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Final Report

Price and Market Liberalization in Egypt

Vol. 1 of 2: Main Report

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Glossary

c.i.f.	cost, insurance, and freight
ECR	Egyptian Company for Refractories
ERSAP	economic reform and structural adjustment program
f.o.b.	free on board
GAFI	General Authority for Investment
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GOE	Government of Egypt
GOFI	General Organization for Industrialization
IMF	International Monetary Fund
MT	metric ton
PBDAC	Principal Bank for Agricultural Development
PEO	Public Enterprise Office
RAKTA	General Company for Paper Industry
SME	small and microenterprise
SORNAGA	El Nasr Company for Refractories and Ceramics
SPR	Sector Policy Reform
SSP	single super phosphate
TSP	triple super phosphate

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Preface

This report incorporates the results of field interviews carried out by the Nathan Associates study team in Cairo in July and August 1994 and in Alexandria in October 1994. The study was carried out in close collaboration with the Research Department of the Egyptian Ministry of Economy and Foreign Trade, whose director, Dr. Ali Soliman, suggested expanding the proposed survey from the ad hoc set of interviews originally intended to a more formal inquiry. This inquiry was carried out in August and September 1994 by Al Qarar Consultants, a local Egyptian research organization, using a survey instrument based on a questionnaire designed by the Nathan Associates study team in July 1994. The preliminary survey results are presented in Chapter 5 and in Appendix C.

This report was drafted by Harold Lubell (Chief of Party), George Rosen, L.G. Thomas, and Richard Sines, with the assistance of Professor Mahmoud Hosny of Helwan University. Mahmoud Alyan helped arrange contacts with public and private sector industrial managers and accompanied the team to numerous interviews.

Executive Summary

SUMMARY OF FINDINGS

Chapter 1

The objectives of the exercise reported on here were "to assess the [Government of Egypt] achievement in implementing its economic reform program regarding price and market liberalization... and to make recommendations on any further actions needed."

Egypt is still in the process of transition from the Egyptian socialism of the 1960s to the freer market economy introduced by in the 1970s and continued in the 1980s and 1990s. The recession and inflation of the late 1980s led the Egyptian government to request a major aid and debt relief package from the World Bank and the International Monetary Fund (IMF); this package was approved in 1991 but made conditional on Egypt's adoption of an economic reform and structural adjustment program (ERSAP). As part of the ERSAP, the government agreed to a considerable number of price and market liberalization measures.

Since 1991, the Government of Egypt (GOE) has removed price controls on all products produced under monopoly conditions or benefiting from subsidized inputs except pharmaceuticals, rationed sugar, edible oils, cigarettes, and, of course, bread. Electricity prices are being raised to cover long-run marginal costs and are now said to be at international levels. Agreements were also made to free cotton production and pricing.

Because public sector companies still dominate many of Egypt's industrial branches, the extent of the liberalization of prices from government control is in reality rather limited. However, Egyptian producers in both the public and the private sectors are now subject to price competition from imports (after payment of customs duties) and from new firms entering the local market. At this point, further price liberalization depends on greater market liberalization.

Chapter 2

Although the current legal framework of Egypt's pricing and regulatory system originated in price controls dating back to World War II, the framework developed in all its intricacies during the 1960s in the period of Egyptian socialism. The "open door" policies of the 1970s left most of the controls in place but destroyed what coherence they had once had. Current efforts to liberalize the Egyptian economy have yet to deal with a large number of residual administrative constraints, as well as with the monopoly practices of existing private sector enterprises and those that will be created by privatization.

Chapter 3

Much of Egypt's industry is still dominated by government-owned companies that control the prices at which they sell—within limits set by the prices of competing imports after customs duties. In some sectors, however, public sector firms have been pushed into a minority position by more efficient and more dynamic private sector and joint venture firms.

Chapter 4

An examination of pricing and marketing practices in 12 sectors of the Egyptian economy reveals the current state of price and market liberalization in Egypt. One of the sectors, hotels and tourism, is the focus of a policy requirement attached to USAID/Egypt's Sector Policy Reform (SPR) cash transfer for 1992–1993 through 1993–1994. The other sectors were selected to get an up-to-date view of the evolving process of price and market liberalization in Egypt. The pharmaceuticals sector is treated separately in Volume 2 of this report.

The sectors examined reflect different kinds of market "imperfections." These imperfections include residual government price controls (which might or might not be effective), public sector monopoly or oligopoly practices, private sector monopoly practices that include collusion between private sector enterprises and government officials to keep out competitors, and simpler strong-arm tactics to keep out competitors.

One definition needs to be clarified. When Egyptians currently say that a price is "free," they mean that the price in question is not being set by ministerial decree. In that sense, prices of most goods produced by private and public sector companies are "free" because prices are now set by the individual producing company rather than by a supervisory ministry. In reality, the pricing policy of public sector companies is usually subject to (1) close scrutiny by their respective GOE holding companies and (2) the advice of the Public Enterprise Office (PEO) and the Ministry of the Public Business Sector, to which the PEO reports. In addition, both private and public enterprises are subject to a variety of regulations that affect pricing and are still in effect.

Hotels and Tourism

The hotel and tourism sector is one in which existing government price controls are currently without effect. By law, the Ministry of Tourism is required to review (and approve) price lists of hotels, restaurants, and tourism-related enterprises. In 1992, the ministry approved a price jump of 60 to 70 percent, which set the "rack rates" (price ceilings) above what the market would bear.

In reality, it is the market that sets the price. The big hotels are not supposed to sell below 50 percent of their rack rate in order to prevent them from competing "unfairly" against the smaller two- and three-star hotels. However, the rack rate for Egyptians and other residents is 50 percent of the ceiling rack rate. Discounted by another 50 percent, that reduces the floor for Egyptians and residents to 25 percent of the ceiling. Such weekend and off-season discounts are given by hotels with leisure and recreational facilities such as swimming pools. Moreover, hotels can negotiate the number of free room-nights that they include in confidential package deals. Embassies, international agencies, corporations, and tour operators negotiate rates below the hotel rack rates that set a theoretical ceiling. The rules set a theoretical floor to prices that a hotel is permitted to charge; in practice, in a weak market the floor is porous. On the other hand, the rules are still in force, and a different minister might be inclined to apply them rigidly.

Agriculture

The current wave of liberalization of Egyptian prices was initiated in agriculture in the mid-1980s, along with other agricultural policy reforms. However, price controls remain on cotton and sugar cane, which are important crops.

Cotton and Cotton Goods

Major problems remain for the cotton sector. Raw cotton is the most important cash crop of Egypt's agriculture and a major component of exports; cotton textiles and their downstream manufactures are the country's biggest industrial employer and one of the country's biggest export earners.

The cotton industry, from the production of raw cotton on the farm to fabrication of final consumer goods such as household textiles and garments, is currently one of the more tightly regulated sectors in Egypt. Until recently, cotton growing was subjected to strict government controls in terms of compulsory cultivated areas, production quotas, and prices. Now, only cotton prices are controlled. However, lint cotton may be imported only with special permission from the Minister of Agriculture, only from growing areas free of the boll weevil, and then only if lint bales are fumigated at the port of origin and the Egyptian port of entry. Egypt's cotton imports are currently limited by area of origin to Arizona, which is free of the boll weevil but whose prices are 30 percent higher than elsewhere. No imported cotton may be delivered to spinning mills in Egypt's designated cotton-growing areas, where about 50 percent of spinning capacity is located. Imports of yarn face no quota restrictions but are subject to a 30 percent tariff and require approval by the Cotton Textile Consolidation Fund as well as authorization by one of the public sector holding companies. Imports of cotton textile fabrics and products are prohibited. Exceptions require special exemptions and bear special tariffs of 80 to 110 percent. Other imports are illegal, although there are two well-known smugglers' markets at Al Azhar and Bulaq in Cairo for used clothing that comes in from Libya, Sudan, and the Port Said free zone.

Before Law 203 established the public sector holding companies, the cotton companies were attached to the Ministry of Economy, which set the export price of raw cotton. The lint cotton price is still set by the government on the advice of a committee of spinners, farmers, and traders. The Cotton Textile Consolidation Fund, created by Law 251/1953, today has among its functions establishing minimum export prices for cotton yarn and most woven fabrics for all exporters for each count of yarn and each type of woven fabric. Minimum prices are announced twice a year, in March and September, on the basis of production costs (1) reported by public and private sector companies and (2) prevailing in international markets according to commercial attaches abroad. Export prices of knitted fabrics were freed in 1984.

Agricultural Inputs: Fertilizer

Because the number of fertilizer producers in Egypt is small, the sector is oligopolistic by definition.

Phosphatic Fertilizer

Egypt has two phosphatic fertilizer companies, one of which has two plants. Both companies are in the public sector under the Holding Company for Mining, Refractories, and Ceramics. Before 1991, the fertilizer producers had to sell all of their output to the Principal Bank for Agricultural Development (PBDAC), which resold to the farmers at subsidized prices. As part of the reform program, price controls have been abolished. The producers now sell directly at prices that cover costs and some profit, and they make their own distribution arrangements. The producing companies are willing to sell to anybody but, in fact, sell to a small number of big traders able to take delivery of large quantities and to provide letters of credit.

Nitrogenous Fertilizer

There are three public sector nitrogenous fertilizer producers in Egypt. KIMA produces ammonium nitrate from electricity and air in Aswan. Talha Fertilizers and Chemicals Industries Company produces ammonia, ammonium nitrate, and urea in Talha based on natural gas. Abu Qir Fertilizers and

Chemicals Industries Company, the newest of the three, sets its prices at cost plus a margin of about 20 percent. Abu Qir is the price leader in Egypt; Talha sells at about the same prices as Abu Qir.

Bread

Bread, the politically sensitive commodity of mass consumption, continues to be heavily subsidized.

Rationed Products

Like bread, rationed products—sugar, rice, vegetable oil, and tea—are sold at fixed and subsidized prices.

Food Processing

Food processing in Egypt is a relatively competitive industry, both internally and internationally, with both public sector companies and private sector firms active in the sector.

Tobacco

The Egyptian tobacco industry is a public sector monopoly with all prices, both ex-factory and retail, set by ministerial decree; the only private sector activity is the production of sweetened tobacco for water pipes (*shisha* and *goza*). Efforts to begin privatizing and breaking up the government tobacco monopoly are currently under discussion. An important aspect is to ensure that the GOE replaces its current monopoly profits from tobacco with higher taxes.

Cement

The oligopolistic cement industry in Egypt is composed of a small number of public sector firms at the production level. These firms deliver their output to a private sector distribution system rife with strong-arm exclusionary practices and supplying market activities that are partly illegal. Until 1991, cement production and distribution were in effect a government monopoly, with public sector producers obliged to sell their output to a central Cement Sales Office at ex-factory prices subject to Ministry of Housing decree. The central Cement Sales Office was abolished by Ministry of Housing Decree 152/1991, which also eliminated the authority of the Ministry of Housing to decree prices of cement (as well as reinforcing bars). The cement producers are now free to set their own ex-factory prices and to sell directly to traders or final users; however, ex-factory prices are still set by consensus of the producers and the GOE. On the distribution side, entry requires a sufficient financial base, storage facilities, and enough muscle to hold one's own in a rough milieu.

Refractories

Another producers' oligopoly is refractories, where there are only two major producers, both in the public sector. The two companies bid against each other for local contracts in a peculiar way. They will submit the same initial price; but then each discounts up to 20 percent or 30 percent off that price "to get the piece of cake."

Glass and Glass Products

Another industry dominated by two major public sector producers is glass and glass products, one of which is a small shareholder in the other. The interlocking nature of the industry is being intensified by the 10 percent participation of the larger firm in a new joint venture company; the company is to produce float glass using an English process for which Egypt has bought the license. Participation by

existing public sector companies, which also have the needed local technical expertise, in new joint venture companies is a pattern that some of the public sector companies seem to have adopted in other sectors as well.

Paper

In the paper industry, collusive practices by private sector importers have been documented by the General Company for the Paper Industry (RAKTA), an Egyptian public sector company that produces writing and printing paper manufactured from rice straw and bagasse (sugar cane residue). RAKTA took its case to the parliament and was able to bring about changes in government practices for procuring paper supplies. These changes included specifying quality characteristics instead of country of origin.

Chapter 5

Chapter 5 presents some of the findings of a preliminary report by Al Qarar Consulting Center on the Ministry of Economy survey of industrial pricing practices commissioned for this study.¹

Chapter 6

Chapter 6 summarizes briefly some of the impacts of policy reform. Because one of the immediate aims of price liberalization was to raise the prices of a variety of subsidized commodities, prices have indeed risen. In agriculture, the immediate impact of the resulting increase in fertilizer prices was a sharp drop in fertilizer use by the farmers, followed by a recovery in fertilizer sales as farmers began to use fertilizer in a more socially cost-efficient manner. The primary impact of the freeing of agricultural prices and elimination of the system of compulsory planting and forced deliveries has been a significant shift in cropping patterns. The increases in ex-factory prices of cement turned the cement producers into profitable enterprises, enabling them to overhaul equipment, improve productivity, and increase production. In spite of a number of specific price increases, the 1991 stabilization and reform program, by tightening fiscal and monetary policy, brought about a decline in the overall rate of inflation.

The most important reform in the foreign trade area has been the replacement of import bans by increased tariffs. The only remaining bans are on imports of fabrics, ready-made clothing, and (according to some but not all sources) poultry. The effect has been to set ceilings on the prices of locally produced goods, the ceiling being the landed import price of a competing good plus the customs duty.

The study team did not run across examples of restrictions on internal trade other than rumors of local monopolies in rural transport and of strong-arm tactics designed to keep out competitors in cement distribution and in the marketing of fresh produce.

With the exception of the tobacco industry, there are few true monopolies in Egypt. Markets for basic manufactured goods are organized as informal arrangements among duopolistic or oligopolistic public sector companies in the same lines of production.

Chapter 7

Chapter 7 sets out some conclusions concerning price determination in Egypt. The liberalization of Egyptian prices from control by the GOE is only partial. Direct price controls by ministerial decree are

¹An English translation of the preliminary Al Qarar report and a copy of the survey questionnaire are presented in Appendix C.

now limited to bread, certain rationed consumer goods, pharmaceuticals, utilities, sugar cane, and (until the Alexandria Cotton Exchange is opened) cotton. Other prices have been freed in the sense that they are no longer subject to ministerial decrees. However, with the bulk of manufacturing carried out in public sector companies, the GOE still has a strong influence on price setting.

Standard practice by manufacturers is now to set local prices to cover fixed and variable costs and a profit margin of something between 5 and 10 percent, but under a ceiling set by the price of competing imports after payment of customs duties. Export prices will vary with the market to which they are directed, in line with the income and price levels ruling in those markets.

In the hotel and tourism industry, neither the ceiling nor the floor prices approved by the Ministry of Tourism are binding. However, the rules remain on the books and the possibility of their enforcement continues to exist.

RECOMMENDATIONS FOR FURTHER ACTION

Chapter 8 sets out the following recommendations for further action.

Price Liberalization

In the case of hotels, the legal requirement for obtaining approval of changes in ceiling prices (the rack rate) by the Ministry of Tourism seems superfluous because all changes are being approved, the ceilings are in most cases well above what the current tourist market will bear, and the floor prices are not being enforced. It seems reasonable, therefore, to suggest that the current system of theoretical price setting be abolished entirely, leaving the Ministry of Tourism responsible for monitoring the facilities and services provided by each hotel to justify the number of stars by which it is categorized, and the Ministry of Health responsible for checking on the sanitary conditions of hotels and restaurants.

Market Liberalization

The Egyptian government is committed to market liberalization as the major means of stimulating more rapid economic growth and higher living standards than in the past. However, for market liberalization to succeed it is important that development of private enterprise and investment in industry and trade be far more rapid than in the past. For this to occur, major reforms in the institutional framework of the economy are necessary—not so much to reduce the overall role of government, but rather to shift that role from direct operation in and control and regulation of industry to establishing and operating a network of institutions, thus permitting an effective market system.

This implies withdrawal of government from its microregulation and control of industry, especially its (1) detailed regulation of entry of firms and (2) detailed and time-consuming taxation procedures at various levels, both of which discourage investment. These practices should be replaced by a "one-window" system that simply permits free entry within such limits as broader aspects of health and environment might require. All such decisions affecting entry, as well as decisions on taxes, should be made rapidly.

The current legal system greatly hinders investment, extension of credit, and settlement of claims among business firms. Reform of the legal system should have high priority.

In many existing industries, the informal connections between a small number of enterprises encourage collusion in price setting and distribution. The government should consider developing adequate antitrust legislation to discourage such collusion and encourage free entry of competitors.

Currently, for many industries, imports are the main competition for domestic producers and monopolistic pricing is limited by such imports. It is therefore important that the government both

reduce customs tariff rates (to a revenue-yielding basis only) and reduce or eliminate various regulations that raise the cost of importing products into Egypt.

Further Research

It would be interesting to find out more about distribution networks and practices for commodities such as cement and fresh produce, which have an unsavory reputation for restricting entry through strong-arm methods. It is not a task that can be carried out by foreign consultants.

Beyond that, it is time to start examining what institutional framework, or what variant of antitrust legislation, is appropriate to limit the extent and negative effects of cartel behavior by firms operating in the Egyptian market.

A serious re-examination of the institutional framework of the government's economic decision-making is needed. Such a study would attempt to clarify the functions now exercised by the numerous actors in field, including the classical economic Ministries of Finance, Economy and Foreign Trade, Internal Trade, Industry, and the Business Sector (formerly Public Enterprises); the other ministries intervening directly and indirectly in the economy, such as Health and Education; the numerous (and essentially ad hoc) authorities, such as the General Authority of Export and Import Control; and the various investigatory agencies, such as the Military Officers Administrative Censorship Authority under the Presidency and the Public Funds Investigation Department of the Ministry of Interior. The study would also, perhaps, make recommendations for their rationalization.

Agenda for Action

A number of areas that need immediate study and support were identified by Egypt's business community during the Private Sector Investment Conference held in Cairo on October 9 and 10, 1994. These areas, which constitute an appropriate agenda for action to accelerate market liberalization, include the following:

- **Legal constraints.** Change laws and institutions to allow (1) enforcement of contracts; (2) proliferation of private business organizations and trade associations that can become more effective advocates for their members; (3) easy entry, operation, and exit of firms; and (4) continued removal of time-consuming regulatory and taxation procedures in favor of a system that simplifies business operations.
- **Public-private sector dialogue.** Develop purposeful mechanisms for an ongoing dialogue between government, small and large businesses, donors and labor.
- **Export promotion.** Analyze the impact of the General Agreement on Tariffs and Trade (GATT) by (1) examining international competitiveness of Egyptian industries relative to competing suppliers to global markets, and (2) identifying areas where technical support to industries could be used to develop Egypt's international competitiveness, increase intra-industry and intra-firm trade, expand foreign direct investment, and, where appropriate, develop new economic policies in light of the new GATT agreements governing trade. Also examine closely those industries, such as plastics, machine made carpets and horticulture, that have demonstrated Egypt's capacity to export; determine how these exports can be further promoted.
- **Public monopolies.** Speed up privatization, particularly through the sale of the shares in capital markets, to allow the private sector to expand and diversify. Also, study ways to prevent the continued expansion and "crowding out" of the private sector by the public sector. At a

minimum the expansion and funding of public sector enterprises should be monitored, taking into account that much of their expansion can be funded by internal resources.

- **Private monopolies.** Study the appropriateness of enacting antitrust legislation prohibiting noncompetitive behavior by the private sector. Investigate sectors that appear to be dominated by effective private monopolies, such as cement distribution and agricultural wholesaling. Also, analyze the existence of monopolized imports—for example, in the area of building construction materials and paper. Examine what institutional framework, or what variant of antitrust legislation, is appropriate to limit the extent of cartel behavior by firms operating in the Egyptian market.
- **Technology sourcing.** Study why it is difficult to transfer environmentally sound "high tech" goods from economically advanced countries to Egypt. Determine whether strengthening Egypt's weak intellectual property rights laws and enforcement would encourage investments in these areas.
- **Small and microenterprise promotion.** Prepare the groundwork for establishing and promoting a small and microenterprise program in Egypt, with special emphasis on those owned and managed by women.
- **Information gathering and dissemination.** Determine a list of important business statistics and information and put in place a system to collect, prepare, and disseminate that information. Determine how private and government promotion agencies can provide better foreign market intelligence and active marketing and promotional assistance.
- **Port and airport services.** Develop an efficient strategy to demonopolize the public sector shipping agency and other public port services.

1. Background

OBJECTIVES OF THIS STUDY

As stated in the scope of work, the objectives of the study are

to assess the GOE achievement in implementing its economic reform program regarding price and market liberalization (outside of utilities, financial services, agricultural output and energy); to study the actual and expected level, availability of goods and services in Egypt, and foreign trade [as affected by price liberalization]; and to make recommendations on any further actions needed. This will help both the GOE and USAID in formulating policy measures for the next stage of economic reform.

The study shall review in particular GOE regulations and practices affecting prices and market transactions, including subsidies, and monopolistic practices by both government and private entities. The ministries and other organizations that are responsible for setting or enforcing prices and market behavior shall be identified and visited. Public and private shops as well as hotels and other service activities shall be surveyed to get a picture of the extent to which they are free to set their own prices, especially at the retail level. The study shall identify commodities and services having prices or availability set by government or monopolistic suppliers both private and those controlled by the government, thus having the same effect as price regulations.

HISTORY: FROM EGYPTIAN SOCIALISM TO ECONOMIC LIBERALIZATION

The market framework within which the Egyptian economy functions is the heritage of more than 20 years of Egyptian socialism as modified by the "open door" policies of the 1970s and 1980s.²

Private and Public Enterprise Policy, 1952–1990

The 1952 revolution saw the overthrow of both monarchy and Egypt's traditional dominant rural groups (see Appendix A). In the industrial sector the new government accepted the existing private ownership, and took steps to implement policies long advocated by the private entrepreneurs to stimulate industry, adopting policies that were supportive of the private industrial sector. However, after the 1956 invasion of Egypt by Great Britain, France, and Israel, President Gamal Abdel Nasser nationalized all British, French, and Belgian banks, insurance companies, trading companies, and other assets in early 1957. A public holding company, the Economic Organization, was set up in 1957 to control all public nonfinancial enterprises (including those formerly foreign-owned). In 1960 the Bank Misr Group, which controlled Egypt's largest private enterprises, was nationalized, and in 1961 and 1963 further nationalizations occurred. By the end of 1963 almost all private large- and medium-sized enterprises in manufacturing and trade had been nationalized. The nationalized companies were consolidated into appropriate groupings based on their outputs, and organized into a complex network

²See John Waterbury, *The Egypt of Nasser and Sadat* (Princeton, 1983); H. Ansari, *Egypt, The Stalled Society* (Albany, New York and Cairo, 1986 and 1987); and Bent Hansen, *Egypt and Turkey: The Political Economy of Poverty, Equity and Growth* (World Bank, 1991).

of joint stock companies controlled by various general organizations attached to different ministries. Output targets were given to each plant, prices and wages were controlled, and employment directives were given. A 5-year program for industry was introduced in the mid-1950s, followed by an overall Five Year Development Plan for 1959–1964.

Nasser's Charter (*Mithak*) of 1962, which defined Arab Socialism and provided a rationalization for the economic policies from 1956 to 1962, presented a vision of a mixed public and private economy tightly controlled by government in a secular and classless society.

Following Nasser's death and Anwar Sadat's succession to the presidency, the economic difficulties of the public sector increased and were no longer concealed. In October 1973 Sadat outlined his policy of *infitah* (opening) to deal with the country's economic problems and accelerate economic growth. The new policies encouraged entry of new private businessmen into trade and industry in the late 1970s and early 1980s. In addition to the traders, a new group of entrepreneurs set up firms to produce more sophisticated and capital intensive industrial products in such fields as chemicals, metals, and the finer textiles. Many of the new investments were joint ventures with foreign firms.

The growth of the private sector at this time was stimulated by the general expansion of the economy in the early 1980s. However, the latter half of the 1980s witnessed a downturn in the Egyptian economy that erased many of the gains of the previous 5 years.

The 1991 Reforms

In early 1991, the Egyptian government approached the IMF and the World Bank for a loan and for debt relief. An aid and debt relief package was approved but it was made conditional on Egypt's adoption of an economic reform and structural adjustment program (ERSAP-I).

During the past 3 years, one major aspect of the macroeconomic stabilization program has been largely successful. The government's fiscal deficit has been sharply reduced; government expenditures have been reduced as public investment and subsidy expenditures are cut; and revenues have risen as a result of broader taxes and improved tax collection. Combined with a tighter credit policy, the stabilization program has reduced the apparent rate of inflation from an earlier high of more than 20 percent to less than 10 percent. As a result of greater confidence in the Egyptian economy, the country's foreign exchange position has improved greatly. However, at least initially, the effects of these stabilization policies have not been encouraging for the economy as a whole. The rate of growth of output has been low and open unemployment has risen, particularly among the politically sensitive group of secondary school and university graduates.

The structural reforms of ERSAP-I have been directed toward improving the functioning of the economy so that it will grow steadily and efficiently and provide employment and greater well-being for the entire population. The reforms seek to move from government operation of the bulk of industry and tight controls over the private economy to a system in which private individuals and enterprises make the microeconomic decisions and are responsible for their own profits and losses. By concentrating on industries that will take advantage of Egypt's comparative advantages in labor and natural resources, these reforms will lead to greater efficiency in the economy as a whole—and thus to continued economic growth and lower unemployment.

Under the ERSAP-I program the government agreed to introduce a long-range program to privatize a large number of public sector enterprises; this is proceeding, although at a slower pace than targeted. A program of reforming the functioning of public enterprises has also been introduced to force them to operate with greater independence and reduced government support.

The government also agreed to remove price controls on all products produced under monopoly conditions or benefiting from subsidized inputs—except pharmaceuticals, rationed sugar, edible oils, cigarettes and, of course, bread. To cover long-run marginal costs electricity prices have been raised,

but at a slower pace than originally envisioned. Agreements were also made to free cotton production and pricing of cotton. Equally important, the government has agreed to greatly simplify the entire industrial investment process and to reduce required approvals and red tape at all levels in the process.

More specifically, prices of so-called "noncompetitive" products, of competitive products with high trade protection, and of a specific groups of goods under the control of the Ministry of Industry (e.g., animal feed and cotton seed) were completely freed. Prices of products benefiting from high input subsidies or produced by monopolies (i.e., pharmaceuticals, cement, and cotton), although remaining administered, were raised closer to their market equivalents. Similarly, energy and transport prices, although still government-determined, were moved closer to their economic values; railway fares, along with the prices of electricity, petroleum-based products, and natural gas, were adjusted upwards in line with their long-run marginal cost or their international equivalent levels.

The government's gradual efforts to liberalize trade had three major components:

- A reduction in import tariff dispersion (with few exceptions, all tariff rates were brought into the 5 to 70 percent bracket);
- Elimination of all export quotas (except tanned hides) and all import bans (except textiles and poultry products); and
- Easing of some of the nontariff bureaucratic barriers to trade by, for example, streamlining the list of products requiring prior import approvals and improving the administration of the drawback and temporary admissions systems.

