VERIFICATION REPORT

AGRICULTURAL POLICY REFORM PROGRAM
Tranche I
Policy Benchmarks for Accomplishment
by December 31, 1997

Submitted by

The Government of Egypt

to

The United States Agency for International Development,
Cairo

March, 1998

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With the Technical Assistance of the MVE Unit of APRP
Abt Associates Inc.
EQI MSI

USAID Award 263-C-00-97-00003-00

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LIST OF ACRONYMS

ACDI	Agricultural Cooperative Development International
ALCOTEXA	Alexandria Cotton Exporters Association
APCP	Agriculture Production and Credit Project
APRP	Agricultural Policy Reform Program
ARC	Agricultural Research Center
ATUT	Agricultural Technology Utilization and Transfer (USAID funded project)
CAA	Central Audit Agency
CACU	Central Agricultural Coops Union
CALCOT	California Cotton
CAPC	Central Administration for Pest Control
CAPMAS	Central Agency for Public Mobilization and Statistics
CAS	Central Administration for Seeds
CASC	Central Administration for Seed Certification
CASP	Central Administration for Seed Production
CATGO	Cotton Arbitration and Testing General Organization
CIDA	Canadian International Development Agency
cif	Cost insurance and freight
CIT HC	Cotton and International Trade Holding Company
CN	Calcium Nitrate
CSPP	Cotton Sector Promotion Program (GTZ-funded)
CY	Calendar Year
EE/NIS	Eastern Europe / Newly Independent States
EE	Eastern Europe
ELS	Extra Long Staple
EPIQ	Environmental Policy and Institutional Strengthening IQC
EU	European Union
FAO	Food and Agriculture Organization (UN)
fob	Free on board
GARPAD	General Administration for Reclamation, Projects, and Agricultural Development
GATT	General Agreement on Tariffs and Trade
GIS	Geographic Information System
GOEIC	General Organization for Export and Import Control
GOE	Government of Egypt
GTZ	Deutsche Gesellschaft fuer Technische Zusammenarbeit
HC-RFM	Holding Company for Rice and Flour Mills
HCSWRMC	Holding Company for Spinning Weaving and Ready Made Clothes
IBTCI	International Business and Technical Consultants, Inc.
IFPRI	International Food Policy Research Institute
IIMI	International Irrigation Management Institute
IIP	Irrigation Improvement Project
IPM	Integrated Pest Management
IPO	Initial Public Offering
LS	Long Staple
MALR	Ministry of Agriculture and Land Reclamation

MD	Managing Director
MEFT	Ministry of Economy and Foreign Trade (former)
MEIC	Ministry of Economy and International Cooperation
MLS	Medium Long Staple
MOU	Memorandum of Understanding
MPE	Ministry of Public Enterprise
MPWWR	Ministry of Public Works and Water Resources
MTS	Ministry of Trade and Supply
MVE	Monitoring, Verification and Evaluation Unit
PBDAC	Principal Bank for Development and Agricultural Credit
PD	Presidential Decree
PEO	Public Enterprise Office
PPC	Program Planning Committee
RDI	Reform Design and Implementation (APRP Unit)
RMC	Ready Made Clothes
RMG	Ready Made Garments
SFD	Social Fund for Development
STPU	Strategic Thinking and Planning Unit
TAMIS	Technical and Administrative Management Information System
TCC	Textile Clothing Consultants bv (Netherlands)
TCF	Textile Consolidation Fund
TMT-HC	Textile Manufacturing and Trade Holding Company
USAID	United States Agency for International Development

ACKNOWLEDGMENTS

This report is the work of many dedicated individuals. They are primarily the listed authors, but many others provided assistance. The Chairman of the PPC, Dr. Saad Nassar, has always given his complete support and encouragement to the MVE unit. Eng. Mahmoud Nour provides overall coordination of APRP's work. Mr. George Kondos assists Mr. Nour and the MVE Unit in innumerable ways. Dr. Randall Parks helps all of the APRP units by managing the entire APRP office establishment.

