Economic Reform and Structural Adjustment Program (ERSAP), & PRIVATIZATION

In 1991, the Egyptian Government signed agreements with the International Monetary Fund (IMF) and the World Bank. The agreement aimed at eliminating or reducing price distortion in the Egyptian economy by going back to market based operations, as well as; to restore the international credit worthiness of Egypt in the international market. There are seven components for the ERSAP program:

1-Public Sector Reform:

It has two main objectives:

(A) Change the institutional legal and financial environment of public enterprises and to raise the autonomy of their mangers, while making them conform to the same rules as the private sector;

(B) Privatization of public enterprises in the commodities and financial sectors, with the exception of strategic enterprises like Mills.

The Public Sector Organizations (PSOs) will be transformed into Holding Companies (HC's), with a number of public sector companies affiliated to each HC. The main functions of HC are to approve the business plans of Affiliated Companies (AC’s), evaluate the performance of their managers, decide on restricting plan of AC’s and the buying or selling whether wholly or partially, and the liquidation of non-viable ones.
In order to change the institutional framework mentioned in Part A, a new public investment law was passed by the parliament to replace law 97. The new law will make the Public Companies subject to the same rules as the private sector. Thus, the objective of the Public Sector Organization become maximizing profit instead of just fulfilling the state’s economic and social objectives, regardless of its effect on efficiency. On the financial level, the government has been discriminated against the Private Sector by subsidizing PSOs directly and indirectly. Directly, it has provided investment funds at low interest rates through the National Investment Bank, and also subsidized them through the budget. Indirect financial support was formulated through easy credit facilities through Public Commercial Banks. Nowadays, PSOs are required to meet their financial needs through the same channel as the Private Sector.

2- Pricing Policies

The government effort in this sector began as early as the mid 1980’s. In the industrial sector, most products have been freed from administered prices. In May 1994, only 26% are subject to price control in comparison to 56% at the beginning of the program. At the end of June 1995, all prices of industrial goods with few exceptions were liberalized.

In the energy sector, prices have been highly subsidized. The prices of petroleum products were about 75% of the International prices and in the mid 1970’s and the early 1980’s, they fell to only 20% because of the rise on world oil prices, whereas the domestic prices remained unchanged. To close the gap, the domestic prices of oil
were increased, so that in 1988 it was four times its level in 1980. However, because of the devaluation on the Egyptian pound, the price of domestic oil was still at 30% of the international prices.

The government made Nemours attempts to bring it to the international level; in May 1991 it reached 48%; June 1992, 67% of world prices It was followed by an 11% increase annually until 1995. Electricity prices have also subsidized by the government. The prices have fallen shot of their Long Run Marginal Cost (LRMC). In May 1991, prices increased by 50%, but still remained only 60% of its LRMC. An annual increase of 10% was introduced to close the gap.

In Agriculture, price controls were applied, with very few exceptions, by the year 1992\93 - Regarding agricultural inputs, subsidies have been reduced for livestock feed, fertilizers and pesticides. Also, the crop area controls on cotton were removed except to the minimum extent technically needed.

3-Investment Policies:

The two laws pertaining to investment, Law 159 (Domestic Investment) and Law 230 (Foreign Investment), required getting a license before starting new projects or just expanding production capacity of old projects. By that, the government ensured that PSOs will continue to monopolize certain sectors, just by refusing to give a license. Also, protecting infant private enterprises from new competitors. In May 1991, Law 159 was canceled and licensing procedures for new investment were abolished with the exception of production that effects national security,
environment, public health and public morality - religion. As for expanding existing projects, the licensing was replaced by registration. By the end of June 1991, license for joint ventures and foreign investment was abolished.