Egyptian authorities also began dismantling some of the regulatory obstacles to business entry and operation, including the following efforts:

- Investment licensing approvals for industry and nonindustrial companies incorporated under Law 230/1989 (the main legal vehicle for foreign investors) became automatic (except a "negative list" grouping health, environmental and national security activities).
- For industrial and nonindustrial Law 230/1989 firms, approval requirements for business expansions, changes in product mix, and new products were removed.
- Legal provisions for agricultural land rental contracts were made more flexible.
- Bans on private placement services and job advertising were discontinued.
- Some overlapping regulatory jurisdictions by local, governorate, and central authorities were streamlined.
- Private sector participation in the distribution of certain products (cement, pesticides, fertilizers) was allowed.

Ideally, the decontrolling of prices and the easing of investment will both stimulate private investment in industry and increase the extent of competition in price and quality. This should lead to greater export capability for Egyptian industry, stimulation of economic growth, and increased employment, especially among educated urban youth. One hopes, too, that it will end the repeated downturns in the economy and the periodic need to approach foreign aid donors for emergency loans.

PRICE AND MARKET LIBERALIZATION: RATIONALE AND MEASUREMENT

What Role for Government?

Liberalization of the economy implies changes in the functions of government; it does not imply abandonment of government intervention in the economy. The desired change is the withdrawal of government from the micro-level operation of economic enterprises in order to focus on fostering an "enabling environment" for efficient and competitive enterprise activity. This implies the creation and

protection of a competitive, as opposed to a monopolistic, economic environment in which producers can enter and exit the market with a minimum of constraints, and in which consumers are protected from shoddy products and other forms of exploitation. Privatization is part of the current ethos of market liberalization; however, where a small number of government enterprises dominate a segment of the market, privatization will not by itself create competition. Instead, it might simply replace market domination by public enterprises with market domination by private enterprises. The government will then be obliged to intervene to counteract any negative effects of the market behavior of private sector monopolies or oligopolies. The government also has an accepted social obligation to alleviate the economic condition of the weaker segments of society; what is controversial is the choice of economic instruments with which to fulfill that obligation.

Liberalization and the Direction of Price Movements

Price liberalization in Egypt was initially advocated by the World Bank and A.I.D. as a policy instrument for re-introducing economic rationality into the allocation of resources, particularly in agriculture. The primary focus was on removing price subsidies, which kept the prices of both agricultural inputs and agricultural outputs below their "economic price." In that context, *price liberalization* became a code term for "raising prices." In the case of agricultural inputs, liberalization did indeed raise prices, particularly for fertilizer. During the past few years, as the farmers have recovered from the shock, the increase in input prices has led to more rational use of fertilizer and possibly to increases in output.

In the case of cotton, *price liberalization*, which at first meant "raising prices," now implies freedom for textile producers to move prices up and down in response to changes in the world market.

For public sector industrial producers, price liberalization also meant an increase in prices in order to reduce the drain of their financial deficits on the public budget. Now the producers are free to set their own prices in a highly cartelized domestic market, within the limits permitted by the prices of imports after customs duties. However, prices are still set by agreement among producers, the holding companies to which they are attached, the PEO, and what is now called the Ministry of the Business Sector (under Minister Atif Ebeid), as in the case of the cement industry (see Chapter 4).

How then should price liberalization be measured? Except in a volatile commodity market such as cotton, where the resurrected Alexandria Cotton Exchange will be operating, price fluctuations are not a desirable criterion. Identical prices of quasi-identical products are not necessarily an indicator of non-competitive pricing because in the real world, where classical perfectly competitive markets do not exist, it is reasonable competitive behavior to meet a competitor's price reductions or to follow his price rises to see what the market will bear.

The way pricing is often done in the real world is price discrimination by the type of market of potential sale. Prices for identical products will be high in rich countries and lower in poor countries, high in opulent sections of town and low in the slums. A more subtle approach is to shape a product for consumers of a particular income bracket, and to modify it for consumers of different income brackets. One example of this is plastic brushes, which were mentioned during interviews for this report. The producer—who estimates that he supplies 80 percent of the Egyptian market while exporting 75 percent of his production to the Gulf states, Israel, South Africa, and elsewhere—produces three types of broom-brushes: a rather shoddy-looking brush for the poor, which is priced at a markup of 10 percent; a medium-quality brush for middle-income consumers; and a slow-moving, fancily decorated brush for the rich that is priced at a markup of 100 percent. The constraints on his pricing are set by the prices of competing imports (after customs duties) from Italy. Indicators of price liberalization are therefore elusive.

It is no longer clear what the aim of price liberalization is supposed to be. There are several possibilities: to protect other downstream producers and consumers; to hope to arrive at greater efficiency through economic pricing; to promote competition. In effect, as price subsidies disappear, the focus shifts from price liberalization to market liberalization.

Public Sector Controls and Private Monopolies

With the exception of pharmaceuticals, cotton and cotton goods, bread, and the remaining rationed consumer goods, the Egyptian government's direct economic controls are gradually being dismantled. The public sector companies, although still burdened by excess manpower and sometimes antiquated machinery, are now required to function as normal business enterprises. At the moment, the public sector holding companies and their associated companies still retain control of much of the country's basic industry; and in the absence of any antitrust legislation or policy, they function as cartels. If the government's aim in distributing associated companies of a given sector of industry among several holding companies was an attempt to reduce the extent of cooperation (or collusion) among them, it has been unsuccessful. The company managers meet formally and informally to share information on foreign markets and international prices; there is nothing to prevent them from sharing other information as well. That their domestic prices are often identical or close is an indication of informal agreements on prices, as would be expected in an oligopolistic market.³

Many of the associated companies are likely to be wholly or partly privatized within five years. The odds are that privatization will not change their behavior with respect to price setting and market sharing, especially if the privatization is only partial and the government retains a strong interest keeping redundant public sector company workers from being forced back into the labor market.

Competition will come from new joint venture and purely private firms operating in an expanding market.

Price Effects of Trade Liberalization

The liberalization of foreign trade has affected both imports and exports. In the case of imports, the end of the physical bans on most commodities has increased the importance of foreign competition for price setting for the local market by Egyptian firms. Most of the company managers interviewed for this report set their prices somewhere between cost and "the market price," by which they mean the import price including customs duty. As customs tariffs are reduced, the ceiling on local prices will be lowered correspondingly, putting increased competitive pressures on local producers.

In the case of exports, the elimination of most restrictions on exports and the unification of the foreign exchange regime have given producers with underutilized capacity greater incentives to enter export markets—especially in the Middle East, but also in Europe and the United States. The more enterprising businessmen of both the public and private sectors have been able to exploit particular market niches to expand their export activities.

³However, if the associated companies are hungry for business, they have been known to cut prices "under the table," as in the case of the phosphatic fertilizer industry (see "Agricultural Inputs: Phosphatic Fertilizer" in Appendix B).

2. Legal Framework for Pricing and Regulation

PRICE CONTROLS, 1939–PRESENT

As described in a review of Egypt's price policies prepared for the Shora Council, Egypt's Senate, in 1985, present-day concern with commodity pricing in Egypt began at the start of World War II in 1939 (Majlis El Shora 1985). Since then, GOE intervention in pricing developed in three stages to the mid-1980s: (1) 1939–1960: the period of World War II and its aftermath; (2) 1961–1974: the period of Egyptian socialism of President Nasser; (3) 1975 to the mid-1980s: the period of the "open door" policies of President Sadat. The period since the mid-1980s might be characterized as progressive (or perhaps creeping) liberalization. The first stage, 1939–1960, reflected decisions and measures taken to meet unusual circumstances of World War II and the British withdrawal from Egypt. The second stage, 1961–1974, evolved under legislation of the Nasser period. The third stage, 1975–mid 1980s, combined the "open door" policy with measures carried over from the previous stage (see Appendix A).

REMAINING PRICE AND SUPPLY CONTROLS

The most important controls directly affecting prices and supply through ministerial decrees and decisions that are still in place pertain to the cotton and cotton goods sector, including the ban on imports of cotton and of ready-made clothing. Others are a ban on imports of poultry, fixed prices for subsidized bread, and fixed prices for the quantities of several consumer goods distributed against ration cards (see Chapter 4).

One of the regulations affecting retail trade restricts publicized "sales" to two 4-week periods during the year, in February and August. Within each 4-week period, the "sale" period for private sector retailers is limited to 2 weeks—either the first or the second 2 weeks, as the retailer wishes.⁴ The public sector retailers, such as the Omar Effendi chain, have their "sale" period during the first 2 weeks and are permitted to use the second 2 weeks for "clearance." According to the Head of the Commercial Section of Omar Effendi, 60 percent of annual clothing sales are made during the "sale" periods.

Since 1991, the extent of the government's direct intervention in the economy through laws and decrees has been reduced. Nevertheless, the regulatory environment as described by the World Bank in 1992 has not been greatly modified (World Bank 1992).

Investment projects other than those covered by a negative list are now legally required only to be registered with the General Organization for Industrialization (GOFI), the main licensing authority. Investments still covered by the negative list, however, require government approval and must satisfy certain requirements (such as minimum local content) depending on the nature of the investment project. The investments are subject to comprehensive technical scrutiny (although less comprehensive than previously) by either GOFI or the General Authority for Investment (GAFI). Other restrictive regulations remain even for investments not on the negative list, such as those requiring investors to (1)

⁴Price cutting outside the "sale" periods must be done without publicity.

obtain investment approvals or licenses, or both, from local governorates to set up and operate industries, (2) obtain approvals from various agencies to import equipment, and (3) follow cumbersome and time-consuming procedures in establishing their companies.

Other regulations affecting business operations in Egypt—covering such areas as the supply of material inputs, employment, industrial safety, the environment, and product standards—are intended to protect domestic industry from competition, ensure export supplies, allocate scarce resources, protect consumer and workers from exploitation, and protect the environment. Some are desirable; some are not.

Egypt's legal system, the heritage of the pre-1952 monarchical regime as modified by more than 30 years of Egyptian socialism, itself places many constraints on the development of a market economy, thus indirectly affecting production and supply availabilities.

A recent report assessing the Egyptian legal and judicial sector summarizes the following legal and judicial constraints and barriers to entry that impede the development of a competitive market structure (Bentley 1994, vol. III, 9):

- Case delays, judgment enforcement difficulties, inadequate arbitration rules;⁵
- Inadequate university legal education system;
- Lack of post-degree continuing education for judges, lawyers, and officials;
- Inadequate legal information systems;
- Antiquated commercial law institutions such as the Commercial Register;
- Outmoded laws such as the Civil and Commercial Codes;
- Lack of institutionalized economic law and policy analysis;
- Lack of institutionalized private sector input on economic legislation;
- Inadequate post-enactment information to the public on commercial laws;
- Need of post-enactment monitoring of commercial laws; and
- Uncompleted law reforms.

Bentley's comment on Egypt's Commercial and Civil Codes is typical:

Outdated provisions of the Civil and Commercial Codes preclude Egypt from effectively benefiting from modern developments in business and financial transactions such as secured transactions, asset-based financing and equipment leasing because of the lack of a modern system of creating non-possessory security interests (i.e., mortgages) in all forms of tangible and intangible property (1994, vol. I, 8).

PRACTICES THAT RESTRICT INTERNAL TRADE

The existing system of ownership and control of the public sector enterprises ensures oligopolistic behavior by the associated companies under the several holding companies. The private sector is not yet big enough to create serious problems of monopoly or oligopoly except in minor market niches. That situation will change as the private sector grows.

The legal framework for dealing with issues of monopoly, unfair competition, consumer protection, and trade liberalization is weak. Bentley (1994, vol. III, 193–196) points out that there are gaps in Egypt's legislative framework for protecting market mechanisms and free competition. For example,

⁵The World Bank report *The Private Sector Regulatory Environment* (12 June 1992) suggests finding and supporting pragmatic alternatives to judicial bankruptcy proceedings, such as negotiated settlements and arbitration for bankruptcy and other business disputes. However, in order to prevent fraud or the formation of monopolies, an autonomous body or commission would need to be established to examine and approve mergers on the basis of transparent guidelines.

although Law 241/59 prohibits monopoly in connection with the distribution of locally made products, there is no comprehensive law against monopoly and monopolistic practices or restrictive trade practices. Similarly, although the Civil Code contains general provisions imposing liability for fault—i.e., tort liability—that could be used by a party injured by faulty products or unfair competition, and although other laws and regulations provide for some minimum product labeling and health and safety standards, more modern and comprehensive consumer protection legislation appears to be required.

3. Entities that Control Prices by Dominating the Market

This chapter describes (1) government and private entities that control prices by dominating the market and (2) the commodities they control directly or indirectly.

Exhibit 1 presents a thumbnail sketch of the Egyptian economy in terms of three loosely defined characteristics: "government controlled and monopolistic," "private and monopolistic," and "workably competitive."

Exhibit 1. Characteristics of the Egyptian Economy

Sector	Description
Agriculture	Mostly workably competitive
Mining	Mostly government controlled and monopolistic
Construction	Mostly workably competitive (and much of it unlicensed or clandestine)
Manufacturing	Majority government controlled and monopolistic, with some branches workably competitive
Transportation	Mostly government controlled and monopolistic, with some workably competitive elements
Communication	Mostly government controlled and monopolistic
Public utilities	Mostly government controlled and monopolistic
Wholesale trade	Partly workably competitive, partly subject to private monopolistic behavior, and other parts government controlled and monopolistic
Retail trade	Mostly workably competitive
Finance, insurance, and real estate	Mixed, but basically government controlled; could be more competitive
Other services	Preponderantly government services in the formal sector

GOE-owned companies still dominate much of Egypt's industry (in manufacturing, public sector companies accounted for 68.5 percent of the value of production and 74.4 percent of employment of larger-scale firms in 1988–1989) and the department-store component of retail trade. The public sector companies "control" prices in those sectors in the sense that they (rather than the ministries) now set prices—as constrained by demand and the competitive price of imports after customs duties. The range of activities in which the public sector companies operate is indicated by the sector names of the 17 holding companies to which the 314 individual companies were "associated" as of 1993 (see Exhibit 2).

Among the sectors discussed in Chapter 4, the public sector firms that are clearly dominant and price setters in their fields are producers of

- Phosphatic fertilizer (with two public sector producing companies and no private sector producers),
- Tobacco (an official monopoly except some specially treated tobacco for smoking in water pipes), and
- Cement (with seven companies operating essentially as a cartel).

**Exhibit 2. Holding Company Sectors and
Associated Individual Companies, 1993**

Holding Company Sector	No. of Associated Companies
1. Spinning, weaving and ready-made clothing	17
2. Consumer goods	17
3. International trade and cotton	22
4. Engineering industries	22
5. Metallurgical industries	17
6. Mining, refractories and building materials	19
7. Chemical industries	24
8. Food industry and distribution	24
9. Rice and flour mills	20
10. Agricultural development and animal wealth	20
11. Public works and land reclamation	13
12. Construction and urbanization	26
13. Construction and electricity distribution	16
14. Housing, tourism and cinema	21
15. Nile and inland transportation	12
16. Maritime transportation	13
17. Pharmaceuticals and medical appliances	11
Total	314

In some sectors, however, public sector firms have been pushed into a minority position by more efficient and more dynamic private sector and joint venture firms. The public sector producer of air conditioners, Koldair, is now effectively bankrupt and has been displaced in the market by several private and joint venture producers. Manufacturing of plastic articles is now largely a private sector activity (86.6 percent of the value of production in 1988–1989), with individual firms established in particular niches. In automobile assembly capacity, as shown in Table 1, the public sector is now in the minority.

**Table 1. Automobile Assembly Capacity
in 1994 (vehicles per year per shift)**

Nasco (GOE) ^a	12,000
AAV (military + Chrysler)	4,000
Suzuki Egypt (private)	5,000
GM (private)	4,000
Gabour (Hyundai) (private)	10,000
JAC (Citroen) (private)	25,000
Total	60,000

^a1960 technology.

Areas in which private sector activity is said to be strongly collusive are cement distribution (see Chapter 4), fresh produce marketing, and some importing and wholesaling activities.

In the case of fresh produce marketing, the GOE intervened by closing the old fruit and vegetable market at Rod al Farag and opened a modern, well-equipped market in Al Aubour near the Cairo airport. The transfer of the market broke up most of the former system of strong-arm controls, and succeeded in lowering commodity costs by as much as 20 percent, although some of the strong-arm elements have moved with the market.

It is alleged that the importation of some foodstuffs (such as fish and fish products, cheese, and vegetable oil) is tightly controlled by a few wholesalers in Alexandria and Cairo who are able to block competing imports inside the Port of Alexandria by collusive means.

It is also alleged that efforts to develop a local marble industry (marble blocks and artificial marble blocks) in Beni Suef have been seriously hampered by pressure on the bank financing the local producer from importers of Italian marble.

Another sector in which collusion is alleged to keep out competitors is the importation of newsprint (paper).

A curious situation appears to exist in the production of fire extinguishers, where it appears the General Authority for Standardization has delegated to an existing Egyptian-German joint venture, "Bavaria," its authority to approve of new plants that would operate in competition with Bavaria.

4. Pricing Practices in Selected Sectors

This chapter summarizes pricing and marketing practices over a range of significant sectors of the Egyptian economy.⁶ One of the sectors, hotels and tourism, is the focus of a policy requirement attached to USAID/Egypt's Sector Policy Reform (SPR) cash transfer for 1992–1993 through 1993–1994. The other sectors were selected to get an up-to-date view of the evolving process of price and market liberalization in Egypt. The pharmaceuticals sector is treated separately in Volume 2 of this report.

The sectors examined reflect different kinds of market "imperfections," among them

- Residual government price controls of varying degrees of effectiveness,
- Public sector monopoly or oligopoly practices,
- Private sector monopoly practices that include collusion between private sector enterprises and government officials to keep out competitors, and
- Simpler strong-arm tactics to keep out competitors.

One definition needs to be clarified. When Egyptians currently say that a price is "free," they mean that the price in question is not being set by ministerial decree. In that sense, prices of most goods produced by private and public sector companies are "free" because prices are now set by the individual producing company rather than by a supervisory ministry. In reality, the pricing policy of public sector companies is usually subject to (1) close scrutiny by their respective GOE holding companies and (2) the advice of the PEO and the Ministry of the Public Business Sector, to which the PEO reports. In addition, as discussed in Chapter 2, both private and public enterprises are subject to a variety of regulations that affect pricing and are still in effect. In the case of tobacco, for example, the Minister of Finance will occasionally issue a unilateral ministerial decision to raise ex-factory prices, which decision is then followed up by the head of the tobacco monopoly in close collaboration with the Ministry of Industry.

HOTELS AND TOURISM

The hotel and tourism sector is one where existing government price controls are currently without effect. The Ministry of Tourism has an official regulatory function in the sector; it sets and enforces standards for hotels and restaurants and it used to set prices for each licensed hotel. It still has the function of approving and enforcing prices, although in the current market situation, price setting is not effective. By law, the Ministry of Tourism is required to review (and approve) price lists of hotels, restaurants, and tourism-related enterprises. The hotels submit requests to increase prices to the Ministry of Tourism in April or May; the hotel receives a reply setting the range of prices that it is permitted to charge as of the following October. In 1992, the ministry approved a price jump of 60 to 70 percent, which set the rack rates above what the market would bear. In reality, it is the market that

⁶Each sector is discussed in more detail in Appendix B.

sets the price. The big hotels are not supposed to sell below 50 percent of their rack rate in order to prevent them from competing "unfairly" against the smaller two- and three-star hotels. However, the rack rate for Egyptians and other residents is 50 percent of the ceiling rack rate. Discounted by another 50 percent, that reduces the floor for Egyptians and residents to 25 percent of the ceiling. Such weekend and off-season discounts are given by hotels with leisure and recreational facilities, such as swimming pools. Moreover, hotels can negotiate the number of free room-nights that they include in confidential package deals. Embassies, international agencies, corporations, and tour operators negotiate rates below the hotel rack rates that set a theoretical ceiling. Although the rules set a theoretical floor to prices that a hotel is permitted to charge, in practice the floor is porous in a weak market. However, the rules are still in force, and a different minister might be inclined to apply them rigidly.

AGRICULTURE

The current wave of liberalization of Egyptian prices was initiated in agriculture in the mid-1980s, along with other agricultural policy reforms. Reforms in agriculture initiated in 1986 include removal of

- Direct government controls on input prices and most output prices (except cotton and sugarcane), elimination of government controls on crop acreage;
- Government crop procurement quotas;
- Constraints on the private sector's buying from and selling to private sector companies both at home and abroad; and
- Farm subsidies.

The changes in agricultural policy since the mid-1980s are remarkable, and the farmers are still adjusting to those changes (see World Bank 1993a). However, price controls remain on cotton and sugar cane, which are important crops.

COTTON AND COTTON GOODS

Major problems remain for the cotton sector. Raw cotton is the most important cash crop of Egypt's agriculture and a major component of exports; cotton textiles and their downstream manufactures are the country's biggest industrial employer and one of the country's biggest export earners. The cotton industry, from the production of raw cotton on the farm to fabrication of final consumer goods such as household textiles and garments, is currently one of the more tightly regulated sectors in Egypt. Unlike other sectors, where the number of producers is small and oligopoly control can be easily exercised at a dinner or over a cup of tea, the number of participants in the cotton business is large, which makes regulation a necessary instrument if control is to be exercised.

In the context of the current general concern with deregulation and liberalization, the cotton sector has been and is being studied in detail by, among others, Chemonics International for USAID (Chemonics International 1993 and 1994).

Until recently, cotton growing was subjected to strict government controls in terms of compulsory cultivated areas, production quotas, and prices. Currently only cotton prices are controlled. Since the nationalizations of the early 1960s, cotton spinning has been located entirely in the public sector. Textile fabric production and clothing manufacturing are also largely concentrated in the public sector. The private sector re-emerged with the "open door" policy of the 1970s. According to the Chemonics reports, among the 25 public sector cotton textile companies, there are 13 problem companies whose

aggregate net worth is negative, with indebtedness equal to 119 percent of total assets. What is needed, if the companies are not to be liquidated, is a general agreement on debt resolution.

Lint cotton may be imported only with special permission from the Minister of Agriculture, only from growing areas free of the boll weevil, and then only if lint bales are fumigated at port of origin and Egyptian port of entry. Egypt's cotton imports are currently limited by area of origin to Arizona, which is free of the boll weevil but whose prices are 30 percent higher than elsewhere. No imported cotton may be delivered to spinning mills in Egypt's designated cotton-growing areas, where about 50 percent of spinning capacity is located. Imports of yarn are permitted with no quota restrictions, but are subject to a 30 percent tariff and require approval by the Cotton Textile Consolidation Fund as well as authorization by one of the public sector holding companies.

Imports of cotton textile fabrics and products are prohibited. Exceptions require special exemptions and bear special tariffs of 80 to 110 percent. Other imports are illegal, although there are two well-known smugglers' markets at Al Azhar and Bulaq in Cairo for used clothing brought in from the Port Said free zone, Sudan, and Libya.

Before Law 203 established the public sector holding companies, the cotton companies were attached to the Ministry of Economy, which set the export price of raw cotton. The government still sets the lint cotton price on the advice of a committee of spinners, farmers, and traders.

The Cotton Textile Consolidation Fund, created by Law 251/1953, today has among its functions establishing minimum export prices for cotton yarn and most woven fabrics for all exporters for each count of yarn and each type of woven fabric. Minimum prices are announced twice a year, in March and September, on the basis of production costs (1) reported by public and private sector companies and (2) prevailing in international markets according to commercial attaches abroad. Export prices of knitted fabrics were freed in 1984.

AGRICULTURAL INPUTS: FERTILIZER

Phosphatic Fertilizer

Because the number of fertilizer producers in Egypt is small, the sector is oligopolistic by definition. Egypt has two phosphatic fertilizer companies, one of which has two plants. Both companies are in the public sector under the Holding Company for Mining, Refractories and Ceramics. Egypt's production capacity of phosphate fertilizer is 1.3 million MT. Before the freeing of prices, local consumption was 1.3 million MT, but farmers cut their fertilizer consumption drastically when the fertilizer price jumped three years ago. Although the farmers are once again increasing use of fertilizer, local consumption is currently only 0.8 million MT, which makes it possible to export. Kafr El Zayat exports 20 percent of its output of single super phosphate (SSP), mostly to Bangladesh but also to Nigeria, Italy, and Spain. The company is trying to break into Pakistan. The Assiout plant is having difficulties in exporting triple super phosphate (TSP), for which there is much more competition worldwide. Abu Zabaal exports SSP in powder form only, and TSP mostly in powder form and some in granulated form.

There are no imports of phosphates, although the private sector is free to enter the market. The private sector could import to produce mixed fertilizer. The customs tariff rate on imports of bagged phosphate used to be 10 percent; it is now 30 percent.

Before 1991, the fertilizer producers had to sell all of their output to the PBDAC, which resold to the farmers at subsidized prices. As part of the reform program, price controls have been abolished. The producers now sell directly at prices that cover costs and some profit, and they make their own distribution arrangements.

The ex-factory price is set at fixed plus variable costs plus a 5 to 7 percent margin. In effect, farmer resistance to price increases constrains prices. Abu Zabaal sells SSP and sulfuric acid at the same prices as Kafr El Zayat.

The producing companies are willing to sell to anybody but, in fact, sell to a small number of big traders able to take delivery of large quantities and to provide letters of credit. The traders receive a further 2 percent discount for cash, which is used for about 40 percent of payments. The traders open local letters of credit to pay the factory and to advance credit to the farmers. Small traders cannot compete directly with the big traders because of the factory discounts for larger quantities.

Nitrogenous Fertilizer

There are three public sector producers of nitrogenous fertilizer in Egypt. KIMA produces ammonium nitrate from electricity and air in Aswan. Talha Fertilizers and Chemicals Industries Company (Talha) produces ammonia, ammonium nitrate, and urea in Talha based on natural gas. Abu Qir Fertilizers and Chemicals Industries Company (Abu Qir), the newest of the three, was set up as a joint stock company with funding from Germany; it produces ammonia, nitric acid, ammonium nitrate, and urea from natural gas and magnesium oxide in Abu Qir.

Abu Qir sets its prices at cost plus a margin of about 20 percent. Abu Qir is the price leader in Egypt; Talha sells at about the same prices as Abu Qir, which has always operated at a profit—unlike KIMA and Talha, which run losses. KIMA operates at a loss because it was established to use surplus electricity off the Aswan High Dam but is now obliged to pay close to world prices for its electricity inputs. The major input of Abu Qir and Talha is natural gas, which originally was made available at 6 millimes per cubic meter but now costs 150 millimes per cubic meter (£E 150 per MT). Nevertheless, Abu Qir's output is internationally competitive. Talha's plant is older and less efficient than Abu Qir's.

