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AN ACTION PLAN TO RESTRUCTURE, DEREGULATE, AND PRIVATIZE THE TEXTILE SECTOR OF EGYPT

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ACRONYMS

CTCF	Cotton Textile Consolidation Fund
ELS	Extra Long Staple (cotton)
GOE	Government of Egypt
HC	Holding Company
HCCFT	Holding Company for Cotton and Foreign Trade
HCSW	Holding Company for Spinning and Weaving
HCTMT	Holding Company for Textile Manufacturing and Trade
HVI	High Volume Instrument (to measure fiber properties)
LE	Egyptian Pound
LS	Long Staple (cotton)
MALR	Ministry of Agriculture and Land Reclamation
MDCI	Management Development Center for Industry
MEFT	Ministry of Economy and Foreign Trade
MOI	Ministry of Industry
MPE	Ministry of Public Enterprises
PEO	Public Enterprise Office
SFD	Social Fund for Development
TF	Task Force (for textile sector restructuring)
TFM	Task Force Manager
USAID	U.S. Agency for International Development

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EXECUTIVE SUMMARY

This report follows up a major 1993 report, Assessment of Potential for Liberalization and Privatization of the Egypt Cotton Textile Subsector. The purpose of the follow-up is to provide the Ministry of Public Enterprises (MPE), Government of Egypt (GOE), with a plan of action for restructuring that will enable privatization. This is done subject to the understanding that liquidation and/or divestiture will be not be used as a primary technique to instigate the process for the public sector textile companies.

The intent of this report is to point the way toward genuine, demonstrable change that is consistent with and conducive to privatization. Thus, it aims at the dismantling of government monopoly power over production, pricing, and distribution of both inputs and outputs. Moreover, it stipulates necessary conditions, such as debt resolution, that must be met. Fulfilling these conditions, while systematically restructuring the companies as recommended, offers a way to reach the ultimate objective of privatization.

While the approach presented in this report is defensible, it risks the result of perpetuating companies in an uncompetitive, money-losing condition. Indeed, that is exactly what will happen if this plan is entered into without a firm resolve by GOE leadership. If the drain on the vitality of Egypt's economy that is being caused by the public sector of textiles is going to be stopped, bold leadership that does not stop with half-way measures is required.

It should be noted that review of this report has brought a warning from USAID that only a convincing plan, executed in a timely manner and focused on the ultimate objective of privatization, will be supported by that agency.

Analysis

Executing this restructuring plan will be made more difficult by uncertainty about how much the regulatory environment for Egypt's textile mills have been changed much by three new cotton laws. The extent of change cannot be known until the behavior of key persons and groups empowered by these laws is revealed. Furthermore, decisions taken by the designated groups can be postponed or stopped with objections by a "government representative." For the year ahead, the only substantive alternative afforded domestic textile mills seems to be the freedom to buy their domestic cotton through any registered trader. But the constraints and controls on cotton

and textile pricing, trade, and market access are hardly changed from a year ago. Furthermore, the phytosanitary regulations that prohibit a meaningful choice in imported cottons remain in place.

One reason to be concerned about market imbalances is a large and fairly sudden shift in the global supply/demand balance for Upland type cottons; world stock levels decreased by about 20% and world prices increased about 50%. (This was caused primarily by crop shortfalls in the Middle East and Asia--especially in Pakistan and China.) In sympathy with this dramatic tightening in Upland cotton markets, there was minor tightening in the long staple (LS) and extra long staple (ELS) cotton markets where Egypt's cotton participates. But while global ELS prices were **rising** about 7%, Egypt **lowered** its export offering prices about 19%. The result has been rapid sales and a depletion of Egypt's previously excess cotton stocks. Public sector spinning mills now confront a market in which adequate domestic cotton supplies next season depend upon an adequate harvest and "normal" export quantities. In 1994-95, short domestic cotton supplies and limited import alternatives could disrupt Egyptian textile. Ironically, the blame would likely be erroneously placed on open-market activities, rather than on the **lack** of them.

Restructuring is also made difficult and expensive by the advanced state of financial and technical deterioration in many public sector textile companies. It was concluded a year ago that the total indebtedness of the sector came to 77% of the total value of its assets. At that time, the total indebtedness of the thirteen companies revisited by this study came to 119% of the total asset value. Now their debts have exceeded 146% of asset value; furthermore, the net worth of these thirteen companies taken together is now negative.

Low rates of return on investments have made adequate capital reinvestment impossible; investments that were made tended to be concentrated in spinning frames and weaving looms, with little corresponding investment in machinery and equipment that precede and follow these stages in manufacturing. Neither were investments made in equipment to control ambient conditions nor to otherwise enable product quality control. The result is that neither the product quantity nor quality that should come from the newer machinery is possible to achieve.

Another handicap to restructuring is the fact that, after thirty years of public sector existence, the skills of modern management--including delegation of authority and the teamwork required to compete in an open market--are not well developed within the sector's current management. Middle and lower management, in the Western sense of the term, is almost nonexistent in these public sector companies.

Learning new techniques and adapting them to specific circumstances is fundamental to becoming and staying competitive. The process becomes "natural" once an industry is fully engaged in a "spiral" of global manufacturing and marketing activity; global competition is a never-ending educational process. The public sector textile companies have not yet broken into this spiral; therefore, the challenge being taken on by the GOE is to help these companies become fully engaged without having to destroy them and start all over with new private sector companies. A necessary condition for success is to convince those in the companies that they must start learning now and that they can never stop.

Egypt's spinning sub-sector produces medium count and course count yarns, yet the cottons grown in Egypt are suited for making fine count yarns. Furthermore, the only cotton allowed to be imported into Egypt is also suitable for making fine count yarns. This is a classic example of violating the so-called "law of comparative advantage"; it asserts that, in order to be competitive, a country must produce products for which it has a relative cost advantage. Textile manufacturers in Egypt should position themselves either (1) to capitalize on the extra fine cotton fiber available domestically by producing higher valued, fine count textiles, or (2) to produce lower valued textiles using course count cotton fiber and cheap labor.

It is possible that companies in Egypt could position themselves for either type of competition--if the freedom were available in Egypt to make a choice. The choice of competing in the fine count textiles would require different kinds of manufacturing facilities than now exist in the public sector; therefore, this is not a viable restructuring alternative. Access to less expensive fibers and yarns is possible through imports, however, and the low cost labor in Egypt could then enable competitive production of lower valued yarns and fabrics. The labor cost advantage could also be extended into the labor intensive production of ready-made textile products--many of which could be exported to balance the foreign exchange account. Since the imperative of utilizing an abundance of labor weighs very heavily on the GOE, the ambivalence toward import policies that could help do this is paradoxical.

The textile and apparel industries in Egypt could also benefit from freedom to import polyester and other synthetic fibers, which are used heavily in blends with cotton. The quality and quantity of domestically produced synthetic fibers is inadequate; besides, the excess capacity being installed in Far East countries and elsewhere on the Asian continent offers the prospect of ready access to competitively priced, high quality synthetic fibers and yarns.

The foregoing discussion suggests that Egyptian policy should be focused more on the "downstream" segments of the textile industry, since the country's comparative advantage is greater there. Another component of this "downstream" could be the dyeing and finishing segment. There is excess dyeing and finishing capacity in the public sector, but it lacks state-of-the-art equipment and management to respond to global demand. It may be, however, that marginal investment in modern color laboratories and in training to operate them could transform some of the dyeing and finishing facilities into competitive operations. Therefore, such facilities might be candidates for early privatization if the market were liberalized enough to reveal the potential of downstream textile manufacturing.

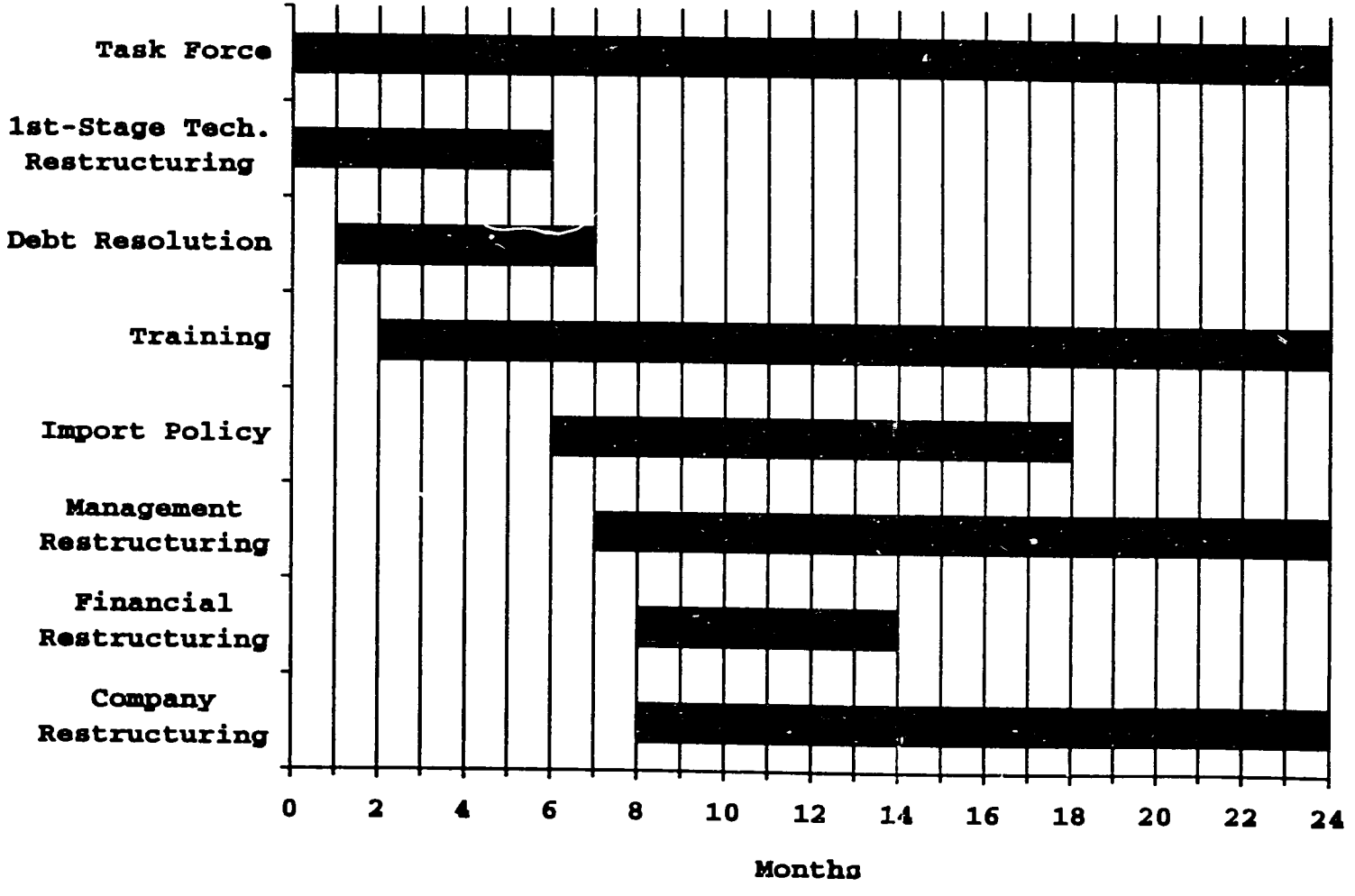
The breaking up of larger, integrated companies into smaller, service-oriented companies could foster cooperation between public and private sector textile companies, leading to a more flexible, competitive textile industry. This, in turn, would prepare the market for private sector investment in those public sector companies that performed well--or showed the potential to perform well--in a deregulated market.