The MVE Unit has been collaborating technically with all the other units located on the 15^{th} floor: RDI, IFPRI, and the CSPP of GTZ. The collegial environment that prevails among these units is an important factor in verification.

The MVE Unit would also like to thank our USAID colleagues for giving us strong management support. Thanks go to Thomas Olson, Mohammed Omran, Ali Kamel, Glenn Rogers, Craig Anderson, Wadie Fahim, Mahmoud Mabrouk, and our Contracting Officer, James Athanas.

The staff of the MVE unit also deserve credit for their strong support to the authors of this work: our financial manager, Hesham Salah; our office manager, and our administrative assistant,Yvonne Louis Azer. Mona El Diwany, Tamer El-Meehy and their colleagues at EQI were always professional in both technical and administrative assistance.

There are individuals too numerous to name who gave their time and effort to make information about diverse topics available to the staff and consultants of the MVE Unit. Some of these individuals hold high positions in the Government; many are in the private sector. All of them have busy schedules. Many of these individuals are named in the benchmark sections below; some are not. To all we extend our gratitude for their cooperation.

PREFACE

This report is an update to the July, 1997 verification report. In general it does not repeat the analysis and conclusions reported therein. However, for the convenience of the USAID Mission, those benchmarks for which the accomplishment exceeded full accomplishment per the July, 1997 verification report are included in the summary of accomplishment table below. The reader is referred to the previous report for details on the *previous* level of accomplishment of all tranche I benchmarks.

Because policy reform in certain key areas began under a previous project, some of the benchmarks verified in this report mention dates beginning as early as 1994. The deadline for accomplishment for all of the benchmarks verified in this report, however, was December 31, 1997.

The task of the MVE Unit in this first tranche of APRP has not been easy. Many of the benchmarks call for complex analysis and judgment. This was true in the first part of tranche I, and it remains true in this update on those benchmarks that were carried over from the previous June 30 deadline for accomplishment.

In this critically important policy reform program, the MVE team has striven to produce a verification report that is both accurate and fair a difficult task. One can abide by the letter of the benchmark's requirement, or try to understand the spirit and context of the benchmark. The interpretation of some benchmarks, moreover, may change with events. The inherent feasibility of a few benchmarks in this first tranche was also a serious question.

The MVE Unit is aware of its delicate position, providing technical assistance in verification to the Government of Egypt and providing its best assessment of benchmark accomplishment to USAID. The constructive dialogue between the Government of Egypt and USAID could be a victim of overzealous interpretation of these benchmarks. This dialogue can only be maintained if both sides have confidence in its integrity and fairness. Finally, the purpose of APRP is to achieve real benefits for the people of Egypt, not only accomplishment of benchmarks and a cash transfer. It is in this light that the analyses in this report should be judged.

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EXECUTIVE SUMMARY

1. Prices, Marketing And Trade

1.1 Cotton

Cotton is the most important single commodity subsector in Egypt, so it is not surprising that the Government is approaching its liberalization cautiously. There has been some additional progress to date on cotton liberalization benchmarks. In addition, there are apparently serious discussions under way at the highest levels of the Government that are evaluating the lessons of the previous marketing seasons and contemplating more radical liberalization in 1998/99.

By the December 31, 1997 deadline for this verification update, four of five benchmarks on cotton market liberalization were partially accomplished. The GOE producer floor price remained above world (lint equivalent) prices, which influenced the pricing of seed and lint cotton at the into-mill and export levels. Lint prices paid by spinners were set in 1997/98 on the basis of ALCOTEXA export prices. Several private exporters reported that the GOE influences the process by which ALCOTEXA sets opening minimum export prices, which are generally not adjusted downward during the course of the marketing season. Opening ALCOTEXA prices were set lower for the 1997/98 than in 1996/97. Export commitments increased in the first four months of the 1997/98 season relative to 1996/97, especially for Giza 86.