After agricultural input prices and marketing were liberalized and the production companies were obliged to set up their own distribution systems, Abu Qir at first tried to find distributors in each governorate, then settled for contracting with any distributor with enough financing and access to storage space to take fertilizer throughout the year. To encourage year-round sales, Abu Qir gives distributors deductions for off-season purchases. The distributors' margins vary with the season and can be negative in the off-season (November through December). Competition appears to be keen.

BREAD, THE POLITICALLY SENSITIVE COMMODITY

Mass consumption of bread in Egypt is of two kinds: flat-loaf, whole-grain *baladi* bread; and flat-loaf *shami* bread (the Damascus-style *pitta* bread now common in the United States and the United Kingdom) made from more refined flour. "White" bread is a luxury product.

There are three kinds of flour commonly used for baking in Egypt: flour with a wheat content of 82 percent, which is used to produce baladi bread (with bran used in the baking process); flour with a wheat content of 76 percent, used to produce shami bread; and flour with a wheat content of 72 percent, used to produce "white" bread and other baked goods. Whereas the prices of both baladi and shami bread are fixed and subsidized, the prices of 72 percent flour and "white" bread are not subsidized, and the prices of bread and other bakery products made from 72 percent flour are free of price controls. The price today of both a 140-gram loaf of subsidized baladi bread made of 82 percent flour and a 120-gram loaf of subsidized shami bread made from 76 percent flour is still £E 0.05. In addition, an unsubsidized shami loaf made of 72 percent flour has been introduced. The subsidy on the flour used to produce bread sold at £E 0.05 was more than 60 percent of its market price in 1991–1992.

RATIONED PRODUCTS

Rationed products, like bread, are sold at fixed and subsidized prices. Food subsidies in Egypt date back to the 1940s as part of the system of food ration cards introduced during World War II. Products subsidized included edible oils, sugar, tea, and kerosene. The government restructured the food ration card system in 1965 and added several basic food items such as wheat flour and rice, which were included in the subsidy program. Initially the food subsidies applied only to cooking oil, sugar, and tea. Later, other commodities were added, including rice, bread, flour, beans, lentils, coffee, sesame, shortening, imported cheese; frozen meat, poultry, and fish; and soap. Food subsidies reached their peak as a percentage of government expenditures in 1974 (19.0 percent), declined to 8.1 percent in 1978, rose again to 16.7 percent in 1980–1981, declined again to a trough of 2.5 percent in 1987–1988, and rose again to 10.0 percent in 1991–1992 (IFPRI, Table 3.8, p. 3.18). In 1991–1992, total food subsidies—including losses of the public sector food marketing companies—reached £E 3.3 billion, of which £E 1.1 billion was for wheat and flour, £E 0.6 billion for edible oils, £E 1.0 for sugar, and the rest for other commodities, including rice and tea (IFPRI, pp. 3.16–3.29).

The government began raising the prices of subsidized rationed and regulated food items in 1986–1987 and continued through 1991–1992. The prices of rationed and regulated rice, rationed tea, and regulated oil were raised in 1986–1987. The prices of regulated sugar and regulated tea were raised in 1989–1990, and of rationed cooking oil and rationed sugar in 1991–1992 (IFPRI, Figure 3.1, p. 3.21, quoting Abdel-Latif and Kamel 1993). In 1991–1992, the subsidy on the prices of rationed sugar and rationed oil was more than 50 percent, and more than 40 percent on the price of regulated sugar. There was a negative subsidy (i.e., the Ministry of Supply made a profit) on regulated oil, on rationed and regulated tea, and on rationed and regulated rice. Under the current adjustment program, it is proposed that all subsidies (except that on bread) be eliminated by 1995.

FOOD PROCESSING

Food processing in Egypt is a relatively competitive industry, both internally and internationally. In fruit and vegetable preserves, there are three public sector companies and a considerable number of private sector firms. Some of the private sector firms producing fruit preserves export part of their production: Egypt's comparative advantage in manufacturing fruit preserves and jams is that two of the inputs, fruits and glass jars, are relatively cheap in Egypt. However, sugar, which makes up 40 percent of a jar of jam, is an input purchased at the world price.

TOBACCO

The Egyptian tobacco industry is a public sector monopoly with all prices, both ex-factory and retail, set by ministerial decree; the only private sector activity is the production of sweetened tobacco for water pipes (*shisha* and *goza*). The monopoly, the Eastern Tobacco and Cigarette Company, is a major profit earner for the GOE. As a monopoly, Eastern Tobacco controls production and distribution to the retail level, and it sets price ceilings for ex-factory sales and for retail sales—on instructions from the Ministry of Finance and the Ministry of Industry. The Egyptian government sets customs duties. Cigarettes are broadly distributed throughout Egypt in retail shops.

Efforts to begin privatizing and breaking up the government tobacco monopoly are currently under discussion. Several options for restructuring the industry, ranging from creating a private sector monopoly to developing a more competitive market structure with separate firms, are being considered. After the monopoly is broken up, the government will continue to influence domestic prices by controlling customs duties and sales taxes. However, the ex-factory prices would be determined by the

firm or firms themselves. As customs duties fall, sales taxes may be expected to rise. The government would evidently have to replace its current profits from tobacco with higher taxes.

CEMENT

The cement industry in Egypt is composed of an oligopoly of a small number of public sector firms at the production level that deliver their output to a private sector distribution system rife with strong-arm exclusionary practices supplying market activities that are partly illegal.

Until 1991, cement production and distribution were in effect a government monopoly, with public sector producers obliged to sell their output to a central Cement Sales Office at ex-factory prices subject to Ministry of Housing decree. The Cement Sales Office was abolished by Ministry of Housing Decree 152/1991, which also eliminated the authority of the Ministry of Housing to decree prices of cement (and reinforcing bars). The producers are now free to set their own ex-factory prices and to sell directly to traders or final users. A coordinating committee of cement producers, which includes the joint venture Suez Cement Company, discusses prices, primarily to monitor international prices in the context of potential competition from imports. One result is that ex-factory prices vary little from company to company, by perhaps £E 0.5 per MT. One effect of the increase in ex-factory prices since abolition of the Cement Sales Office is that the cement producers have started to improve their efficiency. Two of the eight furnaces at the cement plants have been overhauled, and each of the three Helwan plants has added around 10 percent to its production level.

On the distribution side, entry requires a sufficient financial base and storage facilities. Given the desire of the producers to offload their production quickly and at minimum cost to themselves, the bigger traders get preference, which squeezes the smaller traders out of the market. In practice, the market price to Egyptian users of cement appears to be determined by the price of imported cement, which sets a ceiling after tariffs and transport costs are included.

REFRACTORIES

Another producers' oligopoly exists in the area of refractories, of which there are only two major producers: the Egyptian Company for Refractories (ECR), with a total capacity of close to 500,000 MT per year; and the El Nasr Company for Refractories and Ceramics (SORNAGA), with a capacity of 60,000 tons per year. Both companies are in the public sector under the Holding Company for Mining, Refractories, and Ceramics. The two companies bid against each other for local contracts in a peculiar way: they will submit the same initial price, but then each discounts up to 20 percent or 30 percent off that price "to get the piece of cake."

GLASS AND GLASS PRODUCTS

Another industry dominated by two major public sector producers is glass and glass products. The larger of the two companies, El Nasr Glass and Crystal Company, owns a minority block of shares in the smaller National Glass Company. According to the commercial director of El Nasr, prices are based on cost and "the market." The interlocking nature of the industry is being intensified by the 10 percent participation of El Nasr in a new joint venture company to produce float glass by an English process for which Egypt has bought the license. Participation in new joint venture companies by existing public sector companies, which also have the needed local technical expertise, is a pattern that some of the public sector companies seem to have adopted in other sectors as well. In the short run, dividends from the new plants will improve the financial position of the existing public sector firms; in the medium term, participation in joint ventures is a step in the eventual transition to privatization.

PAPER

The paper industry is a sector in which collusive practices by private sector importers have been documented. The General Company for Paper Industry (RAKTA), an Egyptian public sector company that produces writing and printing paper manufactured from rice straw and bagasse (sugar cane residue), took its case to the parliament and was able to bring about changes in government practices for procuring paper supplies. These changes included specifying quality characteristics instead of country of origin.

5. Ministry of Economy Survey of Industrial Pricing Practices

BACKGROUND

As part of this study, a survey of industrial pricing practices in Egypt was commissioned for the Ministry of Economy and Foreign Trade and carried out by Al Qarar Consulting Center in cooperation with the Research Department of the ministry. The questionnaire was applied to a sample of 100 medium- and large-scale industrial firms; 96 of the responses were retained as valid. The industrial branches included were spinning and weaving, cotton, engineering, metallurgical industry, food industry, construction, rice and flour, chemicals, and pharmaceuticals. Of the 96 respondents retained, 28 were public sector firms, 56 were private sector firms, and 12 were joint ventures. The locations selected were Greater Cairo, Alexandria, Mehalla, 10th of Ramadan City, and 6th of October City.

FINDINGS

An English translation of the preliminary Al Qarar report is presented in Appendix C along with a copy of the survey questionnaire. A few of the findings are summarized here.

Some 59 percent of the sample firms indicated that they obtain their inputs from foreign suppliers; 37 percent reported that they sold at least part of their output through Egyptian exporters.

Almost half of the firms considered their branch to be "dominated" by more than 5 companies. Of that group of respondents, 64 percent were large public sector or joint venture firms employing 1,000 or more workers. Only 4 of the 96 considered their branch to be dominated by one company.

Fifty-five firms stated that their prices were determined by total costs plus a standard markup, 33 stated that their prices were determined by supply and demand, and 11 stated that their prices were based on their variable costs; only 6 referred to government controls. As to size of markup, 29 percent of the 96 respondents reported a markup between 1 percent and 9 percent, 32 percent reported a markup of between 10 percent and 24 percent, and 30 percent reported no fixed markup; 8 percent reported a markup between 25 percent and 49 percent.

Surprisingly enough, 37 percent of the 96 respondents reported no change in their prices during the previous 12 months; otherwise, 51 percent reported price increases and 12 percent reported price decreases. The majority of price changes were explained by changes in input costs.

Of the 96 firms, 70 replied that they relied on nonprice competition, 30 of them to a high degree. Reliance on nonprice competition was greater among the larger firms than among the middle-sized and smaller firms. Of those relying on nonprice competition, 23 provided supplier credit facilities as one of its forms.

An open-ended question concerning problems and proposed solutions elicited a number of interesting replies, some expected and some unexpected. Among the proposed solutions were increasing government control on input prices, strengthening the role of the Ministry of Commerce in reducing commercial fraud and smuggling, and paying more attention to technical and vocational education to supply adequate technically skilled labor.

6. Impact of Policy Reform on Prices, Availability of Goods and Services, and Foreign Trade

PRICE LIBERALIZATION AND REMAINING PRICE CONTROLS

Because one of the immediate aims of price liberalization was to raise the prices of a variety of subsidized commodities—including fertilizer and other agricultural inputs, cement, bread, and rationed consumer goods—prices have indeed risen. The immediate impact on government finance has been to reduce (1) the explicit subsidy component of the budget relative to central government expenditures and (2) the implicit subsidy represented by the current deficits of some of the public sector companies now free to charge prices that cover their costs.

In agriculture, the immediate impact of the resulting increase in fertilizer prices was a sharp drop in fertilizer use by the farmers, followed by a recovery in fertilizer sales as farmers began to use fertilizer in a more socially cost-efficient manner. The primary impact of the freeing of agricultural prices and elimination of the system of compulsory planting and forced deliveries has been a significant shift in cropping patterns.

The phosphatic fertilizer producers reacted by shifting production from powdered fertilizer to granulated fertilizer, which is more expensive but more effective than powder, and by using the newly created excess in their production capacity to move into export markets.

The increases in ex-factory prices of cement turned the cement producers into profitable enterprises, enabling them to overhaul equipment, improve productivity, and increase production. The ex-factory price increases may also have cut into the margin that the cement distributors have been able to extract from the cement market for unlicensed building activities, because the import price sets a cap on the domestic market price.

Electricity in Egypt is now priced at about long-run marginal cost, and fuel oil and natural gas inputs to thermal power are priced at international levels. Because the same principle is applied also to hydroelectricity off the Aswan High Dam, the cost basis for operating the public sector aluminum plant at Nag Hammadi and the KIMA nitrogenous fertilizer plant at Aswan has been radically changed: those factories were originally established in Upper Egypt to use power off the High Dam when it was practically a free good.

The GOE has nibbled away at the controlled price of bread by (1) increasing the availability of unsubsidized breads to reduce the demand for subsidized baladi and shami bread and (2) raising the price of the subsidized breads little by little. However, this basic and politically sensitive commodity is still, and will most likely remain, heavily subsidized.

Despite all the specific price increases noted above, the 1991 stabilization and reform program, by tightening fiscal and monetary policy, brought about a decline in the overall rate of inflation (as measured by the cost-of-living index) from more than 20 percent in 1990–1991 to around 7 percent in 1994.

An important "controlled" price is that of water, whose zero cost to farmers presumably distorts cropping patterns. Domestic sugar is still price-controlled and free water is especially significant for sugarcane production.

The freeing up of cotton prices, scheduled to occur when the Alexandria Cotton Exchange is reopened, is expected to rationalize some of the operations of the spinning and weaving sector.

TRADE AND FISCAL REFORMS

The most important reform in the foreign trade area has been the replacement of import bans by increased tariffs. The only remaining bans are on imports of fabrics, ready-made clothing, and (according to some but not all sources) poultry. The effect has been to set ceilings on the prices of locally produced goods, the ceiling being the landed import price of a competing good plus the customs duty. The most frequently heard answer to the question "Where are prices set?" is "Somewhere between cost and the market price," where the market price is the import price. To that extent, Egyptian producers are now operating in a competitive market. Rationalization of the tariff structure to take account of tariffs on inputs to earlier stages of production is now a major concern of the members of the Egyptian Federation of Industries.

The Ministry of Finance still relies primarily on indirect taxes (including customs) for its revenues. Sales taxes of 5 percent to 30 percent were recently introduced to compensate for revenue losses as a result of reduced customs tariff rates. Unfortunately, there are still numerous indirect "nuisance" taxes, such as stamp taxes, that add to the difficulties of moving documents through the bureaucracy.

Property registration appears to be a significant source of government revenue rather than a simple procedural matter. Its high cost is a strong incentive to avoid property registration and has led to black-market purchases of cement for unregistered buildings and a general lack of transparency in property rights.

RESTRICTIONS ON INTERNAL TRADE

No examples of restrictions on internal trade are apparent, other than rumors of local monopolies in rural transport and of strong-arm efforts to exclude competitors in cement distribution and in the marketing of fresh produce. In the latter case, although the old produce market at Rod al Farag on the Nile to the north of Cairo has been closed and moved east into the desert next to the airport, the same groups are alleged to be in control.

MONOPOLISTIC PRACTICES

With the exception of the tobacco industry, there are few true monopolies in Egypt; markets for basic manufactured goods are organized as informal arrangements among duopolistic or oligopolistic public sector companies in the same lines of production. Serious competition in phosphate fertilizers is hardly to be expected when there are only two firms in the industry, both of them in the public sector and under the same holding company. In the cement industry, there was an explicit understanding between the PEO and the seven cement producers to raise prices in 1992 in order to cut into the margin of the cement distributors and to make the producing companies profitable.

In the glass industry, there are two public sector companies, the El Nasr Glass and Crystal Company and the National Glass Company. El Nasr owns a minority block of shares in National; both produce soft drink bottles and supply the local Coca-Cola bottling plant. The same two are the only manufacturers of plate glass in Egypt. A new float glass plant is being built by a joint venture company in which El Nasr holds 10 percent of the shares; it will be the only producer of float glass in Egypt, and thus a local monopoly. El Nasr now imports float glass. The only competition to the local plant, once it is completed, will be from imports.

Another instance of duopoly is in mining and refractories, where two big public sector companies, ECR and SORNAGA, dominate the market. Their posted prices are the same, but they compete with each other in responding to tenders by discounting the posted price.

7. Conclusions

From the material presented in the preceding chapters, it is clear that the liberalization of prices from Egyptian government control is only partial. Direct price controls by ministerial decree are now limited to bread, certain rationed consumer goods, pharmaceuticals, utilities, sugar cane, and (until the Alexandria Cotton Exchange is opened) cotton. Other prices have been freed in the sense that they are no longer subject to ministerial decrees. For example, ex-factory prices in most of manufacturing are now set by producing companies themselves. However, with the bulk of manufacturing carried out in public sector companies that operate under the tutelage of the PEO, the government still has a strong influence on price setting.

Standard practice by manufacturers is now to set local prices to cover fixed and variable costs and a profit margin of something between 5 and 10 percent—but under a ceiling set by the price of competing imports after payment of customs duties. Prices for exports may be set at levels too low to allow a company to break even as it enters new markets, but usually producers for export try to cover at least variable costs and, where they can, at least part of fixed costs. Export prices will vary with the market to which they are directed, in line with the income and price levels prevailing in those markets.

In the hotel and tourism industry, the Ministry of Tourism is obliged by law to review and approve proposed changes, usually increases, in the rack rates charged by hotels. The rules also set the maximum discounts off the rack rates. In the current state of the market,⁷ the rack rate is applied only for individual tourists staying for a few nights. Tour operators, corporations, embassies, and the international agencies usually negotiate discounts from the rack rates so that the ceilings are not effective. Similarly, there is scope for tour operators to negotiate effective rates below the floor by including "free" room-nights in the package. As a result, neither the ceiling nor the floor is binding. However, the rules remain on the books and the possibility of their enforcement continues to exist.

Food-processing and production of other consumer goods, including consumer durables, appear to operate in relatively competitive markets in Egypt. Prices are set by the producing companies in competition with other local producers according to what the market can bear, with ceilings set by the prices of competing imports after payment of customs duties. Wholesale and retail markups vary with the type of good.

⁷The exception, perhaps, is during the month of August, which is the peak season in Cairo for tourists from the Gulf states and Saudi Arabia.

8. Recommendations for Further Action

PRICE LIBERALIZATION

In the case of hotels, the rationale for having the Ministry of Tourism approve a hotel's rack rate (i.e., its maximum rate) is not evident. If it is to protect the foreign tourist from being exploited, the "market" is likely to do it better by diverting tourists to other destinations. The hotels are probably more sensitive to market conditions than the Ministry of Tourism and are therefore quite capable of doing their own price setting. In any event, the Ministry of Tourism is now approving whatever rack rates are requested by the hotels. The rationale for the rules on minimum rates is clearer: to protect the smaller two- and three-star hotels from "predatory" price cutting by the bigger four- and five-star hotels. However, certain sources suggest that floor prices are not being enforced. Because neither the ceiling nor the floor prices are effective, it seems reasonable to suggest that the system of theoretical price setting be abolished entirely, leaving the Ministry of Tourism with the responsibility for checking on the facilities and services provided by each hotel to justify the number of stars by which it is categorized, and the Ministry of Health with the responsibility for checking on the sanitary conditions of hotels and restaurants.

The case of pharmaceuticals is less simple because it is poor Egyptians who are supposed to be protected by the current reluctance of the Ministry of Health to authorize price increases (rather than rich foreign tourists, as in the case of hotels). In fact, it is the poor who are affected the most by the low quality of the pharmaceuticals produced by the public sector companies as a result of financial difficulties brought about by price fixing without adequate direct subsidization; higher income households can afford to shop for the more reliable products prescribed by their doctors. Volume 2 of this report suggests several categories of reform for the Egyptian pharmaceutical industry, the most urgent being (1) increased transparency for Ministry of Health procedures for approving drug prices and (2) "focused" deregulation of nonessential drugs and of new chemical products introduced into Egypt, accompanied by explicit subsidies for essential drugs.

As indicated earlier, liberalization of prices of commodities produced by the public sector companies has in most cases resulted in price increases, which have served to rationalize the economics of the industries affected. However, the small numbers of firms in such branches of activity as cement and phosphatic fertilizer, and the close relationships they developed during thirty years of direction by their respective ministerial overseers, have created industry-specific cartels whose degree of control is mitigated only by competition from imports and by the entry of newer private sector or joint venture firms that bring in more recent technology with them. Now that the public sector companies, along with joint venture and purely private companies, are setting their own prices in oligopolistic markets, the problem of market liberalization—which is more difficult to resolve than price liberalization—has to be faced.

MARKET LIBERALIZATION

The Egyptian government is committed to market liberalization as the major means of stimulating the economy toward more rapid growth and the achievement of higher living standards than in the past.

However, for market liberalization to succeed, development of private enterprise and investment in industry and trade must be far more rapid than in the past. For this to occur, major reforms in the institutional framework of the economy are necessary. The authors of this report are not currently in a position to lay out such an institutional reform program. It is possible, however, to identify areas of needed change whose effect would not be to reduce the overall role of government as much as to shift that role from direct operation in, and control and regulation of, industry to establishing and operating a network of institutions, thus making possible an effective market system.

This change implies withdrawal of government from its microregulation and control of industry, especially its (1) detailed regulation of entry of firms and (2) detailed and time-consuming taxation procedures at various levels, both of which discourage investment. These practices should be replaced by a "one-window" system that simply permits free entry within such limits as broader aspects of health and environment might require. All such decisions affecting entry, as well as decisions on taxes, should be made rapidly.

The current legal system, with its confusion and delays in decision, puts great constraints on investment, extension of credit, and settlement of claims among business firms. Reform of the legal system should have high priority; it may call less for reduction in government than a shift in government functions to create a more effective legal system.

In many existing industries, the informal connections between a small number of enterprises encourages collusion in price setting and distribution. The government should consider developing adequate antitrust legislation to discourage such collusion and encourage free entry of competitors. Where economies of scale result in only one or several firms in a branch of industry, government regulation of that branch to prevent excessively high monopolistic prices should be considered.

Currently, for many industries, imports are the main competition for domestic producers and monopolistic pricing is limited by such imports. It is therefore important that the government both reduce customs tariff rates (to a revenue-yielding basis only) and reduce or eliminate various regulations that raise the cost of importing products into Egypt. There are evidently many such costly "nuisance" barriers in addition to tariffs impeding imports. Their extent should be determined and they should be eliminated. Similar regulations and controls on exports, and the inefficiency and high cost of the services provided by the Port of Alexandria, raise the prices of exported goods and thus weaken Egypt's competitive position in world markets and reduce its export earnings. Again, the extent of such regulations should be determined and the objectionable ones eliminated.

In addition, it is essential to facilitate the availability of information on the Egyptian economy and on the domestic market. Although such information is collected by the various ministries and CAPMAS, much of it is closely held and its diffusion is extremely limited.

FURTHER RESEARCH

It would be interesting to find out more about distribution networks and practices for commodities such as cement and fresh produce, which have an unsavory reputation for restricting entry using strong-arm methods. It is not a task that can be carried out by foreign consultants.

Beyond that, it is time to start examining what institutional framework, or what variant of antitrust legislation, is appropriate to limit the extent of cartel behavior by firms operating in the Egyptian market. Bentley (1994, vol. III, 9) suggests that all existing laws and regulations relating to monopoly, anti-competitive business practices, unfair competition, and consumer protection should be thoroughly reviewed in the light of Egyptian and international experience, and that comprehensive, modern legislation should be prepared accordingly.

Also needed is a serious re-examination of the institutional framework of economic decision-making by the Egyptian government. Such a study would attempt to clarify the functions now exercised by the

numerous actors in field, including the classical economic Ministries of Finance, Economy and Foreign Trade, Internal Trade, Industry, and the Business Sector (formerly Public Enterprises); the other ministries intervening directly and indirectly in the economy, such as Health and Education; the numerous (and essentially ad hoc) authorities, such as the General Authority of Export and Import Control; and the various investigatory agencies, such as the Military Officers Administrative Censorship Authority under the Presidency and the Public Funds Investigation Department of the Ministry of Interior. The study could perhaps make recommendations for their rationalization.

This report will have fulfilled one of its major purposes if it either contributes directly to such action or leads to the use of other recent research, such as the Bentley report (1994), various World Bank reports, or the past work of Egypt's own economists, to take such action. Any further policy-oriented research that is felt to be needed should be undertaken rapidly so that it can lead to decisions within the near future.

AGENDA FOR ACTION

This report has shown that, despite the transition toward more open markets, much of the Egyptian economy is still dominated by government-owned enterprises operating behind relatively high trade barriers. Moreover, economic niches opening up to the private sector, particularly in wholesale distribution and imports, are often dominated by effective private sector monopolies. Egypt's poor business climate, including inadequate laws and institutions, (1) favors maintenance of the status quo for both Egyptian and foreign firms, (2) discourages private sector investment by new foreign entrants, and (3) discourages investment by Egypt's small and microenterprises (SME).

Market liberalization requires the creation of a competitive market economy, the improvement of the business environment, and the exploitation of new local, regional, and global market opportunities. The wide-ranging conditions for improving the private sector investment climate were examined at length during the Private Sector Investment Conference held in Cairo on October 9 and 10, 1994. At that conference, the leaders of the private sector business associations recommended a number of changes needed to liberalize markets, including the following:

- Creating the legal and judicial framework for an efficient market—particularly the enforcement of commercial contracts and the definition and enforcement of property rights.
- Establishing the legal basis for creating effective, specialized trade and manufacturing associations in the private sector to support firms in such areas as marketing, technology sourcing, and general economic information.
- Establishing permanent dialog between the government, donors, and the private sector as represented by their business associations.
- Improving the quality and lowering the costs of the extremely expensive services provided at ports and airports.
- Encouraging exports by identifying and promoting products in which Egypt appears to have a comparative advantage.
- Developing a promotion program for SMEs, including those owned or operated by women.
- Developing antitrust legislation and enforcement to prevent private sector monopolies.
- Expanding the role of private sector in areas dominated by the public sector.
- Gathering and disseminating timely and reliable information useful to business decision-makers.
- Continuing to reduce the administrative and regulatory barriers that hamper efforts to (1) enter, operate in, and exit from markets and (2) link Egyptian-based firms with international markets in trade, investment, finance, and technology.

- Developing and "deepening" competitive financial institutions, including banks and insurance companies. Long-term investment credit, consumer credit and credit for SMEs, especially for women, are particularly weak.

Although many of these recommendations are being addressed by the government and donors, some have been neglected and need immediate study and support. According to Egypt's business community, these include

- Legal constraints,
- Private monopolies,
- SME promotion,
- Information gathering and dissemination, and
- Port and airport services.

Each is now discussed in turn.

Legal Constraints

- Change laws and institutions to allow (1) enforcement of contracts, (2) proliferation of private business organizations and trade associations that can become more effective advocates for their members, (3) easy entry, operation, and exit of firms, and (4) continued removal of time-consuming regulatory and taxation procedures in favor of a system that simplifies business operations.
- Redirect the legal system to apply punitive damages for non-compliance with regulations, and reduce ex-ante enforcement methods through rules and regulations.
- Reform labor laws to reduce government interference with hiring and internal business relations with employees.
- Review and modernize the Civil and Commercial Codes and implement the enabling legal framework needed for modern business and financial transactions in Egypt.
- Develop a modern system of security interests and mortgages by all creditors—not just banks—in all forms of property by simple registration of a security agreement in the Commercial Register. This includes real property, personal property, and intangible property.
- Develop a modern system for equipment leasing.
- Develop provisions for other financial and commercial transactions in accordance with modern international commercial and financial practice.
- Replace the current system of exorbitant percentage fees for registering mortgages with a system of low, flat fees such as £E 50 for each *feddan* (1.038 acres) of mortgaged land to make credit less costly and more accessible to investors and businesses, especially smaller ones.