Finally, the problem of at least 30% excess labor in the non-production parts of the public sector textile companies is a limiting factor on the comparative advantage of the industry. As said in the 1983 Report, the Social Fund for Development (SFD) is the most obvious resource to help solve this dilemma in the near term. Cooperation and assistance is also available from agencies like the USAID, subject to adherence to privatization as a preeminent objective. In the longer term, growth through liberalization and privatization could offer alternatives to the excess labor, taking them out of the public welfare system and into the bona fide work force.

Action Plan

There are seven basic dimensions to the plan: institutional adjustments; technical restructuring; debt resolution; policy adjustments; management restructuring; financial restructuring; and company restructuring. An eighth dimension, training, is interwoven throughout most of the others. Among all of these logical dimensions, there is significant overlapping of timing of activities. Exhibit 1 on page 5 is a Gantt chart, covering a two-year period, that provides a convenient reference for the subsequent discussion of the action plan. Four of the time lines (task force, training, management restructuring, and company restructuring) are expected to extend beyond the 24 months covered by the Gantt chart; all other dimensions are completed within 18 months.

Exhibit 1: TWO-YEAR GANTT CHART



Even as the overall plan is being developed and executed, it is suggested that particular attention be focused on four companies: Misr Helwan Spinning and Weaving Company(Helwan) and Upper Egypt Spinning and Weaving Company, El Sharkeya Spinning and Weaving Company (Zagazig), and Port Said Spinning and Weaving Company (Portex). Reasons are that these present a wide range of problems and situations and that wrestling with the particular problems presented by these companies will leaven the thinking about what is possible for the sector as a whole.

Institutional Adjustments:

- The first actions must be to (1) clearly charge the MPE/PEO with leadership and oversight responsibility and (2) select a Task Force Manager (TFM) and assemble a core group for the Task Force (TF). **These actions will constitute the "start-up" of this action plan.** The TF can be refined and altered over time as the MPE sees fit, but it must be put in place quickly so that assistance may be provided to the MPE/PEO from the very beginning. Without the TF, the MPE/PEO cannot effectively lead in developing solutions or adequately monitor results.
  > The core group of the TF would work very closely with a small group from each Affiliated Company (AC). Each group would be chosen based on current, in-depth knowledge about the conditions and the problems within the company.
  > The utility of the TF to the MPE/PEO will depend on the selection of an appropriate "Task Force Manager" (TFM) and a deputy to help him. The TFM could be an expatriate, with an Egyptian as his deputy. Ideally, both of them should be known and respected among managers within the various textile mills. Basic qualifications include: knowledge that spans technical, financial, marketing, and issues; expertise in collecting, organizing, and analyzing data; and thorough understanding of the principles, requirements, and results of liberalization.
  > The TFM and his deputy will provide liaison between the MPE/PEO and the textile ACs, reporting to the designated person(s) within the MPE. As actions for restructuring and deregulation are undertaken, the TFM should also help verify compliance with decisions, monitor the progress made, and report regularly to the MPE/PEO.
  > In addition to the TFM and his deputy, it is recommended that the TF include at least two expatriate technical experts: one in textile spinning and weaving and one in dyeing and finishing. Egyptian members of the TF should include individuals with experience in textile machinery, fiber evaluation, spinning, weaving, finishing, finance, and marketing.

- By the first month after the start-up, a special, government sanctioned negotiating team should be designated to work out a "general agreement for debt resolution." The charge given to this team should be to submit to the MPE after no more than six months a framework agreement within which the debts of individual companies will be resolved. The banking sector and the GOE can bring to bear any expertise deemed necessary. It is also recommended that participation of a privatization expert be solicited from the USAID.

- Within two months after the start-up, designate a small committee charged with soliciting and offering ideas for training programs to the MPE. Members should include people from the TF and from the HCs. Also, it would not be surprising that some implications for training came out of the negotiations on debt resolution.

Technical Restructuring:

- Immediately the TF, under the direction of the MPE, should begin to devise first-stage technical restructuring of **every mill** within **every company** in the public sector. This involves removal of obsolete or unfit machinery and equipment, with corresponding rationalization of plant utilization. Failure to do this will amount to failure to make a good-faith start on debt resolution or on any subsequent restructuring objectives. Indeed, the framework for debt resolution cannot be finalized without a clear understanding of the results of first-stage technical restructuring. Generally speaking, any subsidization that is given by the GOE and any concessions given by the banks for the textile companies should come only after the implications of the first stage of technical restructuring are understood.

- Decisions of first-stage restructuring should be implemented, as available on a company-by-company basis, immediately after approval by the MPE. The implications of first-stage restructuring should be clear within three months and execution should be completed within six months after start-up.

- The time table for subsequent stages of technical restructuring in indeterminate--depending on the experience gained in the first stage, the implications of debt resolution, conditions in the domestic and global markets, etc. Certainly no more than one stage should be attempted within a year's time. In general, subsequent stages should focus only on improving the "balance" of the manufacturing process--without adding any production capacity to the company. Anything beyond these kinds of steps would fall outside the realm of technical restructuring.

Debt Resolution:

- Starting as soon as possible, the debt resolution team should quickly establish ground rules; they must be based on the fact that most of the wealth that collateralized the textile sector's debts does not exist any longer; what remains is to determine how the losses will be allocated between the GOE and the banks, and how further losses of Egypt's wealth can be minimized.

- Within six months the team is to submit its proposed framework agreement to the GOE through the MPE. Then all deliberate effort must be made to finalize it and make it official as soon as possible. Failure here should force a reorientation of the rest of the restructuring process. Nothing beyond first-stage technical restructuring makes sense unless a framework for debt resolution is in place.

- To enable operation of some companies the negotiating team may have to propose some government-guaranteed, short term loans for the purchase of raw materials. The TF will provide the appropriate vehicle to alert the negotiating team about the extent of this problem and identify the companies cannot operate without unsecured loans.

Policy Adjustments:

- Given that the new cotton laws are not likely to substantially liberalize cotton prices for at least the next year or two--but will basically just reset the minimum price levels for the major types of cotton--the textile sector should seek an understanding of probable impacts on domestic cotton production by types, on domestic versus global price levels, etc.

- Since exports will be given priority and import alternatives are very limited, the textile industry should formulate contingency plans in the event that domestic supplies are seriously inadequate.

- A directive should be given to, beginning about six months after the start-up, investigate regulatory measures that meet adequate phytosanitary regulations **without** denying the textile spinning sub-sector meaningful access to imported cottons that are not in the ELS or LS categories. Regulations specifying actions and documentation required should be explicit. Penalties for violations should be preemptively harsh, perhaps including a ban on imports from countries where violations occur and on trading companies that are party to a violation. But the regulatory gridlock on cotton imports should be removed within 18 months after the start-up.

- The prerogative of the CTCF to control cotton textile exports should be discontinued immediately, along with any other "police powers" it has taken on. (This need not affect any of the service functions it performs for the textile industry.) Care should be taken to put such "customs service" duties in an agency that is well insulated from vested interests within the textile industry.

The ever-present interferences in company management and in markets--by government ministries, holding companies, general assemblies, entities like the CTCF, etc.--have unintended consequences that greatly penalize the entire industry and, ultimately, the total economy of Egypt. If the policy mechanisms could be refocused toward the **facilitation**, through better information and a fair regulatory environment, of industry's efforts to succeed--and away from **control** of the industry's activities and decisions--then a new era of growth and development would become possible.

Management Restructuring:

- Management restructuring must begin in subtle ways early in the process, but it should be formally initiated when the debt resolution framework is submitted. Ultimately, management restructuring will provide a basic impetus to privatization. The process should shift the management's thinking toward production and marketing efficiency--and broaden its participation in all those aspects of the business that enable efficiency (i.e., procurement, sales, employee development and training, quality control, strategic planning, risk management, etc.).

- The strategic objective of improved management may be advanced by breaking large, vertically integrated textile manufacturing companies into smaller, less complex companies. This will foster the convergence of management **skills** with management **requirements**.

- Training of management should begin with the initiation of training activities and be a continuous feature of the management restructuring process. Those managers who make the transition to the private sector must be able to contribute to the goals of a modern management team and to make business arrangements with both buyers and sellers of goods and services in an open market environment.

Financial Restructuring:

- During the first year after start-up, impetus should be given to instituting the best accounting and financial techniques--even if they have to be done simultaneously with mandated public sector techniques. Certainly this includes

full implementation of the current directive that separate records be provided for each distinct operation within a company. Also, it seems unavoidable that the need for an independent audit and an independent financial evaluation will come out of debt resolution negotiations; this should be anticipated.

- About a month after the general framework for debt resolution has been delivered by the negotiating team, the TF should focus on deriving the implications for each company. This will probably be the juncture at which expert restructuring consultants could provide the most help, since thorough examination of the alternatives facing each company will then be feasible. Recommendations on financial restructuring should be delivered within 6 months after the process formally begins.

Company Restructuring:

- While first-stage technical restructuring will condition subsequent company restructuring, a focused effort on it should coincide with the formal start of financial restructuring efforts. Of course, progress in every other dimension of the programmatic plan will have implications for subsequent steps in company restructuring. Thus, the way to proceed will become clearer from study of enterprise accounting results, from feedback through the TF, from deliberations of the debt resolution negotiations, etc.

- Beginning as early as the second year after start-up (perhaps even earlier for a company like Helwan), a basic tactic for company restructuring should be the formal separation of different operations within a large company into multiple companies. (Therefore, the debt resolution framework should enable such separations where they have merit.) The eventual privatization of the "pieces" of such companies will also be much easier.

- The start of company restructuring should bring overt measures that accelerate the transformation of the companies toward a private enterprise management structure. If this does not happen, it will likely be a signal that either the banks are incompetent at negotiating a reasonable restructuring arrangement or the GOE is unwilling to allow one.

Comments on Training

The need for training is implicit in every issue covered on restructuring. The industry in Egypt has fallen behind during the last 30 years; especially during the last 15 years, which has brought a revolution in the **integration** of fiber and spinning

technology, quality control, and marketing. Evidence of these changes are not limited to industrialized countries in North America, Western Europe, and the Far East; it may also be seen in the textile industries of countries like Pakistan, India, the Czech Republic, or Indonesia.

Practical alternatives for Egypt will not closely resemble the ultra-high tech, capital intensive operations in the U.S., with their computerized selection of the cotton bales to comprise each mill lay-down and with no human hands touching the cotton after it is placed on the automatic opening/blending equipment. But the principles involved can be applied in ways that avoid expensive capital and utilize relatively cheap labor. Cost-effective utilization of computerized information flows on market and price conditions may already be feasible in Egypt, since the technology is becoming increasingly robust and affordable.

Training should be pursued in much broader terms than a classroom context. Ultimately, it will be Egyptians who must decide what mix of training activities will work best for them. The mix could include any of the following:

- Contractual arrangements or joint ventures with international textile companies, allowing Egyptian personnel to visit and work with those in the other company and foreign personnel to visit and work with Egyptians. In addition to the shared learning experiences, the personnel may engage in solving mutual problems that will directly contribute to success in shared objectives.

- Short-term (up to several weeks) and intermediate-term (up to several months) training programs aimed at upper level managers in textile mills. The most likely objective would be intensive training in integrating the requirements of (1) raw material selection, handling, and processing, (2) cost and quality control, (3) product design and promotion, (4) export marketing, and (5) risk management. This kind of program might be assembled under the auspices of the Management Development Center for Industry (MDCI) in Cairo; alternatively, it might be done at some learning center outside Egypt.

