Affairs data on Egyptian government projects and activities supported by CIP-generated local currency. To determine the reliability of the data provided by the Ministry of Foreign Affairs, we questioned officials at USAID in Egypt, who informed us that they had seen bank statements confirming deposits and releases of funds and that they had a sufficient level of confidence in the data. We determined that the data were sufficiently reliable to indicate the general purposes for which special account funds were used and to provide illustrations of the sums allotted to particular types of projects. We also interviewed eight Egyptian companies from various sectors (e.g., industry and agriculture) and 6 of the 31 participating Egyptian banks that used the CIP during fiscal years 1999-2003. Finally, we spoke with industry and bank representatives from the Egyptian Chamber of Commerce in Cairo who are familiar with the program.

Specifically, to determine trends of the program's users and uses, we analyzed USAID data on CIP transactions during these 5 fiscal years. In addition, to obtain information about participants' experiences with, and opinions of, the CIP, we analyzed data from surveys, conducted by a USAID contractor, of (1) firms that export to Egypt from the United States and (2) Egyptian firms that import from the United States under the CIP. To calculate the number of firms that used the CIP in fiscal years 1999-2003, the average and median value of the transactions, and the annual number of first-time CIP users, we analyzed USAID data on individual export and import transactions.

To examine the internal controls that USAID uses to manage the CIP in Egypt, we reviewed reports of USAID's Office of the Inspector General from 1999

through 2003. We also interviewed officials from the Inspector General's office in Washington, D.C., and the Regional Inspector General's office in Cairo. In addition, we spoke with officials from USAID's Office of Management Planning and Innovation in Washington, D.C., regarding the actions that USAID had taken to address recommendations from the Inspector General's office during this time frame.

To assess the reliability of the survey data, we reviewed the contractor's description of the methodology, queried the contractor and USAID officials in Egypt, and examined the data electronically. We determined that most of the survey responses were sufficiently reliable to report on respondents' opinions and experiences; however, we noted that we could not generalize from the survey respondents to all CIP participants. Furthermore, because the survey was designed to collect the opinions of firms that participated in fiscal years 1994-2002, we could not focus our analysis exclusively on 1999-2003.

To assess the reliability of the transactions data, we performed basic reasonableness tests and queried USAID officials in Egypt. In the course of our assessment, we found a relatively small number of data entry errors. We were able to correct these errors in the importers' transaction data, and we were also able to combine data for firms that were clearly linked, such as firms with a parent-subsidiary relationship. However, we were not able to make these corrections for the exporters' database and, as a result, the figure reported likely includes a small number of duplicate firms. Nevertheless, we determined that the importers' and exporters' transactions data were sufficiently reliable for the purposes of this report.

To gain a better understanding of Egypt's macroeconomic environment during fiscal years 1991-2003, we conducted a literature review and interviewed researchers in Egypt, Egyptian government officials from the Ministry of Finance, and officials from Egypt's private and public banks. For the statistical analysis, we used data from Egypt's Central Bank and other official sources, as well as country reports provided by the U.S. Embassy in Cairo and independent economic forecasting agencies.

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Highlights

Highlights of GAO-04-846T, testimony before the House Committee on International Relations

Why GAO Did This Study

The Commodity Import Program (CIP), managed by the U.S. Agency for International Development (USAID), is intended to foster a competitive private sector in Egypt, in addition to assisting U.S. exporters. The program also supports the government of Egypt and USAID activities and expenses in Egypt. Since 1992, Congress has appropriated at least \$200 million per year for the CIP.

In 1998, the United States negotiated a reduction in its economic assistance to Egypt, including the CIP, through fiscal year 2009. In this context, GAO was asked to discuss its ongoing analysis of (1) program participants, use of the CIP and the Egyptian government's and USAID's use of program funds and (2) factors that have affected the CIP's ability to foster a competitive private sector in Egypt.

We received comments on a draft of this statement from USAID, which we incorporated where appropriate. In general, USAID agreed with our observations.

www.gao.gov/cgi-bin/getrpt?GAO-04-846T

To view the full product, including the scope and methodology, click on the link above. For more information, contact David Goolsby at (202) 512-3149 or goolsbyd@gao.gov.