Private Monopolies

- Study the appropriateness of enacting an antitrust law that would make noncompetitive behavior by the private sector illegal. Antitrust enforcement is a response to the private-sector monopoly problem; its primary objective is to improve market performance by preserving and enhancing the natural competitive forces of the market place. Analyze sectors that appear to be dominated by effective private monopolies, such as cement distribution and agricultural wholesaling.
- Analyze the existence of monopolized imports—for example, in the areas of building materials and paper. Barriers preventing competitive rivalry should be reduced. Examine what

institutional framework, or what variant of antitrust legislation, is appropriate to limit the extent of cartel behavior by firms operating in the Egyptian market. All existing laws and regulations relating to monopoly, anti-competitive business practices, unfair competition, and consumer protection should be thoroughly reviewed in light of Egyptian and international experience; comprehensive, modern legislation should be prepared accordingly.

Small and Microenterprise Promotion

- Prepare the groundwork for establishing and promoting a SME program in Egypt. Actively promote SMEs, including their entry and growth, with special emphasis on those owned and managed by women, particularly in sectors with non-competitive market structures.

Information Gathering and Dissemination

- Determine a list of important business statistics and information and put in place a system to collect, prepare and disseminate that information.
- Determine how private and government promotion agencies can provide better foreign market intelligence and active marketing and promotional assistance.

Port and Airport Services

- Develop an efficient strategy to demonopolize the public sector shipping agency and other public port services, particularly where they could substantially lower the costs of doing business in global markets. Privatization of these services, without increased competition, would not have much impact on lowering high monopoly prices. The public and private sectors should work together to consider venues through which the private sector can penetrate the facilities at the Port of Alexandria. Private shippers argue that one viable option would be to begin allowing the private sector to provide all the port services on a competitive basis.

Demonopolization of government services in the Port of Alexandria, the new port at Dekheila, and Port Saïd, appears to be justified at a minimum for

- Shipping agencies
 - Stevedoring of both cargo and containers,
 - Bonded warehouses, and
 - General terminal dredging.
- Conduct similar studies for the international airports.

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Appendix A

PRICE CONTROLS, 1939-PRESENT

As described in a review of Egypt's price policies prepared for the Shora Council, Egypt's Senate (Majlis El Shora 1985), current concern with commodity pricing in Egypt began in Egypt at the start of World War II in 1939 with Decree 101/1939, which set maximum prices for some foodstuffs and necessities. Government intervention in pricing subsequently developed in three stages to the mid-1980s: (1) 1939–1960, the period of World War II and its aftermath; (2) 1961–1974, the period of the Egyptian socialism of President Nasser; and (3) 1975 to the mid-1980s, the period of the "open door" policies of President Sadat. The period since the mid-1980s may be characterized as progressive (or perhaps creeping) liberalization.

Stage 1: 1939–1960

The first stage, 1939–1960, reflected decisions and measures taken to meet unusual circumstances. In line with the war-time measures taken by the British in the U.K., the GOE's Decree 101/1939 set a maximum price for some foodstuffs and raw materials, established domestic pricing committees, and defined their functions. It also established a central committee to determine the bases of pricing. The Minister of Commerce and Industry headed the committee.

In 1939, the government intervened to determine the prices of all kinds of bleached rice. It began to intervene to determine the price of unmilled rice in 1942. In 1940 there was a bumper wheat crop, which led to a decline in prices. The government intervened in the wheat market to purchase the crop at a minimum price. The opposite occurred in 1941, when there was a dramatic decrease in the wheat crop. A price measure for vegetables was introduced in 1943, obliging retailers to sell fresh vegetables at the wholesale price plus a maximum markup of 40 percent. A July 1943 decree determined the duties of the Ministry of Supply, but the ministry itself was established only in 1945, by Law 95/1945. Law 95 gave the Ministry of Supply the authority to determine the prices of items and commodities under its control and to supervise their distribution in accord with the Ministry of Commerce and Industry.

Decree 163/1950 (1) established price committees in the governorates to determine the maximum price of foodstuffs and other commodities such as pharmaceuticals and (2) established a high committee for pricing whose duties included determining the bases of pricing, forming committees, investigating complaints about the pricing tables prepared by the committees, supervising price movements, and proposing measures to fight inflation. Under the decree, the Ministry of Commerce and Industry was authorized to issue executive decisions to limit the profits producers, importers, wholesalers, and retailers could make on any locally produced goods or imported items if the ministry saw what it considered to be abnormally high profits.

Under a decree issued on December 31, 1951, the Ministry of Supply took over the duties of the Ministry of Commerce and Industry concerning price control and profit determination.

In 1952, retail prices in Cairo were set at the wholesale price plus 25 percent, and for a short period price adjustments were permitted. The government set the prices of some necessities such as bread, sugar, and vegetable oil, which were rationed, and it subsidized the consumer price for certain goods.

A-2

A budget line to reduce the cost of living, introduced at £E 2.3 million in 1945, was increased to £E 3 million in 1952–1953. Expenditure on subsidies of wheat, sugar, kerosene, and miscellaneous goods was funded out of profits on rice, seeds, fertilizers, and cotton.

A presidential decree of May 18, 1959, under Law 142/1959 gave the Minister of Industry the authority to determine the prices of domestic industrial products.

Presidential decision 291/1960 reorganized the high authority of pharmaceuticals and medicines and established a committee for pricing medicines through coordination between the Ministry of Supply and the Ministry of Health.

Stage 2, 1961–1974

The second stage, 1961–1974, evolved under the legislation of the Nasser period. Law 48/1962 of May 5, 1962, amended by Law 53/1966 (the "unified agriculture" law), aimed at organizing the allocation of agricultural inputs such as seeds, fertilizers, and pesticides through rationing and fixed prices.

Presidential Decree 2017/1971 established a department for price planning in the Ministry of Planning to

- Propose the basis for pricing policy;
- Determine the goods and services to be subject to compulsory pricing by the Government, and goods and services to be left to market forces;
- Determine the goods and services needing protection from imports;
- Determine the goods and services to be subsidized for social reasons, the value of each subsidy, the resources of each subsidy fund, and the basis for allocation;
- Determine the goods needing an export subsidy, the value of each, and how to restrict each in the future;
- Determine the goods that need a stabilization fund to keep prices fixed;
- Study the domestic production costs for the major goods, and set efficiency indicators for export industries;
- Study the existing structure of prices, analyze the components of each, and compare the prices with world prices; and
- Monitor prevailing prices and their real directions through price supervisory entities.

The department for price planning was abolished in 1977.

Decision 63/1972 of the Minister of Supply delegated to the governors some of the duties of the Minister of Supply concerning pricing mechanisms.

The following types of price policy were applied:

- Price stabilization of goods considered to be necessities, such as sugar, tea, flour, and cooking oil. To ensure availability in sufficient quantities from domestic production, the transfer of commodities such as rice and soy beans from one governorate to another could be prohibited. To determine the subsidy to be paid to keep prices stable, the government calculates the average cost of production or importation for each item.
- Differential price policy, involving two prices: one fixed and below cost, and the other determined according to actual cost including the profit margin of intermediaries. The Ministry of Supply practiced this policy to fight the black market in some commodities after the 1973 war. Sugar, tea, oil, and rice were rationed at subsidized prices. Amounts beyond the ration had to be purchased at market prices (total cost).

- Variable price policy, applied to goods imported through public sector companies or the General Authority for Foodstuffs to take account of different grades of some commodities and different countries of origin, which are reflected in different import costs. The authorities distinguish between different groups of consumers according to their income. Goods for the poor or the mass of the population are to be sold at reasonable prices after government subsidy. For goods for high income groups, price covers total cost and profit margin. In both cases, prices vary according to import costs but the margin of variation for mass consumption goods is smaller than for high income goods.
- Periodical pricing policy, to be applied to agricultural products that depend on climatic conditions for their supply, and for which period of supply is short. Production locations are scattered around the country and production costs vary from place to place. Most such products are perishable. Their prices are determined on a weekly basis because they depend on supply and demand conditions and the availability of substitutes and their prices regardless of production costs.

Stage 3, 1975–mid-1980s

The third stage, which lasted from 1975 through the mid-1980s, combined the "open door" policy with measures carried over from the previous stage. Presidential Decision 100/1975 reorganized the Ministry of Supply and defined its duties concerning food commodities. Presidential Decision 101/1975 reorganized the Ministry of Commerce and defined its duties concerning nonfood commodities. Ministerial Decision 119/1977 was issued to determine the percentage profit margin for all imported goods through the intermediary chain to the end user. The total was 300 percent of import costs. The importer was obliged to keep all documents concerning the importation process.

The main concern was to keep the level of domestically produced or imported necessities stable by

- Increasing the supply of necessary foodstuffs to fight price increases;
- Direct purchasing by government bodies and public sector companies of some commodities from producers in order to balance supply throughout the year at reasonable prices, and to exclude intermediaries and brokers in order to lower the cost of marketing;
- Allowing the private sector to import most food commodities and without import duties;
- Pricing basic commodities and necessities at unified prices throughout the country and throughout the year through price stabilization funds;
- Maintaining the policy of dual pricing of the same commodity, selling rationed quantities at lower prices and any additional quantities at market prices (e.g., sugar, vegetable oil, and tea); and
- Obliging four- and five-star (tourist) hotels and restaurants to purchase their nonfood commodities at actual (unsubsidized) cost.

Appendix B

PRICING PRACTICES IN SELECTED SECTORS

Hotels and Tourism

Tourism, which accounted for 10 percent of Egypt's foreign exchange earnings in 1987–1992, is the focus of considerable government attention and concern. The government owns hotels, restaurants, and travel agencies as a legacy of the socialist government under President Nasser, and the Ministry of Tourism has an official regulatory function in the sector. The ministry sets and enforces standards for hotels and restaurants; and it used to set prices for each licensed hotel. It still has the function of approving and enforcing prices, although price setting is not effective in the current market situation, as will be explained later.

Market Structure

There are four tourism authorities in Egypt: Tourism Promotion, Tourism Development, Conference Centers, and Managerial Service. The Tourism Promotion Authority has 17 offices abroad.

The trade distinguishes two streams of tourism: so-called "cultural tourism" focused on the monuments of the Pharonic and Islamic eras; and "beach tourism" directed toward the Red Sea and Sinai resorts.

Of the 663 hotels in Egypt in 1992, 393 were in the three- to five-star categories (91 of them in Cairo); 126 were in the five-star category (20 in Cairo).

The majority of the larger hotels in Egypt are government-owned but run under management contracts with major international hotel chains on a profit-sharing basis. Five public sector companies now run 11,000 room accommodations in Egypt.

The public sector hotels are of two kinds: those nationalized in the 1960s, and those built after the 1952 revolution. The first group included the legendary pre-World War II grand hotels such as the Mena House at the foot of the Giza Pyramids, the old Semiramis on the Nile Corniche near the British Embassy in Cairo, the Cataract Hotel in Aswan, and the San Stefano and Cecil's in Alexandria—as well as Cairo's "new" Shepherd's Hotel, built in 1957 on the Nile Corniche to replace the old Shepherd's on Opera Square, which was destroyed in the riots of January 25, 1952. The second group includes: the Nile Hilton, built symbolically on the site of the razed Kasr El Nil British Army barracks to the north of the old Semiramis; the Sheraton Hotels in Greater Cairo (Giza, Gezira, and Heliopolis), Hurgadha, and Luxor; the Cairo Marriott in Gezira; the Aswan Oberoi; and the Movenpick hotels at the Giza Pyramids, in Heliopolis, and in Luxor. Most of the smaller private hotels in Cairo and elsewhere were not nationalized and a number of bigger private and joint venture hotels, such as the Maadi Pullman, have been built since the 1980s.

Public sector hotels currently up for sale include Shepherd's, the Cairo Sheraton in Giza, the Gezira Sheraton, the Hurghada and Luxor Sheratons, and the Aswan Oberoi. The Semiramis Intercontinental is a joint venture. The Cairo Meridien and the Hurghada Sheraton were sold to Saudi businessmen in 1991. It is rumored that Marriott is taking over the Heliopolis Sheraton.

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Restaurants are assigned to standard categories by the Ministry of Tourism on the basis of the facilities they offer.

There are 703 travel agents in Egypt. The biggest of the travel agencies is GOE-owned Misr Travel. The major private sector travel agencies specialize in tourists from different countries: ATOM specializes in those from Spain; Garanah Brothers, France; Spring Tours (Yehyeh Tarabeya), Germany; Traveler Egypt, the United States; and Abdel Kader Latif, Israel. Two other companies specialize in tours from Japan.

The hotel year runs from October through September. The high season in Cairo and Upper Egypt is October to March. The British tourists come in October and November, the Germans in winter, the Arabs in summer. The Red Sea summer season attracts tourists mostly from Italy.

Excepting Red Sea resorts, where price cutting is rampant and air charters take tourists directly from Europe, hotel occupancy rates have been low for the past two years, mostly because of the bad publicity given in the international press to the few attacks on tourists by Islamic fundamentalists (with considerably fewer casualties than inflicted by bandit attacks on tourists in Miami, Florida) and partly because of the jump in Egyptian hotel prices in 1992 requested by the hotels and granted by the Ministry of Tourism. With Europe coming out of recession, it is hoped that the tourist business in Egypt will pick up in the 1994–1995 season.

Regulatory Environment

All hotels in Egypt are obliged to join the Hotel Association, which is a government organization, a branch of the Egyptian Chamber of Commerce. Views differ among hotel operators as to how effective the association is in influencing the market.

The tourism sector is regulated by the Ministry of Tourism, which is concerned with maintaining standards, particularly for hotels catering to foreign tourists. The Ministry of Tourism licenses hotels, restaurants, tourist agencies, and antique dealers; checks the state of each establishment's facilities at least once a year; and grants price increases only after examining the physical premises of the licensed hotels. The Ministry of Tourism and the Ministry of Health play a legitimate role in inspecting hotel and restaurant facilities.

Restaurants are licensed by the Ministry of Tourism. Compliance with health and sanitation standards is checked by the Ministry of Tourism and the Ministry of Health.

The hotels are classified by the Ministry of Tourism into categories according to an established set of criteria. For example, a comfortable tourist hotel on the upper floors of a building in downtown Cairo will be classified as a two-star hotel; a three-star hotel has to have a street-level entrance and lobby.

Prices

By law, the Ministry of Tourism is required to review (and approve) price lists of hotels, restaurants, and tourism-related enterprises. Requests to increase prices are submitted to the Ministry of Tourism in April or May; the hotel receives a reply setting the range of prices that it is permitted to charge as of the following October. For example, one of the smaller two-star tourist hotels in downtown Cairo is currently allowed to charge a maximum of £E 85 per night and a minimum of £E 52 for a double room with bath, air conditioning, and breakfast. For the small hotel owner, there is therefore a ceiling on his maximum price—if, that is, he can apply it; in the current market he cannot. At the lower end of the range, in the current soft market, the extent of discounting appears to be ignored.

In May 1992, when Fouad Sultan was Minister of Tourism, the ministry issued a decree that set a precedent for applying price liberalization to the sector. Previously, the ministry dictated the price structure. Since May 1992, the ministry has simply endorsed prices proposed by the chamber

concerned, thus reflecting "market forces." In 1992, there was a price jump of 60 to 70 percent, which set the rack rates above what the market would bear. Since 1992, the ministry is ignoring the floor price issue because of the crisis in the tourism sector.

In reality, there is no longer any effective price setting. The hoteliers all insist that the market sets the price. In a boom, hotels set the price; in a slump, the tour operators set the price by pushing hotels to 50 percent of the rack rate or below. To some extent, big hotels can squeeze tourist agents; small hotels cannot.

The big hotels are not supposed to sell below 50 percent of their rack rate in order to prevent them from competing "unfairly" against the smaller two- and three-star hotels. Rumor has it that the Cairo Marriott did, and was fined £E 10,000, which made no difference to them; but that since then, there has been no interference with price discounting. There is, however, another explanation of the Marriott's operation that keeps it within the rules. The bottom of the rate range permitted by the rules is 50 percent of the ceiling rack rate approved by the Ministry of Tourism. However, the rack rate for Egyptians and residents is 50 percent of the ceiling rack rate. Discounted by another 50 percent, that reduces the floor for Egyptians and residents to 25 percent of the ceiling, which explains the Marriott's weekend bargains. Such weekend and off-season discounts are given by hotels with leisure and recreational facilities such as swimming pools. Moreover, hotels can negotiate the number of free room-nights that they include in confidential package deals.

A.I.D.'s Policy Requirement on Hotels

One of the policy measures for the enterprise sector attached to A.I.D.'s 1993 cash transfer states that "the GOE will remove all price controls from hotels, restaurants and all other businesses associated with tourism." Legally, the Ministry of Tourism has the task of authorizing the prices to be charged by the hotels at the beginning of each season. In practice that comes down to authorizing changes in the posted rack rates of hotels. The approved rack rate sets a ceiling on a hotel's prices. In actual practice, since May 1992, all increases requested by the hotels have been authorized. A cynic would say that if the hotels wish to price themselves out of the market, they are free to do so. The rules also set a theoretical floor to prices that a hotel is permitted to charge; in practice, the floor is porous.

At the moment, hotel prices are in reality free to move up and down below a ceiling that is not effective because it is above the top of the market. The hotel rack rates, which set a theoretical ceiling, apply to the individual foreigner who walks in off the street looking for a night's lodging. Embassies, international agencies, corporations, and tour operators negotiate rates below the rack rate. The rack rates are currently above what the traffic can bear except during the influx of Saudi and Kuwaiti tourists into Cairo during the month of August; they will remain so until there is a mass influx of tourists or conference participants to fill the hotels. At the same time, there is a theoretical floor that, as explained previously, is not effective: in a weak market the floor is not enforced; in a strong market, the prices charged would in any case be above the floor.

On the other hand, the rules are still in force, and a different minister might be inclined to apply them rigidly.

Agriculture

The current wave of liberalization of Egyptian prices was initiated in agriculture in the mid-1980s, along with other agricultural policy reforms. Reforms in agriculture initiated in 1986 include removal of government controls on most input and output prices (except cotton and sugarcane), elimination of government controls on crop acreage, removal of government crop procurement quotas, elimination of constraints on the private sector's buying from and selling to private sector companies both at home and

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abroad, elimination of farm subsidies, and limitations on state ownership of land. The changes in agricultural policy since the mid-1980s are remarkable, and the farmers are still adjusting to those changes.

Agriculture in the Egyptian Economy

Agriculture is still a central source of growth in Egypt's gross domestic product (GDP) and employment. In 1974, agriculture accounted for 30 percent of GDP and 47 percent of employment. Despite a relative decline in recent years owing to the faster growth in other sectors such as petroleum, services, and construction, 20 percent of both GDP and total exports, and about 36 percent of employment, still originate in agriculture; and more than 50 percent of the Egyptian population is directly dependent on agriculture.

Gross domestic product originating in agriculture grew by 2.7 percent annually in the 1960s, 3.5 percent in the 1970s (as a result of water control enabled by the Aswan Dam), and 2.5 percent in the 1980s. During the past decade, since the initiation of agricultural policy reforms, production of wheat, maize, beans, fruits and vegetables has increased significantly, whereas cotton production has, for a variety of reasons, declined.

Regulatory Environment

Until the mid-1980s, the government intervened heavily in production, pricing, and marketing of major crops and inputs. The policies were aimed at achieving a high level of self-sufficiency in basic food products, production of basic foodstuffs at low prices, employment, and implicit taxation to finance industrial growth and generate government revenues. To this end, prices were set, subsidies were generalized, mandatory crop areas were established and enforced, and imports and exports were controlled with little emphasis on economic efficiency. Farmers were obliged to depend on the government for input purchases and product sales. Prices did not reflect scarcity, leading to central allocation with large distortions and waste, because at the same time institutional performance was weak. Agricultural production lagged behind population growth, leading to increasing dependence on imported foodgrains, pulses, edible oils, sugar, meat, and milk products to meet the country's food needs.

Since 1986 the government has undertaken a series of policy and regulatory reforms in agriculture. The key measures were the following (World Bank, 1993a, 9):

- Crop area allotments with delivery quotas at fixed procurement prices were removed for all major crops except cotton, sugar cane, and rice in May 1987 by a decision of the Minister of Supply. According to a source at the Ministry of Economy, compulsory deliveries of the remaining crops were removed in April 1992 by a further decision of the Minister of Supply.
- Private sector processing and marketing of agricultural products and the delivery of agricultural inputs are being encouraged; restrictions on private sector rice processing and on inter-governorate transportation of milled rice have been liberalized; and a program for divesting lands held by public sector companies has been initiated, although implementation remains slow.
- Constraints on imports and exports are being reduced, and foreign trade in agricultural goods has been shifted to the free foreign exchange market.

Although agriculture policies are still in transition, overall price liberalization has closed the differential between domestic and world market prices, leading to substantial changes in cropping patterns as evidenced in crop area increases of 65 percent for wheat, 12 percent for rice, and 11 percent

for maize between 1985 and 1990, with production increases of 128 percent for wheat and 30 percent for rice and maize. During the same period, the area of berseem, the predominant fodder crop, declined 13 percent because of the reduced profitability of livestock resulting from liberalization. Exchange rate liberalization, improved foreign exchange transactions, and liberalized marketing have encouraged exports and increased production in horticulture. On the negative side, cotton acreage and average cotton yields have declined and the profitability of cotton is low.

Government Price Control and Decontrol

On the output side, all agricultural producer prices, except cotton and sugarcane, have been completely liberalized, and cotton prices paid to farmers were raised to 66 percent of their border price equivalents for the 1992–1993 growing season. On the input side, subsidies on fertilizers and pesticides have been significantly reduced and are expected to be completely phased out by 1995.

From the 1960s to the mid-1980s, the GOE applied three pricing techniques to agriculture:

- Direct intervention in determining prices of strategic crops considered essential for the industrial sector, such as cotton and sugar cane. Domestic trade in those commodities was prohibited.
- Indirect intervention in determining crops delivered only on a quota basis (wheat, beans, rice, onions, sesame).
- Nonintervention in the free market for other crops, with prices determined by supply and demand.

At the same time, the GOE paid direct subsidies on pesticides, fertilizers, improved seeds, gypsum for soil improvement, fuel oil, diesel oil, concentrated feed mix, and other items (IFPRI, pp. 3.2–3.10).

From the mid-1980s, the Ministry of Agriculture began to increase the supply price of quota deliveries and to eliminate quotas and compulsory deliveries. The local wheat price rose from 47 percent of the world price in 1982 to 130 percent in 1986. A Ministry of Supply directive of May 1987 removed quotas and compulsory deliveries of all crops except cotton, sugar, and rice. Among the results were reductions in supply prices and increases in quantities supplied of 70 percent for lentils and 7 percent for broad beans. Decrees were issued in 1987 increasing all crop prices except those for cotton, sugarcane, and rice, and increasing prices for compulsory delivery crops. In 1988, subsidies on agricultural inputs were canceled. In 1991, Ministry of Agriculture Decree No. 583 freed cooperative marketing of wheat, and Ministerial Decree No. 1531 freed cooperative marketing of rice and barley. A Ministry of Supply directive of April 1992 removed quotas and compulsory deliveries for the three remaining crops: cotton, sugar, and rice. In 1992, Ministry of Agriculture Decree No. 922 changed the rules concerning price determination and supply of sunflowers, and Ministry of Agriculture Decree No. 937 changed the rules concerning soya beans.

As a result of price fixing, cultivated areas declined from the mid-1970s to the late 1980s for cotton, maize, rice, and sugarcane. Cultivated areas rose for crops whose prices were free, such as vegetables, fruits, and berseem.

Major problems remain for the cotton sector.

Cotton and Cotton Goods

Raw cotton is the most important cash crop of Egypt's agriculture and a major component of exports, and cotton textiles and their downstream manufactures are the country's biggest industrial employer and one of the country's biggest export earners. Public sector cotton textile companies employ 200,000 workers; the private sector, another 300,000. In 1991, the textile sector accounted for 26.7 percent of

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value of industrial production excluding petroleum. In 1990–1991, textiles and textile articles accounted for 33 percent of total export earnings excluding crude oil (down from 51.5 percent in 1987).

The cotton industry, from the production of raw cotton on the farm to fabrication of final consumer goods such as household textiles and garments, is currently one of the more tightly regulated sectors in Egypt, in part because of its size and its importance to the Egyptian economy. Unlike the situation in other sectors, where the number of producers is small and oligopoly control can be easily exercised at a dinner or over a cup of tea, the number of participants in the cotton business is large, which makes regulation a necessary instrument for control if control is to be exercised.

In the context of the current general concern with deregulation and liberalization, the cotton sector has been and is being studied in detail by, among others, Chemonics International for USAID. The discussion of the cotton sector presented here is based on several interviews carried out by our team and on the Chemonics International reports of July 1993 and 1994.

Market Structure

Until recently, cotton growing was subjected to strict government controls in terms of compulsory cultivated areas, production quotas, and prices. Currently, only cotton prices are controlled.

Since the nationalizations of the early 1960s, cotton spinning has been located almost entirely in the public sector. Textile fabric production and clothing manufacturing are also largely concentrated in the public sector. As of May 1993, there were 56 textile and textile-related companies in the public sector: 25 cotton textile companies, 6 cotton trading companies, 5 cotton ginning companies, 6 non-cotton textile companies, and 14 other companies. The private sector re-emerged with the "open door" policy of 1977.

Under Law 203/1991 (June 19, 1991), the 25 government-owned cotton textile companies that had been part of the Textile Industries Corporation (created under Law 97/1983) became part of the Holding Company for Spinning, Weaving, and Ready-Made Clothing. Two other holding companies, those for Consumer Goods and for International Trade and Cotton, are also concerned with cotton production and export trading. In February 1993, the associated companies were redistributed among the three holding companies.

At the time of the nationalizations, 8 of the smaller of the 25 cotton textile companies retained some private ownership; they are referred to as "mixed" companies.

Under Investment Law 230/1989, two large, wholly state-owned companies for export are not in the holding company portfolios: El Amria, owned by Misr Bank; and Miratex, owned by several public sector companies and the Government of Iran. Their output of yarns, fabrics, and ready-made garments is entirely for export. Three other "mixed" companies also operate under Law 230.

There is a large number of small private sector firms and household enterprises in knitting, garments, and other ready-made textile goods, but no data are available on the value or volume of their production.

According to the Chemonics report, among the 25 cotton textile companies, there are 13 problem companies whose aggregate net worth is negative, with indebtedness equal to 119 percent of total assets. What is needed, if the companies are not to be liquidated, is a general agreement on debt resolution.