- Short courses (duration between a few days and a few weeks) on subjects such as financial accounting techniques, managing employees, delegating authority, procurement and handling of raw materials,etc.

- Travel to inspect and analyze the techniques used in other countries' textile industries. Trips should be carefully arranged to ensure consultation with experts and examination of infrastructures and processes.

- Circulating teams of technicians to give hands-on training to workers operating the various equipment in mills. One aim could be to significantly improve processing performance within existing machinery constraints. Another could be to train workers to spot the symptoms when a machine should be stopped in order to avoid producing below quality standards.

One way or another, a successful transition for Egypt's textile industry will embody a re-education of the industry's leaders and managers--not only in terms of technical and marketing skills, but in some philosophical concepts as well. Priority should be put on upper and middle managers, because they must reinforce new attitudes and approaches with all other employees. Obviously, re-education is a relatively slow process; any way to speed it up without traumatizing the students should be considered.

INTRODUCTION

Objectives

The purpose of this report is to provide the Ministry of Public Enterprises (MPE), Government of Egypt (GOE), with a plan of action to liberalize/privatize the country's cotton/textile sector. It requires (1) a reassessment of the current situation--institutional, economic, financial and technical--for the textile industry and (2) identification of crucial polices, programs, and structural adjustments not yet done.

In addition to the overall action plan, specific analyses are provided for thirteen public sector companies that have been designated as most problematical by the Public Enterprise Office (PEO) of the MPE. For four of these firms technical restructuring plans are provided.

Background

In 1992/93, the GOE and the U.S. Agency for International Development (USAID) agreed to study the textile industry in depth, in order to develop a plan for liberalizing and privatizing this important sector. The 1993-94 agreement between the Ministry of Industry (MOI) and USAID embodies a policy measure--the Sector Policy Reform Program--which calls for developing a plan to liberalize/privatize the textile sector.

As a result of these agreements, a study was conducted during the summer of 1993 and a report was produced, titled Assessment of Potential for Liberalization and Privatization of the Egypt Cotton Textile Subsector. (Hereafter, this report will be referred to as the 1993 Study.) It included institutional, economic, financial, and technical evaluations; it concluded with a proposed set of measures and the programmatic implications of these measures. The report was provided to the Chairman of the Holding Company for Spinning and Weaving (HCSW), then called the Textile Industries Holding Company. Results were also made available to the Holding Company for Cotton and Foreign Trade (HCCFT) and the Holding Company for Textile Manufacturing and Trade (HCTMT). These three Holding Companies (HCs) currently have jurisdiction over the public sector textile companies.

Early in 1994, the MPE requested a short-term consultation to follow up the aforementioned study, with the objective of developing an up-to-date action plan that could be used to restructure, deregulate, and privatize the textile sector. This report is the result.

Procedures

This study involved three distinct components:

- **Reassess and Update the analyses and conclusions.** - Review the findings and conclusions of the 1993 foundational study. Assess the impacts of recent laws, reform measures, and decrees. Determine the current state of institutional, economic, financial, and technical conditions in the public sector of textiles.

- **Prepare an action plan.** - Include recommendations on institutional changes, policy initiatives, and relevant structural adjustments. Derive the programmatic implications and recommend a time-table.

- **Develop more detailed information on thirteen selected companies and specific recommendations for technical restructuring of four of these companies.** - Update and augment financial and technical data. Focus on technical restructuring steps to improve basic efficiency in four of these companies.

PART I

RESTRUCTURING FOR PRIVATIZATION

SECTION I
REASSESSMENT OF SITUATION AND OUTLOOK

No significant factual or analytical errors have been found in the 1993 Study. During the intervening year's time, however, some conditions have changed. These are discussed in tnis section.

A. Legal/Institutional

Three new laws aimed at liberalizing the cotton sector have been approved by the People's Assembly of Egypt. Their thrusts are toward improved pricing, a more open domestic market, and private sector participation in cotton exporting.

Provisions of the three laws--and the executive regulations now accompanying them--are summarized below. Before considering each one, however, **there are two key entities that may constrain all activities under all three laws**: an official "**government representative**" and the **General Committee for Internal Cotton Trade (GCICT)**.

Government Representative - This person is placed by the MEFT, to be the eyes and ears--and ensure the control--of the government bureaucracy. He has no vote, but **he has a temporary veto power over all votes**, because his objection to any decision requires that there be a ministerial judgement rendered on its acceptability. He has the right to set in on any and all meetings; he should be informed of any meetings that are taking place.

GCICT - This English translation of this entity in the 1993 Report was the "General Committee for Organizing Local Cotton Trade". Its composition is the following:

- 5 cotton traders
- 5 cotton producers
- 2 cotton ginners
- 2 commercial bankers
- 2 Spot Market members
- 1 Commercial Chamber member
- 1 Industrial Union member
- 1 Agricultural Association Union member
- 1 from MALR
- 1 from MEFT
- 1 from CATGO
- 1 from HCCFT
- 1 official government representative

The traders and producers are elected by secret ballot in

the General Assembly. All members serve for 3-year terms, with consecutive terms allowed. Four consecutive absences without prior arrangements automatically terminates membership. Meetings are required once every two months, but may be held more often.

The President of the GCICT is designated by the MEFT, but according to which producer or trader receives the most votes in the General Assembly. He may select two vice presidents; one from the traders and one from the producers.

The GCICT is generally charged with executing objectives of the General Assembly, with oversight of the government cotton offices in each governorate, and with oversight of implementation of laws affecting cotton. It is specifically charged with proposing internal regulations as needed for organizing the domestic market. Further, it is expected to monitor the government's cotton policies and recommend changes that are deemed to be necessary.

The GCICT is to establish and oversee a "Registration Office" to control the official designation of legal "cotton traders" in Egypt. This office will consist of 3 members (with 3 alternates) that are selected by the GCICT for 3-year terms. Two of the members must be traders and one must be a producer.

Most of the regular activities required of the GCICT will be carried out by an "Executive Office" that has 5 personnel: the GCICT President, two vice-presidents, a trader, and a producer. The trader and producer are to be selected by the GCICT membership.

Law 141 (1994): For Establishing the Cotton Spot Market - Reestablishes a spot market in Alexandria. Trader and broker members (either individuals or other entities) are officially cleared by the MEFT. Basic requirements are the following:

- Be a registered cotton trader or broker
- Have a place of business in Alexandria
- Demonstrate equity of at least LE100,000
- Provide a deposit with the Spot Market Committee of LE10,000
- Have no criminal record

All deals actually done on the Spot Market must be handled by a registered broker--who must be an Egyptian citizen.

The Spot Market is to be directed by the Spot Market Committee. It consists of 4 exporters, 4 traders, 4 producers, 4 spinners, 1 broker, and 2 commercial bankers--plus the official government representative. Members serve three-year terms; all except the government representative and the bankers are to be selected by secret ballot within the General Assembly (which consists of all official members of the Cotton Spot Market).

Each year the General Assembly is required to meet each year in

the second half of February. At that meeting the Spot Market Committee is elected, consisting of the President, two vice presidents, a Secretary, and a Fund Manager. The Spot Market Committee has the responsibility for making the regulations for running the Spot Market; including official paperwork or other documentation of business done, preparation of an annual report, etc. It may establish any sub-committees it deems necessary to carry out its duties. It must meet one time each month, but may meet more often if necessary. It is subject to oversight by the General Assembly.

There is an explicit requirement to have a Cotton Technical Committee, selected each year by secret ballot within the Spot Market Committee or by the larger body of Spot Market members. It consists of 3 exporters, 3 ginners, 3 traders, 2 producers, 2 bankers, and 1 broker. It is charged to "supervise" or "provide direction" for the cotton trade deals actually done through the Spot Market. It is also responsible for estimating and announcing the weekly premiums and discounts associated with different types and qualities of cotton traded in Egypt.

Law 210 (1994): For the Organization of Internal Cotton Trade - Most basically, this allows producers to sell their cotton to any licensed cotton trader. It also allows both producers and traders to gin any cotton they own directly; it includes the right to utilize any person certified to class seed cotton for sale. It incorporates an indeterminate "transition period" that enables any seller who does not want to undertake the marketing of his cotton to deliver it to a traditional collection center and receive the guaranteed minimum price for it.

Direct marketing of cotton requires being licensed. Basic conditions to receive a license are the following:

- Be an Egyptian citizen
- Be registered by the MEFT
- Demonstrate an equity of at least LE30,000
- Provide a deposit of LE3,000 to the General Committee for Internal Cotton Trade (GCICT)
- Have no criminal record
- Never have taken bankruptcy

Oversight powers reside in a General Assembly. It consists of:

- the GCICT
- the same government representative that covers the GCICT,
- 3 cotton producers from each cotton growing governorate (selected by the Agriculture Society Assembly for 3-year terms), and
- cotton traders equal in number to producers, with at least one from each cotton growing governorate (selected by registered traders).

The General Assembly is headed by the President of the GCICT, or by one of his vice presidents when he is absent. It is required to meet in July of each year in Alexandria; it may meet anytime the president determines it is needed.

Law 211 (1994): For Replacement of Cotton Exporter Union Law - The Cotton Exporter Union was previously subject to Law 202; this law supersedes it. It allows for either individuals or "entities" to be registered as members of the Cotton Exporter Union. Only registered traders are eligible and only Union members can export. Other basic requirements are:

- Be registered on the Spot Market
- Demonstrate an equity of at least LE500,000
- Place a deposit of LE10,000
- Pay annual dues of LE5,000
- Pay fee of LE5 for each bale of cotton exported

The Cotton Exporter Union is to be located in Alexandria, with branch offices established as deemed necessary. The General Assembly of the Union consists of all Union members (plus the government representative). It selects a President and a Management Committee (consisting of two Vice Presidents, a Financial Manager and an Administrative Manager) by secret ballot for 3-year terms. The President heads the Management Committee, which is responsible for annual reports, budgets, etc. Moreover, the Management Committee is empowered to make almost any management or policy decisions (including those that regulate trades done by all registered traders) on behalf of the entire Cotton Exporter Union--subject to the constraint that the decisions do not interfere with the proper functioning of any other legal entity.

The extent of liberalization that actually results from these laws will be largely determined by implementation procedures developed in the months ahead. These thrust of these procedures will emerge from the collaboration of four key GOE Ministries: the Ministry of Agriculture and Land Reclamation (MALR), the Ministry of Industry (MOI), the Ministry of Public Enterprises (MPE), and the Ministry of Economy and Foreign Trade (MEFT).