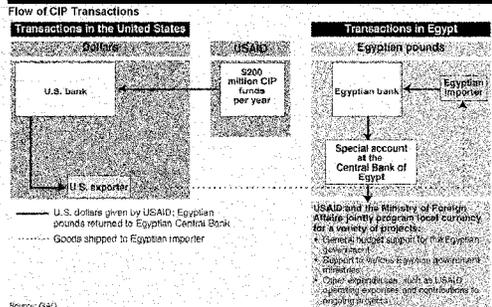
June 17, 2004
FOREIGN ASSISTANCE

Observations on USAID's Commodity Import Program in Egypt

What GAO Found

The CIP provides loans to Egyptian importers of U.S. goods and, through loan repayments, supplies funds to the government of Egypt. During fiscal years 1999-2003, about 650 Egyptian firms used the CIP to import \$1.1 billion in U.S. products from approximately 670 U.S. exporters. In a 2003 USAID survey, about two-thirds of CIP importers said that they would have imported U.S. goods without the program, but half said that it helped increase their firm's production capacity and one-third said that it helped increase their firm's employment levels. The Egyptian government and USAID jointly determine the uses of the funds from loan repayments. In fiscal years 1999-2003, about three-quarters of these funds supported Egypt's general and sector budgets and about 15 percent supported USAID-administered activities and operating expenses in Egypt.

Despite the positive results reported by some CIP users, various factors have limited the program's ability to foster a competitive private sector in Egypt. According to the State Department, the slow pace of Egypt's economic reforms has created a climate not conducive to private enterprise. Further, according to several U.S. government studies, the Egyptian government's inconsistent foreign exchange policies have hampered firms' ability to do business in Egypt, limiting the extent to which the CIP can relieve the country's foreign currency needs. In addition, because of experience with bad loans, the recent economic slowdown, and the resulting increased risk of nonrepayment, bank officials told us that they are generally reluctant to provide loans to entrepreneurs. Finally, because the CIP is not designed to reach firms in Egypt's large informal economy, the program's ability to foster a competitive private sector is necessarily limited.



Chairman HYDE. Thank you very much, Dr. Gootnick. Ms. Ros-Lehtinen.

Ms. ROS-LEHTINEN. Thank you so much, Mr. Chairman. Timing is everything. I appreciate the opportunity to ask our panelists some questions.

Earlier this month, the United States approved \$300 million in aid to Egypt. Will this be viewed entirely as a signal that the United States is fully satisfied with Egypt's economic and political reforms? You heard the remarks by the Chairman and Mr. Lantos with regard to United States aid to Egypt.

Mr. WALKER. Let me take a crack at this. I think it is always a problem when we are providing additional aid without the kinds of controls that some of us have suggested here: That the money has to be related to U.S. reform objectives, and that there has to be an agreement, and that the money is not an entitlement but is something that can be taken away. And I think that these are very important elements to the overall program, and to the success of the program.

Whether this \$300 million will make a substantial difference in the attitude, my impression has been that the Egyptian Government has been resisting the state aid program recommendations that were called for by the Committee, and it seems to me that those recommendations make a lot of sense, although I don't believe that they go far enough.

So there ought to be considerably more conditionality in the way that we deal with this program.

Ms. ROS-LEHTINEN. Thank you. If I could ask another question. The Chairman of the Egyptian parliament's Arab Affairs Committee recently argued that without a serious resolution to the ongoing problem of the Arab-Israeli conflict, progress with wider Middle East initiatives is destined to grind to a halt.

To what extent is reform in the Arab world held hostage to some vague idea about a resolution of this conflict?

Ms. DUNNE. Congresswoman, I would agree with you that the issue has become tied in peoples' minds, and also is used by the Government. If there is an external crisis of some kind, a security crisis of some kind, that can be a way of postponing discussion of internal problems and needs for internal changes.

I think that dynamic is beginning to change. As I mentioned in my statement, despite the fact that there is significant discomfort among many Egyptians with many aspects of United States policy, and there has been a lot of talk about United States and Middle East initiatives, and lack of credibility and so forth.

Nonetheless, still the issue of reform has come to be very much on the public agenda. As I said, the message is getting through. As acceptable or unacceptable as the United States happens to be at the moment as a messenger of the need for democracy and reform, I think that the message is getting through.

And I think that there have been a lot of Egyptians for a long time who have wanted this to be on the agenda, and are taking the opportunity now to step forward and have their say about the kind of reforms that are needed.

But certainly it is an easy excuse for them to say that they can't push for reform with leaders whom we meet, because first we have

to deal with the Arab-Israeli conflict, and it is a wonderful excuse for them to do nothing to reform their own Government, to privatize, and do everything that they need to do.

Mr. WALKER. If I might add something, Ms. Ros-Lehtinen. I think that the problem has been that many people in the Arab world do not believe that we are committed to the problem, and dealing with the problem of the Palestinian issue.

And therefore they tend to raise that in order to put it on our agenda. They are afraid that it is not on the agenda. Reform in this part of the world should be seen as a critical necessity for these countries and their own interests.

That to me is the most persuasive argument that we have, but I do believe that indeed, along with Dr. Dunne, people in the region, and particularly in Egypt, are beginning to understand that. It does not reduce the need for dealing with the Palestinian issue, however.

Chairman HYDE. The gentlelady from California, Ms. Lee.