In the opinion of the Chairman of the Holding Company for Spinning, Weaving, and Ready-Made Clothing, too much was invested by the public sector in spinning, without taking into account that the area of raw cotton production in Egypt is limited. If Egypt did not have its large spinning mills, it could import yarn. According to the chairman, it is the GOE's intention now not to replace some of the existing spinning mills, in order gradually to reduce spinning capacity.

One of the problems noted by Ethridge (Chemonics International 1994) is that the public sector factories are now obliged to buy an entire year's inventory when the cotton is harvested, with down payment, leaving the textile mills with no flexibility and no possibility of entering the hedged futures market.

Regulatory Environment

According to the Chemonics report (1994), in 1963 all trade channels for domestic and international raw cotton were pre-empted by government control: five cotton ginning companies and six cotton trading companies had a monopoly on market channels from before ginning to the point where fiber is sold. Cotton became the property of the trading companies before it was ginned. They bought cotton only through agricultural "cooperatives." Gins and trading companies received guaranteed margins. Only the trading companies could export cotton, and only at or above a pre-determined price. A mill manager in Egypt had no right to inspect or refuse cotton delivered to his mill and he had no choice of price. The trading companies had exclusive authority to import cotton.

Lint cotton may be imported only with special permission from the Minister of Agriculture and then only from growing areas free of the boll weevil, and then only if lint bales are fumigated at port of origin and Egyptian port of entry. Egypt's cotton imports are currently limited by area of origin to Arizona, which is free of the boll weevil but whose prices are 30 percent higher than elsewhere.

No imported cotton may be delivered to spinning mills in Egypt's designated cotton-growing areas, where about 50 percent of spinning capacity is located. Imports of yarn face no quota restrictions but are subject to a 30 percent tariff and require approval by the Cotton Textile Consolidation Fund as well as authorization by one of the public sector holding companies. Private sector textile producers rely on yarn imports to safeguard themselves against unreliable quantities and qualities of yarns from Egypt's public sector spinners.

Imports of cotton textile fabrics and products are prohibited. Exceptions require special exemptions and bear special tariffs of 80 to 110 percent. Other imports are illegal, although there are two well-known smugglers markets at Al Azhar and Bulaq in Cairo for used clothing that comes in from the Port Saïd free zone, Sudan, and Libya.⁸

Three new laws concerning the cotton sector were introduced in 1994 but have yet to be implemented. The regulatory environment for the textile sector has, therefore, not changed much since introduction of new cotton laws. Domestic cotton can now be bought through any registered dealer, but prices are still controlled. Phytosanitary regulations blocking imports are untouched.

Law 141/1994 re-establishes a cotton spot market (the Cotton Exchange) in Alexandria; all deals that will actually be done on the Cotton Exchange must be handled by a registered broker, who must be an Egyptian citizen. There will be a Spot Market Committee, which among its functions, is responsible for setting the official schedules of premiums and discounts for the different types and qualities of cotton traded in Egypt. So far, according to Ethridge, the only immediate effect of the new law will be to set up a revised system for setting minimum prices.

Law 210/1994, on the organization of the internal cotton trade, allows producers to sell their cotton to any licensed cotton trader, who must be an Egyptian citizen. Businessmen claim that trading in cotton is now free: anyone can get into the trade and private traders are now in the market.

⁸In contradiction to that prohibition, one of the private sector garment manufacturers we interviewed complained about "dumping"—presumably in Port Saïd—by Hong Kong producers of end-of-season fashion textile remainders at one-third the price.

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Law 211/1994, which replaces the previous Cotton Exporter Union Law, defines the individuals or entities to be registered as members of the Cotton Exporter Union; only registered traders are eligible and only members of the Cotton Exporter Union can export.

In addition, companies are now allowed to buy their domestic cotton through any registered trader. Companies will eventually be allowed to import cotton, but the phytosanitary regulations in force largely negate that having any practical effect.

Exporters are reimbursed tariffs on imported inputs under drawback or temporary admission regimes.

Prices

Before Law 203/19... established the public sector holding companies, the cotton companies were attached to the Ministry of Economy, which set the price of raw cotton. The lint cotton price is still set by the GOE on the advice of a committee of spinners, farmers, and traders. According to the Chairman of the Holding Company for Spinning, Weaving, and Ready-Made Clothing, once the cotton exchange is re-established, the price of lint cotton will be the "competitive international price." For those in the trade, cotton prices will be "free." Each public sector textile producing company has a board which decides on its product prices. There is also a consortium of spinners who agree on minimum price levels and quality premiums. "Any price cutting is under the table."

The Cotton Textile Consolidation Fund, created by Law 251/1953, today has among its functions establishing minimum export prices for cotton yarn and most woven fabrics for all exporters for each count of yarn and each type of woven fabric. Minimum prices are announced twice a year, in March and September, on the basis of production costs reported by public and private sector companies and in international markets according to commercial attaches abroad.

Domestic prices are loosely derived from the minimum export price using dictated margins. For example, to get a domestic textile mill price, free-on-board (f.o.b.) costs are subtracted from the export price; to get a farm-level price, a margin for ginning and all other cotton handling is subtracted from the mill price. Ethridge (Chemonics International 1994) claims that as a consequence, for any given type and grade of cotton, prices do not function as market signals and there have been no price incentives for performance in ginning, sorting, storage, distribution.

Export prices of knitted fabrics were freed in 1984.

Egyptian exports of extra-fine cotton declined from 180,400 MT in 1982–1983 to 16,400 MT in 1991–1992, partly because of increases in Egyptian cotton consumption and partly because of increases in price. According to the Chairman of the Spinning and Weaving Holding Company, the World Bank pushed Egypt to raise its cotton price. Now the world price of textiles is below Egyptian costs and Egypt is getting raw cotton at the international price.

The world cotton market is currently in a state of flux. Cotton prices have jumped because of shortfalls in production in Pakistan and China. Tightening of world markets for upland (short-staple) cotton also affects long-staple cotton. Egypt recently exported its stocks of long-staple cotton at low prices. Because the supply situation next year is uncertain, it is possible, according to Ethridge, that Egypt might have to import long-staple cotton at higher prices.

Agricultural Inputs: Phosphatic Fertilizer

Market Structure

Egypt has two phosphatic fertilizer companies, both of them in the public sector under the Holding Company for Mining, Refractories, and Ceramics: the Abu Zabaal Fertilizer and Chemical Company

on the Ismailia Canal; and the Société financière et industrielle d'Egypte, which has two plants, one in Kafr El Zayat in the Delta and the other in Assiout in Upper Egypt.

Egypt's production capacity of phosphate fertilizer is 1.3 million MT. Before the freeing of prices, local consumption was 1.3 million MT, but farmers cut their fertilizer consumption drastically when the fertilizer price jumped 3 years ago. Although the farmers are once again increasing use of fertilizer, local consumption is currently only 0.8 million MT, which makes it possible to export.

There are no imports of phosphates, although the private sector is free to enter the market. The private sector could import to produce mixed fertilizer. The customs tariff rate on imports of bagged phosphate used to be 10 percent; it is now 30 percent.

The Kafr El Zayat plant produces single super phosphate (SSP) (15 percent P_2O_5). The Assiout plant produces both SSP and triple super phosphate (TSP) (45 percent P_2O_5). Kafr El Zayat is now preparing SSP in granules (4 percent water content), which release phosphorus more slowly than powder (10 percent water content) but are \$6 (£E 20) per MT more expensive to produce than powder because of the increased cost, particularly for energy, of drying and grinding. Local farmers are used to using SSP, but they have had to be convinced to buy the granules. As a factor affecting the environment, the granules are preferable to powder.

Kafr El Zayat's main physical inputs are phosphate rock from Upper Egypt and imported sulfur (from Saudi Arabia and Poland). Because of the cross hauls of phosphate rock and sulfur, production costs in Assiout and in the Delta are not much different. Exports to Asia are shipped from three Red Sea ports (Suez, El Hamaween, and Safaga) to avoid Suez Canal tolls. Shipments to Europe out of Alexandria are hauled by rail from Tanta in the Delta (if there is no time pressure to catch a ship) or by road (if there is time pressure).

Kafr El Zayat exports 20 percent of its output of SSP, mostly to Bangladesh but also to Nigeria, Italy, and Spain. The company is trying to break into Pakistan. The Assiout plant is having difficulties in exporting TSP, for which there is much more competition worldwide, because 80 percent of the world phosphate market is for TSP. Egypt's main competitors in the export market are Tunisia and Morocco. Other users of SSP are India, China, Lebanon, and Israel.

Abu Zabaal produces up to 300,000 MT of SSP, 80,000 MT of TSP (half or more of which is exported), 300,000 MT of sulfuric acid, and 45,000 MT of phosphoric acid. The sulfuric acid is used mostly to produce SSP and TSP, but 70,000 MT are sold locally for other industrial uses. As for Kafr El Zayat, the main physical inputs to the Abu Zabaal plant are phosphate rock from Upper Egypt and sulfur imported from Saudi Arabia and Poland. Abu Zabaal exports SSP in powder form only, and TSP mostly in powder form and some in granulated form. Exports of TSP (to New Zealand, Philippines, Sudan, Sri Lanka), shipped from Suez, Damietta, and El Hamaween, are expected to reach 50,000 MT in 1994. Abu Zabaal exports through English agent but is now in direct contact with international traders in France, London, and Switzerland.

Abu Zabaal's current capacity of granulated TSP is 135 MT per day. A granulation plant with capacity of 400 MT per day being built with Kuwaiti Fund financing is scheduled to begin operating in December 1995.

Abu Zabaal has its own rock phosphate mine at Sibaya in Upper Egypt, producing 500,000 T beneficiated to increase P_2O_5 content from 22 percent to 28 or 29 percent. The cost of Egypt's rock phosphate cost is low at \$23 per MT but its P_2O_5 content is lower than in Morocco, where cost is \$33 per MT. The rock phosphate is transported by rail from Upper Egypt or shipped down the Nile to Shoubra El Kheima, where it is unloaded to trucks. Abu Zabaal now has two unloading cranes on the Ismailia Canal, waiting for the canal to be deepened for ship use.

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The market is now better for powdered TSP, which can be used as a raw material for mixed fertilizer, than for granulated TSP. As a result, Abu Zabaal is trying to buy up PBDAC's old stocks of powdered TSP.

Regulatory Environment

Before 1991, the fertilizer producers had to sell all of their output to the PBDAC, which resold to the farmers at subsidized prices. As part of the reform program, price controls have been abolished. The producers now sell directly at prices that cover costs and some profit, and they make their own distribution arrangements.

Prices and Distribution

The local market price is currently close to £E 230 per MT. For Kafr Zayat, the components are as follows:

<i>Price Components</i>	<i>Amount</i>
Price ex-factory	200
Taxes (7 percent):	
5 percent sales tax	10
2 percent trader's tax	4
Trader's margin	5
Transport	10
Total Market Price	<u>229</u>

The ex-factory price is set at fixed plus variable costs plus a margin ranging from 5 to 7 percent. In effect, farmer resistance to price increases constrains prices.

Kafr El Zayat's ex-factory selling price is £E 200 per MT of SSP, with discounts for volumes of

- £E 2 (1.0 percent) per MT for 20,000 MT,
- £E 3 (1.5 percent) per MT for 40,000 MT, and
- £E 10 (5.0 percent) per MT for 100,000 MT.

The producing company will sell to anybody but is, in fact, this year selling 100,000 MT each to six big traders (last year there were only three) able to take delivery of large quantities and to provide letters of credit. The traders receive a further 2 percent discount for cash and about 40 percent of payments are made in cash. The traders open local letters of credit to pay the factory and to advance credit to the farmers. The traders' margin is between £E 3 and £E 5 per MT delivered to retailers who sell to the farmers. Small traders cannot compete directly with the big traders because of the factory discounts for larger quantities.

Abu Zabaal sells SSP and sulfuric acid at the same prices as Kafr Zayat.

Abu Zabaal sells SSP to the local market through four or five distributors who can come in with a sizable guarantee, this year in the form of a letter of credit of £E 500,000. Until 3 years ago, all deliveries were made to the PBDAC. The company no longer sells to PBDAC. Distribution was difficult for the first two years but is now normal. The factory gives 30 days suppliers credit and sets the market price; the distributor's margin of 5 percent or 6 percent comes out of the discount the distributor gets for high volume purchases. The ex-factory price is a maximum, because the distributor will pass on part of his discount to compete for customers. The commercial director of Abu Zabaal considers the market to be competitive because there are two factories (Abu Zabaal and Kafr Zayat) and there is lots of fertilizer available. He also explained to us that he has to go through big distributors to make sure the factory gets paid.

Kafr Zayat's export price of bagged phosphate to Bangladesh is \$62 f.o.b. Suez/Red Sea plus \$25 freight plus customs, etc., which is competitive with \$65 f.o.b. Bombay. In May 1993, Kafr El Zayat sent a trial shipment of granulated SSP to Bangladesh, where the response has been favorable because the use of granules slows release of the phosphorus and reduces losses of effectiveness under conditions of flood irrigation. Initially Kafr El Zayat attributed all its fixed costs to local sales and priced its trial exports at variable cost. It is now including 70 percent of the proportional amount of fixed costs in the export price.

Abu Zabaal's export price for TSP covers only variable cost. The export price is calculated from the international price for TSP with 46 percent P_2O_5 , whereas Abu Zabaal's TSP is 43 percent, i.e., $\$155 \times 43/46 = \145 . Similarly, Abu Zabaal's price for sulfuric acid (£E 275 per MT) is derived from the international price and international specifications; Abu Zabaal's sulfuric acid has a maximum of 37 percent P_2O_5 , whereas the international water-soluble standard is 42 to 44 percent P_2O_5 .

Abu Zabaal may make a profit on exports this year because phosphate prices are rising; unfortunately, so is the sulfur price:

	<i>\$ per MT f.o.b.</i>	
	<i>1993</i>	<i>1994</i>
TSP granulated	115	155
TSP powder	105	145
Sulfur	50	80

Because the world price of sulfur is at the moment rising sharply, phosphate production costs will rise shortly. Under the previous regime, it might take 8 months to get approval from the Ministry of Industry and the Ministry of Agriculture for a price increase. The sales committee of the producing company can now take its own decision to change prices.

Bread, the Politically Sensitive Commodity

Mass consumption of bread in Egypt is of two kinds: flat loaf whole grain baladi bread; and flat loaf shami bread (Damascus-style pitta now common in the United States and the United Kingdom) made from more refined flour. Baladi bread is preferred in Cairo and Upper Egypt; shami bread is preferred in Lower Egypt and Alexandria. "White" bread is a luxury product.

Total wheat consumption of Egypt is 10.5 million MT. Local production is 4.8 million MT (of which 1.1 million MT are sold by farmers to the GOE on a voluntary basis at the support price) and 5.7 million MT are imported.

There are three kinds of flour commonly used for baking in Egypt: flour with a wheat content of 82 percent, which is used to produce baladi bread, with bran used in the baking process; flour with a wheat content of 76 percent, used to produce shami bread; and flour with a wheat content of 72 percent, used to produce "white" bread and other baked goods. The prices of baladi bread and shami bread are fixed and subsidized; the prices of 72 percent flour and "white" bread are not subsidized, and the prices of bread and other bakery products made from 72 percent flour are free of price controls.

Price

The Ministry of Supply sets the price and the weight of the loaf for bread made of both 82 percent and 76 percent flour. The prices of subsidized baladi and shami bread are set by the Ministry of Supply. Given the importance of bread in the consumption of the lower income groups, the GOE has been reluctant to increase the bread price. Nevertheless, increases in the price of bread have been introduced

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gradually over the years. In the early 1970s, the price of baladi bread was 5 millimes (.5 piaster, or £E 0.005). At the end of the 1970s, it was 10 millimes (1 piaster, or £E 0.01). In the early 1980s it was raised to 2 piasters (£E 0.02).

In 1983–1984, the GOE introduced mass production of shami bread from 76 percent flour, which reduced the relative demand for baladi bread. The standard 120 gram loaf of shami bread was sold at £E 0.05, thus establishing a break in the system of fixing bread prices. In 1987–1988 the price of the standard 140 gram loaf of baladi bread was also raised to £E 0.05, without causing riots. The price today of both the 140 gram loaf of subsidized baladi bread made of 82 percent flour and the 120 gram loaf of subsidized shami bread made from 76 percent flour is still £E 0.05. In addition, an unsubsidized shami loaf made of 72 percent flour has been introduced.

The last decree setting a price for 72 percent bread was 2 or 3 years ago. Until then, the Ministry of Supply practiced price discrimination, selling 72 percent flour to hotels and restaurants at £E 1,200 per MT and to pastry shops at £E 800 per MT. The revenues were used to subsidize 82 percent and 76 percent flour. Since then, no decree has been issued and the market is free. Unsubsidized shami bread made from 72 percent flour is now sold at £E 0.10 or £E 0.15 per 120 gram loaf and other shami loaf sizes are also available at different prices.

Subsidy

The subsidy on the price of bread sold at £E 0.05 was more than 60 percent in 1991–1992. Currently, the calculation runs as follows:

The GOE buys wheat from the international market, most recently 430,000 MT at \$86 per MT fob + \$15 transport and insurance = \$101 c.i.f. = £E 340 per MT. The purchase price for local wheat sold voluntarily to the GOE is £E 500 to £E 520 per MT. The market price of wheat is £E 550 per MT.

The price of imported flour is \$170 to \$200 per MT cif = £E 670. The GOE sells flour at £E 320 per MT. The local price of 72 percent flour is £E 700 per MT. The subsidy on GOE flour is £E 380 per MT.

The bakers are now pressing for cancellation of the production of 76 percent flour altogether, to allow them to use 72 percent flour for standard shami bread in addition to other luxury baked goods. The U.S. flour exporters support the bakers' position because the U.S. exports 72 percent flour.

The price of flour would increase from the subsidized £E 300 or £E 320 to the market price of £E 700. Liberalizing the price of bread made with the unsubsidized flour would increase the bread price from the current 5 piasters (£E 0.05) per loaf of shami bread to 15 piasters (£E 0.15) or more per loaf.

The GOE position is that eliminating subsidized shami bread made from 76 percent flour would shift part of the demand to baladi bread for which there is now limited production capacity, and part to more expensive breads. The population of Lower Egypt, where shami bread is preferred, would resent continuing to subsidize the baladi bread eaters of Cairo.

Removing the bread subsidy, a policy position supported by the U.S. government, therefore requires weighing two sets of equity considerations, namely the alleviation of poverty associated with the subsidized bread consumed by the poor and regional differences in the pattern of consumption, against efficiency of resource use.

Rationed Products

Market Structure and Regulatory Environment

Food subsidies in Egypt date back to the 1940s as part of the food ration card system introduced during World War II and applied for edible oils, sugar, tea, and kerosene. The GOE restructured the food

ration card system in 1965 and added several basic food items such as wheat flour and rice, which were included in the subsidy program. Initially the food subsidies were applied only to cooking oil, sugar, and tea. Later on other commodities were added, including rice, bread, flour, beans, lentils, coffee, sesame, shortening, imported cheese, and frozen meat, poultry and fish. The aggregate cost of subsidies increased dramatically after 1973 with the steep rise in world food prices and then continued to increase to the mid-1980s with the population increase and falling exchange rate even though world food prices declined in the late 1970s. Food subsidies reached their peak as a percentage of government expenditures in 1974 (19.0 percent), declined to 8.1 percent in 1978, rose again to 16.7 percent in 1980–1981, declined again to a trough of 2.5 percent in 1987–1988, and rose again to 10.0 percent in 1991–1992. (IFPRI, Table 3.8, p. 3.18.) In 1991–1992, total food subsidies including losses of the public sector food marketing companies reached £E 3.3 billion, of which £E 1.1 billion for wheat and flour, £E 0.6 billion for edible oils, £E 1.0 for sugar, and the rest for other commodities including rice and tea (IFPRI, pp. 3.16–3.29).

The main subsidized commodities—sugar, cooking oil, rice, and tea—used to be sold (a) at especially low prices in fixed monthly quotas against ration cards through special ration shops (*tamween*) and (b) at regulated prices through cooperatives and government retail stores (*gamaya*). Currently, all the ration shops sell all the subsidized commodities except bread. The cooperatives and government stores sell regulated commodities and other low price (and low quality) goods.

There are now two types of ration cards. A green card is issued to government and public sector employees and anybody else who can prove through social security papers that his or her income is less than £E 2,000 per year. A red ration card is issued to any other Egyptian who then pays a higher but still subsidized price for the rationed quantity. In 1981–1982, 99 percent of the Egyptian population were beneficiaries of green ration cards; in 1991–1992, the proportion was still 90 percent.

The local sugar industry consists of the public sector Sugar Company, and one joint venture company at Kafr es Sheikh producing and processing sugar cane. Total national output of sugar is 1.5 million MT, of which 600,000 MT go to the rationing system and the other 900,000 MT to the free market. The Sugar Company sells its output at the market price which is set by the world price. The GOE pays the subsidy on rationed sugar. Local production covers half of total Egyptian consumption of sugar, either as direct consumption by households or as an input to the food processing industries; the other half is imported. Import tariffs are 15 percent on processed sugar and 5 percent on raw sugar. Anyone can import sugar.

Prices and Subsidies for Rationed and Regulated Commodities

The GOE began raising the prices of subsidized rationed and regulated food items in 1986–1987 and continued through 1991–1992. (Traditional baladi and shami bread are not rationed but are heavily subsidized.) The prices of rationed and regulated rice, rationed tea, and regulated oil were raised in 1986–1987. The prices of regulated sugar and regulated tea were raised in 1989–1990, and of rationed cooking oil and rationed sugar in 1991–1992 (IFPRI, Figure 3.1, p. 3.21, quoting Abdel-Latif and Kamel 1993). In 1991–1992, the subsidy was more than 50 percent on the prices of rationed sugar and rationed oil, and more than 40 percent on the price of regulated sugar. There was a negative subsidy (i.e. the Ministry of Supply made a profit) on regulated oil, on rationed and regulated tea, and on rationed and regulated rice. Under the current adjustment program, it is proposed that all subsidies (except on bread) be eliminated by 1995.

The subsidies on edible oil and sugar are established by decrees of the Ministry of Supply. Currently an estimated 18,000 MT per month of vegetable oil sold to ration card holders is subsidized by providing 0.5 kg of vegetable oil per month per person for £E 0.50, the price set by the Minister of Supply. The free market price is £E 3.00 per kg or £E 1.50 per 0.5 kg of oil. The subsidized vegetable

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oil, with a subsidy of £E 1.00 per 0.5 kg of oil per person per month, is provided to an estimated 75 percent of the Egyptian population.

The sugar price currently set by decree of the Minister of Supply is £E 0.50 per kg for the ration of 0.5 kg per person per month. The free market price per kg of sugar of the same quality is £E 1.65, so that the subsidy on rationed sugar is £E 1.15 per kg.

Food Processing: Fruit and Vegetable Preserves

Food processing in Egypt is a relatively competitive industry. In fruit and vegetable preserves, there are three public sector companies, and a considerable number of private sector firms. Two big public sector firms, Kaha and Edfina, are not doing well. They have some good equipment. They are good at canning, especially tomatoes, and producing tomato paste. But they are having trouble recovering from the loss of Soviet bloc markets. Fruit preserves are less important than vegetables in their total output.

There are a number of private sector firms producing fruit preserves, among them Vitrac which exports more than 50 percent of its production, to Japan, Australia, USA, Canada, and elsewhere. Contacts for the export market are made through two major trade fairs held alternatively in Paris and Cologne; but Egyptian preserves cannot be sold in the EEC countries because the EEC bans imports of sugar products to maintain the high price of protected sugar in Europe.

The comparative advantage of Egypt in manufacturing fruit preserves and jams is that two of the inputs, fruits and glass jars, are relatively cheap in Egypt. However sugar, which makes up 40 percent of a jar of jam, is an input purchased at the world price.

Employment in the manufacture of fruit and vegetable preserves is highly seasonal because of the different times at which they are harvested. For fruits, the apricot season is one month in Egypt's non-existent springtime; plums are harvested in the summer, strawberries in February, figs and dates in December. The jam producers buy small and medium-sized strawberries, because big strawberries would in any case have to be cut. The big strawberries are shipped fresh, for example by PICO, which also exports fresh peaches and apricots.

Exports of fresh fruits and vegetables are handicapped by the non-availability of refrigerated ships and nitrogen containers. Exports are by air, with air freight at 4 or 5 times the ex-farm price and payable in hard currency.

Tobacco

Market Structure

The Egyptian tobacco industry is a public sector monopoly with all prices, both ex-factory and retail, set by ministerial decree; the only private sector activity is the production of sweetened tobacco for water pipes (*shisha* and *goza*). The monopoly, the Eastern Tobacco and Cigarette Co., is headquartered in Giza. It is an affiliated company of the Holding Company for Mining, Refractories and Building Materials, which is headquartered in Maadi. The Eastern Tobacco and Cigarette Co. employs an estimated 14,052 workers in approximately 10 plants located throughout Egypt. Eastern Tobacco is a major profit earner for the GOE. In large part for this reason, in 1993 it was put under the Mining and Refractories Holding Company. The substantial earnings of Eastern Tobacco help offset the losses of other affiliated companies in its holding company that continue to experience substantial financial losses. With Eastern Tobacco, the holding company, which comprises 19 separate government enterprises, earns £E 34 million annually. Without Eastern Tobacco, the holding company would be losing approximately £E 100 million annually.

Total tobacco and cigarette sales currently come to an estimated £E 3.0 billion per year. They generate an estimated £E 2.2 billion per year in government revenues through import customs duties, sales taxes, and other taxes, including the income tax and an end of the year commercial tax.

The company's top seller is Cleopatra cigarettes, a local brand. It also produces other Egyptian brands, such as Belmont, Capital and Boston; and foreign brands including Philip Morris brands, R.G. Reynolds brands, Lite, Rothman, Cieta, Gitanes and Kent. Altogether, the company produces more than 15 brands locally. Other brands may be imported, but with substantial customs duties.

Prices and Distribution

As a monopoly, Eastern Tobacco controls production and distribution to the retail level, and it sets price ceilings for ex-factory sales and for retail sales. The GOE sets customs duties. Cigarettes are broadly distributed throughout Egypt in retail shops.

According to the Chairman of Eastern Tobacco, the prices of all brands are fixed by the government as follows: first, the Ministry of Finance fixes the ceiling of ex-factory prices and sales taxes; then the Ministry of Industry fixes the retail prices. Initial pricing changes, which have always been price increases, are made by the Ministry of Finance, which may or may not consult with the chief executive office of the tobacco company. After ex-factory prices are raised, the Ministry of Industry always consults the company's chief executive officer to determine the new higher prices to be set for the retail sales. Pricing decrees from the Ministry of Finance are irregular, but are always followed shortly thereafter by decrees for retail prices from the Ministry of Industry.

Efforts to begin privatizing and breaking up the government tobacco monopoly are currently under discussion. Several options for re-structuring the industry, ranging from creating a private sector monopoly to developing a more competitive market structure with separate firms, are being considered. However, after the monopoly is broken up, the government will continue to influence domestic prices by controlling customs duties and sales taxes. However, the ex-factory prices would be determined by the firm or firms themselves. As customs duties fall, sales taxes may be expected to rise.