A conference was convened on June 26, 1994, which brought together key people from the four Ministries, the HCs, and from other agencies and businesses involved with cotton and textiles. After the conference, a set of recommendations to guide the implementation procedures were produced, titled Conclusions of the Cotton Conference, Cairo, June 26, 1994. Not all recommendations are binding, but they will be influential on subsequent developments. Some official actions were taken that actually constitute further developments. These actions are embodied in "Joint Ministerial Decision 368", officially released

by the MALR and the MPE. Major components include the following:

- It establishes a new committee that meets each year during the last week in August, **in order to set minimum prices to both farmers and to textile mills**. (This makes it implicitly clear that the textile sector will be required to help provide the "floor" under farm prices.) Announcement of these prices will be in early September.
- It also requires that the committee meet in the first half of October to update projected domestic production and compare this with updated expectations for consumption in the domestic and export markets. If necessary, the committee will negotiate with domestic textile mills to alter their stated requirements for quantities and types of domestic cotton. Priority will be given to fulfilling contracts for exports; import requirements will be estimated accordingly. **Imports will remain subject to phytosanitary and other regulations promulgated by the MALR.**
- It directs that official export prices should <u>not</u> be announced in advance and that they should be varied according to price movements during the marketing year. (Of course this implies that there will still be an "official export price", which necessarily restricts an open market export policy.)
- It is intended that, in the event that actual producer selling prices are <u>above</u> the announced minimum price to cotton producers, the difference may be all passed back to the farmer <u>or</u> some of the difference may be kept for a fund to be used in stabilizing prices in the future. (How this may be accomplished under a liberalized system of private trading is most unclear; attempting to make it work will likely put the whole market liberalization process at risk.)
- It recommends that, between now and August of this year, domestic textile mills should contract their needs for the entire marketing year ahead, including a contractual schedule for delivery times and other such particulars. It is further recommended that the contract include a down-payment by the mills. (Full compliance with this recommendation would require extraordinarily exact planning by the textile mills; such exact planning is not possible in the U.S. or in other market-oriented textile industries.)
- It charges the Cotton Exporter Union with the responsibility of establishing a "database" for the benefit of cotton trading.

The Cotton Conference highlighted two specific concerns it would like to have addressed in the Executive Regulations of the new laws. It is recommended that:

(1) the representation of producers and traders should be <u>equal</u> on all committees, and

(2) the requirement that registered traders must have past trading experience should be deleted.

Depending on how policy objectives and implementation evolve, these laws could significantly alter the market structure over a 3-to-5-year period. However, given the inevitable time

lags in implementation and the lack of market orientation within Egyptian businesses, it is almost impossible for significant open-market activity to occur during the next year or two. **The danger in the near term is that imbalances and instabilities that are likely to develop will be blamed on open-market activities, rather than on the lack of them.**

If progressive implementation does occur, it will eventually become clear that continued import prohibitions on raw cotton deny the textile spinning sub-sector the ability to match its fiber requirements with its product mix in a cost-effective way. A fundamental dilemma facing Egypt's spinning sub-sector--which still must be confronted by policy makers--is that it is primarily a producer of medium count and course count yarns in a country that produces cottons appropriate for making fine count yarns.

There have been no new laws focused on corresponding legal changes for textiles, but some of the cotton liberalization is supposed to spill over into this sector. For example:

- Companies are now allowed to buy their domestic cotton through any registered trader.
- They are eventually supposed to be allowed to import cotton, but it is clear that this will not occur during 1994-95. Regardless, the phytosanitary regulations largely negate the practical value of having a choice in imports.

Beyond these allowances, the constraints and controls on textile pricing, trade, and market access are little changed from a year ago. Accordingly, the incentives (or lack thereof) for private sector interest in textiles are practically unchanged.

Continued deterioration of the public sector textile companies over the past year has certainly sharpened management's focus on improving their performance. The institutional structure within the HCs has been twisted and contorted; however, it has not been reshaped in a fundamental way. It remains essentially a monopolistic and hierarchical structure; meaningful autonomy of action by separate companies within a HC still does not exist. Indeed, existing management in most of the affiliated companies would be unprepared to exercise such autonomy.

B. Economic

Inevitably, conditions in the domestic and international markets have changed since last year. The global textile recession that began in late 1991 has entered a modest recovery since the beginning of 1994. However, the domestic market for Egypt's textiles may have deteriorated during the current year. On balance, Egypt's textile sector has had some opportunities to reduce its huge inventory of finished goods.

There has been a substantial shift in the global supply/demand balance for yarns, so that a shortage in yarn supply is now worrying textile industries worldwide. In Egypt, unavailability of yarns for domestic weaving mills--particularly those in the private sector--is most likely to reoccur. It may be the public sector weaving mills that are most distressed this time around, since advancing liberalization within the public sector is lessening their automatic access to yarns produced within the public sector. The necessity in open markets of planning for raw material flows will no doubt be a hard lesson.

A large and fairly sudden shift occurred in the global supply/demand balance for short and medium staple cottons (i.e., the Upland cottons), with world stock levels decreasing by about 20% and world price levels rising by about 50%. This was caused primarily by crop shortfalls in the Middle East and Asia, especially in Pakistan and China.

In sympathy with this dramatic tightening in Upland cotton markets, there was minor tightening in the long staple (LS) and extra long staple (ELS) cotton markets where Egypt participates. Compared to the end of the 1992-93 marketing year, export offering prices for U.S. Pima are about 7% higher. The same comparison for Giza 75 and Giza 70, however, reveals that they are lower; down about 11% and 19%, respectively. These price reductions, coming on top of others, brought Egypt's cotton prices to less than half their level in the early 1990's and to their lowest level in many years.

This significant lowering of Egypt's export prices has combined with strengthening world prices to make Egyptian cotton very competitive. This may be clearly illustrated by measuring these prices relative to those for U.S. cottons. Using quarterly price data from Cotlook, Ltd., Exhibit I-1 shows the percentage that offering prices for Giza 75 and Giza 70 were either above or below those for U.S. Pima. Between the first quarter of the 1992-93 marketing year (August-July) and the third quarter of the 1993-94 marketing year, Giza 75 prices went from 11% above those for U.S. Pima to 16% below. Giza 70 went from 48% above to only 3% above.

Exhibit I-2 shows the same comparison, except that U.S. Acala cotton prices are used. (Acala cotton is the type imported by Egypt during recent years.) Results show that Giza 75 prices went from 70% above to only 2% above those for Acala, while Giza 70 went from 127% above to 25% above.

It should be no surprise that the result has been rapid sales and a depletion of Egypt's previously excess cotton stocks. Unfortunately, these stocks have been sold at a large discount off the purchase prices and carrying costs borne by Egypt's public sector Trading Companies. After years of being priced out

Exhibit I-1

EGYPT COTTON PRICES VERSUS U.S. PIMA PRICES
PERCENTAGE ABOVE OR BELOW

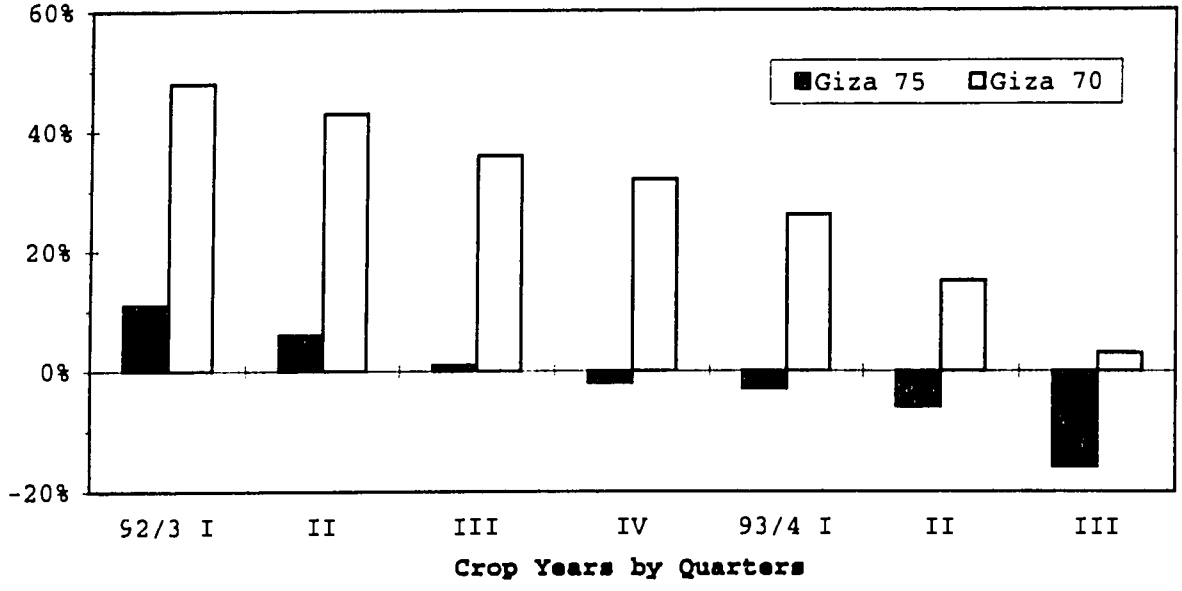
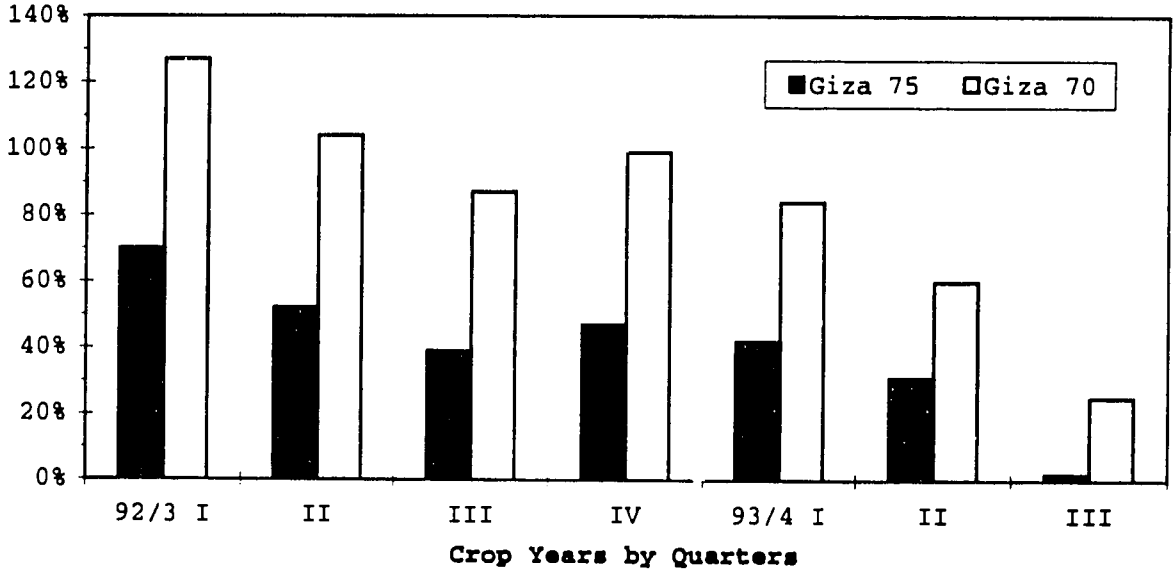


Exhibit I-2

EGYPT COTTON PRICES VERSUS U.S. ACALA PRICES
PERCENTAGE ABOVE OR BELOW



of the market, such large discounting can quickly bring customers attention back to Egypt. Justification must be based on the objectives of reestablishing Egypt's presence and convincing of its intention to serve export markets. Certainly price competition will be the key to Egypt's participation in export markets. The approach revealed in Exhibits I-1 and I-2 is one way to monitor competitiveness; a time series of such data will give a good idea about where Egypt's relative prices need to be in order to be attractive to export customers.

While the public sector spinning mills probably have adequate cotton inventories to operate until the next cotton harvest, they now confront a market in which adequate domestic cotton supplies next season depend upon an adequate harvest and "normal" export quantities. It is easy to imagine a scenario in 1994-95 that results in short domestic cotton supplies and frantic import activity, perhaps with Egypt paying more for the cotton it imports than it receives for the cotton it exports. There is resistance to consideration of the fact that **genuine liberalization of cotton exports without corresponding liberalization of cotton imports will risk short-term chaos in Egypt's textile sector**. This would likely lead to demands to retreat on export liberalization, rather than to advance on import liberalization. Policy planning that fails to anticipate such risks is not worthy of the name.