4- External Polices

The ERSAP defines External Polices from 3 aspects, which are:

1) Exchange Reform
2) Trade Liberalization
3) Debt Relief

1) Exchange Reform

This reform abolished the old Exchange System and introduced a Dual Exchange System in February 1991. The Dual System consisted of a Primary Market and a Free Market. The sources of Foreign Exchange in the Primary Market were Suez Canal dues, exports including oil, cotton and rice, official loans and transfers. The exchange rate in the Primary Market was determined according to the average price in the free market during a whole week. The Free Market rate was determined upon Market Mechanism. It included tourism proceeds, free accounts, retention accounts, banknote, and travelers cheques’ purchases. As a part of the reform, non-bankers dealers were allowed to deal in Foreign Exchange after getting a license.

2) Trade liberalization:

The government started its reform to that sector during 1991 as a part of the agreement with the International Monetary Fund (IMF), and World Bank (WB). The
reform included the following:

(I) Reducing the product coverage of import bans from 37.2% to 11%. However, most of the change was in agriculture products that are produced mainly by the Private Sector.

(II) Commodities requiring government authorization to import were reduced from 55% to 18%.

(III) The difference between the minimum tariff (0.7%) and the maximum (120%) was narrowed to 5-100% and to be reduced much further to reach 10-80%, with the exception of basic food items and luxury goods.

(IV) Abolishing the foreign exchange budget for Public Enterprises (PEs) as part of the new Public Investment Laws. This will allow managers of PEs to import whatever they need for the production process. Also, letters of credit that have discriminated against the Private Sector were abolished.

Regarding exports, the list subject to export bans were reduced from 20% to 6%, and the subject to export quotas were reduced from 17% to 4%, also they reduced the number of commodities that need government authorization to be exported from 37% to 2%; namely cotton, yarn, and fabrics.

3) **Debt Relief**

The large External Debt Obligations of Egypt make its balance of payments highly
vulnerable to external shocks like a decline in oil prices, or a sudden increase in the value of dollars, which will result in an increase in the real value of the debt service. After six months of the eruption of the Gulf War, Egypt made an agreement with the Paris Club Creditors. Accordingly, Egypt was to be relieved from 50% of the Official Debt. This will be done over three stages on the condition that Egypt will continue to implement the Structural Adjustment Program (SAP). The first stage was 15% granted at the time of the agreement (25th May 1991), another 15% on January 1993 and the last 20% on July 1994. As an expression of gratitude for the support in the Gulf War, the USA cancelled 90% of Egypt's military debt.

5- Monetary Reform and Policies

**Main components:**

1- Developing Domestic Debt management including selling of Treasury bills to financial institutions and public at market interest rate.

2- Shift to indirect monetary controls. For example, lowering reserve requirement on Egyptian pound deposits, while extending its coverage to include all Egyptian pound deposits in commercial and investment banks.

3- Starting 3rd of January 1991, banks were free to set their own lending and deposits rate.

4- Central Bank started to regulate Banks’ Net Foreign Currency positions in two ways: First, the banks ratio of foreign exchange liabilities to foreign currency assets should not exceed 105%. Second, the difference between them should be limited to 15% of the individual banks’ capital.
The ERSAP calls for tight Monetary Policy and Credit Policies. The main feature of this policy are: imposing credit ceilings on the banking system to slow down their monthly Average Growth Rate. The interest rate of Treasury Bills was raised from 14% in January 1991 to 18% on the following March.

6- Fiscal Policies

The Government of Egypt aimed at keeping the budget deficit below 9.5% of GDP in 1991/92, and 6.5 of GDP for the year 1992/93, and 3.5% by the year 1995/96. According to government figures, the first two were achieved, whereas the last rested at a rate of 4.2% of GDP.

Regarding revenue, steps were taken to increase governmental revenue. This was done through restating Customs Duty rates, introducing a general sales tax, and the increase in energy prices. In addition, excise taxes on cigarettes increased, as well as stamp taxes.

Regarding expenditure, the government aimed at restraining the Wage Bill, so that it is not more than 16% above that of 1990/1991, reducing Public Investment to 11%, reducing subsidies by one Billion.