A recent study of pricing and taxing policies for cigarette sales from 1984 to 1994, which was funded by the Eastern Tobacco Company, pointed out that government efforts to raise prices and sales taxes to increase government revenues have at times failed to raise revenues, because of elastic demand which led to substantial sales declines following price rises.

There are a variety of scenarios for privatization in terms of factory ownership and distribution. The key factor would be that companies would have to pay sales taxes and customs duties, but otherwise would be able to sell the cigarettes competitively in retail markets. The GOE would evidently attempt to replace its current profits from tobacco with higher taxes.

Cement

Market Structure: Production and Distribution

Until 1991, cement production and distribution were in effect a government monopoly with public sector producers obliged to sell their output to a central Cement Sales Office at ex-factory prices subject to Ministry of Housing decree. The Cement Sales Office was abolished by Ministry of Housing Decree 152/1991, which also eliminated the authority of the Ministry of Housing to decree prices of cement (and reinforcing bars). The producers are now free to set their own ex-factory prices and to sell directly to traders or final users.

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Production

On the production side, the cement industry in Egypt, which until recently was entirely owned by the public sector, consists of eight companies. One of them, Suez Cement, has two plants and is now partly privatized as a joint venture firm (with 22 percent of shares owned by the private sector as of July 1994). Other cement companies up for privatization are Beni Suef (originally Japanese-financed), El Amareya (originally World Bank-financed), and Helwan.

Under Law 203/1991 establishing the public sector holding companies, the various cement companies were assigned to three different holding companies: El Ameriya and Assiut to the Holding Company for Metallurgical Industries; Tourah, Helwan, National, and now Beni Suef to the Holding Company for Mining, Refractories, and Ceramics; and Alexandria to the Holding Company for Chemical Industries. The intention was probably to prevent re-creation of the monopoly previously exercised by the Cement Sales Office, but the cement companies still consult with each other and with the Ministry of Industry and the PEO. A similar approach of dividing companies among different holding companies was also applied to fertilizers, Nile transport facilities, textiles, engineering companies, grain milling, cotton plants, foreign trade companies, contractors, tourist facilities, and cinemas.

Cement industry employment, production, and equity by company and plant in 1992–1993 were as shown in Table B-1.

Table B-1. Cement Industry Employment, Production, and Equity in Egypt by Company, 1992–1993

Company and Plant	Employees (number)	Production (thousand MT)	Equity (million £E)
Tourah	4,212	2,823	138.0
Helwan	4,589	2,850	188.4
Alexandria, El Mex	n.a.	753	n.a.
National, Helwan	4,649	2,018	- 9.9
Assiut	n.a.	1,833	n.a.
El Ameriyah	1,994	2,298	9.8
Beni Suef	-	-	-
Suez Cement:			
Suez	641 ^a	1,052	n.a.
Quattamia	739 ^a	1,490	n.a.
Cairo office	158 ^a	-	-
Total	n.a.	15,117	n.a.

^aAs of December 31, 1991.

n.a. = not available.

Source: Arab Swiss Engineering Co., POB 26 New Maadi, at the request of Chairman, Suez Cement Co.

The volume of cement production in Egypt is now 16.5 million MT per year; consumption is 15.5 MT. The market for imports is small, and limited to situations of temporary bottlenecks, because (a) the quality of Egyptian cement is high, (b) importing bagged cement is inefficient, and (c) an importer needs to process 100,000 tons per month (1.2 million tons per year) of clinker to make the operation worthwhile. That was feasible when local production was only 50 percent of local consumption of cement. Egypt is now trying to export cement.

The world market for cement is booming. The Egyptian market is sheltered by transport costs and high demand in the Middle East region. Russia, Turkey, and Rumania are potential competitors. Ex-factory prices in Egypt are lower than in Israel, and there is some talk of establishing an Egyptian-

Israeli joint venture in the Sinai. Ex-factory prices in Egypt are also lower than in Saudi Arabia, which is a potential market for Egyptian exports of cement.

The distribution networks of the companies are regionally based, but there is some competition between companies in the same area and some between areas on grounds of quality or a combination of personal and business relationships.

Entry into production is limited by high costs of investment. There has been some discussion of introducing small cement plants as used in China; but the concentration of Egypt's demand for cement in the Nile valley facilitates bulk transport, and the greater efficiency and higher productivity of large plants would appear to make them more appropriate for Egypt.

Distribution

On the distribution side, under the system inherited from the Cement Sales Office, cement was sold only to the 28,000 traders holding licenses. With the abolition of the Cement Sales Office in 1991, its equipment and personnel were reallocated to the producing companies, which continued to sell cement through the previously licensed traders. The producing companies would now like to get rid of the sales departments they inherited, but they are locked in by the personnel problems they inherited at the same time.

On July 1, 1994, a new "distribution network" system was introduced. Under the new system, small users (i.e., those using less than 1,000 MT per month) are supplied through the distribution networks, whereas larger users (those using more than 1,000 tons per month) can purchase directly from the factory at prices discounted for large-volume sales. Each producing company has its own network of local distributors in its area. The producers try (probably without success) to set the distributors' margin on such sales. For example, Tourah gets its distributors to agree to limit their margins to 12 percent, but the agreement is not enforced.

Because experience is one of the criteria for entry into the new distributors' networks, many of the previous licensed distributors are now included. But some of them are excluded, and have suddenly found themselves arbitrarily cut out of their way of making a living. Other criteria for qualification to enter the network are being from a good family, having a good reputation, having a sufficient financial base to be a reliable trader, and to have storage facilities. Given the desire of the producers to offload their production quickly and at minimum cost to themselves, the perception in the market is that the producers give the bigger traders preference, which squeezes the smaller traders out of the market. At the moment, it looks as if the new system has reduced the number of eligible traders. Licenses have been replaced by membership in the distribution networks.

Suez Cement is not included in the new system worked out by the PEO and the holding companies. Suez Cement was in any case never tied to the Cement Sales Office and has no facilities of its own for transporting bags or bulk. It therefore sells to, and depends on, traders from all over Egypt; but it also has a tendency to favor the bigger traders who can keep to schedules and provide letters of credit.

The reason for the change in the distribution system was that, in a situation where there is plenty of local cement production and no ban on imports, the market price of cement was well above the sales price of the old Cement Sales Office. From the point of view of the GOE, the licensed traders were a "mafia" extracting excessive margins from consumers of cement as monopolists manipulating regional supplies. A first move in cutting down the traders' margin was to raise ex-factory prices, which was done in 1992. But market prices are still well above production cost, and also well above the ex-factory price. Replacing the exclusive right of the licensed traders to buy from the factory by the networks of approved distributors was a second step in attacking a so-called "mafia." It is not likely to lower the market price.

A more likely explanation of the existence of a black market in cement than manipulation by "mafias" is that much of the building in Egypt is unlicensed and clandestine, in part because obtaining building permits is cumbersome and costly, and in part because building is illegal in agricultural areas of the Delta where much of it occurs. Unlicensed builders cannot go to the factories to buy their cement; they have no choice but to get their cement from the traders.

Prices

Until 1992, ex-factory prices of building materials (including cement and reinforcing bars) were set by decrees of the Ministry of Economy in coordination with the Ministry of Housing, at levels that in some cases did not cover production costs of the cement companies; and all local production of cement (and reinforcing bars) was sold through the GOE's central Cement Sales Office. The Cement Sales Office was abolished by Ministry of Housing decree 152/1991. The last Ministry of Economy decree on prices of building materials was issued in 1992.

In practice, the market price to Egyptian users of cement is determined by the price of imported cement, which sets a ceiling after tariffs and transport costs are included. The price of imports, at the international cement cartel's landed price at Alexandria plus tariff plus transport cost, sets a ceiling to the price in Egypt. The import price of cement is currently £E 200 to 230 per ton (including tariffs of 10 percent on bulk clinker and 20 percent on bagged cement).

Since the abolition of the Cement Sales Office in 1991, cement prices are set by the producers rather than directly by the GOE; but GOE influence is strong. According to the Chairman of the Cement Section of the Chamber of Industries (who is the chairman and managing director of Suez Cement), prices vary little from company to company, by perhaps £E 0.5 per MT. A coordinating committee of cement producers, which includes Suez Cement, discusses prices, but primarily to keep tabs on international prices in the context of potential competition from imports.

Opinions vary as to the local market price for cement. One expert said it is between £E 180 to £E 185 per MT. The chairman and managing director of Suez Cement estimates the current price in the Cairo market at £E 240 per MT.

Until 2 years ago, the older factories, which produce at £E 132 per MT, were selling cement (to the licensed traders) at £E 145 per MT including taxes.⁹ In 1993, the producers, pushed by the GOE to raise their selling prices to take some of the margin away from the licensed traders, raised ex-factory prices to £E 160 per ton. The producers used some of the additional revenue to overhaul equipment in their factories.

The business community (and the Ministry of Economy) interpreted the procedure as an unfriendly exercise of monopoly power. It was suspected that all the local factories underwent "regular maintenance" at the same time in order to bring about a shortage of cement and to raise prices.

As a result of the increase in ex-factory prices, cement producers started to improve their efficiency. Two of the eight furnaces at the cement plants were overhauled. Each of the three Helwan plants added between 200,000 to 400,000 tons per year to production of 3.0 million tons per year (10 percent on the average).

⁹However, CAPMAS's *Quarterly Review of Industrial Product Prices* shows Portland cement at £E 127 for April 1993.

Refractories

Market structure

There are two major producers of refractories in the public sector operating under the Holding Company for Mining, Refractories, and Ceramics: ECR (Egyptian Company for Refractories) with total capacity of close to 500,000 MT per year and SORNAGA (El Nasr Company for Refractories and Ceramics) with capacity of 60,000 tons per year. ECR produces fire clay, alumina silicate, high alumina, magnesite, and chrome-magnesite. SORNAGA produces fire clay, alumina silicate and unshaped magnesite. The industry also has 20 smaller units (one big company and the others small) with total capacity of 40,000 MT per year producing fire clay and low alumina.

ECR has four plants, two old and two new. Of the four, two (one new, one old) are in Helwan and two (one new, one old) are in Alexandria. The new plant in Helwan is a "Soviet plant," with a capacity of 126,000 MT per year, producing such materials as alumina, fireclay, and chromium magnesite. The old plant in Alexandria has a capacity of 15,000 MT per year. The new plant, whose capacity is 95,000 MT per year, is the "American plant," built with USAID assistance. It is supposed to be one of the best refractory plants in the world. ECR also has mines in the Sinai (producing kaolin) and in Aswan (ball clay). The clay mine competes with other local mining companies in sales to the open market.

ECR has two rotary calcinators (like the rotary kiln for the cement industry), with a capacity of more than 250,000 MT per year, producing calcinated kaolin. Raw material capacity is more than 200,000 MT per year. Refractories demand is 170,000 to 180,000 tons per year.

A special refractory plant will start producing in 1995. Trials by consumers will be needed before they buy, and sales will depend on trials. There is stiff competition from imports.

Current market shares (percent) for refractories are the presented in the following table:

<i>Refractory</i>	<i>Percentage</i>
ECR	40
SORNAGA	20
Private	15
Imports	25
Total	100

There is no local competition for calcinated materials, although there is competition from China. Egypt exports to Germany, Italy, and Greece.

Prices

According to the commercial director of ECR, ECR's prices depend (1) on competitors' prices (local and imports) and (2) on cost. There is never any interference from the GOE. Fire clay is all local. High alumina and magnesite are imported.

SORNAGA and ECR bid against each other for local contracts. If the consumer is a cement company, ECR and SORNAGA will submit the same initial price; then each discounts up to 20 percent or 30 percent off that price "to get the piece of cake."

Customs duty was 15 percent 2 years ago, then 30 percent, and now 20 percent—applicable also on products not locally produced, such as bauxite. There has been dumping from Turkey in Egypt and Syria but the Turkish exporters are now raising their prices.

An example of how the pricing system works is the following. Bids on a recent Dakhei'a tender (still open) for 5,000 MT of magnesite masses for steel have been received from Turkey, Austria, France, Greece and Spain. The bids ranged from \$227 to 259 per MT; ECR's bid was \$240 per MT, which is

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below cost taking into account imported raw materials (normal list price is \$350 per MT). Prices cannot be discounted too far because that leads to suspicion of poor quality; also after-sale service has a cost. Dakheila's decision will take into account both experience and price. ECR provided a trial sample of 100 or 200 MT at a special price of \$150 per MT. Dakheila will order 2,000 MT on the basis of experience and 3,000 MT from three or four companies at the lowest price bid. For competition from abroad, 10 percent will be added.

ECR exports to Syria and Libya in 1993–1994 (July 1993-June 1994) were 5,000 MT, or 7 percent of total sales. Export prices are below local prices and depend on the market; for example, Syria's price is lower than that of Saudi Arabia. Price varies over a range of 20 percent according to the market and to the customer, taking into account the commission to agents (and "under-the-table services"): Syria, 5 percent; Libya, 20 percent. Prices in Libya are 50 percent higher than in Syria.

Glass and Glass Products

There are two major public sector producers of glass and glass products in Egypt, the El Nasr Glass and Crystal Company and the National Glass Company, in addition to some smaller private sector producers of glass products. El Nasr participates in National for 11 percent (£E 24.8 million) of National's capital.

El Nasr was opened in 1932; it was nationalized in 1961. It produces plate glass, bottles for soft drinks (70 percent of Coca Cola's bottles), and other glassware for the local market and for export. Its raw materials are local: sand, soda ash, and sodium carbonate from Alexandria. According to the commercial director of El Nasr, prices are based on cost and "the market."

National Glass and the private sector produce bottles for soft drinks, supplying (among other customers) Coca Cola when El Nasr runs short. Academia Company in Suez produces pharmaceutical bottles.

There is now no high-quality plate glass produced in Egypt (e.g., for mirrors). There are two local producers of plate glass using 1950s technology, one at the rate of 9,000 MT per year, the other at 6,000 MT per year. Competition is from Rumania and the local price is set accordingly. If the import price is 101 or 102, the local price is 100; cost is 80 or 90. El Nasr imports float glass for a shatterproof glass factory in Alexandria. The price of float glass is £E 25 to 30 per square meter; the price of plate glass is £E 14 per square meter.

El Nasr is participating for 10 percent in a new joint venture company to produce float glass by an English process for which Egypt bought the license. The float glass plant is being built on a 62 *feddan* (260,000 square meter) site at 10th of Ramadan City. Its production capacity will be 160,000 tons per year of 2 to 12 mm plate glass in 4 colors. Other participants in the joint venture are National Bank of Egypt for 10 percent, Suez Canal Bank for 5 percent, Saudi investors for 10 percent, and others at 5 percent and 10 percent, for a total of 70 percent. The remaining 30 percent of shares will be sold to the public when production starts three years from now.

Participation by existing public sector companies, which also have the needed local technical expertise, in new joint venture companies is a pattern that some of the public sector companies seem to have adopted in other sectors as well. In the short run, dividends from the new plants will improve the financial position of the existing public sector firms; in the medium term, participation in joint ventures is a step in the eventual transition to privatization.

Appendix C

PRELIMINARY RESULTS OF SURVEY OF INDUSTRIAL PRICING PRACTICES IN EGYPT

RESEARCH SCOPE AND OBJECTIVES

This study examines aspects of price formation and the current liberalization of prices in Egypt involving a sample of subsectors of the economy. The investigation was carried out in the context of the macroeconomic restructuring of the Egyptian economy.

More specifically, the objectives of this study can be stated as follows:

- Identifying the major factors influencing price determination.
- Finding out the methods of price determination in the firms to be studied.
- Understanding the nature of the Egyptian market structure and the behavior of the market variables and its relationships to price formation.
- Throwing light on the current price policies and practices of the sample firms.
- Identifying similarities and differences among industrial sectors concerning price formation.
- Knowing more about the pricing problems faced by sample members and their suggestions for the relief of these problems.

METHODOLOGY

To achieve the research objectives, the following methodology was employed:

- Develop the conceptual framework of the study within which the empirical investigation was undertaken.
- Determine the size and the structure of the sample. A sample of 125 firms was designed on the basis of proportional representation. Firms were included in the sample on the basis of
 - Size,
 - Location,
 - Ownership pattern, and
 - The industrial sector (see the section "Sample Characteristics" for more details).
- Design the questionnaire (see Exhibit 1, p. C-12), which was considered the major tool for collecting required data. The questionnaire consists of a number of variables covering both the classification and the subject (price formation policies and practices). It was reworked to make it more reliable and relevant to the Egyptian environment.
- Collect data using the suggested sample structure and the questionnaire.
- Process and interpret data. The data were checked for accuracy, then coded and processed using SPSS (a statistical programming package). A number of SPSS statistical procedures were applied, including
 - Frequency analysis,
 - Descriptive statistics,
 - Correlation matrix, and
 - Cross-tabulation.

BACKGROUND AND THEORETICAL FRAMEWORK

Since 1978, Egypt has been undergoing political and economic changes. The country is now in a period of transition from being a centrally planned society to a society based on individual initiative and free enterprise, a process that involves economic, political, and social transformations. To adjust the old economic structure, some reforms and legislation were enforced to replace the old socialist production structure by a free market economy.

The Egyptian program of economic reform encompassed several factors:

- Limiting the role of the state in economic activity by reducing public investments, abolishing many kinds of subsidies, and minimizing employment opportunities created by the state.
- Liberalizing internal and foreign trade.
- Allowing a competitive market mechanism based on free prices to dominate.
- Motivating exports.
- Restructuring some state-owned companies in order to remedy the imbalances suffered by the public sector.
- Increasing the participation of the private sector in economic activity by encouraging private investment from the sale of certain public assets within a privatization program.
- Liberalizing determination of the exchange rate.
- Changing the role of the banking system from merely executing the state's policies to initiating monetary and financial policies and monitoring the stability of the financial system.

Adjusting the rules and regulations that govern the Egyptian economy results in accentuating price fluctuations, especially upward ones.

According to the mechanisms that govern the competitive market, the variation in quantities supplied and demanded is responsible for price determination.

- The variation in the quantity *supplied* is due to cost of production, innovation and technology, degree of substitution of production factors, value-added tax (VAT) , and government regulations.
- The variation in the quantity *demand* is governed mainly by the following factors: consumer income, consumer tastes, direct taxes, price of related goods (substitutes and complements), marketing efforts, and credit facilitates.

Additionally, the impact of macro (environmental) and meso variables cannot be neglected in price formation policies and practices, since, for the firm

Total revenue = sales volume x unit price, and

Profit = total revenue – total costs.

Price is one of the main determinants of the firm's profitability and potential output.

In general, the free market allows prices to be determined purely by the forces of supply and demand. However, government actions may shift demand and supply curves for political and social reasons. Theoretically, the market will not be free when effective price controls exist. These price controls are government rules or laws that forbid the adjustment of prices. Controls may be floor prices or ceiling prices.

The Egyptian economy is shifting toward the application of free market mechanisms within a liberalization program. This tendency should affect price policies and practices. However, the impact of government price controls still exists at various levels of the economic sector.

SAMPLE CHARACTERISTICS

A total of 125 firms were included in our sample. As seen in Tables C-1 through C-4, the firms represented nine industrial sectors, three ownership patterns, three sizes based on number of employees, and five main industrial locations.

One hundred responses were received (a response rate of 80 percent). Excluding four invalid responses, the total number of responses processed was 96.

Table C-1. Structure of Firms Sampled, by Industrial Branch

Industrial Branch	Frequency	Percentage	Valid Percentage	Cumulative Percentage
Spinning and weaving	17	17.7	17.7	17.7
Cotton	1	1.0	1.0	18.8
Engineering	14	14.6	14.6	33.3
Metallurgical industry	10	10.4	10.4	43.8
Food industry	10	10.4	10.4	54.2
Construction	12	12.5	12.5	66.7
Rice and flour	2	2.1	2.1	68.8
Chemicals	23	24.0	24.0	92.7
Pharmaceuticals	7	7.3	7.3	100.0
Total	96	100.0	100.0	

Table C-2. Firms Sampled, by Ownership Pattern

Industrial Branch	Frequency	Percentage	Valid Percentage	Cumulative Percentage
Public sector	28	29.2	29.2	29.2
Private sector	56	58.3	58.3	87.5
Joint ventures	12	12.5	12.5	100.0
Total	96	100.0	100.0	

Table C-3. Firms Sampled, by Number of Employees

Industrial Branch	Frequency	Percentage	Valid Percentage	Cumulative Percentage
Less than 100	26	27.1	27.1	27.1
100 to 499	26	27.1	27.1	54.2
500 to 999	12	12.5	12.5	66.7
1,000 and more	32	33.3	33.3	100.0
Total	96	100.0	100.0	

Table C-4. Firms Sampled, by Location

Industrial Branch	Frequency	Percentage	Valid Percentage	Cumulative Percentage
Greater Cairo	40	41.7	41.7	41.7
Alexandria	13	13.5	13.5	55.2
Mehalla	20	20.8	20.8	76.0
10th of Ramadan City	11	11.5	11.5	87.5
6th of October City	12	12.5	12.5	100.0
Total	96	100.0	100.0	

DATA ANALYSIS

Each of the following responses is keyed to a question asked in the survey (see Exhibit 1 starting on p. C-12; the number in parentheses following the question corresponds to the page number on which the survey question appears).

Question 7: Who are the company suppliers? (p. C-13)⁵

<i>Company Suppliers</i>	<i>Number</i>	<i>Percentage</i>
Egyptian public sector companies	64	66.7
Egyptian private sector companies	80	83.3
Foreign suppliers	59	61.5
Cooperatives	4	5.2

From the preceding responses, the following can be suggested:

- The private sector appears to be the largest supplier; this status can be justified by the growing role of the sector in the Egyptian economy. In addition, the private sector possesses many outlets all over the country.
- The public sector still enjoys a significant dominance, even with the private sector's growing influence. This may be because of its monopoly in some industries and the large size of its companies.
- Foreign suppliers have become a major source of production inputs because of foreign trade liberalization and the ability of Egyptian producers to manufacture quality goods that can compete locally and internationally.
- According to the responses of the sample members, cooperatives play a minor role as suppliers. This is consistent with the actual share of cooperatives in Egypt. This situation can be explained by the marginal impact of cooperatives despite the official support of the government.

Question 8: Who are the main customers of your company? (p. C-13)

<i>Main Customers</i>	<i>Number</i>	<i>Percentage</i>
Egyptian exporters	37	38.5
Wholesalers	68	70.8
Retailers	35	36.5
Cooperatives	12	12.5
Public sector	19	19.8
Private sector	17	17.7
Company outlets	17	17.7

These responses show that wholesalers are the largest customers of our sample members. This is an expected result reflecting the great financial capacity and marketing abilities of wholesalers.

In addition, liberalization policies have resulted in a growing share of the export sector in the Egyptian economy. Egyptian firms are encouraged to be involved in export activities, especially to European and Arab markets.

⁵This is a multiple-response question; percentage total is greater than 100 percent.

Question 9: How many companies dominate your market? (p. C-13)

<i>Market dominated by</i>	<i>Number</i>	<i>Percentage</i>	<i>Cumulative Percentage</i>
One company	4	4.2	4.2
Two companies	5	5.2	9.4
Three companies	9	9.4	18.8
Four companies	5	5.2	24.0
Five companies	10	10.4	34.4
More than five companies	45	46.9	81.3
None	10	10.4	91.7
Don't know	8	8.3	100.0
Total	96	100.0	

A significant change has been recorded concerning the market structure in Egypt during the last 10 years. This change involved the relationship between public and private firms and their relative shares in the Egyptian economy. The core of this change is the increasing replacement of monopolistic practices by competitive practices. Nevertheless, some sectors are showing a great deal of monopolistic dominance in both the public and private sectors.

When the variable of Question 9 (number of dominant companies, Variable 18) was related to other independent variables using cross-tabulations, the following findings were obtained:

- Sixty-four percent of those responding "more than five companies" belong to the public sector.
- Sixty-six percent of those responding "more than five companies" are companies with 1,000 or more employees.
- About 60 percent of companies replying "one company" are in the textile sector.

Question 10: Are dominant companies in the public, private, or joint-venture sector? (p. C-14)

<i>Sector Affiliation</i>	<i>Number</i>	<i>Percentage</i>	<i>Cumulative Percentage</i>
Public sector	7	7.3	7.3
Private sector	28	29.2	36.5
Both public and private sectors	56	58.3	94.8
Joint ventures	5	5.2	100.0
Total	96	100.0	

The preceding responses suggest that about 60 percent of dominant companies belong to both the public and private sectors. This indicates that the market and the production structure tend to be competitive.

Question 11: How do you determine your selling prices? (p. C-14)

	<i>Number</i>	<i>Percentage</i>
Government controls	6	6.3
Supply and demand (market)	33	34.4
Holding Company (for public sector)	9	9.4
Trade association	1	1.0
Cooperatives	0	0.0
Based on variable costs	11	11.5
Total costs plus standard mark-up	55	57.3

It is known that until the mid-1970s the competitive market in Egypt was a special case; since the late 1970s it has been turning to a general trend. In such a competitive market it is expected that cost factors and market factors have a considerable influence on the pricing decisions of Egyptian producers. This means that the amount of output supplied and the price must reflect the cost of production. In addition, the price will reflect supply conditions (policies of other producers) and demand conditions (purchasing power).

Question 12: [What is] the size of markup? (p. C-14)

<i>Size of markup (percent)</i>	<i>Number</i>	<i>Percentage</i>	<i>Cumulative Percentage</i>
1-9	28	29.2	29.2
10-24	31	32.3	62.5
25-49	8	8.3	70.8
50-74	—	—	—
75-99	—	—	—
Not fixed	29	30.2	100.0
Total	96	100.0	

The following indications can be drawn from the responses to this question:

- A considerable portion of the sample firms (30 percent) adopt no formal systematic pricing policies. Rather, they rely on ad hoc methods.
- The bulk of the firms sampled (63 percent) tend to fix their markup size within reasonable business margins. This can be related to competitive practices and the changing market structure, as well as to the recession experienced by the Egyptian economy, which prevents producers to target higher profit rates.

When correlating this variable (the size of markup, Variable 27) with the independent variables, it was found that

- About 47 percent of companies achieving a 10 to 24 percent markup belong to the public sector, whereas 75 percent of the joint ventures reported no fixed markups.
- As far as the private sector companies are concerned, it was found that a higher proportion (56 percent) seek to achieve a 49 percent markup.