Finally, it should be noted that still unknown about GOE policies on setting cotton support prices are the specifics about how the program will operate throughout the full range of prices in the open market. Thus, if the fixed minimum farm prices set for Egyptian cottons turn out to be above the open market prices during the harvest period, then only the GOE (presumably represented by public sector traders) will be a significant buyer of the cotton. Unless the GOE stands ready to resell the cotton to private traders when open-market prices rise, the cotton trade situation in Egypt will effectively revert to a government function as it has been up until the latest round of changes in the laws. Such issues need to be clarified sooner rather than later; the GOE needs to go on record about how government inventories will be handled.

C. Financial

The 1993 Report stated the following (p. vi):

"In short, sector financial data point to massive under-capitalization and a chronic imbalance between resource use and the rate of return on operations. With total indebtedness at 77% of the value of fixed assets, the sector has relied on debt to build up productive resources. The aggregate return on these resources has been negative and, on the basis of current losses, sectoral net worth would be

exhausted in just over 20 years. In practice, this situation is likely to occur much sooner, given the debt overhang and the exponential increase in losses."

The above conclusions relied on the financial reports of the twenty-five public sector cotton textile companies for the 1991-92 fiscal year. There is no doubt that such aggregate results from the financial reports for the 1992-93 fiscal year would yield much worse results. It was not possible to do this again for all 25 companies; however, the two-year comparison can be made for the 13 companies designated by the PEO for reexamination.

The 13 selected companies were among the least financially healthy last year, as is clearly revealed by the financial data in Exhibit I-3. Their total indebtedness was 119% of the value of fixed assets and the rate of losses at that time would have caused their aggregate net worth to be exhausted in just 2 years. Based on the 1992-93 financial results, their total indebtedness reached 146% of the value of fixed assets and the rate of losses would cause their aggregate net worth to be exhausted in just 3 months. Thus, it is a safe bet that aggregate net worth of these 13 companies is currently negative. Except for the still large net worth of Kafr El-Dawar, the negative value would be very large in the aggregate (Exhibit I-3).

Within the HCs, there now seems to be a consensus that the worst of the companies must be dealt with or they will pull under the entire sector. Unfortunately, even this consensus reveals an ingrained tendency to conceive of the companies as just "divisions" of one big "company"; or, perhaps more accurately, as one big "welfare program" (or a "jobs program", since in Egypt a "job" is seen as the most appropriate vehicle to carry a welfare program). While company management is now trying to develop a more commercial orientation, there is still very little enterprise autonomy in areas of finance, purchasing, and product mix. There have been steps taken within some of the affiliated companies to systematically generate the data needed for appropriate profit/cost analysis.

There seems to be an assumption by some in the HCs that removing the burden of the worst companies will leave the remaining companies profitable; this is a dangerous delusion. It would provide the remaining companies with a better domestic business environment, but the realities of global competition will demand much greater technical, procurement, and marketing. efficiencies of all remaining companies.

D. Technical

The technical situation has hardly changed since the 1993 Report. Thus, the average operating efficiency for spinning

remains below 60% and that for weaving below 75%. The efficiency percentages of global competitors are at the 85-90% level, with an 80% level being a threshold target for economic viability. Roughly a quarter of all spindles and a fifth of all looms should be removed, regardless of the economic feasibility of replacement. Both of these removal levels would go higher if other, non-technical factors are incorporated into the assessment.

Obsolescence is pervasive in the dyeing and finishing segment of the public sector textile industry. With few exceptions, only a thorough reinvestment program to modernize equipment and upgrade technology and management will result in competitive dyeing and finishing companies. Furthermore, there is excess dyeing and finishing capacity in the public sector and significant capacity in the private sector. Consequently, apart from marginal investments aimed at improving technical and management capabilities, there is no basis for reinvestment in the public sector dyeing and finishing companies.

There are some critical areas of technical knowledge which could greatly improve the competitiveness of the Egyptian textile industry. These include:

- Techniques of fiber selection, handling, opening and blending.
- Methods for regulating ambient conditions within plants.
- Techniques of planning for procurement, production and marketing as a continuous process.
- Methods for quality control and quality assurance.

Building and upgrading these modern skills--through business partnerships, management contracts, education and training programs, etc.--is part of a necessary reinvestment in infrastructure.

E. Selected Issues Regarding Comparative Advantage

It has already been mentioned that Egypt's spinning sub-sector produces medium count and course count yarns, yet the cottons grown in Egypt are suited for making fine count yarns. Furthermore, the only cotton allowed to be imported into Egypt is also suitable for making fine count yarns. This is a classic example of violating the so-called "law of comparative advantage"; it asserts that, in order to be competitive, a country must produce products for which it has a <u>relative</u> cost advantage. Textile manufacturers in Egypt should position themselves either (1) to capitalize on the extra fine cotton fiber available domestically by producing higher valued, fine count textiles, or (2) to produce lower valued textiles using course count cotton fiber and cheap labor.

It is possible that companies in Egypt could position themselves for either type of competition--if the freedom were

available in Egypt to make a choice. The choice of competing in the fine count textiles would require different kinds of manufacturing facilities than now exist in the public sector; therefore, this is not a viable restructuring alternative. Access to less expensive fibers and yarns is possible through imports, however, and the low cost labor in Egypt could then enable competitive production of lower valued yarns and fabrics. The labor cost advantage could also be extended into the labor intensive production of ready-made textile products--many of which could be exported to balance the foreign exchange account. **Since the imperative of utilizing an abundance of labor weighs very heavily on the GOE, the ambivalence toward import policies that could help do this is paradoxical.**

The textile and apparel industries in Egypt could also benefit from freedom to import polyester and other synthetic fibers, which are used heavily in blends with cotton. The quality and quantity of domestically produced synthetic fibers is inadequate; besides, the excess capacity being installed in Far East countries and elsewhere on the Asian continent offers the prospect of ready access to competitively priced, high quality synthetic fibers and yarns.

The foregoing discussion suggests that Egyptian policy should be focused more on the "downstream" segments of the textile industry, since the country's comparative advantage is greater there. Another component of this "downstream" could be the dyeing and finishing segment. As previously stated, there is excess dyeing and finishing capacity in the public sector but it lacks state-of-the-art equipment and management to respond to global demand. It may be, however, that marginal investment in modern color laboratories and in training to operate them could transform some of the dyeing and finishing facilities into competitive operations. Therefore, such facilities might be candidates for early privatization if the market were liberalized enough to reveal the potential of downstream textile manufacturing.

The breaking up of larger, integrated companies into smaller, service-oriented companies could foster cooperation between public and private sector textile companies, leading to a more flexible, competitive textile industry. This, in turn, would prepare the market for private sector investment in those public sector companies that performed well--or showed the potential to perform well--in a deregulated market.

Finally, the problem of at least 30% excess labor in the non-production parts of the public sector textile companies is a limiting factor on the comparative advantage of the industry. As said in the 1983 Report, the Social Fund for Development (SFD) is the most obvious resource to help solve this dilemma in the near term. Cooperation and assistance is also available from agencies

like the USAID, subject to adherence to privatization as a preeminent objective. In the longer term, growth through liberalization and privatization could offer alternatives to the excess labor, taking them out of the public welfare system and into the bona fide work force.

SECTION II
RECOMMENDATIONS

This section highlights the foundational objectives for restructuring, deregulating, and privatizing the textile sector. It also recommends a structural framework for accomplishing these objectives. In doing this, it is recognized that, with rare exceptions in the cotton/textile complex, the GOE will choose to approach privatization through a process of restructuring and deregulation. It is not willing to take the risk of using aggressive privatization as means to foster restructuring and deregulation; rather, it conceives of privatization as a likely end-product of successful liberalization.

The predisposition to "gradualism", unfortunately, has already put Egypt's progress toward privatization far behind that for most other countries pursuing the objective for a comparable amount of time. The approach presented in this report risks the result of perpetuating non-viable companies; indeed, this will happen without a firm resolve by the GOE to get beyond half-way measures. Realizing this, USAID has made it clear that only a convincing plan, executed in a timely manner and focused on the ultimate objective of privatization, will be supported by that agency.

The intent of this section is to point the way toward genuine, demonstrable change that is consistent with and conducive to privatization, subject to the constraint that liquidation and/or divestiture will be not be used as a primary technique to instigate the process for the public sector textile companies. Pointing the way requires first raising the appropriate issues and developing a convincing approach to dealing with them. Therefore, before getting to specific recommendations, an introductory discussion of the basic issues is in order.

An imperative for liberalization of any economic sector is the dismantling of monopoly power over production, pricing, and distribution of both inputs and outputs. One way to do this is to, by law, deny the government authority to make certain types of laws abridging the freedom of individuals to produce, price, and sell within the market. In Egypt, however, the predisposition is strong toward vesting monopoly power in the regulatory agencies of government.

The basis for embracing liberalization as a worthy objective rests on an axiom that, once accepted, makes liberalization inherently superior to government-backed monopoly power over the economy. This axiom is that **the human nature of those in government is not different from the human nature of the rest of**

a country's citizens. The body of **selected** people is no less a body of people than those who make up the larger population. It is no surprise that private enterprises will ultimately abuse monopoly power; neither should it surprise that public enterprises will abuse monopoly power.

If the fundamental challenge of restructuring the textile sector is seen as the removal and prevention of monopoly power, then many courses of action will become clearer. For examples: the structures that set prices independent of the market will be dismantled; no agency will have the sovereign power to override the laws regulating cotton and textile trading; each textile company will be required to function as a separate business, rather than as part of a national textile corporation.

A somewhat uncomfortable corollary to the foregoing conclusion is that existing businesses will be exposed to (and will be subject to) competition. The exposure will almost certainly be less than with an early privatization of these businesses, but liberalization either exposes business to market forces or it is a fraud. This competition, unless prevented, will either impose discipline on or cause the failure of these businesses.

This report acknowledges the imperative for the GOE to moderate the suddenness and the severity of competitive pressures that would come from precipitous removal of protective, monopolistic structures. However, government leaders are asked to acknowledge the necessity of following through with a definite and timely plan to restructure these companies in order to <u>eventually</u> remove such protection; otherwise, there is no basis for collaboration in making a successful <u>transition</u> to a more open-market economy. An implication of this acknowledgement is that those monopoly-granting agencies which:

- do not clearly benefit the competitiveness of the businesses they regulate,
- offer advantages to some public sector companies at the expense of others,
- clearly retard adjustments that should be made quickly, or
- exist primarily for the benefit of those who occupy the agencies

are <u>not</u> entitled to any extensions of their monopoly power.

Finally, in Egypt as in most other countries, there are many influential people whose existence and experience within the confines of government bureaucracy have left them with an automatic inclination toward central planning of the economy and the society. This inclination, unless held in check, will surely thwart a liberalization process that has been entrusted to the government.

Those who would develop a liberalized environment in Egypt

by restructuring and deregulation must be willing to forego veto power over individual company decisions and over diverse open-market arrangements that do not violate basic rules of free competition. **Allowing such bureaucratic monopoly power means that the inevitable mistakes in bureaucratic judgement will cause industry-wide (and economy-wide) damage.** Whereas the central planner may see himself as presiding over the economic health of an entire industry, he instead fosters a sick industry that does not adapt well to changing market conditions and cannot compete effectively outside the artificial environment dictated by bureaucratic regulations.

Frequently the objectives of central planners for a given industry are significantly shaped by a desire to extract revenue for the government to use in pursuing other programs within a larger (and ever more complex) arena of central planning. Then the potential for damaging, unintended consequences increases exponentially.