7- Social Polices:

The IMF thought of a plan to minimize the negative social effect of the ERSAP on
the poor by creating a Social Fund for Development (SFD). The objectives of SFD are:

I- Mobilize domestic and international funds on confessional terms.

II- Finance selected projects in the area of labor intensive public works, small enterprise and community development.

III- Develop and implement a labor mobility program to go simultaneously with the public enterprises reform.

IV- Strengthen the government’s capacity to design and monitor poverty alleviation policies on the long run.

*Privatization in Egypt*

"The Privatization program has had its detractors. Variously attacked for being too slow and neglecting the social consequences of reform, the program has weathered much criticism. However, few people have questioned the extent of the commitment toward actual privatization."

(Ericson, 26).

By the early 1990s, it had become abundantly clear that the state was a poor manager of industry and that the competitiveness of Egypt’s overstaffed, under-performing and grossly indebted Public Sector Companies had deteriorated to a point at which they would be incapable of generating job opportunities for the 50,000 annual new entrants to the labor Market (Moore, 57). The transfer of State-owned Public Enterprises (PEs) to the Private Sector is perceived as the corner-stone of the Economic Reform Program. The Government has thus embarked on preparing the
legislative and legal environment for privatization. By issuing Law 203 of 1991, Public Sector Companies were rendered as independent economic entities, and a framework for their management was established comparable to that of the Private Sector. Furthermore, the Market Law 95 of 1992 was in turn issued to regulate the Stock Market and introduce a framework for trading (Kahttab, 4). This was followed by setting Government Guideline for privatization, which were published in 1993 and updated in 1996. The guideline identified the privatization objectives to be (Privatization Guideline, 10):

**Increasing the Productivity of Public Enterprises**

- A better utilization of financial resources of the Government.
- Increasing FDI and acquiring high-technology.
- Increasing the ownership rights between citizens and increasing and encouraging the Private Sector.
- Increasing job opportunities and enhancing technical skills of labor.
- Allocating the revenue of selling the PEs to pay back their debts banks and correcting the trend of other PEs that need restructuring.
- Activating Capital Markets.

**Privatization Progress**

By November 30th 1999 the government had privatized 131 of the 314 Public Sector Companies originally targeted for privatization, accordingly to the latest figures from the PEO. Transactions included the sale of majority stakes in 17 companies.
through public offerings, the asset sale or liquidation of 28 companies, 19 anchor investor sales and 28 companies sold to employees’ Shareholder Associations. The sales proceed from the Privatization Program stood at LE. 14.92bn, but only LE 11.206bn were collected. PEO officials said that the difference represents the installments of the Labor Unions and other anchor investors (PEO). The Government is now left with those state enterprises possessing bad debts, excess labor and outdated technology. Rather than sell these off cheaply, or close them down, the government has chosen the restructuring option.

It was revealed that such companies need massive investments to restructure, and it is indebted by 4 million Egyptian pounds. It employs over 1 million workers. Dr Ebid, the ex-Prime Minister and the ex-minister of Public Enterprise Office, said that one third of this machinery has expired, thus products are not up to the required standards and more than one third of the product is a stagnant stock. Accordingly the PEO established a strategy to restructure these companies.

The Government strategy to restructure the public CO.

1. Restructuring the Financial Position

- Rescheduling or cancellation of debts.
- Converting debts to capital contributions by the lenders.
- Increasing capital for companies in need of investment.
- Re-evaluation of assets.
- Collecting accounts receivable from others.
2- Inclusive Restructuring

- Developing management systems and managers skills.
- Developing the wages and incentives system.
- Continuous training and developing of workers’ skills.
- Establishing a fund within Holding Companies to finance the restructuring.

Constraints Facing the Privatization Program

For example: Social Constraints:

A major characteristic of the Egyptian Economy for several decades has been the domination of social consideration over Economic Efficiency. This manifested itself in various practices, the most notable of which was the government allocation of labor to government entities and Public Sector Co. This served to absorb the inflow of new labor, regardless of the optimal number of employees required by each organization. This overstaffing inflated the Public Sector, which was estimated at twice the necessary workforce.

