How Viable Is the East European Model for Egypt?

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VARIOUS Egyptian ministers over the past few weeks have been quoted as saying that the new 1,000-day government reform plan will be structured around the experiences of a number of Eastern European countries, prominent among them Poland, Romania and the former East Germany, now part of a united Germany.

If the government follows the Polish example for reform, we should expect some very interesting results. On the privatization front, it took the Polish government over two and a half years to develop a divestiture strategy with which to identify companies to sell. It took another six months to create a legislative framework that would allow the process to move forward. Of the 150 firms selected for sale by the government a year ago, the list has now been cut to only five. In short, when it comes to privatization, Egypt should steer away from the Polish experience, for it is only useful as an example of what not to do.

On the other hand, the Poles have enjoyed great success in increasing their level of exports. Over the past 18 months, these exports have grown by an incredible 56 percent. This has obviously done much to improve their balance of trade. Various creditor nations are now considering forgiving large debts to help facilitate additional reforms. Poland's success in this area stems from exchange rate reforms and a new devaluation policy, both of which have done much to make exports cheaper relative to world prices and to curb imports.

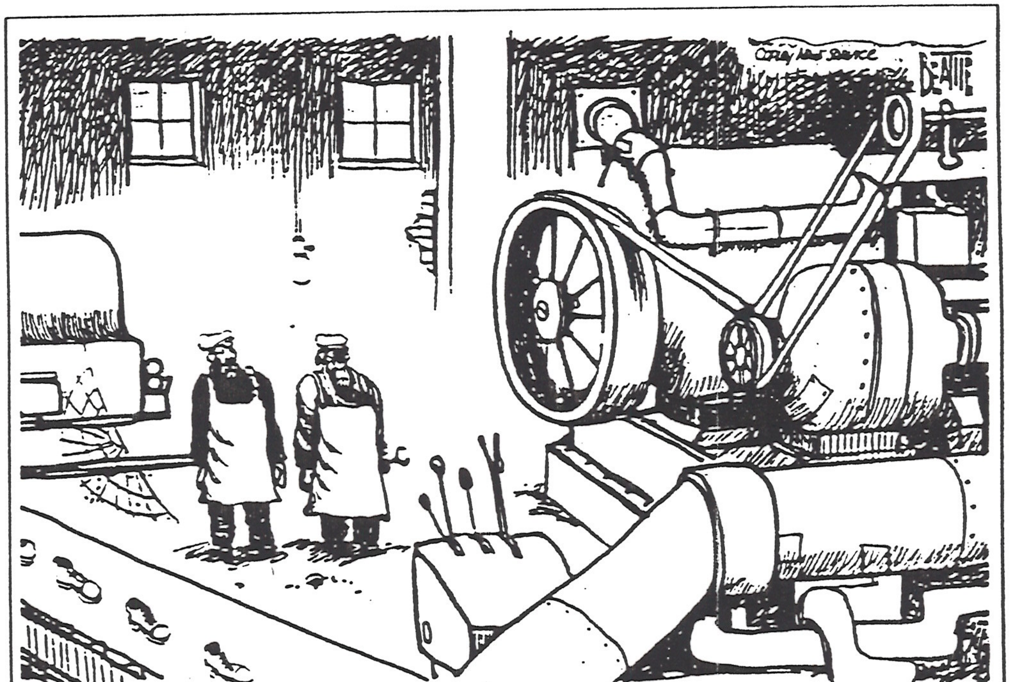
In fact, Poland's exchange rate reforms are very similar to those proposed to the Egyptian government by the International Monetary Fund, reforms that Cairo has been slow to implement. Egypt can learn much from the Polish experience in this regard. Even though Poland has not been keen to privatize, it has implemented a host of reforms aimed at increasing industrial efficiency.

Warsaw's policy of eliminating redundancy in the workplace already has caused unemployment to rise to almost one million. It should be remembered that unemployment did not exist in the communist era when every citizen was guaranteed a state job, an employment policy that the Egyptian government continues to follow. Thus, following the Polish line with regard to state enterprise reform can mean improved efficiency at the cost of higher rates of unemployment, an outcome which is likely to be rejected by the current cast of Egyptian politicians.

Can anyone imagine the Egyptian government selling a state enterprise for nothing?

If Egypt is to emulate the reforms undertaken in Germany, as some ministers have suggested, we may witness changes the country has never seen before. Germany's potent privatization program includes techniques such as selling enterprises at negative purchase prices. This means it has sold enterprises free of charge to various entrepreneurs and in addition provided compensation to the buyers.

The logic behind negative purchase prices is tied to the level of short and long-term debts accumulated by state firms that in many cases exceeded the market value of their assets. In order to encourage buyers to acquire such enterprises the state had no choice but to offer them sufficient compensation to eliminate the firm's debt. Only the elimination of debt would allow the new owners to operate their businesses profitably within a fair period of time, thus creating an incentive for buyers to acquire such enterprises.



PRIVATIZATION IS A GOOD IDEA. WHAT I DON'T LIKE IS THAT WE NOW OWN THIS PLACE.

Of course, in Egypt there are a large number of state-owned enterprises whose market value does not cover debts and outstanding liabilities. Negative purchase prices could create the necessary conditions that will allow for their sale.

But can anyone imagine the Egyptian government selling a state enterprise for nothing? Can anyone in Egypt imagine the government giving businessmen money to encourage them to buy state enterprises? If Egypt's ministers are serious when they say they will copy Germany's experiences in the areas of public-sector reform, no one should be shocked if negative sales prices become a standard policy.

Romania, confronted by the same problem of extensive state enterprise debts, is considering legislation that will allow owners of companies nationalized in 1948 to repurchase them under the negative purchase price policy. In addition, Romania has started privatizing state enterprises through the auction process. Various firms have been sold at auction and the initial bidding price for these enterprises was based on debt and liabilities versus market value of their assets. But can any Egyptian imagine Misr Dairy being sold at auction for nothing?

The kinds of reforms being implemented in Eastern Europe are radical. It is interesting that the Egyptian government is signaling that such reforms might be forthcoming here too. They have begun to realize that the world is changing and Egypt must follow suit or be left behind.

Of course, it remains to be seen how the general public will react to serious devaluation, higher rates of unemployment, negative sales prices and the sale of state enterprises through auction. Such reforms will require a government with courage and political will — one that rejects the philosophy of maintaining the status quo and instead strives to improve the domestic economy. It will be a government that understands that in economics the old adage, "No pain, no gain," applies.