The following table shows the relationship between ownership (Variable 2) and nonprice competition (Variable 27):

<i>Mark-up (percent)</i>	<i>Public Sector</i>	<i>Private Sector</i>	<i>Joint Venture</i>	<i>Row Total</i>
Missing	—	1 (1.8 percent)	—	1 (1.0 percent)
1-9	13 (46.4 percent)	14 (25.0 percent)	1 (8.3 percent)	28 (29.2 percent)
10-24	6 (21.4 percent)	23 (41.1 percent)	2 (16.7 percent)	31 (32.3 percent)
25-49	—	8 (14.3 percent)	—	8 (8.3 percent)
Not fixed	9 (32.1 percent)	10 (17.9 percent)	9 (75.0 percent)	28 (29.2 percent)
Column total	28 (100 percent) (29.2 percent)	56 (100 percent) (58.3 percent)	12 (100 percent) (12.5 percent)	96 (100 percent) (100 percent)

Question 13: What happens if you do not cover your costs? (p. C-14)

	Number	Percentage
Reduce over-all profits	72	75.0
Borrow from banks	31	32.3
Try to raise prices	6	6.3
Re-evaluate assets	4	5.2

The responses to this question suggest that if a producer ends up with a loss, he is forced to reduce his targeted profit to restore economic balance and liquidity. Some producers resort to borrowing from banks.

Question 14: How much have sales prices varied during the last 12 months? (p. C-15)

Price Variation (percent)	Number	Percentage	Cumulative Percentage
No change	36	37.5	37.5
Up to 1-5	17	17.7	55.2
Up to 11-15	14	14.6	69.8
Up to 16-20	4	14.6	39.8
21 or more	5	5.2	86.3
Down 1-5	2	2.1	88.7
Down 6-10	5	5.2	93.7
Down 11-15	2	2.1	95.8
Down 16-20	2	2.1	97.9
Down 21 or more	1	1.0	99.0
Missing	1	1.0	100.0
Total	96	100.0	

Two main findings can be synthesized from the preceding responses:

- The general trend is toward a conservative price increase because of recession and competitive practices. Additionally the government has not yet started to impose the second stage of the sales VAT.
- A sizable portion of the sample firms reported no changes in their prices. It is believed that this does not reflect an actual trend, because many organizational and macroeconomic variables generate the need to change, especially increased production costs.

Question 15: How do you explain the changes in your sales prices during the last 12 months? (p. C-15)

Reason	Number	Percentage	Valid Percentage	Cumulative Percentage
Government price controls	5	5.2	7.8	7.8
Holding company decisions	3	3/1	4.7	12.5
Trade association decisions	—	—	—	—
Cooperative decisions	—	—	—	—
The company decision	1	1.0	1.6	14.1
Changes in input cost	39	40.6	60.9	75.-
Changes in your mark-up	1	1.0	1.6	76.7
Competition	15	15.6	23.4	100.0
Missing	32	33.3	—	—
Total	96	100.0	100.0	—

The responses to this question seem to be consistent with the foregoing arguments: input costs and competition are viewed as the main factors explaining price changes.

Question 16: Does your company depend on nonprice competition? (p. C-15)

<i>Nonprice Competition</i>	<i>Number</i>	<i>Percentage</i>	<i>Cumulative Percentage</i>
Yes	70	72.9	72.9
No	25	26.0	99.0
No reply	1	1.0	1.0
Total	96	100.0	

From these responses the bulk of the sample firms appears to depend on nonprice competition. Producers find it difficult to gain competitive advantages through price differentiation; therefore, they give more importance to forms of nonprice competition in order to strengthen competitiveness. Recently, the role of nonprice competition has been increasing because no significant increase in income has taken place and because of the recession.

Question 18: To what extent does the company rely on nonprice competition? (p. C-16)

<i>Extent of Reliance</i>	<i>Number</i>	<i>Percentage</i>
High	30	47.8
To some extent	36	51.5
Low	4	5.6
Total	70	100.0

When this variable was correlated with some independent variables, it was found to be highly related with the size of the firm (number of employees); that is, large firms with 1,000 or more employees were found to depend highly on nonprice competition (81.3 percent), whereas in medium-sized firms the percentage is 70 percent and in small firms the percentage is 65 percent.

As shown in the following table, when this variable (Variable 34) was associated to location (Variable 5) it was found that

- Firms located in urban areas (Cairo and Alexandria) tend to depend on nonprice competition more than those in rural areas.
- Firms located in new industrial cities tend to depend to a greater extent on nonprice competition than the other two categories.

<i>Nonprice Competition</i>	<i>Cairo</i>	<i>Alexandria</i>	<i>Mehalla</i>	<i>10th of Ramadan</i>	<i>6th of October</i>	<i>Row Total</i>
Yes	30 (75.0 percent)	10 (76.9 percent)	11 (55.0 percent)	8 (72.7 percent)	11 (91.7 percent)	70 (72.9 percent)
No	9 (22.5 percent)	3 (23.1 percent)	9 (45.0 percent)	3 (27.3 percent)	1 (8.3 percent)	25 (26.0 percent)
No reply	1 (2.5 percent)	—	—	—	—	1 (1.0 percent)
Column total	40 (100 percent)	13 (100 percent)	20 (100 percent)	11 (100 percent)	12 (100 percent)	96 (100 percent)
	(41.7 percent)	(13.5 percent)	(20.8 percent)	(11.5 percent)	(12.5 percent)	(100 percent)

Question 17: If yes, what is the form of this nonprice competition? (p. C-15)

<i>Form of Nonprice Competition</i>	<i>Number</i>	<i>Percentage</i>	<i>Rank</i>
Quality	66	68.8	1
Guarantee	20	20.8	3
After sale services	13	13.5	4
Credit facilities	23	24.0	2

As might be expected, quality appears at the top of the list for respondents. With severe price competition, firms appear to pay more attention to quality in order to keep their existing customers and to convert potential customers to actual ones. This result seems consistent with a general trend in Egyptian industry to emphasize quality aspects in order to compete internally and internationally. According to the responses to Question 16, credit facilities are ranked second. This form of non-price competition has begun to gain more momentum in the Egyptian business community in order to promote sales and to cope with the recession, as well as to attain adequate working capital turnover.

Guarantees and after-sale services were also viewed as forms of nonprice competition. After-sale services were given least importance among nonprice competition forms.

This is true as far as the Egyptian market is concerned—Egyptian marketers seem reluctant to adopt these services because of either lack of ability or unwillingness. This situation can also be explained by the dependence of Egyptian consumers on the informal craft sector.

Question 19: What is the impact of the following internal factors on your product prices? (p. C-16)

	<i>Number</i>	<i>Percent</i>
High	21	30.0
Moderate	38	54.3
Weak	10	14.3
None	1	1.4
Total	70	100.0

The conclusion here is that Egyptian producers depend on some forms of nonprice competition, especially in quality and credit facilities, to compensate for the decline in purchasing power.

Question 20: Assess the impact of the internal factors on your product prices. (p. C-16)

<i>Factors</i>	<i>Aggregate Sum²</i>	<i>Weighted Mean Score³</i>	<i>Rank</i>
A - Objectives:			
Profitability	301	3.14	7
Growth	330	3.44	6
Survival	374	3.90	3
Social responsibility	300	3.13	8
B - Technology	337	3.50	5
C - Cost	395	4.11	2
D - Marketing policies	342	3.56	4
E - Used capacity	265	2.76	9
F - Location	396	4.12	1
Grand mean		3.52	

²Frequency (number) × score values.

³Aggregate sum divided by 96.

From the responses to this question, it can be said that for our respondents, cost, location and survival top the list of factors influencing product prices. Other factors are associated with various degrees of impact according to size, location, ownership, and industry branch.

Interestingly, the responses to Question 20 show that respondents seem to place more importance on survival as a strategic objective than on profitability. This was especially obvious in the new firms and in the highly competitive industries.

Question 21: Assess the impact of the following external factors on your product prices. (p. C-17)

Factors	Sum ⁴	Mean Average ⁵	Rank
Local competition	396	4.12	1
Local demand	349	3.65	5
Trade association	193	2.01	14
Availability of labor	287	2.99	12
Availability of raw material	371	3.86	4
Government regulations:			
Labor	319	3.32	9
Taxation	389	4.05	2
Credit	329	3.43	7
Exporting	317	3.30	10
International competition	322	3.35	8
International interest rate	279	2.91	13
International foreign exchange	344	3.58	6
International inflation rates	297	3.09	11
Import prices	368	3.83	3
Mean		3.39	

The responses to Question 21 confirm the consistency of these results with the expectation of economic theory. This means that environmental factors involving local competition, taxation, import price, raw materials (production costs) and local demand are ranked as the most important factors influencing the product prices according to our respondents.

These findings tend to support our arguments in the preceding sections. The answers to Question 21 appear to be compatible with the other answers and attitudes of our sample members concerning various pricing issues.⁶

Some significant correlations were identified among the environmental variables:

- Credit facilities and exporting (0, 61)
- International interest rate and exporting (0, 56)
- Taxation and international competition (0, 62)

⁴Frequency × score values.

⁵Aggregate sum divided by 96.

⁶This is one of several control questions deliberately included in our questionnaire.

Question 22: What are the problems affecting the pricing in your company, and what [are] your suggestions to overcome them? (p. C-17)

<i>Problems</i>	<i>Rank</i>
High prices of inputs (raw materials)	1
Tariff barriers	2
Taxation (VAT)	3
Increasing energy prices	4
Government price controls	5
Severe international competition	6
Lack of liquidity	7
Local competition	8
Commercial fraud	9
Inadequate credit facilities	10
Increasing borrowing costs (interest rates)	11
Unstable exchange rates	12
Shortage of skilled labor	13
Seasonality of demand	14

The problems are ranked according to their frequency, which may reflect the relative importance from the respondent's point of view.

With these problems in mind, sample members were asked to provide their own suggestions to relieving these problems. Their responses were as follows:

- Increase governmental control of input prices
- Reduce customs duties on importing materials and capital equipment.
- Allow more credit facilities and tax holidays (exemptions)
- Give management in both public and private companies full freedom and responsibility in pricing governed only by market forces
- Strengthen the role of the Ministry of Supply and Domestic Trade in reducing commercial fraud and smuggling
- Pay more attention to technical and vocational education to supply adequate technical skilled labor
- Develop a better investment climate

Exhibit C-1. Questionnaire

1. Name of the company:

Industrial Sector:

Main products:

2. Ownership Pattern:

Public.

Private.

Joint venture (% Egyptian).

3. Legal Status:

Proprietorship.

Partnership.

Simple commandite.

Joint stock.

Partnership with shares.

De facto partnership.

Other.

4. Number of Employees:

Less than 100.

100-499.

500-999.

1000 and more.

5. Location:

Greater Cairo.

Alexandria.

6th of October.

10th of Ramadan.

Mehalla.

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10. Are Dominant Companies:

- Public sector (51% or more public).
- Private sector (51% or more private).
- Both public and private.
- Joint venture.

11. How Do You Determine Your Selling Prices?

- Government price controls set price.
- Market sets price.
- Holding company sets price (for public sector).
- Trade association sets prices.
- Cooperative sets price.
- Prices set at variable cost.
- Price set at full cost plus standard mark-up.

12. Size Of Mark-Up (%)

- 1% to 9%
- 10 - - - 24
- 25 - - - 49
- 50 - - - 74
- 75 - - - 99
- No fixed mark-up

13. What Happens If You Do Not Cover Your Cost (Negative Mark-Up)?

- Reduce over-all profit.
- Borrow from bank to restore liquidity.
- Try to raise prices.
- Reevaluate assets.
- Other.

14. How Much Have Your Sales Prices Varied During the Last 12 Months?

No change.

- Up to (%): a) 1 -- 5
- b) 6 -- 10
- c) 11 -- 15
- d) 16 -- 20
- e) 21 +

Down (%):

- a) 1 -- 5
- b) 6 -- 10
- c) 11 -- 15
- d) 16 -- 20
- e) 21

15. How Do You Explain the Changes in Your Sales Prices During the Last 12 Months?

- Government price controls.
- Holding company decision (for public sector).
- Trade association decision.
- Cooperative decision.
- Our decision.
- Change in input cost.
- Change in your mark-up.
- Change in competition situations.

16. Does Your Company Depend on Nonprice Competition?

- Yes
- No (jump to 19).

17. If Yes, What Are the Forms of This Nonprice Competition?

- Quality.
- Guarantees.
- After sale services.
- Credit facilities.
- Others.

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18. To What Extent Does the Company Rely on Nonprice Competition?

- High extent.
- To some extent.
- Little extent.

19. What Is the Impact of This Nonprice Competition on Your Prices?

- High.
- Moderate.
- Weak.
- None.

20. Assess the Impact of the Following Internal Factors on Your Product Prices:

Factors	Degree of significance	Highly significant	Fairly significant	Neither Nor	Highly insignificant	Fairly insignificant
		1	2	3	4	5
1- Objectives						
a-Profitability						
b-Growth						
c-Survival						
d-Social responsibility						
2- Technology used						
3- Cost						
4- Marketing policies						
5- Rate of capacity used						
6- Location						

21. Assess the Impact of the Following External Factors on Your Product Prices:

Degree of significance	Highly significant	Fairly significant	Neither Nor	Highly insignificant	Fairly insignificant
Factors	1	2	3	4	5
1- Domestic competition					
2- Domestic demand					
3- Commercial traditions					
4- Availability of skilled labor					
5- Availability of raw materials					
6- Governmental regulations					
a-Employment					
b-Taxation					
c-Credit conditions					
f-Export policies					
7-International economic factors					
a-Foreign competition					
b-International interest rate					
c-Exchange rate					
d-Inflation rate					
e-Import prices					

22. What are the problems affecting the pricing in your company, and what's your suggestions to overcome them?

Appendix D

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Final Report

Price and Market Liberalization in Egypt

Vol. 2 of 2: Pharmaceutical Industry

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Preface

This report was prepared for USAID/Cairo by Nathan Associates Inc. under USAID IQC AEP-5451-I-00-2058-00, Delivery Order No. 15, PIO/T 263-0233-3-92199. The report was drafted by Harold Lubell (Chief of Party), George Rosen, L.G. Thomas, and Richard Sines, with the assistance of Professor Mahmoud Hosny of Helwan University.

Dr. Ali Soliman, Director of the Research Division of the Ministry of Economy and Foreign Trade, Government of Egypt provided valuable guidance and advice. Mahmoud Alyan helped arrange contacts with public and private sector industrial managers and accompanied the team to numerous interviews.

Price and Market Liberalization in Egypt

INTRODUCTION

As privatization and price liberalization have gradually spread through the Egyptian economy, the pharmaceutical industry remains a significant holdout. In its 1991 agreements with the International Monetary Fund (IMF) and the World Bank, Egypt committed itself to liberalizing most of its economy, ending subsidies and lifting price controls. Under specific terms of these agreements, prices were to be removed for five categories of manufactured products. Pharmaceuticals were originally placed in Group III, competitive products with high trade protection. But after discussions with the World Bank, drug products were moved to a special Group V—items with high subsidies or monopolies, including fertilizer and cement. This move was unfortunate for the pharmaceutical industry because all industrial prices, except for those for industries in Group V, have now been liberalized.

This volume examines the structure of the pharmaceutical industry in Egypt, the problems with Egyptian government regulation of prices, and proposals for reform and liberalization.

STRUCTURE OF PHARMACEUTICAL INDUSTRY

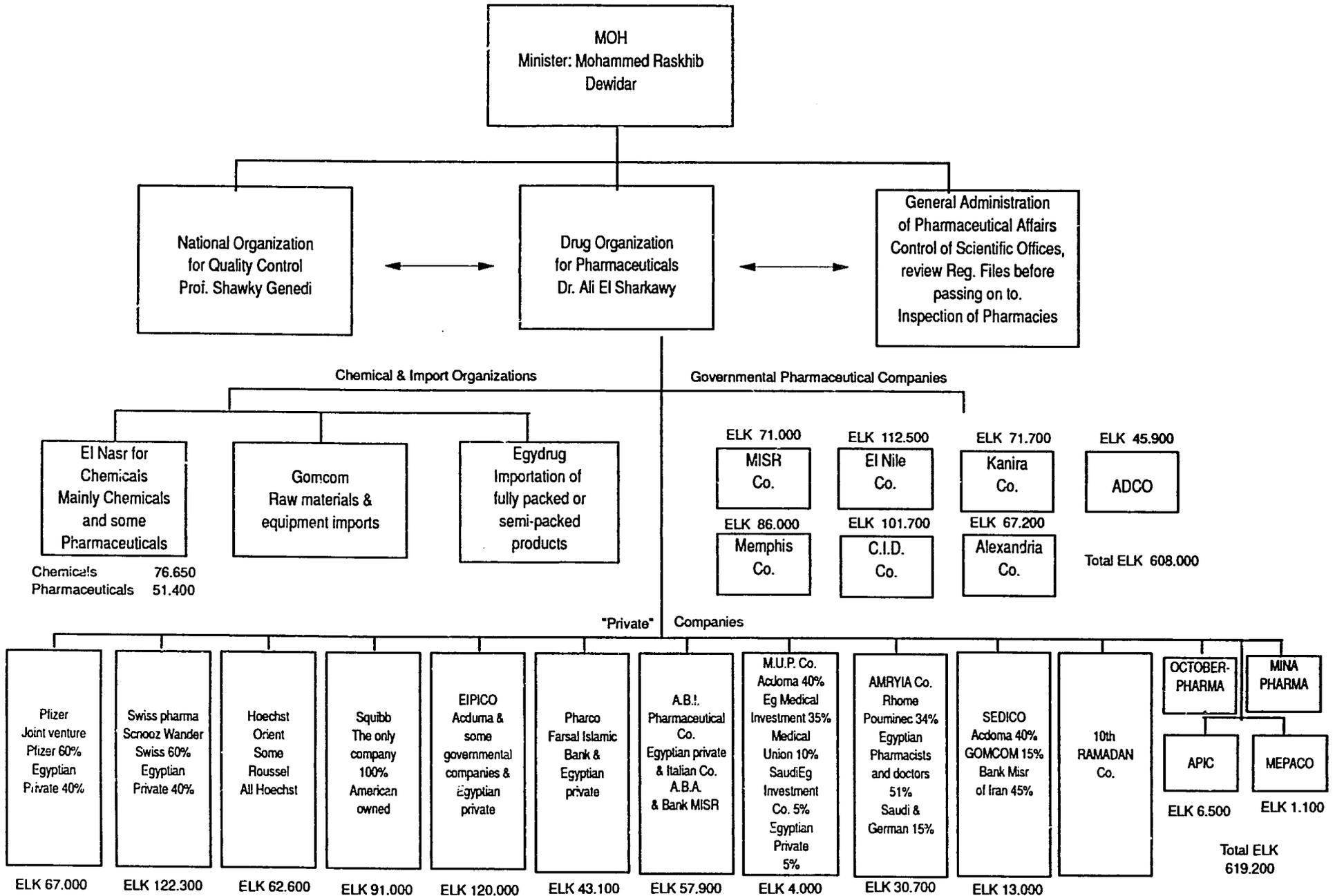
Egypt produces 93 percent of its pharmaceutical consumption locally. That production, however, consists mainly of local fabrication and packaging of bulk raw materials imported from abroad. Taking into account imported raw materials and machinery, perhaps only 35 percent of pharmaceutical sales are truly local in nature.

Egypt's government has hoped to encourage local production of bulk raw materials. Unfortunately, the technical sophistication, high capital intensity, and large economies of scale that accompany the manufacture of bulk raw materials for pharmaceuticals all work against local production of fine chemicals. In addition, the damaging regulations of pricing for the multinational drug firms that currently fabricate in Egypt have largely eliminated any chance whatsoever of any potential transfer of bulk production to Egypt.

Four types of firms operate in Egypt (see Figure 1):

- **Government-owned firms.** Seven government-owned firms supply about 60 percent of consumption. Another two small public firms import drug products and another firm makes bulk chemicals.
- **Multinational firms.** Five multinational firms produce and sell products in Egypt (for recent data on these firms, see Figure 2). Three of these firms (Hoechst, Pfizer, and SwissPharma) entered the Egyptian market in the early 1960s when 100 percent foreign ownership in the industry was prohibited. Accordingly, the Egyptian operations of those multinational firms are joint ventures with minority local ownership. SwissPharma is a combined effort of two Swiss multinationals, Ciba-Geigy and Sandoz, and Hoechst data in Table 1 include the operations of its Roussel joint venture with the French government. Bristol-Myers Squibb

Figure 1. Pharmaceutical Industry in Egypt



Note: Pharmaceutical Total Turnover: EL 1000 million (Est. 250 million) for Government and private pharmaceutical companies. Production shown is 1991 and in ELK.

subsequently entered Egypt as a 100 percent foreign-owned firm during the boom years of the 1970s, and Glaxo entered comparably in 1990, as liberalization and economic reform looked promising.

- **Privately owned Egyptian firms.** In the last decade, privately owned Egyptian firms such as EIPICO, the number 2 firm in the market in 1991, have emerged and been successful. By now more than 15 such firms thrive in the Egyptian pharmaceutical industry.
- **Scientific offices.** The vast majority of the more than 250 firms operating in Egypt are scientific offices. Scientific offices do not manufacture or directly sell drugs. Instead, they only market products to doctors and hospitals, and contract out manufacturing to firms with local production facilities. Most of the world's largest firms, such as Merck or SmithKline Beecham, operate in Egypt only through scientific offices.

Table 1. Egyptian Subsidiaries of International Pharmaceutical Companies

Description	SwissPharma	Pfizer	BMS	Hoechst	Glaxo	Total
Year established	1962	1961	1979	1964	1990	
Present share capital	33.8	26.5	44.5	10	140	400
Sales budget (1994)	160	85	170	120	130	700
Total number of personnel including marketing	900	441	700	800	800	4000
Total area	80	40	40	20	40	
Fixed assets	115	61.2	16	30	87	400
Market share (percent)	8.4	3.7	9	4	3	30

The cost structure of the global pharmaceutical industry is distinctive and plays an important role in competition and industry pricing. On average, the time from synthesis of a new chemical entity until its market launch exceeds 10 years. During that time, the drug must undergo extensive animal and human tests to demonstrate safety and effectiveness. Only 1 percent of promising new drugs will survive these tests and be brought to market. These tests, and the financing of them over a decade, cumulate to research and development costs of more than \$250 million per new drug launched. Moreover, to introduce new drugs to world markets and generate sales sufficient to recover research and development (R&D) costs, additional marketing expenses of \$250 million will be incurred. These enormous fixed costs of R&D and market launch must be covered out of markups over manufacturing costs.

The markups to cover the innovation costs for new drugs drive competition among the multinational firms. Optimally, in the presence of distinct markets with differing standards of living, the markups will vary across markets according to ability to pay (or standard of living). Markups for new drugs are higher in wealthier markets, such as the United States and Japan, and lower in poorer markets. But the markups over production costs are expected to be positive in all countries. This is precisely the problem in Egypt.

LEGAL STRUCTURE OF PRICING REGULATION

Egypt's regulation of drug prices is at the core of controversy over its industrial policy toward pharmaceuticals. All types of drug firms operating in Egypt argue that prices set through government regulation are too low—at times absurdly low. Indeed, drug prices in Egypt may be the lowest in the world in many categories.

Price regulation in Egypt dates back to decrees issued by the government of King Farouq in 1950, at the dawn of the modern pharmaceutical industry. Those arrangements were altered in 1962 by Republic of Egypt Decree No. 113, Article No. 10, which, like comparable U.S. enabling legislation for regulations, is stunningly vague:

Pricing... "shall be determined by the Ad-Hoc Committee. This Committee is formed by a ministerial order issued by the Minister of Health in consultation with the Minister of Industry and the Minister of Supply." [In practice, the last two Ministries have long since washed their hands of pharmaceutical pricing.]

"Anyone who sells any commodity mentioned above [pharmaceuticals] at a price and/or profit more than the announced, or abstains from selling any commodity ... shall be liable to punishment in accordance with the provisions of the aforementioned law."

"The responsible staff assigned for supervision of the said Law shall control infringements of the above Clause."

This decree obviously puts few constraints on Ministerial authority.

The process actually set up in Egypt to determine pharmaceutical prices is rather straightforward. Figure 2 (for 1978) and Figure 3 (for 1993) both show the cost elements in the formal cost-plus procedures that have supposedly governed pricing regulation. Those procedures and cost elements would seem to guarantee a positive profit on all drug products sold in Egypt. Yet alongside the formal processes, informal understandings have dominated the actual workings of the Ad-Hoc Committee over the decades. The committee has sought to set lower prices for essential medicines consumed by the poor and to allow higher prices for less essential products as compensation. In the 1970s, essential medicines seemed to encompass all ethical (prescription) drugs, and over-the-counter (OTC) products were given higher prices. In the 1980s, the definition of essential medicines seems to have been somewhat narrowed to specific categories of drugs such as antibiotics, antidiabetics, and contraceptives. OTC products remain with higher markups. Thus, from the outset a tension existed between formal processes guaranteeing profit that would be ignored in favor of informal understandings insuring differential profits, and perhaps losses.

According to Heba Handoussa, the system worked rather well in the 1960s and 1970s. Yet in the 1980s, it performed abominably. What went wrong in the 1980s?

Figure 2. Computation of Imported Semi-Finished Products (Bulk), 1978

Franco price (importer)		X
Price of packaging and packaging materials		X
Labor and power		X
Primary cost		X
Overheads		X
Promotional contribution		X
Total average cost		100
Importer's profit (factory)	at 25 percent	25
Ex factory price		125
Wholesaler's profit	at 7.6 percent	9.5
Wholesale price		134.5
Retailer's profit	at 11 percent	14.8
Public price		149.3

Figure 3. Cost Sheet for Drugs Produced Locally, 1983

Product :

Registration No. :

Dosage :

Formula	££	MMS
<ul style="list-style-type: none"> • Raw materials • Packaging materials • Direct costs 		
Total direct cost		
<ul style="list-style-type: none"> • Indirect industrial cost (20 percent) • Administrative cost (30 percent) • Marketing costs (15 percent) • Clinical research (3 percent) • Scientific Office promotion allowance (11.6 percent) • Royalties (11.6 percent) 		
Total cost Profit percentage (25 percent, except 15 percent for essential products)		
Ex Factory Price <ul style="list-style-type: none"> • Cash payment (4.5 percent) • Distribution fees (7.86 percent) 		
Pharmacy Price <ul style="list-style-type: none"> • Pharmacy profit (25 percent) • Consumption taxes (5 percent) • Medical stamps 		
Public price		

PRICING REGULATION IN PRACTICE

To see how the Egyptian price regulatory scheme currently works in practice, it is best to examine actual prices set. Tables 2 and 3 compare prices for identical products sold in various countries by two of the multinational drug firms operating in Egypt. Table 2 reports prices for Glaxo's leading products. Egyptian prices are indeed low, averaging around one-fourth that of the United States and Germany, and even half that of other developing countries such as Brazil and the Persian Gulf states. Table 2 clearly shows the expected variation of prices across countries in terms of ability to pay. More detailed and interesting data are reported in Table 3, showing prices for products of Bristol-Myers Squibb. Egyptian prices set for that firm are not only far lower than those of the United States and United Kingdom, but are also quite clearly lower than those of any other Middle Eastern nation. Prices in Egypt are even lower than those of Sudan, a poorer nation. Other multinational drug firms operating in Egypt argue that these data are fully representative of their own experiences.

