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EGYPT

State Firms and Fairy Stories

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CAIRO — The Egyptian government budget over the past several years makes interesting reading. A budget, like a storybook, can tell many fairy tales; and a major tale concerns the money lost every year in state enterprises.

It is estimated that between the financial years 1982-83 and 1987-88 losses of Egypt's major economic authorities, such as state housing companies, and major utilities — 276 companies in all — amounted to roughly E£1.313 billion, $507 million at the current exchange rate. In addition, budget figures reveal that the 117 public-sector industrial enterprises supervised by the Ministry of Industry lost over E£1.2 billion in the same period.

Now, under pressure from the public to reform its enterprises and decrease its deficits, the Ministry of Industry has decided to remove state firms from the budget.

The main objectives of this reform are as follows:

1. To eliminate future overdrafts by ensuring that the revenues and expenditures of state enterprise operations are properly balanced. The Ministry of Industry proposes to form conglomerates that will replace the existing holding companies. These new conglomerates will then become responsible for monitoring the cash flows of the companies that report to them and will have to appropriately link their returns to expenditures. Enterprises, under the supervision of conglomerates, will receive no external assistance from the state.
2. To develop a system of self-financing within state firms. Enterprises would try to cover their own wages and operating expenses, including organization expenses. The state of many government enterprises is now so bad that they can cover neither their own payrolls nor their full organization budgets from their returns.

Since these deficits are currently derived solely from central government sources, an intricate system of linking state firms making surpluses to those incurring deficits will have to be developed. The purpose of this system is to ensure that no one public industrial firm turn to the central budget for assistance and that all overdrafts of losing firms be covered from the surpluses of other profitable state-owned enterprises.

With Prime Minister Atif Sidki now admitting that self-financing of state enterprises currently does not exceed 25 percent of their operational requirements, the government wants to see reform in this area soon.

However, removing state firms from the budget could have severe implications. The conglomerates would be forced to allocate the surplus from viable enterprises to nonviable enterprises to keep them afloat.

This would be self-defeating since it will limit the ability of viable enterprises to improve the quality of their goods, their marketing and their ability to survive in a competitive atmosphere.

It could cause significant morale problems for managers, who will lose their surpluses to firms that cannot maintain a stable financial position on their own. Then, managers may not actively seek to maximize their returns since they know that their own enterprises will not enjoy the surpluses.

State enterprises may be tempted to adjust their prices upward in the hope that their returns may improve. Thus, a whole group of commodities prices will rise. Such increases will further lower the availability of a large number of commodities for Egypt's poor, who will find themselves unable to pay for these increments.

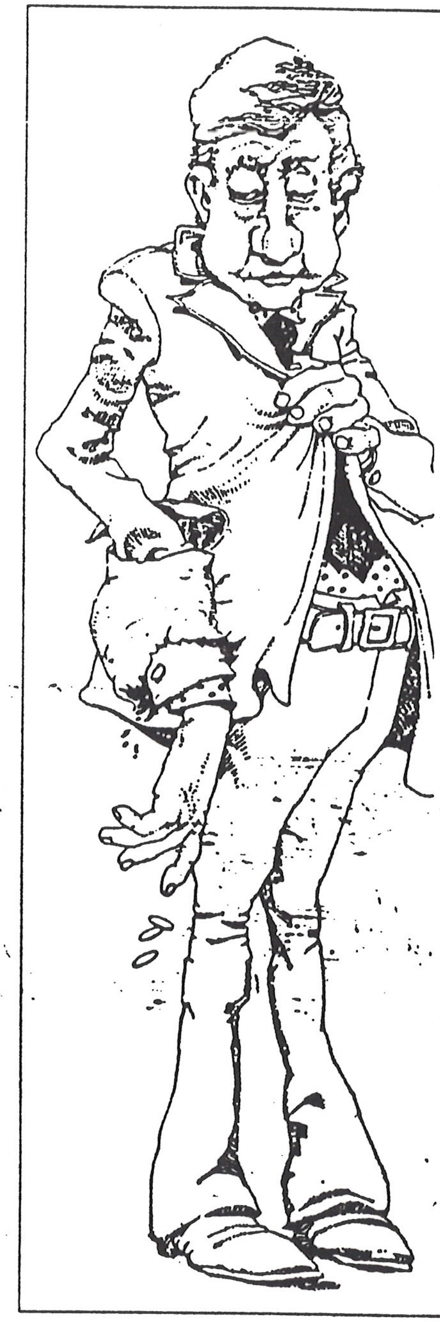
Nonetheless, there are important benefits to taking state companies off the budget if revenues and expenditures can be balanced out. These include the following:

1. The chronic losses incurred by individual state companies will be eliminated if conglomerates redistribute profits from successful firms to failing ones.
2. The budget deficit will be lowered if the government removes public industrial expenditures from the operations component of the state budget.
3. Firms will be pressured to ensure that their revenues, and solely their revenues, generate their wages, incentives and operating expenses.

To curb the deficits incurred by nonviable enterprises without absorbing funds from the state budget, the government can liquidate them or privatize their assets.

Removing state firms from the budget obliges the government to take a stand on both privatization and liquidation as options for faltering state firms. If the government rules out these options, the current bail-out system will continue and allocations from the central state budget will be likely.

If the government reduces the number of bail-outs for state firms, a policy of company self-sufficiency may work since only the



fittest of Egyptian public firms will survive. But if bail-outs continue at their current rate, the government will merely have created a different accounting procedure for recording overdrafts. Hopefully, this will not be the case.