Ms. LEE. Thank you. Mr. Chairman, I would like to yield my time at this point to Mr. Wexler from Florida, who has to leave.

Chairman HYDE. The Chair will go to Mr. Wexler.

Mr. WEXLER. Thank you, Ms. Lee and Mr. Chairman. I just want to quickly congratulate the Chairperson of our Middle East Subcommittee, Ms. Ros-Lehtinen, who I think has done an extraordinary job in keeping this Committee and her Subcommittee involved in the Israeli-Palestinian, and broader Israeli-Arab conflict, in a very constructive way.

And I applaud the highlighting of the substance of this Committee. I think there are certain self-evident truths that need to be stated, and then also talk about what I think are somewhat extraordinary developments on the ground.

And that is it is self-evident, it seems, that the pursuit of the peace process, and pursuit of the road map, and pursuit of the disengagement plan from Gaza, is certainly not mutually exclusive from pursuit of a democratic transformation plan and strategy.

But I think we are somewhat remiss at this point in this Congress for not pointing out what on the ground has occurred with respect to Egypt in the last 3 to 4 weeks, which is dramatic.

The cooperation between Prime Minister Sharon and President Mubarak in the last 4 weeks dwarfs any cooperation that has occurred between Israel and Egypt in the last 3 years.

Foreign Minister Sharon's trip to Cairo was the warmest, as I understand it, the warmest receipt of an Israeli official in Egypt in a long, long time. We very ceremoniously engaged, and I was all for it, with Prime Minister Sharon when he came to Washington in support of his disengagement plan.

But let us be honest about it. When we, the United States, supported the plan, and it was viewed as an Israeli-American plan, it received nothing but condemnation throughout the world.

I am not saying that is justified, but that was the reality. It wasn't until Egypt and Jordan—but principally Egypt in a very significant way—began to engage in this process that the international community began to embrace it. But in my mind it is the peace process.

The peace process at this point is Israel's, Prime Minister Sharon's, disengagement plan. It is no broader than that, and it is no smaller than that. If Prime Minister Sharon's disengagement plan succeeds, the peace process will move forward, and if it fails, there is no alternative.

Egypt effectively, along with Jordan at this point, has accomplished with Chairman Arafat what we were unable to accomplish. I am not criticizing us because I think we did the exact right thing.

But they have finally begun the process of transforming—hopefully successfully—and mandating that Arafat give up control of the security forces and hand them over to the Palestinian Prime Minister, and it is Egypt's intervention that has caused this dynamic.

It is Egypt's intervention which has gotten Chairman Arafat to finally, possibly, move in a constructive fashion to consolidate the security forces. So as we discuss what we expect from Egypt, and it is very legitimate, and I have been one of the harshest critics of Egypt in certain ways, their press is still awfully anti-Semitic, Egypt should move their Ambassador back to Israel as an even greater sign of support of the peace process.

But what I hope we have learned in the last 4 weeks is that the peace process as it is embodied in a very, I believe, constructive Israeli disengagement plan, the key ingredient of the success of that plan at this point is Egyptian commitment to the reform of the Palestinian authority. And Egyptian commitment to the shutting down of the tunnels from Egypt to Gaza, and Egyptian commitment to empowering the moderate forces within the Palestinian authority to take on Hamas.

All of this other discussion, while it is incredibly important and incredibly justified by our part to get to the question that Ms. Ros-Lehtinen brought forth, and that is the excuses of the Arab world so often as putting aside all of what they should do, and laying at rest the excuse of the Israeli-Palestinian conflict finally for the first time in years, Egypt is acting in a way that not only embraces our hopes, but actually implements them in a way that we have been unable to do.

And I think that if we fail to provide that kind of acknowledgment, then maybe we are not doing justice to, in fact, the dramatic change of heart that has occurred. As I understand it, U.N. Chief Cofenan is now talking with Prime Minister Sharon about successfully implementing Israel's plan to disengage.

Why has that happened? It happened in principal part because of the cooperation of Egypt and Jordan now. Why is it now being embraced by a broader audience? Because moderate Arab countries are being brought to the table by moderate Arab countries, and I think we should follow this very same recipe with respect to our hopes for democratic transformation.

We can lead, but only to a point. And I would hope that we would recognize that at a point our leadership almost becomes counterproductive, and if we don't respect the goals and the objectives of the moderate Arab leaders, and respect their views, as much as we may differ with them.

Chairman HYDE. The gentleman's time has expired.

Mr. WEXLER. Thank you, Mr. Chairman, very much.

Chairman HYDE. You are welcome. Mr. Rohrabacher.

Mr. ROHRABACHER. Thank you very much. I agree with my colleague's praise of Ms. Ros-Lehtinen's leadership of the Subcommittee. Let me note that the progress that my colleague has highlighted in his presentation, it is not just the change in Egypt.