Table 2. Comparative Public Prices of Selected Pharmaceuticals, Glaxo Egypt SAE (US\$)

Product	United States	Germany	Brazil	Greece	Gulf States	Egypt
Zantac (150 mg, 20 tabs)	30.9	39.8	14.4	15.0	23.1	5.9
Zinnat (125 mg, 10 tabs)	16.2	21.5	18.9	11.3	11.3	6.1
Ventolin (100 dose, inh)	—	11.9	10.0	4.3	8.4	2.9
Zofran (4 mg, 10 tabs)	—	165.8	235.2	95.8	—	74.9

Notes: Prices are per pack as of May 1994. Dash indicates information not available.

Why are prices in Egypt so low? Comparison of Tables 4 and 5 provides one answer. Table 4 shows the extent of inflation besetting Egypt in the 1980s, with general consumer prices in 1992 about 6 times those in 1980. Yet as Table 5 shows (again for the products of Bristol-Myers Squibb), drug prices have increased at a far slower rate, only about a third as much. This process, by which drug prices once set through regulation are forced to depreciate continuously in real terms, is called *vintaging*. Vintaging means that identical products introduced at different times will be sold at different prices, with the more recent "vintage" of products being sold at a higher price. Vintaging has occurred in the drug price regulations of other nations such as France and Japan, but the severity of vintaging in Egypt is very much in a class by itself.

Tables 3 and 5 together suggest that the abnormally low drug prices set by Egyptian regulations are predominantly due to vintaging alone. In other words, the launch prices for drugs in Egypt are in fact comparable to those of other Middle Eastern nations, though of course appropriately below those of the United States. Consider, for example, the products Kenacomb or Kenacort, launched in 1979, or the family of Velosef products (launched in 1980). If these launch prices had kept pace with inflation (again see Table 4), they would have risen by a factor of more than 6. Yet Egyptian price regulations allowed price increases by a factor of only roughly 2. Examination of Table 3 clearly shows that were prices for these products 3 times higher (as would have occurred had Egyptian regulators raised drug prices to keep pace with general inflation), then the Egyptian prices would be among the highest in the Middle East, not the very lowest.

There are, of course, some counterexamples to this general argument. For example, the Bristol-Meyers Squibb products Corgard and Capozide were given absurdly low prices at launch. Yet discussions with pharmaceutical firms operating in Egypt confirm that the main reason for dysfunctionally low prices in Egypt is in fact vintaging. Further, aberrations such as Corgard and Capozide appear to be a thing of the past, as authorities are widely regarded to have set reasonable launch prices in recent years.

Table 3. Comparative Pricing of Bristol-Myers Squibb Products, by Country Public Prices (US\$)

Product	Egypt	Jordan	Lebanon	Saudi Arabia	Kuwait	United Kingdom	United States
Capoten tab.(20's)	2.4	6.2	5.4	7.2	8.5	11.7	13
Capozide tab.(10's)	2.5	—	8.4	7.2	8.9	13.8	15
Corgard tab.(20's)	1.2	6	5.8	7.7	10	—	30
Motival tab.(20's)	1.1	1.5	—	1.4	2	—	—
Modecate inj.	1.3	4.4	—	5	—	—	22.9
Duricef cap.500mg (8's)	2.8	5.8	6.2	10	12	7.9	30
Duricef susp.125mg	1.8	—	4.7	4.8	6.1	3.4	8.5
Duricef susp.250mg	2.7	5.4	5.5	6	10.6	6.8	14
Velosef cap.250mg (12's)	2.1	3.5	—	6.6	7.5	7	8
Velosef cap.500mg (12's)	3.7	6.3	5.8	12	13.6	13.8	15
Velosef susp.125mg	1.3	2.4	—	3.8	4.5	4.3	6
Velosef susp.250mg	2.2	3.5	3.3	6.5	7.6	8.3	12
Velosef vial 1/2gm	1.3	2.4	3	1.6	4	2.6	—
Velosef vial 1gm	2.3	4	4.4	2.9	5.3	7.5	—
Amikin vial 100mg	1.2	—	5.7	5.9	7	5.8	44
Amikin vial 500mg	4.4	9.5	9.5	9.9	11.6	24.7	73
Theragran-H tab.(30's)	2.1	—	3	2.9	6.4	—	12
Kenacomb cream&oint 15gm	1.2	2.3	1.8	2.7	4	4.3	—
Kenacort-A vial	2	2.7	3.7	3.7	4.8	6	—
Mycostatin O.S.30ml	1.4	3.4	2.2	3.6	5.2	4.3	11.8

Table 3 (continued)

Product	Egypt	United Arab Emirates	Oman	Qatar	Bahrain	Sudan	Pakistan
Capoten tab.(20's)	2.4	6.7	6.5	8.8	8.5	6.2	3.9
Capozide tab.(10's)	2.5	8.5	—	9.2	9.2	—	4
Corgard tab.(20's)	1.2	8.2	7.8	9	8.6	7.2	2.2
Motival tab.(20's)	1.1	2	2	2.4	2	2.6	3.5
Modecate inj.	1.3	6.5	6.5	6.7	5.9	6.1	2.2
Duricef cap.500mg (8's)	2.8	10	10	9	9.2	—	5.5
Duricef susp.125mg	1.8	5.9	5.1	3.1	4.7	—	3.7
Duricef susp.250mg	2.7	6.8	6.2	4.9	6.2	—	6.1
Velosef cap.250mg (12's)	2.1	8.7	8.5	9.3	7.1	6.2	2.6
Velosef cap.500mg (12's)	3.7	14.1	13.6	14.8	10.7	11.6	5.1
Velosef susp.125mg	1.3	5.6	4.3	5.1	4.5	3.6	1.8
Velosef susp.250mg	2.2	10.1	6.6	7.8	7.4	6.6	3.1
Velosef vial 1/2gm	1.3	4	3.8	4.2	3.6	3.7	1.2
Velosef vial 1gm	2.3	5.7	5.4	6.1	5.2	5.3	2.2
Amikin vial 100mg	1.2	6.2	5.7	3.7	6.1	5.7	2.3
Amikin vial 500mg	4.4	10.4	9.5	10.2	10.1	9.5	—
Theragrari-rl tab.(30's)	2.1	5.4	—	4.1	4.5	—	1.7
Kenacomb cream&oint 15gm	1.2	4.1	3.1	3.8	3.2	2.7	1.1
Kenacort-A vial	2	3.6	4	4.1	—	3.6	—
Mycostatin O.S.30ml	1.4	4.5	4.5	4.7	4.7	—	—

**Table 4. 2/9 b. Consumer Price Indices
All Urban Population (1986/87 = 100)**

End of	Food, Beverage and Tobacco (a)															All Items
	Bread & Cereals	Meat, Poultry	Fish	Milk, Cheese Eggs	Fruits	Vegetables	Bulses	Food, Bev., & Tobacco	Clothing and Footwear	Real, Power & Fuel	Furniture and Equipment	Medical Care	Transport & Communi-cations	Recreation and Education	Misc.	
1981	21.0	47.0	.....	49.8	37.2	35.9	37.1	39.3	48.1	89.1	53.6	27.9	55.0	43.2	59.0	41.4
1982	23.9	54.2	.....	58.5	43.3	43.0	40.3	45.0	54.8	89.5	76.8	33.4	82.5	45.7	62.4	47.6
1983	26.0	69.2	.....	70.2	52.0	50.9	45.6	53.3	61.8	94.0	80.4	43.6	82.9	64.8	66.9	55.2
1984	30.1	76.5	.....	81.6	74.4	54.8	53.6	62.1	74.6	93.1	87.7	57.3	83.9	67.6	79.2	64.6
1985	41.9	48.3	.....	89.3	79.6	71.4	62.2	70.5	85.9	95.7	92.7	69.4	83.9	80.1	87.8	73.2
1986	68.3	91.1	.....	96.0	92.8	101.1	88.6	87.8	97.8	98.5	94.1	92.2	86.4	84.8	90.8	89.8
1987	112.9	112.5	.....	107.1	100.4	87.8	106.9	107.7	103.4	102.7	104.3	111.4	102.3	108.8	116.9	107.4
1988	134.4	155.1	170.6	150.2	132.7	129.7	117.2	138.9	130.7	105.4	182.5	129.2	118.7	149.1	125.9	134.9
1989	217.5	175.3	228.1	181.3	142.0	288.4	156.1	187.5	152.3	115.2	242.5	147.8	158.3	175.2	149.8	173.3
1990	282.6	166.4	221.2	200.1	146.0	162.6	183.6	194.4	175.4	136.5	254.4	160.9	187.8	194.9	161.6	185.8
1991	312.4	176.7	239.2	232.7	148.9	319.0	250.9	238.8	225.9	177.3	337.6	202.7	241.0	242.7	216.3	233.7
1991 July	296.6	176.7	242.5	207.3	152.9	219.9	223.0	218.0	231.4	177.3	335.2	187.6	237.8	208.2	216.3	220.9
Aug.	296.0	178.3	242.1	207.8	145.5	208.0	225.1	217.1	225.9	177.3	337.6	183.2	237.8	208.2	216.3	219.9
Sept.	312.4	185.1	230.6	222.9	143.6	286.2	240.4	230.8	225.9	177.3	337.6	188.2	241.0	233.7	216.3	228.6
1992 July	350.7	194.6	251.3	235.6	165.9	136.7	245.0	233.0	240.4	202.9	338.0	202.7	309.4	246.3	264.5	241.9
Aug.	350.7	194.7	252.1	242.7	124.6	144.1	234.7	231.2	240.4	202.9	338.0	202.7	309.4	246.3	264.5	241.0
Sept.	385.2	202.3	206.4	233.1	164.5	137.4	236.2	244.3	221.6	223.4	463.5	237.1	297.5	231.0	240.7	248.4
Percent growth 1992 > 1981	1834.0	430.0	—	468.0	442.0	383.0	637.0	622.0	461.0	250.0	865.0	850.0	541.0	535.0	408.0	600.0

(a) Includes oils and fats, sugar and sweets, beverages, and tobacco, in addition to the selected groups.

Source: Central Agency for Public Mobilization and Statistics.

Table 5. Bristol-Myers Squibb Products Price Increase Analysis

Product	Launch Date	Launch Price (£E)	Price Today (£E)	Today's Price Compared to Launch Price
Kenacomb cream 15 gm	1979	1.70	4.00	2.4 times
Motival tab.(20's)	1979	1.10	3.65	3.3 times
Mycostatin susp. 12ml	1979	0.70	2.75	3.9 times
Modecate vial	1979	2.50	4.70	1.9 times
Moditen tab.(20's)	1979	0.90	1.50	1.7 times
Kenacort-A vial	1979	3.00	6.60	2.2 times
Kenacort tab.(10's)	1979	0.80	2.40	3 times
Corgard tab.(20's)	1980	3.00	5.25	1.8 times
Velosef cap. 500mg (12's)	1980	5.30	12.50	2.4 times
Velosef cap. 250mg (12's)	1980	3.30	7.00	2.1 times
Velosef susp. 125mg	1980	2.15	4.50	2.1 times
Velosef susp. 250mg	1980	3.40	7.50	2.2 times
Velosef vial 1gm	1980	2.50	7.75	3.1 times
Velosef vial 1/2gm	1980	1.80	4.50	2.5 times
Velosef vial 1/4gm	1983	1.35	3.25	2.4 times
Theragran Liquid	1981	1.95	5.30	2.7 times
Rubraton B-Elixir	1982	1.70	4.30	2.5 times
Capoten tab.25mg (20's)	1983	5.00	7.95	1.6 times
Duricef cap.500mg (8's)	1984	7.90	9.50	1.2 times
Duricef susp.125mg	1984	6.00	6.00	same price
Duricef susp.250mg	1984	8.00	9.25	1.2 times
Theragran-H 30 tab.	1985	3.50	7.25	2.1 times
Kenacomb cream/oint.10gm	1987	1.80	3.00	1.7 times
Capozide tab.(10's)	1990	5.75	8.50	1.5 times

Vintaging creates significant distortions in the marketplace. Table 6 compares the average prices of several classes of firms. The recent multinational entrants into Egypt (Glaxo with entry in 1990 and Roussel with entry in 1989) have by far the highest average prices in the market, simply because their prices are for recently launched products. In contrast, the older multinational producers in Egypt have much lower average prices because they have suffered the sort of erosion demonstrated in Table 6. Similarly, the government-owned firms established during the Nasser administration in the 1950s have far lower prices than the new privately owned Egyptian firms started in the last decade.

The low pharmaceutical prices in Egypt have led unsurprisingly to negative profits for Egyptian drug firms. The multinational joint venture firms producing in Egypt have equity traded on the Cairo stock exchange and publicly report local profit-loss. SwissPharma has registered losses since 1988 of around £E 20 million in every year. Pfizer suffered £E 41 million of losses during the period 1991 to 1993. Hoechst's reported profits mix its pharmaceutical and chemical operations and are not available. Estimates of losses for the local operations of Bristol-Myers Squibb are presented in Table 7. These data refer to "local profits", meaning that they ignore any profits on imported raw materials. As discussed previously, these raw materials in fact constitute the majority of costs for the multinational firms. If we combine profits or losses on local operations with those of imported raw materials, we obtain "consolidated profits." Consolidated profits would appear to be roughly zero for the multinational firms during the years of local losses.

Moreover, the daily newspaper *Al-Ahram* reported that the seven government-owned firms collectively lost £E 190 million during 1991 (Menas Associates). Glaxo and the local private firms appear to make minor profits, yet it should be remembered that these firms enjoy higher prices (Table 6).

Table 6. Price Analysis Report of Local Sector According to Bull No. 1082 (8/3/94)

Firm Name	Total No. Products	Avg. Price (EE)	Number of Products						
			1 or Fewer	Between 1 and 2	Between 2 and 5	Between 5 and 10	Between 10 and 15	Between 15 and 20	More than 20
Adco	93	3.78	13	37	23	14	3	2	1
Alex	148	3.37	41	47	39	12	3	3	3
Cid	204	3.24	46	61	70	19	4	2	2
El-Nzsr	109	3	16	30	54	3	0	6	0
El-Nile	197	2.28	63	56	61	14	3	0	0
Kahira	167	3.37	46	53	44	16	3	0	5
Memphis	185	3.36	43	61	58	13	2	5	3
Misr	197	2.99	52	54	61	25	2	2	1
Tot. Public	1300	3.13	320	399	410	116	20	20	15
Hoechst	43	5.7	4	9	17	9	2	0	2
Pfizer	46	8.54	1	9	11	12	7	0	6
Swisspharma	119	5.48	12	15	51	26	7	4	4
Tot. Joint V.	208	6.2	17	33	79	47	16	4	12
Apic	92	5.57	0	9	44	32	3	2	2
Amriya	56	6.18	1	10	27	9	5	2	2
Eipico	130	4.96	6	34	62	15	7	2	4
Glaxo Misr	101	16.87	4	17	38	222	7	3	10
Mepaco	14	2.37	0	3	11	0	0	0	0
Mup	81	6.04	2	4	40	21	11	1	2
Minapharm	27	4.32	1	2	13	10	1	0	0
Octob. pharm	12	5.72	0	0	6	6	0	0	0
Pharco.	75	4.4	5	31	18	15	2	3	1
Rameda	6	11.17	0	0	1	2	1	1	1
Roussel Misr	29	14.06	1	3	9	10	3	0	4
Sedico	42	6.84	0	6	19	10	4	0	3
Sekem	8	2.5	0	0	8	10	0	0	0
Squibb Misr	47	5.93	1	4	23	14	3	1	1
Tot. Private	720	7.37	22	123	318	166	46	15	30
Tot. Local	2228	4.78	359	555	807	329	82	39	57

**Table 7. Bristol-Myers Squibb Income Statement
(£E thousand)**

	December 25, 1993	December 25, 1992
Net sales	148,548	110,473
Cost of goods sold	<u>125,434</u>	<u>90,012</u>
Gross profit	23,114	20,461
Operating expenses	31,312	22,659
Operating income	(8,198)	(2,198)
Interest expense	(14,465)	(14,004)
Foreign exchange	(572)	(133)
Other income/expense	<u>(5,564)</u>	<u>43</u>
Total other income/expense	(20,601)	(14,094)
Pretax profit	(28,799)	(16,291)
Provision for taxes	(5,205)	0
<u>Net income/(loss)</u>	<u>(34,004)</u>	<u>(16,291)</u>

Note: Based on U.S. generally accepted accounting principles, unaudited.

Why would the multinational firms not quit the Egyptian market in the face of these low prices and local losses? Indeed, why would the British firm Glaxo enter in 1990 in the midst of this vintaging mess, with the largest U.K. investment made in Egypt? There are three reasons. First, and by far the most important, is the fact that the government of Egypt has committed itself to price liberalization for pharmaceuticals, with the imprimatur of both the IMF and the World Bank. Liberalization and reform in this industry would raise prices and eliminate losses. Second, Egypt occupies a unique strategic position for medical practice in the Middle East. Egyptians make up about 90 percent of the physicians in Saudi Arabia, and they constitute smaller but significant percentages in other Persian Gulf states. Egyptian pharmacists and nurses are similarly situated. Success in the Egyptian market thus means success in much of the Middle East. Egyptian regulators can exploit these network externalities within limits by imposing local losses to be made up by regional profits. Third, low profits can be imposed on innovative multinational drug firms owing to the cost structure of the pharmaceutical industry. As discussed earlier, perhaps half of the costs for innovative drug firms are not manufacturing costs but R&D and marketing costs. To the extent that innovative firms can at least cover local manufacturing costs, they have some chance to recover global R&D and marketing overhead costs. Egyptian regulators can exploit that cost structure within limits by free-riding on the higher prices paid in other countries, counting on other countries to cover fixed costs while Egypt pays only variable costs.

Low prices and local losses are not the only problems with Egyptian regulation of drug prices. The Ministry of Health, particularly in the last 7 years, has overseen industry prices with remarkable capriciousness. The formal process by which Egyptian prices are set explicitly allows pharmaceutical firms to cover their costs. Yet the petitions of drug firms to raise prices were treated cavalierly

during the 1980s. The criteria for "costs" and allowed markups were changed year to year. Petitions were referred indefinitely from committee to committee. Astonishingly, the Ministry of Health not only refused to increase prices for existing products, but effectively refused to provide any prices for many new products from 1987 to 1993. As a consequence, for 6 years fewer new drugs were introduced into Egypt. As the government slowly addressed both problems, in 1994 it suddenly partly rolled back an earlier grant of price increases. All of these actions are technically a violation of Egypt's own stated formal processes. Yet for over a decade, the Ministry of Health has behaved with utter disregard for those processes.

It is clear from the preceding discussion why identical laws, and similar formal processes, for regulation of pharmaceutical prices appear to have worked quite well in Egypt throughout the 1960s and 1970s, but to have failed after 1980. The critical failure with Egyptian regulation of drug prices arises when already established prices must be altered because of inflation. In noninflationary times, the Egyptian system performs acceptably. But in times of persistent inflation, the system is a disaster.

A somewhat similar problem, but one resulting from technological change rather than from inflation, arose in the United States with telecommunications regulation. For six decades, the Federal Communications Commission (FCC) successfully regulated the AT&T monopoly providing telecommunications services. During that period, the FCC had only to monitor the overall profits of AT&T, a task it easily performed. But in the 1970s, new technologies and competitors suddenly emerged and the FCC had to set prices and determine entry for detailed segments of the rapidly changing industry, a task that was completely beyond its capabilities.

In the United States, the solution chosen for telecommunications in 1981 was deregulation and structural reform of the industry. In Egypt today, the unbroken 15-year record of failure by the Ministry of Health to deal competently with inflation in setting drug prices suggests that Egypt now faces a similar turning point for its pharmaceutical industry.

PATENTS AND INTELLECTUAL PROPERTY RIGHTS

With the emergence of new private firms in the Egyptian pharmaceutical industry has come a new problem: patent piracy. Egypt has long recognized process patents for the manufacture of drug products, but it has no patent protection for new products. In the absence of protection for such intellectual property rights, the new private sector firms may openly copy without penalty the new drugs of the innovative multinational firms. By imitating the new drugs, the local private firms free-ride on the R&D and marketing costs of the multinational firms, making no contribution to recovery of launch costs. At times, copying has been particularly evident in Egypt. One American scientific office contracted with a new private Egyptian firm to produce and distribute an innovation. The American firm transferred significant production and quality control technology, only to find the Egyptian firm producing its own generic pirated version alongside the contracted American version. Because the pirated version needed to cover only manufacturing costs and not R&D or marketing costs, it was of course sold at a lower price.

A new law is under study by the Government of Egypt that would establish for the first time adequate protection of intellectual property rights (IPR). It is not clear how quickly the law will be adopted. Furthermore, a key provision of the General Agreement on Tariffs and Trade (GATT) allows signatory nations to delay for 10 years any implementation of the law in the case of pharmaceuticals. Such a delay could imply up to 14 years or so before adequate IPR protection is established in Egypt.

This situation offers two extremes of policy option for the U.S. government. In several prominent cases (Argentina, Korea, Mexico, Taiwan), the U.S. government held fast and successfully insisted

on immediate establishment of IPR protection, despite contrary provisions of the GATT. In other cases, such as India, the United States has acquiesced on the allowed 10-year delay. An intermediate position would be a compromise—a 5-year delay in establishing IPR protection in Egypt, provided that the new law is adopted promptly.

Enforcement will be an issue for IPR protection whenever the new law takes effect. In the United States, patents are enforced through civil courts, a process that is not practical in many countries, probably including Egypt. A more effective enforcement process would be to deny registration to pirated products, thus blocking their distribution from the outset.

PROPOSALS FOR REFORM

The preceding discussion suggests five categories of reform for the Egyptian pharmaceutical industry: transparency, focused deregulation, privatization, patent law, and public outreach.

Transparency

The informal understandings and capricious behavior of the Ministry of Health should be replaced by formal, verifiable procedures. Such procedures would be "transparent" to all participants. Suggested reforms to achieve transparency include the following:

- The Ministry of Health should clearly establish the basis for determining regulated drug prices.
- The Ministry of Health should create, compute, and publicize an index of pharmaceutical manufacturing cost inflation. These data could be used without challenge in filings for prices.
- Filings for setting the price of new drugs should be approved within 6 months after registration of the new drug. The burden of proof should be on the Ministry of Health to demonstrate explicitly that the proposed tariff violates its established tariff basis. If the Ministry of Health fails to act, the proposed price would take effect.
- Petitions to increase prices of established drugs on the basis of the Ministry of Health's drug inflation index or other relevant data should be approved within 3 months. Again, the burden of proof should be on the ministry to demonstrate explicitly that the proposed price revision violates its established basis for setting prices. If the Ministry of Health fails to act, the proposed revision should take effect.
- The Ministry of Industry and the Ministry of Supply should reclaim their legally mandated role in setting pharmaceutical prices. At the moment, only representatives of the Ministry of Health sit on the Ad Hoc Committee. Representatives of the economic ministries are needed to provide balance.

Focused Deregulation

The poor performance of the Ministry of Health in setting drug prices suggests fundamental problems that may not be solved through administrative reforms. This pessimistic assessment would suggest complete deregulation of pharmaceutical pricing. However, Egypt does not currently have an extensive system of publicly funded health care, and the untargeted, implicit subsidies for the poor given through the artificially low drug prices set by the Ministry of Health are critical for providing affordable health care. Deregulation should be focused in a way to minimize any damage to health care for the poor as follows.

- The Ministry of Health should explicitly deregulate prices for all new chemical products launched in Egypt. New drugs are not "essential" inasmuch as we live without them now.

- The Ministry of Health should identify therapeutic categories, such as perhaps anticholesterol drugs or anticancer drugs, that are not seen as "essential" and deregulate prices for existing products in those categories.
- The Ministry of Health should replace the existing implicit, untargeted subsidies of drugs at the production stage with explicit, targeted subsidies at the retail stage. At the moment, hundreds of millions of Egyptian pounds are spent annually through economic losses at public sector and older multinational firms. Those subsidies are dispersed throughout all older products and throughout the population independently of true need. Targeted subsidies would cost no more and yet would more efficiently meet legitimate need. Moreover, there are already successful examples of deregulation combined with new targeted subsidies in several Egyptian industries, including certain foodstuffs (vegetable oil, sugar, and tea) and certain utilities (transportation and electricity). The pharmaceutical industry should be treated in the same manner.

Privatization

Perhaps those most abused by price regulation are the public sector firms, which lose money on more than 700 of the 1,300 products they sell, largely because the prices for those products were set in the 1970s and have since been adjusted only marginally. The most obvious consequences are large losses, almost £E 300 million a year, funded through overdrafts from government-owned banks. The overdrafts are implicit, untargeted subsidies, which are highly inefficient and objectionable in themselves. The impacts also feed through the internal operations and organization of the public sector firms, which are locked into low wages and low productivity by the low prices because they lack the funds to invest in higher productivity. Worse, the quality of the products manufactured by the public sector firms is at times shockingly bad. A recent study by U.S. Food and Drug Administration officials found appalling conditions of production in several of those firms. At one firm, raw materials were stored in reused, unlined plastic drums encrusted with different colored powders from previous products. In several firms, sterility conditions were so weak as to be untrustworthy. The study found an American scientific office to have contracted with a public sector firm to produce its product for distribution in Egypt, only to find that the first two batches submitted by the public sector firm were chemically inert. The problem appears to be widespread, so much so that Egyptians who purchase drugs from public sector firms have no guarantee that those drugs will have the intended chemical effect or that they will not have unintended side effects from the residues of other chemicals.

Privatization would force the government and the private sector firms to deal with those interrelated problems. Clearly, higher prices will be a necessary first step, because the current losses make private ownership impossible. But the internal reform of public sector firms must go much further and attain higher productivity and much higher standards of quality. Both will require significant investment and transfer of technology, which depend on a transparent regulatory environment that permits profitable operation.

Patent Law

The new IPR law in Egypt, protecting products as well as processes, should be promptly adopted. Egypt should be persuaded to eschew the 10-year delay in effectiveness for product patents available under the GATT. At most a 5-year delay, and then only after prompt adoption of the law, should be considered acceptable, for the following reasons.

- Egypt already fails to pay its fair share of global innovation costs owing to abuses of its price regulation system. Its weak IPR protection system exacerbates the problem.
- The new private sector firms in the Egyptian pharmaceutical industry are only now staking out competitive positions and internal organizations and routines. Failure to adopt adequate IPR protection in Egypt will provide a strong incentive for those firms to base their activities on patent piracy rather than on legitimate and long-lasting bases.
- The growth of the private firms and the restructuring of the public sector firms depend significantly on technological transfer from the multinational firms. Such transfer will be reduced if IPR protection is unavailable in Egypt.

Public Outreach

Reform of the pharmaceutical industry should be accompanied by appropriate outreach to the media and professional associations (doctors, nurses, and pharmacists), communicating three basic points: (1) that Egypt currently does not pay internationally fair prices; (2) that Egypt does not now pay prices that are fair over time; and (3) that Egypt should be regionally competitive in sales and exports of legitimate generic products of good quality because of its network externalities throughout the medical systems of the Middle East. Price reform is an inescapable precursor to attainment of that competitive position. It is striking that there is no trade association in Egypt to make the case for the industry before the public. That absence should be remedied by the industry itself.