- Table #1 shows the size of labor in PEs in 1995/96, prior to labor restructuring efforts.

<table>
<thead>
<tr>
<th>Holding Co.</th>
<th>No. of workers</th>
<th>Average/Workers</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spinning &amp; weaving</td>
<td>96,524</td>
<td>5,532</td>
<td>534</td>
</tr>
<tr>
<td>Textile and trade</td>
<td>96,762</td>
<td>5,085</td>
<td>492</td>
</tr>
<tr>
<td>Industry</td>
<td>Employees</td>
<td>Labor</td>
<td>Excess</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>-----------</td>
<td>-------</td>
<td>--------</td>
</tr>
<tr>
<td>Cotton &amp; foreign trade</td>
<td>49,156</td>
<td>5,900</td>
<td>290</td>
</tr>
<tr>
<td>Engineering industries</td>
<td>62,178</td>
<td>7,688</td>
<td>478</td>
</tr>
<tr>
<td>Metallurgical indust.</td>
<td>72,827</td>
<td>9,337</td>
<td>680</td>
</tr>
<tr>
<td>Mining &amp; refractors</td>
<td>61,826</td>
<td>9,042</td>
<td>559</td>
</tr>
<tr>
<td>Chemical industries</td>
<td>47,400</td>
<td>7,785</td>
<td>369</td>
</tr>
<tr>
<td>Pharmaceutical</td>
<td>29,145</td>
<td>7,583</td>
<td>221</td>
</tr>
<tr>
<td>Food Industries</td>
<td>94,616</td>
<td>4,365</td>
<td>413</td>
</tr>
<tr>
<td>Mills and Silos</td>
<td>56,505</td>
<td>3,858</td>
<td>218</td>
</tr>
<tr>
<td>Agriculture develop.</td>
<td>40,082</td>
<td>3,044</td>
<td>122</td>
</tr>
<tr>
<td>Electrical Construction</td>
<td>90,741</td>
<td>5,466</td>
<td>496</td>
</tr>
<tr>
<td>National construction</td>
<td>57,061</td>
<td>6,817</td>
<td>389</td>
</tr>
<tr>
<td>Tourism and Cinema</td>
<td>19,918</td>
<td>6,326</td>
<td>126</td>
</tr>
<tr>
<td>Maritime transport</td>
<td>24,187</td>
<td>9,468</td>
<td>229</td>
</tr>
<tr>
<td>Transport</td>
<td>33,476</td>
<td>6,900</td>
<td>231</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>932,404</strong></td>
<td><strong>6,271</strong></td>
<td><strong>5,847</strong></td>
</tr>
</tbody>
</table>

**Source:** The Public enterprise office

Out of these 932,404 there is an estimate of about 300,000 redundant labor, most of these working in the Financial, Administrative and Service Departments. Khattab, the Minister of Public Enterprises adds “The restructuring and modernization at the technical and managerial levels will reveal more excess labor, especially if advanced technologies were introduced." (Khattab, 12). The issue of how to deal with excess labor in PEs, while restructuring is undergoing has been a source of uneasiness to both labor and public. In addition, it creates resistance to the program from some labor groups. The option to retire the 300,000 will put a pressure on the job market.
with nearly 1.6 million people already unemployed. The Early Retirement Program will also cause the government around LE. 7.5bn in compensation to excess labor. The one sixth of the sales proceeds (allocated for the Early Retirement Fund) was estimated to be only LE 4bn.