Mr. Sharon has changed a bit, too, and all of this just wasn't Egyptian intransigence, and now they have changed. But, no, Mr. Sharon has changed his way of dealing with people, and his demands, and I remember several years ago his position was very different than what it is today. So let us hope that the changes in heart there and the changes in heart that was brought about in Egypt and Jordan, bring about more peace. And bring about a peaceful solution, and give us a closer chance to find that peace that we are all seeking.

And I would like to just note that when we have hearings like this and where we are trying to find ways—well, inherently a hearing like this will look at the bad side of things, because we are trying to correct the flaws. And whenever you look at the flaws, that means that you are not highlighting the other good parts as well, and there are many good parts and good things that Egypt has to brag about.

And they have been good friends of the United States, and they have been very positive players over this last decade in the cause of peace.

So the way that I look at it, Mr. Chairman, is that this hearing and the testimony of our witnesses today, are some very positive things that need to happen. We need to make some reforms, and we need to make sure that we keep our eye on those reforms.

But at the same time, when we are comparing Egypt, we need to say what Egypt is compared to. If we are comparing it to other real countries, Egypt has actually a lot to brag about. And if we compare it to what Egypt can be in the future if it continues down the path of reform, whether it gets bogged down and not going down that path of reform, well, Egypt, we have to talk about that as well.

First of all, Egypt and Jordan are great friends of the United States and great friends for the cause of peace, and we need to make sure that is on the record.

I understand that Egypt has been engaging—and the Egyptian leadership has been engaging—with Hernado de Soto, and talking about some real solid reform in that regard, and economic reforms. Would the panel like to comment on that?

Is that a serious commitment on the part of Egypt to go to that level of reform?

Mr. WALKER. Mr. Rohrabacher, I am not specifically familiar with what de Soto has been talking to the Egyptian Government about. He has been a major supporter of small enterprise lending in the past, and the AID program has had a number of programs of this nature, and they have been relatively successful.

Actually, some of the most successful programs have been put on by the private sector itself, particularly the Alexandria Businessmen's Council. So I certainly hope that they are in conversation with the Egyptian Government, because he is an excellent resource for that.

Mr. ROHRABACHER. Actually, I understand that Hernado de Soto has done a study in Egypt of property titles, and the fact that so many people who actually live on the land have not been given title, and are actually looking at the possibility of a major change in title and ownership in Egypt.

Mr. WALKER. I think that would be a very welcome development, but it starts a two-fold question. One is the titling of land, particularly on the farms, which has been put up over so many generations, and has not been adequately documented, and that means that farmers don't have collateral which they could use to take loans out, and could create a very difficult problem for growth.

And for expansion into the middle class and into middle-sized entities. It is both a problem there, and it is a problem on the mortgage side, where banks do not give mortgages except for with 100 percent collateral, which most people at that level can't sustain. So I think that this is a very welcome occurrence.

Mr. ROHRABACHER. So with the issues that you have raised today, let us hope as well, or just draw attention to that possible area of reform, which I understand the Egyptian Government is actually considering. So thank you for your testimony, and thank you for your leadership, Mr. Chairman.

Chairman HYDE. Thank you, Mr. Rohrabacher. Because we have two votes on the Floor, by the time we get over there and vote and get back, it could consume over an hour.

Ms. BERKLEY. Mr. Chairman, could I make a 1-minute statement for the record?

Chairman HYDE. Oh, surely. Ms. Berkley, for 1 minute.

Ms. BERKLEY. Thank you very much. I think I would be remiss if I didn't get on the record that I am a little concerned about this overstatement about the great friend that Egypt has been for the United States.

I think it has been a mixed record at best. I would appreciate it if the Chairman gave me permission to submit some questions in writing. In order to be a true partner in peace and a friend to the United States, I would hope that the Egyptian Government would do everything that they can to return their Ambassador to Israel to demonstrate that they truly, truly understand the importance of that.

And that we could get some answers as to that extraordinary arms build-up over the last few years. I would like to know who the Egyptians think their enemies are, and why they are using so many billions of dollars in order to improve their military.

And of course what has troubled me from the beginning is the extraordinary level of anti-Semitism in the Egyptian press. So if I may submit questions in writing on those issues, I would appreciate it.

[No questions for the record were submitted.]

Chairman HYDE. We would welcome your questions, and I am sure that the panel will do their best to cope with them.

Ms. BERKLEY. Thank you very much, and thank you for your testimony.

Chairman HYDE. Because of the time constraints, we are going to adjourn the Committee, but I want to thank you for a serious

and important contribution to this developing problem. Thank you.
The Committee stands adjourned.
[Whereupon, at 11:49 a.m., the Committee meeting was ad-
journed.]