By contrast, the allocation of seed cotton to gins is now largely determined on the basis of competition by particular ginners to provide high-quality ginning services and either lower or share some costs. Allocation systems or quotas for lint cotton no longer exist. Nevertheless, some market restrictions continue to limit private sector participation. At the beginning of the 1997/98 marketing season, the GOE issued Decree No. 931, which required that cotton traders be issued a bank letter of guarantee and was not clear regarding the timing of GOE deficiency payments to private buyers, which limited private buying of seed cotton. Only three large, well-financed private firms chose to commit their funds to sales rings operated by PBDAC. The practice of assigning one buyer to each sales ring does not allow competition among buyers that would serve farmers better.

The benchmark on minimum export prices for yarn and woven fabrics is accomplished. The minimum prices are set by a textile industry committee — not by TCF or any particular GOE agency.

The GOE partially accomplished the benchmark on removal of subsidies on cotton pest control, collecting LE100 (plus administrative costs) per feddan from cotton farmers through PBDAC versus LE 50 per feddan last season. The percentage subsidy has declined in addition because farmers are incurring greater expenses for pest control activities outside the Government-approved program.

1.2 Fertilizer

Three policy benchmarks relating to fertilizer market liberalization were partially accomplished. The tariff on imports of nitrogen fertilizer was not reduced from 30% to 10%, although 1.5 million tons of fertilizer were imported from mid-1995 to 1997 under a temporary exemption. His Excellency the Deputy Prime Minister and Minister of Agriculture and Land Reclamation sent letters to the Minister of Finance supporting a decrease in the tariff. Ex-factory prices were not adjusted periodically in light of border prices during a period when international prices dropped precipitously. Local ex-factory prices became higher than international prices in the second half of 1997. Although there is still a 25 percent quota for PBDAC, there has been very significant progress toward the elimination of quotas in fertilizer distribution, and the public sector share in fertilizer distribution is declining. PBDAC's quota was reduced from 87 percent to 49 percent and again to 25 percent, and its actual purchases constitute only about 14 percent of national production of nitrogenous fertilizer. The private sector is taking a larger share of distributing locally produced fertilizers and is participating in exports and imports.

1.3 Rice

The GOE has achieved the benchmark calling for complete liberalization of the rice subsector. By allowing private dealers, millers and exporters to operate freely and invest in new equipment and facilities, the GOE has created a positive enabling environment that has led to the emergence of a vibrant, liberalized rice subsector. Remaining policy issues, such as the export subsidy (never implemented but on the books) and standards for imported rice need to be addressed through specific, targeted benchmarks.

1.4 Studies

The following studies were completed to satisfy four benchmarks:

- a study of the feasibility of eliminating the tariff on imported cotton yarn altogether, including the likely impact on local spinning mills.

- an assessment of the market information needs of an open and competitive agricultural marketing system, including recommendations for developing a marketing information system.

- an assessment of GOE market regulation services and drafting of a law to protect competition and limit monopoly.

- several studies carried out by APRP, GTZ/CSPP, SPR and ATUT have identified non-tariff barriers to imports and exports of agricultural inputs and commodities. Based on these studies, APRP formulated benchmarks under Tranche II that address and attempt to relax or remove these barriers.

2. Private Investment And Privatization

2.1 Cotton

Significant private sector investment has taken place in cotton trading; privatization of a public trading company remains problematic. Prior to the first Tranche I Verification Report, issued in July, 1997, privatization of public sector cotton trading companies was not feasible, given the debt situation, redundant labor, and limited assets of those companies. Shortly after July, 1997, a large part of the debt of the trading companies was forgiven, though the problems of redundant labor, managers ill-adapted to the demands of a competitive private sector trading environment, and limited assets remain. What is most important is that the GOE has allowed private sector trading companies to form and operate, especially in the export market. This season five private firms have received offers to export about 23 percent of the total exports (commitments as of January 11, 1998).