In order to solve the problem of excess labor without causing a social dilemma and to insure the continuation of the Government Privatization Program, the authorities developed a system of Shared Decision Making to make the process transparent and participatory. The PEO and Holding Companies consult with Labor Union, Ministry of Man-power before taking any decisions. In addition, the PEO offered workers special privileges through participating in the Employee Share-holder Association (ESA). Worker’s in Public Enterprise can buy 10% of the shares in their companies that are sold to Strategic Investors in the Stock Market at a discount of 20%. ESAs are also granted Credit Facilities for the term of repayment of the purchased stake ranging from eight to ten years on annual installments, thus enabling Employees Share-holders to repay from their dividend yield.

One major step towards the relief of excess labor was the implementation of Early Retirement. The optional system has been implemented by PEs suffering from severe excess labor. This system allows workers to request Early Retirement in return for a termination bonus of at least 15,000 and a maximum of 35,000. The worker’s age should range from 50 to 58 years for males and 45 to 58 years for females both should have at least 20 years of experience. To finance the Early Retirement Plan, the government adopted a system that allows Holding Companies to retain one third of the sales proceed and assets. The Holding Companys have
already used the one-third allocated for them to pay LE 2.1bn in compensation to 698,000 workers who retired early.

**CONCLUSION**

The Privatization Program in Egypt has been described by many governmental officials as the corner-stone of development and Economic Reform. But, one must question to what extent was this program successful? And to what extent is the criticism directed to the Egyptian experience valid?

It is very apparent that the privatization was successful in attracting Foreign Direct Investment to the country (Coca-Cola investment in Egypt is around $250 million) and also providing the company with needed technology and training. However, closer examination shows that a number of majority privatization have turned out to be mere reallocations of Public Sector assets among different Public Sectors players. Many economists, diplomats, and consultants have suspected that in order to meet donor nations’ requirements for continued debt relief, while avoiding the pain of the real transfer of assets, Public Sector managers of just-for-show privatization to give the impression of successful reform. One useful means for avoiding actual privatization is the sale of a certain percentage of shares to ESA, which are generally considered under "de facto" management control. Another method is to sell enough shares to public sector banks or Mutual Funds to hamper Private Sectors takeover. A study done in August 1996 showed that 6 of 11 local Mutual Funds were organized by the biggest four Public Sector Banks, (Ericson, 42). Finally, if a company is destined to be bought out, the Public Sector can always sell to itself, the chairman and the board members are afraid of losing their job as privatization is speeding up.
A consultant working in the privatization management adds, "Sometimes so-called private investors that try to present themselves as anchors are joint ventures founded by Publicly Owned Enterprises or at least with a strong position held by a Public Sector Unit”, (Erioson, 43). A number of examples prove the point. In May 1997, the Holding Company for Egyptian Electricity Distribution offered part of all its shares in El-Naser Transformers and Electrical Industries (EIMACO) through a Public Bidding. In June, a deal was signed completing of 89% of EIMACO to a private investor. The buyer was a joint venture between a Private Sector Company and EGYMAC a Publicly Owned Enterprise. On the remaining shares 10% went to ESA, (Mohamed, 2).

Another concern relating to the Privatization Program in Egypt is the valuation process. EI-Wafed, an opposition magazine issued by the Wafed Party, believes that there is major corruption behind the privatization of some companies. The latest was the sale of the Darfalh Factory by the Holding Company for LE. 650,000, while the estimates given by experts was LE. 3,000,000. Another Company was on the verge of being sold for 8 million, but the PEO stopped the operation after they discovered that the estimated price for the company was 32 million. On the other hand, the Private Sector feels that the government fools them. In the first privatized company, Pepsi-Cola, the company paid LE 10 million for the spare parts of the Production-Line, shortly after the purchase they discovered that these spare parts does not function and is completely junk.

The corruption behind all these operation cannot stop a valuable project that has economic benefits such as privatization. However, the corruption that leveled to
high and dangerous positions in the hierarchy of the government should be excluded and placed in a place of discontent, not honor.


*Guidelines to the Government Program to increase private ownership and restructure*. The Public Enterprise office, 1996.


*The IMF and World Bank Agreements with the Egyptian Government In 1991.*


