Egypt's State Firms Need Independence, Not Bailouts

By Khaled Fouad Sherif
Special to the Middle East Times

CAIRO — Egypt has a long history of defending financially unprofitable state-owned enterprises. In early 1960s, bad financial losses were always blamed on imports. Imports, it was claimed, ate up domestic market share, hurting the financial performance of local state enterprises. However, decades later and after the recent wave of severe protectionist policies, state enterprises are still not faring well.

Twenty years ago, Egyptian public-sector producers were not ready to compete in technology and price. They turned to the state seeking protection from international competition in their home market. Dominant producers within the major industries such as steel, automobile, consumer electronics and others formed protectionist political coalitions with key state organizations. They petitioned the executive branch, lobbied the People's Assembly and pushed for import restrictions on competing firms.

Such measures were taken in 1969, when major steel producers at Helwan, a few kilometers south of Cairo, obtained a voluntary restraint agreement, limiting the tonnage of steel that could be imported into Egypt. When these restrictions failed to stem the tide, the industry sought countervailing duties on steel imports.

Other industries have followed the same pattern. Instead of responding to the challenge with product and process innovations, they have struck back with complaints and litigation leading to trade restrictions. The government also granted subsidies, special tax provisions and subsidized loans and loan guarantees to protect state industries threatened by foreign competition.

This last phenomenon has mushroomed since the late 1960s as global competitive pressures increased. To take an example, in 1965 the total cost to the government of special tax credits and tax depreciation allowances to state industries was E£1.9 billion, or approximately 1 percent of gross national product (GNP). By 1980 the cost had grown to a staggering E£28.6 billion, or almost 3 percent of GNP.

In 1965 the cost to the government of subsidized loans and loan guarantees to specific state industries, measured in terms of interest charges and loan defaults, was only E£300 million. By 1980 the annual cost had grown to E£3.6 billion. Outstanding government loan guarantees targeted to specific state industries now total over E£21.6 billion. Taken together, government subsidies and tax expenditures to promote certain state firms have risen from 9.2 percent of GNP in 1965 to 13.9 percent of the GNP in 1980.

A Point Of View

Industries that have lost their competitive edge have fared well in these sweepstakes. The Misr Dairy corporation now has E£80 million in loan guarantees. Egypt's Helwan steelworks have more than E£250 million in outstanding loans and loan guarantees, and they receive approximately E£20 million a year in special tax benefits. The ailing shipbuilding industry receives more than E£200 million in subsidies each year and has more than E£1.3 billion in outstanding loans and loan guarantees.

Price controls on electricity, oil and gas yield cheap inputs for Egypt's state textile manufacturers, desperately competing against textile manufacturers in Southeast Asia and Europe, giving them 26 percent low er fuel costs than their international competitors. The list of government benefits and beneficiaries lengthens year by year as the global competition intensifies.

The benefits also become better hidden. Unlike direct government spending, the public cost of these loans, loan guarantees, and tax benefits is difficult to measure because most of these items do not show up in the annual state budget. Most do not require explicit government authorization and appropriation.

Public officials, therefore, find it easy to manipulate these programs in ways that create the appearance of lower public spending than is actually taking place and to avoid acknowledging the massive government assistance going to state industry.

Thus, it all comes down to another paper chase. If the government is serious about public-sector reform, its attitude toward subsidies and loan guarantees as well as tax exemptions will have to be addressed.

More important is the necessity of ceasing to shelter state firms from competition for decades at a time. The state is behaving as if it were sheltering its son or daughter from the dangers of the outside world. In the end the son or daughter fails to develop independence and cannot compete with others who have more experience in dealing with the real world.

Public-sector reform inherently means less bailouts and more independence for state firms. But reform also implies that state firms will have to compete for survival. After all, the basic principle of economics comes from biology's survival of the fittest.

Khaled Fouad Sherif is assistant professor of management at the American University in Cairo.