

How Egypt's Public Firms Start a Debt Chain Reaction

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ONE OF the major problems affecting many Egyptian state enterprises — a problem which virtually no one wants to talk about — is inter-agency arrears. State-owned companies detrimentally affect government finances through the buildup of inter-agency arrears, or what are sometimes called cross debts. This situation is so common in Egypt that state firms are often found holding on their books arrearages which are more than one year old.

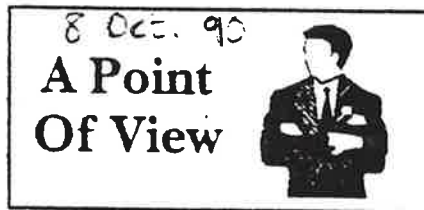
Such arrearages often come about as a result of an inter-government transaction. A public company buys goods or services from another state organization and feels free to delay payment just because it is dealing with another government entity. In many cases state enterprises may even withhold payment in a particular fiscal year to have the debt carried over into the following year at the expense of the supplier firm. According to some rough estimates, unpaid arrearages within the public sector during fiscal year 1987-1988 amounted to as much as 1.7 percent of gross domestic product.

What is frightening is that these kinds of arrearages in many cases include unpaid taxes and unpaid debt service on either principal or interest to public sector banks. The unwillingness of a large number of state enterprises last year to pay their taxes is a case in point.

There is also an example of how these payment delays can lead to a chain reaction. Not long ago, the Egyptian Railways Authority refused to pay state-owned engineering firms for goods it received, citing the fact that the central government had failed to provide it with the full amount of its investment budget. The engineering firms, in turn, decided not to pay the state-owned steel mill for products it had provided. And the steel mill promptly refused to pay its electricity bill to the Egyptian Electricity Authority!

Clearing government arrears to state

enterprises is both expensive and time consuming, especially since there are a number of insolvent state firms that buy goods from other government entities even though they are unable to pay their bills. In these kinds of cases the central government, represented by one organization or another, must either guarantee these arrearages or simply write them off.



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Insolvent state enterprises in many cases seek loans from the public banking system that are recorded as overdrafts to cover arrearages, and these may go unpaid for a significant period of time until the state steps in to correct the books.

Of course, clearing arrearages improves the financial position of those state enterprises holding accounts-receivables which they have been unable to collect. In fact, the majority of accounts-receivables in the balance sheets of state enterprises that are more than six months old reflect the arrearages piled up by other firms that have simply decided not to pay their bills.

In many cases, ministers must interfere to clear up an arrearage problem. It is not uncommon for the minister of electricity to

call the minister of industry about an arrearage, nor is it uncommon for the minister of industry to call the minister of supply about an arrearage.

Do state enterprises stop supplying other public firms when an arrearage problem comes up again and again? Not to my knowledge. I know of cases where the Egyptian Electricity Authority threatened to cut off service to various clients, but such threats were never implemented.

The problem really lies in the brotherly relationship that exists between one state entity and another. You wouldn't hurt your brother, would you? The same applies when it comes to dealing with cross debts involving various state enterprises. No public firm wants to hurt another, because one firm is usually very understanding of another's financial predicament. In any case, the state enterprise holding an unpaid accounts-receivable knows that the problem will be solved by some government entity somewhere, and thus no matter how old the account gets it is still calculated into the current ratio of the firm propping up its solvency position.

Sadly, though, arrears that result from the operations of insolvent state enterprises tend to be settled by having them converted into equity. But, as long as state enterprises do not pay any form of dividends, such conversions in essence become nothing more than government grants.

When arrearages are converted into government grants, and every insolvent enterprise in Egypt expects that to happen, what happens to financial discipline? Well, you can kiss that one goodbye. Thus, such conversions should be accompanied by comprehensive reforms aimed at improving the financial structure of the firms that are constantly incurring arrearages or overdrafting. Government audit procedures should also monitor financial transactions between state enterprises to guard against the buildup of arrearages which are one of the main causes of the current chaos in Egypt's public sector.