A. Institutional

Given the basic nature of the cotton/textile industry, the large number of people employed, and the critical financial conditions existing in the public sector of textiles, decisive and swift action needs to be taken on privatization, deregulation, and restructuring. **This demands the direct involvement and guidance of the process by designated personnel within the MPE/PEO, reporting directly to the Minister.** Given the diverse manufacturing activities, the number of mills involved, and the importance of technical and financial details, an entity is needed that facilitates the gathering and understanding of basic information required to direct and coordinate the process. **This demands the formation of a "task force" to assist the MPE/PEO.**

The requirement for direction by the MPE seems self-evident. The current structure involving three HCs precludes management of the sector-wide process by them. The burden of leading in the liberalization for all public sector industries ultimately falls on the shoulders of the Minister of Public Enterprises, Dr. Atef Ebeid. Within the MPE, the Public Enterprise Office (PEO) exists to focus explicitly on these issues. The MPE/PEO is clearly positioned within the GOE to bear the responsibility for leading in the search for solutions and facilitating appropriate actions throughout the public sector of textiles. More importantly, **if the MPE/PEO does not provide such leadership, there is no other structure to do it.**

In order to provide leadership, the MPE/PEO must have expert assistance. The core of this assistance could be provided by an appropriately constituted textile sector task force (TF). Relevant considerations and suggestions about the composition and

purpose of the TF include the following:

- The Minister of Public Enterprises would continue his ongoing consultations and planning with the HC Chairmen. The TF would provide a transitional capability for authoritative information and recommendations about the various ACs throughout the cotton textile sector.
- The core group of the TF would work very closely with a small group from each Affiliated Company (AC). Each group would be chosen based on current, in-depth knowledge about the conditions and the problems within the company.
- The utility of the TF to the MPE/PEO will depend on the selection of an appropriate "Task Force Manager" (TFM) and a deputy to help him. The TFM could be an expatriate, with an Egyptian as his deputy. Ideally, both of them should be known and respected among managers within the various textile mills. Basic qualifications include: knowledge that spans technical, financial, marketing, and policy issues; expertise in collecting, organizing, and analyzing data; and thorough understanding of the principles, requirements, and results of liberalization.
- The TFM and his deputy will provide liaison between the MPE/PEO and the textile ACs, reporting to the designated person(s) within the MPE. As actions for restructuring and deregulation are undertaken, the TFM should also help verify compliance with decisions, monitor the progress made, and report regularly to the MPE/PEO.
- In addition to the TFM and his deputy, it is recommended that the TF include at least two expatriate technical experts: one in textile spinning and weaving and one in dyeing and finishing. Egyptian members of the TF should include individuals with experience in textile machinery, fiber evaluation, spinning, weaving, finishing, finance, and marketing.

If (1) the authority of the MPE is not dedicated to the removal of obstacles and resistance to liberalization, and (2) the TF is not structured to provide independent, reliable information that enables authoritative decisions by the MPE, then another bureaucratic layer will have been added without justification. **The purpose is to raise the decision making above bureaucratic delays, not to add another layer to the existing bureaucracy.** The public sector of textiles is in crisis; something must be done to salvage it and take it into the arena of private enterprise. If the drain on the vitality of Egypt's economy is to be stopped, there must be bold leadership and a willingness to take decisive actions.

B. Policy

Before proceeding with discussions of cotton and textile policies, a conclusion reached in the 1993 Report (p. II-1)

deserves to be reemphasized. It is the following:

> "Discussions with owners of private sector firms revealed a general belief that the greatest barrier to both liberalization and privatization is that commitment to these changes has never been 'internalized' by the responsible agencies of the Egyptian government. Therefore, private sector participants would not believe anything had changed until a firm timetable was established and major deadlines for change were met. (Therefore)...the rules by which market participants function must be announced well in advance of implementation. They must be progressive and time-specific, and protected from vested interests that would obstruct timely, market-wide implementation."

As revealed by examination of the new laws affecting cotton marketing in Section I, the extent of change embodied in them will not be clear until the behavior of key persons and groups empowered by the laws is revealed. Rather than guess what the eventual results of laws and decrees may be, this section will simply present critical areas of policy that need to be effectively addressed and clarify the issues underlying them.

Cotton Policy

As always, pricing policies will be the primary determinant of both the quantity and quality of Egypt's cotton production. These issues were covered in detail in the 1993 Report, where the failure of price signals to guide anything beyond the feddans devoted to cotton production was carefully documented. In particular, the critical guidance of decisions affecting quality of the cotton produced was entirely missing. For example, the grading or "classing" of cotton is of critical importance to its value, yet classification of cotton by the Cotton Arbitration and Testing General Organization (CATGO) had almost no impact on the price received by farmers and no impact on the price charged to domestic textile mills. Neither did the price received for ginning depend on the quality of lint cotton delivered by the ginning activity. Even the disappearance of covered storage for cotton in Egypt is traceable to the fact that no price signals were communicating that covered storage improves the quality of the fiber and therefore increases its value.

The intent of the new cotton laws to re-connect the users of cotton (the textile mills) to the marketing system offers hope that price signals will be able to help determine the quantities and types of cotton grown, as well as the production, harvesting, and ginning practices that are necessary for delivery of a high quality fiber to industry. To the extent that (1) the managers of textile companies understand the impact of fiber quality on spinning performance and yarn quality, and (2) can work directly with sellers in the market to correspond prices paid with

qualities received, the signals will work over time to improve the performance in selecting and sorting of cotton. To the extent that the price incentives thus generated are also available to cotton farmers, their efforts will focus more on producing and delivering quality cotton. The skills needed (in growing, ginning, grading, storing, testing, sorting, blending, etc.) to realize the full benefits of fiber quality management can be developed over a few years' time. But the freedom to send appropriate price signals that provide incentive for "doing it right"--and disincentive for "doing it wrong"--must be provided. This must be the guiding principal behind implementation of the new cotton laws.

Everyone should be forewarned that free-market price signals would probably not validate the old bureaucratic guidelines for quantities of the various types of cotton to be made available to the market. For example, incentives would likely develop soon and strengthen over time to increase the domestic supply of shorter staple cotton above what is now typical in Egypt--revealing as erroneous the virtual prohibition that has existed on research aimed at developing shorter season, shorter staple cotton of a high quality.

The fallacy of regulations illustrated by the prohibition of development of different types of cotton is that they erroneously assume comprehension of all the intricacies of technologies and markets. **To condemn the error of such regulations, however, does not mean that all regulations are unnecessary.** Necessary regulations include those to protect the integrity of grades and standards, of weights and measures, of varietal purity, of chemical or biological contamination, etc. The challenge to government is to fairly enforce those regulations that protect the integrity of commerce while forbidding the enforcers to use the regulations for denying basic commercial freedoms. As emphasized earlier, the inevitable mistakes in bureaucratic judgement are then institutionalized throughout the entire economy.

A principle of government regulation is that it imposes costs on society, but it may be justified by improvements in the competitive environment, or by other protection afforded to the general welfare. Thus, regulations should generally be a drain on the general government treasury--a worthwhile burden financed out of tax revenues--not a source of revenue for the government.

Another case of the lack of a proper regulatory <u>balance</u> is found in Egypt's policy on cotton imports. Starting with the genuine necessity of protecting Egypt's domestic cotton from infestations that could come in with imported cotton, the regulatory process in Egypt now denies the textile industry reasonable alternatives in imported cottons.

Based on scientific consensus, the GOE can ensure that no pests will come in with imported cotton by enforcing the following regulatory measures:

- Require that the cotton be ginned in such a manner that no seeds remain in the lint and that trash content is below a threshold level, thereby ensuring the absence of non-lint carriers of pests.
- Require that the cotton lint be compressed and packaged to some minimum specifications that ensure the integrity and protection of the cotton bale throughout shipment processes.
- Require that the cotton bale be fumigated according to exacting specifications just prior to loading for international shipment.
- Further require that the bales be sealed in containers immediately following fumigation and that the seals not be broken until the containers are unloaded in Egypt.
- Require that the bales be fumigated again upon unloading them in Egypt.

If these regulations were stringently enforced, the cotton so imported would then be safe to ship anywhere in Egypt without risk of contamination from biological pests originating outside Egypt. It would add substantial cost to the imported cotton, which would penalize imports in their competition with domestically produced cotton. It would also severely limit the number of countries that could meet all of the conditions. But the imperative of phytosanitary safeguards would certainly be met, while the textile spinning sub-sector in Egypt would have <u>meaningful</u> options in procuring a full range of its raw material needs.

Based on an assertion that such measures are not sufficient, Egypt's regulations are extended to include the condition that any cotton imported must be grown in a production area that is certified to be free of boll weevils. This has so far been interpreted to limit cotton imports to only U.S. cottons grown in the states of California and Arizona. Furthermore, even this cotton cannot be used by spinning mills located near cotton growing areas in Egypt. These limitations are too great for a weak industry that is failing in its struggle to adapt to global competition.

At the present time, there is little-to-no support within the public sector for liberalizing cotton imports. If it is done, the public sector companies will resist using short staple cottons; many will continue to resist using any non-domestic cottons. Those who do evolve into the use of shorter staples in their raw material mix will have to adjust both their machinery and their production management techniques. If it is not advantageous in the market, Egypt need not worry that it will become widespread practice. If it is advantageous, however,

preventing it with regulations will further disadvantage Egypt in global competition.

Textile Policy

There remains a serious monopolistic infringement on freedom to export yarn and woven textiles; furthermore, it applies to private sector companies as well as public sector companies. In all probability, the infringement spills over into domestic sales by public sector companies.

This price control occurs in the Cotton Textile Consolidation Fund (CTCF). It is somewhat ironic that the CTCF was legally established in 1953, prior to nationalization of Egyptian industries. It was established as a state organization to address problems faced by private industry in the early 1950's; in those early years it concentrated on sales promotion and technical assistance. Now, however, it establishes minimum export prices for cotton yarn and for most woven fabrics.

The CTCF is controlled by a "Permanent Committee" consisting of twelve members; seven who represent spinning and weaving companies and five provided by different ministries. These members meet intermittently; normally twice a year they establish and announce minimum export prices for all counts of yarn and for each type of woven fabric. These minimum prices are then enforced by control over the approval of an "export visa" that is required in order to get the shipments out of the country. Enforcement apparently is also aided by informal pressure from various people in the textile industry; it is this pressure that may also influence pricing decisions for domestic sales.

It was concluded in the 1993 Study that CTCF price controls were interfering with an orderly process of drawing down large finished goods inventories in the textile sector. The motivations appeared to be the desire by some companies to suppress price competition and reluctance by some to let the inventories be sold at a substantial loss. Losses were greatly increased, however, by holding on to the inventories.

This issue clearly illustrates some basic differences in viewpoints about "proper" control of production and marketing activities. Those who want the CTCF to have control of prices reason that to sell textiles at a price below the Permanent Committee's judgement about what is appropriate will result in losses to the company selling them and will make it harder for other companies to bargain for higher prices. Those who want the companies to be able to determine acceptable selling prices reason that any competent manager will bargain for the best price he can get for the type and quality of goods he has to sell--and that it may be better to sell at a loss sooner than to let the inventories age and take an even bigger loss later. **The**

fundamental mistake, of course, is to produce a significant amount of textile products that lack either the quality or the style that will command a profitable price--or to produce a high quality, stylish product at a cost that is too high to allow selling at a profit. Better to face such mistakes sooner rather than later; postponing the accounting loss may pass for a "solution" within the bureaucracy, but it will further damage the viability of the company.

