Egypt's Bad State Firms Should Be Allowed to Go Bankrupt

26 April 93

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Special to the Middle East Times

REPRESENTATIVES from the Egyptian Ministry of Industry stated recently that they would be announcing in July the public-sector reforms that many have been awaiting for so long.

Industry Minister Mohammed Abdel Wahab emphasized in a recent interview with *Al Goumhoreya* newspaper that the reforms to be announced would involve a reshuffle of the public sector's cards and would link state enterprises to their feeder industries in a fashion that would lead to improved industry performance. He stressed that Egypt had a lot to learn from the Italian experience and that Egypt would follow the lead of conglomerates such as ERI which managed successfully to enhance the profitability of a number of Italy's state-owned enterprises.

One thing, though, that should be kept in mind about Egyptian state-owned enterprises and which makes them so different from those in countries like Italy is that the public-sector law, Law 97 of 1983, does not allow for bankruptcy. This means that even if a company's current liabilities are greater than its current assets for a decade it still cannot be shut down. What is interesting about Law 97 is that it allows for 'liquidation' but not bankruptcy.

One can venture so far as to say that Law 97 does not clarify whether financially unviable firms can be legally allowed to close down or not. No one I know who is familiar with the history of state enterprises in Egypt can identify one state firm that was allowed to go bankrupt, or one that was permanently shut down. China and the Soviet Union have closed insolvent state enterprises, but Egypt has yet to undertake such a step even though the state enterprise portfolio is riddled with firms that are financial disasters.

If the public-sector law is unclear about when and how firms should close down when they have become a financial drain on the economy, they are very far away from the Italian experience. The Italians are liquidating state assets through the privatization mechanism, and so is Egypt, but not in industry.

The country's privatization experience extends to the tourism sector and the agricultural sector, but so far no divestiture has taken place in industry. Why? In my opinion one main reason is that divestiture means liquidating bankrupt state firms, something which is apparently illegal under existing state legislation.

A Point Of View

Existing state legislation turns state industrial enterprises into organizations that are born into the world and are expected to have eternal lives. They simply are not permitted to die as they age, lose market share or if their technology becomes obsolete.

Is the reform plan to be announced in July by the Ministry of Industry going to address this bankruptcy issue? Will the government announce new procedures for closing down state industries which have been unviable year after year? Will the government identify in July those assets in the industrial sector that would likely be better held by the private sector?

No one seems to be talking about the fate of Egypt's major public-sector losers, and many seem to believe that any public enterprise in the state's portfolio, regardless of its financial position or market share, can be turned around if it is simply managed better. One has to wonder about the logic inherent in trying to apply different management techniques in firms that have been unable to generate positive returns over long periods of time.

More importantly, granting state enterprises a status which makes them immune to bankruptcy and which gives them eternal lives is something any economist or any sensible person has to question. One must also wonder about how state enterprise managers react when they know that no matter how deep their company sinks into the red, the government will pick up the tab.

Egypt has proven to be less flexible when it comes to industrial reform than countries such as China, the Soviet Union and virtually all of Eastern Europe. State firms cannot and should not be expected to live forever, primarily because business activity and its continuation is something that should be left to market demand, the price level and a firm's ability to generate real profits instead of make-believe paper profits.

Without a provision for bankruptcy, resources will not be allocated to where they would be most efficiently used, and the price mechanism will also fail to direct resources in this way. A law that prevents bankruptcy is an instrument that inhibits capital or labor mobility even in the face of blatant inefficiency in some sectors.

One must seriously question this kind of legislation, and one hopes that by July the government will have taken some steps not only toward improving the management of state enterprises but also toward developing a mechanism through which resources will be properly allocated. Such steps undoubtedly mean that bankruptcy and liquidation will ultimately have to be permitted.

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