Some people in the textile industry have said that the discussions of prices and other market conditions within the CTCF are helpful. Such discussions should continue; indeed, they should be encouraged in a variety of industry forums, in order to benefit the companies not represented in the Permanent Committee of the CTCF. **But it remains fundamentally important that the power to approve exports be separated from the power to "suggest" minimum export prices.** Whatever regulatory body approves exports should not have selling price as a criterion.

Issues of trade restrictions, both domestic and international, have reoccurred throughout this section. The reason is that they constitute one of the most basic governmental monopoly powers; they provide the foundation for almost all other restrictions that governments place on economic freedom. They are a government's best guarantee that it can perpetually dictate who will benefit from the country's economic activity. Why? Because in the absence of trade restrictions, businesses will eventually find ways to "neutralize" most other government related distortions by "trading around them." In a country that has a history of discouraging private enterprise, a necessary condition for invigorating private sector interest is the assurance that arbitrary interference with access to alternative sources of input supplies and market outlets will not be allowed.

C. Financial

During 1991-92, five of the affiliated companies were technically bankrupt; i.e., had a negative net worth. By now, that number has probably grown to at least ten. The most striking attribute of these ten companies is the very high level of debt they have been allowed to accumulate. In fact, this may be said of twenty of the public sector textile companies. **If restructuring of these companies is to have a chance for success, or if privatization (rather than liquidation of assets) is to be enabled, the debts will have to be completely rescheduled and substantially restructured.** This will require careful negotiations and arrangements with the major banks in Egypt, which hold the lion's share of the debt.

An "umbrella" agreement, covering debt resolution for the entire textile public sector, is needed to fix the environment within which agreements may be struck for individual companies.

In this agreement, threshold arrangements may be made on debt-for-equity swaps, on long term refinancing, on management and monitoring requirements, etc. Doing this will no doubt require guidance, insistence, and guarantees from the GOE. If the GOE will place a priority on early privatization, it should be able to find willingness within the banks to plan accordingly. Moreover, a focus on privatization would encourage a willingness from international agencies to assist in the debt resolution.

The negotiating team for debt resolution should include the MPE/PEO and should be able to utilize information available through efforts of the TF. The banks should be completely responsible for providing their own financial experts and should be allowed to involve any other type of experts (technical, real estate, etc.) that they deem necessary.

D. Technical

The overall condition of capital equipment clearly reflects the fact that the public sector has not adequately reinvested in its productive plants for many years. This was apparently impossible to do because rates of return on the investments were inadequate to allow it--as revealed by the fact that those companies where investments were financed by borrowing have been unable to repay the loans.

Investments made were most concentrated in spinning frames; significant additions to weaving were also made, but corresponding investments were not made in the machinery and equipment that precede and follow the spinning and weaving stages. Neither were investments made in equipment to control ambient conditions or to otherwise enable quality control in the manufacturing process. As a result, neither the product quantity nor quality that should have come from the new machinery was possible to achieve. **One technical imperative is to try to achieve some balance in the production lines.** Having said this, it bears emphasizing that quality control laboratories must become an integral part of the production processes.

Regardless of the assumptions made about cyclical behavior in the textile market, between 25% and 50% of existing machines and equipment should be removed from production based on technical considerations. Furthermore, doing this will have little or no impact on the actual production capacity of the textile sector. This is in part because when new machines were bought, they seldom were used to replace old machines; rather, they were simply added to the old machines. In some cases, the old machines are already out of production; this has just not been acknowledged by removing them from the plant. But in too many cases, these old machines are still running and are losing money for the companies every hour that they operate.

There is remarkable resistance within the textile public sector to the removal of any machine that can still be made to turn out a product. This reflects misunderstanding of the difference between a revenue and a profit from production--or perhaps a belief that profit does not matter as much as continuing to carry on activity. Evidence suggests pressure is exerted by the public sector hierarchy to continue producing with obsolete, unfit machines. This must cease. **A meaningful restructuring process must begin with the admission and accommodation of basic technical realities.**

It is clear that the GOE intends to reinvest in almost all of the textile companies as part of the restructuring process. Therefore, the foregoing discussion may be thought of as the first stage of technical restructuring; it may be followed by a second stage, a third stage, etc. The first stage is aimed at removing only the machinery and equipment that is incapable of producing acceptable quantity and/or quality.

E. Management

Carrying out a successful restructuring in the technical and financial dimensions requires good management. There are other critical dimensions of running a successful (profitable) business. These include procurement of inputs, marketing of outputs, recruitment and development of employees, strategic planning, risk management, etc. Modern management should have the skills to function in all these dimensions.

The reality is that, after thirty years of public sector existence, the above skills are not well developed among public sector managers. **This means that training must be given some priority, and that opportunities to partner Egyptian managers with expatriate managers should be exploited.** A further reality is that (1) these skills are not mastered by a single person within a company in other countries of the world and (2) even if they were, no single person could find enough hours in the day to execute them. Therefore, if a manufacturing business gets above a bare minimum size, its top management must be able and willing to delegate authority, a characteristic which is especially rare in Egypt. **This means that (1) companies' size and complexity should be reduced where feasible, (2) priority should be placed on fostering teamwork by a company's management, and (3) outside interference (which includes the HC) with management's day-to-day business decisions should be minimized.**

F. Training

The need for training is implicit in discussions throughout the previous sections, from the multiple dimensions of management listed in the previous sub-section to the pricing of cotton

between buyers and sellers under new policy guidelines. The industry in Egypt has fallen behind during the last 30 years; especially during the last 15 years, which has brought a revolution in the integration of fiber and spinning technology, quality control, and marketing. Evidence of these changes are not limited to industrialized countries in North America, Western Europe, and the Far East; it may also be seen in the textile industries of countries like Pakistan, India, the Czech Republic, or Indonesia.

Practical alternatives for Egypt will not closely resemble the ultra-high tech, capital intensive operations in the U.S., with their computerized selection of the cotton bales to comprise each mill lay-down and with no human hands touching the cotton after it is placed on the automatic opening/blending equipment. But other countries have taken the principles involved and applied them with less capital intensive techniques that utilize relatively cheap labor. Thus, on-line monitoring of yarn or fabric quality may not be economically feasible, but they have incorporated off-line quality control laboratories into their daily production management. Besides, capabilities for things like computerized information flows are not necessarily inappropriate for a country like Egypt. The technology is becoming increasingly robust and affordable, especially for applications in transferring market and price information.

Learning new techniques and adapting them to specific circumstances is fundamental to becoming and staying competitive. The process becomes "natural" once an industry is fully engaged in a "spiral" of global manufacturing and marketing activity; **global competition is a never-ending educational process**. The public sector textile companies have not yet broken into this spiral; therefore, the challenge being taken on by the GOE is to help these companies become fully engaged without having to destroy them and start all over with new private sector companies. A necessary condition for success is to convince those in the companies that they must start learning now and that they can never stop.

Training should be pursued in much broader terms than a classroom context. Ultimately, it will be Egyptians who must decide what mix of training activities will work best for them. The mix could include any of the following:

- Contractual arrangements or joint ventures with international textile companies, allowing Egyptian personnel to visit and work with those in the other company and foreign personnel to visit and work with Egyptians. In addition to the shared learning experiences, the personnel may engage in solving mutual problems that will directly contribute to success in shared objectives.

- Short-term (up to several weeks) and intermediate-term (up to several months) training programs aimed at upper level managers in textile mills. The most likely objective would be intensive training in integrating the requirements of (1) raw material selection, handling, and processing, (2) cost and quality control, (3) product design and promotion, (4) export marketing, and (5) risk management. This kind of program might be assembled under the auspices of the Management Development Center for Industry (MDCI) in Cairo; alternatively, it might be done at some learning center outside Egypt.

- Short courses (duration between a few days and a few weeks) on subjects such as financial accounting techniques, managing employees, delegating authority, procurement and handling of raw materials,etc.

- Travel to inspect and analyze the techniques used in other countries' textile industries. Trips should be carefully arranged to ensure consultations with experts and in-depth examination of infrastructures and processes.

- Circulating teams of technicians to give hands-on training to workers operating the various equipment in mills. One aim could be to significantly improve processing performance within existing machinery constraints. Another could be to train workers to spot the symptoms when a machine should be stopped in order to avoid producing below quality standards.

One way or another, a successful transition for Egypt's textile industry will embody a re-education of the industry's leaders and managers--not only in terms of technical and marketing skills, but in some basic philosophical concepts as well. Priority should be put on upper and middle managers, because they must reinforce new attitudes and approaches with all other employees. Obviously, re-education is a relatively slow process; any way to speed it up without traumatizing the students should be considered.

SECTION III
PROGRAMMATIC PLAN

This section will provide a time-phased plan for implementing the recommendations of the previous section. The rationale for the recommendations has been given, along with discussions of specific guidelines to follow in execution; this section will concentrate on timing and on additional details of execution.

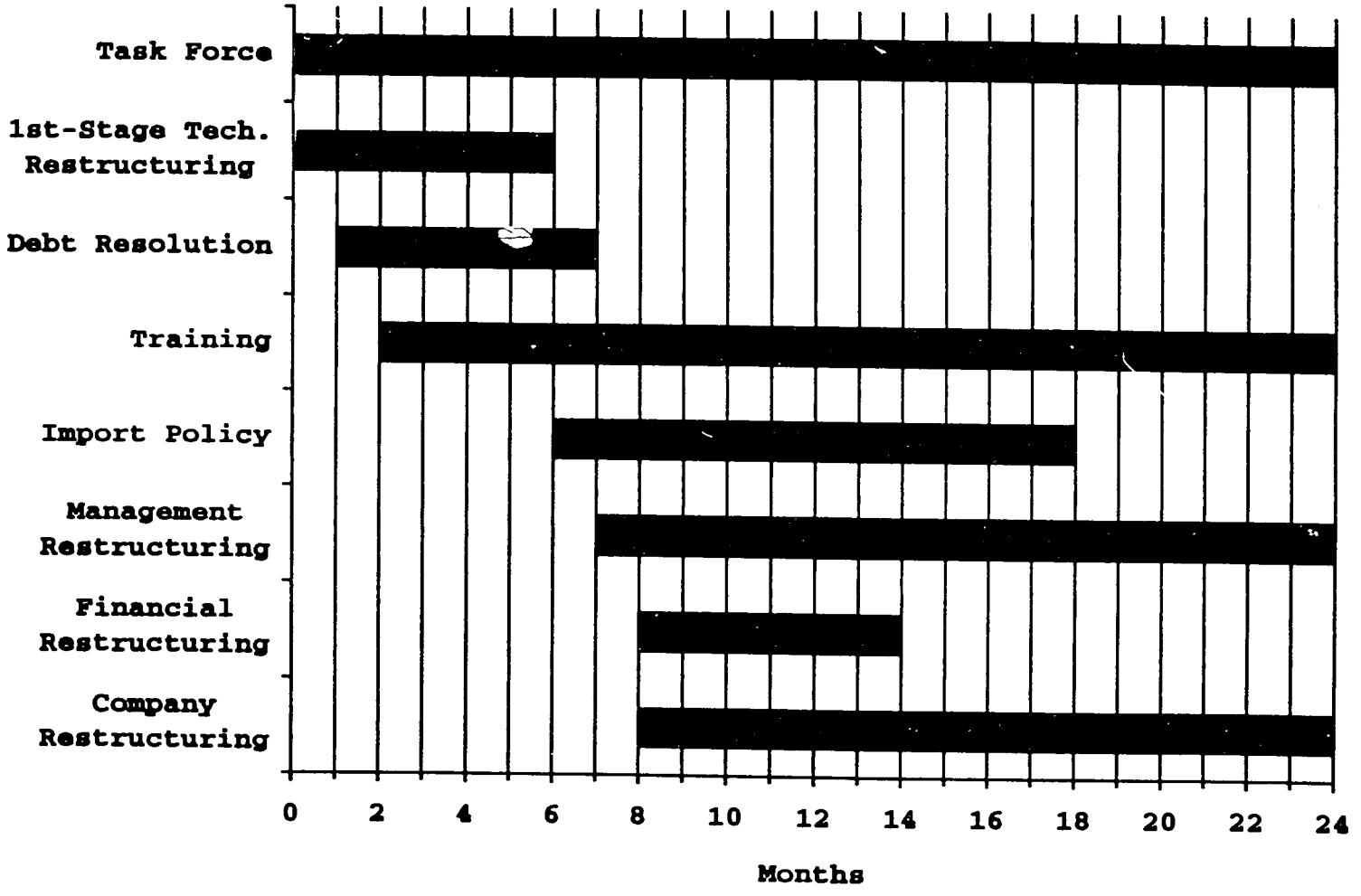
There are seven basic dimensions to the plan: institutional adjustments; technical restructuring; debt resolution; policy adjustments; management restructuring; financial restructuring; and company restructuring. An eighth dimension, training, is interwoven throughout most of the others. Indeed, the issues within all of these dimensions are interrelated and the time frames for many of the activities will overlap significantly. Exhibit III-1 presents a two-year Gantt chart (also reproduced in the Executive Summary) embodying the time frames recommended in this section. Four time lines--for the task force, training, management restructuring, and company restructuring--are expected to extend beyond the 24 months covered by the Gantt chart; all other dimensions included in Exhibit III-1 are completed within 18 months. Also, only first-stage technical restructuring is included, because neither the occurrence nor the timing of any subsequent stages can be stipulated.

A. Selected Companies for Early Action

Even as the overall plan is being developed and executed, it is suggested that particular attention be focused on four companies: Misr Helwan Spinning and Weaving Company(Helwan) and Upper Egypt Spinning and Weaving Company, El Sharkeya Spinning and Weaving Company (Zagazig), and Port Said Spinning and Weaving Company (Portex). Reasons are that these present a wide range of problems and situations and that wrestling with the particular problems presented by these companies will leaven the thinking about what is possible for the sector as a whole.

Helwan is large, vertically integrated company that has a large labor force; it has a mixture of good and bad equipment and is technically bankrupt by a wide margin. Upper Egypt is an interior company with geographically dispersed plants, but with generally good physical facilities and a significant contingent of fairly good capital equipment. Zagazig consists of a home-base facility that is technically and financially defunct, but with two satellite plants that are viable. Portex is a company based in a free trade zone, specialized in weaving and finishing, with an uneven mixture of capital equipment, and with serious

Exhibit III-1: TWO-YEAR GANTT CHART



market access problems. Financial and technical analyses, along with technical restructuring recommendations, on each of these companies are contained in Part II of this report.

B. Institutional Adjustments

The first actions must be to (1) clearly charge the MPE/PEO with leadership and oversight responsibility and (2) select a Task Force Director (TFD) and assemble a core group for the Task Force (TF). These actions will constitute the "start-up" of this action plan. The TF can be refined and altered over time as the MPE sees fit, but it must be put in place quickly so that assistance may be provided to the MPE/PEO from the very beginning. Without the TF, the MPE/PEO cannot effectively lead in developing solutions or adequately monitor results.

By the first month after the start-up, a special, government sanctioned negotiating team should be designated to work out a "general agreement for debt resolution." The charge given to this team should be to submit a framework agreement within which the debts of individual companies may be resolved. If the Minister of Public Enterprises cannot participate personally, a designated representative for him should be constantly involved. Other members should include the Chairmen of the three relevant Holding Companies and selected representatives of the banks which hold the debt of the public sector textile companies. The banks should be free to have their own experts present to help deliberate requirements regarding future ownership structures and future management of the companies. **In addition, it is recommended that a "privatization expert" from the USAID be requested.** The purpose is to ensure that the agreement reached will thoroughly consider implications for current and eventual privatization. It will also permit USAID to assess the feasibility of privatization after debt resolution, which will be necessary for its own program planning.

Within two months after the start-up, designate a small committee charged with offering ideas for training programs to the MPE. Members should include people from the TF and from the HCs. Also, it would not be surprising that some implications for training came out of the negotiations on debt resolution.

C. Technical Restructuring

Immediately upon start-up the TF, under the direction of the MPE, should begin to devise first-stage technical restructuring of <u>every mill</u> within <u>every company</u> in the public sector. **Failure to do this will amount to failure to make a good-faith start on debt resolution or on any subsequent restructuring objectives.** Indeed, the framework for debt resolution cannot be finalized without a clear understanding of the results of first-stage technical restructuring. Generally speaking, any subsidization

that is given by the GOE and any concessions given by the banks for the textile companies should come only after the implications of the first stage of technical restructuring are understood.

Decisions of first-stage technical restructuring should be implemented, as available on a company-by-company basis, immediately after approval by the MPE. **The implications of first-stage technical restructuring should be clear within three months and execution should be completed within six months after start-up.**

The time table for subsequent stages of technical restructuring should depend on the experience gained in the first stage, the implications of debt resolution, conditions in the domestic and global markets, etc. Certainly no more than one stage should be attempted within a year's time. In general, subsequent stages should focus only on improving the "balance" of the manufacturing process--without adding any production capacity to the company. Anything beyond these kinds of steps would fall outside the realm of technical restructuring.

D. Debt Resolution

Starting as soon as possible, the debt resolution team should quickly establish ground rules. They must be based on the fact that most of the wealth that collateralized the textile sector's debts does not exist any longer; what remains is to determine how the losses will be allocated between the GOE and the banks, and how further losses of Egypt's wealth can be minimized. (If desired, the team should request consultation aimed at explaining the limitations and possibilities inherent in their task.) **Within six months the team is to submit its proposed framework agreement to the GOE through the MPE.** Then all deliberate effort must be made to finalize it and make it official as soon as possible.

Obviously the failure to reach a compromise in debt resolution could truncate further steps in a restructuring process; an ill-conceived debt resolution package could preclude privatization for many years. Indeed, a worst-case scenario would be the failure to reach a workable compromise, but continuing with restructuring anyway. **Nothing beyond first-stage technical restructuring makes sense unless a framework for debt resolution is firmly in place.**

Given the lack of liquidity of several public sector textile companies, the negotiating team may have to propose some government-guaranteed, short term loans for the purchase of raw materials--unless there is willingness to let some mills set idle. The TF will provide the appropriate vehicle to alert the negotiating team about the extent of this problem and identify

the companies that cannot continue to operate unless granted unsecured loans.

E. Policy Adjustments

Some policy considerations that deserve early and persistent attention are the following:

- Given that the new cotton laws are not likely to substantially liberalize cotton prices for at least the next year or two--but will basically just reset the minimum price levels for the major types of cotton--the textile sector should seek an understanding of probable impacts on domestic cotton production by types, on domestic versus global price levels, etc.

- Since exports will be given priority and import alternatives are very limited, the textile industry should formulate contingency plans in the event that domestic supplies are seriously inadequate.

- A directive should be given to, **beginning about 6 months after the start-up, investigate regulatory measures that meet adequate phytosanitary regulations <u>without</u> denying the textile spinning sub-sector meaningful access to imported cottons that are not in the ELS or LS categories.** Regulations specifying actions and documentation required should be explicit. Penalties for violations should be preemptively harsh, perhaps including a ban on imports from countries where violations occur and on trading companies that are party to a violation. **But the regulatory gridlock on cotton imports should be removed within 18 months after the start-up.**

- **The prerogative of the CTCF to control cotton textile exports should be discontinued immediately**, along with any other "police powers" it has taken on. (This need not affect any of the service functions it performs for the textile industry.) Care should be taken to put such "customs service" duties in an agency that is well insulated from vested interests within the textile industry.

The ever-present interferences in company management and in markets--by government ministries, holding companies, general assemblies, entities like the CTCF, etc.--have unintended consequences that greatly penalize the entire industry and, ultimately, the consumers in Egypt. **If the policy mechanisms could be refocused toward the <u>facilitation</u> of industry's efforts to succeed through better information and a fair regulatory environment--and away from <u>control</u> of the industry's activities and decisions--then a new era of growth and development would become possible.**

F. Management Restructuring

Management restructuring must begin in subtle ways early in the process, but it should be formally initiated when the debt resolution framework is submitted, Ultimately, management restructuring will provide a basic impetus to privatization. **Indeed, soon after a debt resolution framework is in place, management restructuring should be tied explicitly to a specific privatization process.** All aspects of the restructuring process should shift the management's thinking toward production and marketing efficiency--and broaden its participation in all those aspects of the business that enable efficiency (i.e., procurement, sales, employee development and training, quality control, strategic planning, risk management, etc.). The interactions of TF members with the management should, over time, result in a flow of ideas from the companies themselves about how to prepare for privatization.

The strategic objective of improved management may be advanced by breaking large, vertically integrated textile manufacturing companies into smaller, less complex companies. This will foster the convergence of management skills with management requirements. With encouragement, the smaller companies will quickly learn how to do business among themselves.

Training of management should begin with the initiation of training activities and be a continuous feature of the management restructuring process. Only if the characteristics of management in the public sector firms become compatible with the requirements of private enterprise will it be able to make the transition. Those managers who do make the transition should be able to contribute to the goals of a modern management team and to make business arrangements with both buyers and sellers of goods and services in an open market environment.

G. Financial Restructuring

During the first year after start-up, impetus should be given to instituting the best accounting and financial techniques--even if they have to be done simultaneously with mandated public sector techniques. Certainly this includes full implementation of the current directive that separate records be provided for each distinct operation within a company. Also, **it seems unavoidable that the need for an independent audit and an independent financial evaluation will come out of debt resolution negotiations**; this should be anticipated.

About a month after the general framework for debt resolution has been delivered by the negotiating team, the TF should focus on deriving the implications for each company. This will probably be the juncture at which expert restructuring

consultants could provide the most help, since thorough examination of alternatives facing each company becomes much more feasible at this point. **Recommendations on financial restructuring should be delivered within 6 months after the process formally begins.**

H. Company Restructuring

While first-stage technical restructuring will condition subsequent company restructuring, **a focused effort on it should coincide with the formal start of financial restructuring efforts**. Of course, progress in every other dimension of the programmatic plan having implications for subsequent steps in company restructuring. Thus, the way to proceed will become clearer from study of enterprise accounting results, from feedback through the TF, from deliberations of the debt resolution negotiations, etc.

Beginning as early as the second year after start-up (perhaps even earlier for a company like Helwan), **a basic tactic for company restructuring should be the formal separation of different operations within a large company into multiple companies**. (Therefore, the debt resolution framework should enable such separations where they have merit.) The eventual privatization of the "pieces" of such companies will also be much easier. While an obvious possibility exists for breaking the companies apart if some of the mills are located in different areas, there is no a priori reason why mills located next to one another cannot be separated and placed under separate management.

The start of company restructuring will move privatization issues to the forefront. The actions taken should be calculated to transform the various companies into business enterprises that either attract a threshold level of private investment or cease to exist within a specified period of time. If this does not happen, it will likely be a signal that either the banks are incompetent at negotiating a reasonable restructuring arrangement or the GOE is unwilling to allow one.