2.2 Fertilizer

Privatization of fertilizer plants began with small non-nitrogen producers. The privatization plan now includes all major and minor producers. The Government has also approved private investment in nitrogen production. The benchmark is accomplished.

2.3 Rice

The holding company and the MPE have undertaken several steps in the privatization process. In addition, significant private sector investment has substituted for and superseded privatization. Privatization of increasingly redundant public sector rice milling capacity is not necessary to ensure a strong, vibrant milling industry, which has already emerged. The benchmark is accomplished.

2.4 Seed

The Government, with the assistance of the RDI Unit and GTZ, has recently accelerated the privatization process. Investments and leasing by the private sector are in large measure due to the change in the Government's seed pricing policy and in its overall seed processing policy. Together with the Government's progress in privatization, these meet the spirit of this benchmark.

A second benchmark concerns development of delinting plants for cotton seed and a plan for privatization of these plants; this is accomplished. An acid delinting plant was constructed with GTZ assistance in 1996 and has been operating since March, 1997. With the assistance of the RDI Unit and GTZ, a plan has been developed for the privatization of the acid delinting plant in 1998.

3. Public Investment Policy and Sustainability

3.1 Water Management and Cost Recovery

MPWWR has a well-delineated plan for a cost-sharing implementation program. First steps are under way. The two benchmarks that call for cost sharing are accomplished.

MPWWR has taken many steps to define and finalize administrative and institutional procedures required for farmer cost sharing in irrigation system (capital) improvements, but has not yet begun actual collection from farmers. It was recommended in July, 1997 that this benchmark be considered accomplished in that political and legal difficulties in implementing collections for capital improvements are beyond the control of the Ministry. There is no change in the situation with regard to this benchmark and hence no change in the recommendation.

3.2 Studies

The RDI Unit completed the following studies, accomplishing three benchmarks:

- a summary of past and current water and land resource policies in Egypt, discussion of their shortcomings, and formulation of a revised and comprehensive water resources policy addressing land use for agricultural production.

- a detailed review of the provisions of the new land rental law (96/1992) and its effects.

- an overview of the national agricultural research and extension system that recommended improvements.

Regarding a study of phytosanitary controls on imports of raw agricultural materials, leading to a plan to remove unnecessary restrictions, an APRP/GTZ study has been conducted that conforms to the spirit of this benchmark. A tranche II benchmark also meets the spirit of this benchmark.

SUMMARY OF ACCOMPLISHMENT

Benchmark	Level of Accomplishment			
	Exceeded Full*	Accom-plished	Partial	No Progress
I.A PRICES, MARKETING AND TRADE: Cotton: I.A.1. Verify that benchmarks for cotton in Tranche 7 of APCP are met for the 1996 crop. This includes the following specific benchmarks from Tranche VII of APCP: 1.e. Cotton price controls, including export prices and prices to mills, and all allocation systems currently in use (e.g., lint allocation to spinning mills and seed cotton allocations to gins) are abolished beginning with the cotton planted in CY 1994.			X	
2. By the end of March 1995 : b. No GOE market restrictions will constrain private sector entities' involvement in cotton domestic marketing, ginning, exporting and importing.			X	
3.b. In order to encourage private sector participation in cotton ginning, at least 25% of the publicly owned ginning stands will be offered for sale or lease to the private sector, based on accepted valuation techniques.	X			
4.b. All cotton pest control direct subsidies will be eliminated starting with the CY 1994 cotton.			X	
I.A.2. Verify that the practice of allocating lint cotton to spinning mills according to an administrative formula and administering prices is not being implemented and mills acquire lint cotton at free market prices.			X	
I.A.4. Eliminate minimum export prices for yarn and woven fabrics.		X		
I.A.7. Expand that program of trials and demonstrations for short season cotton varieties for the 1996 season.	X			
I.A.8. Study the feasibility of eliminating the tariff on imported cotton yarn altogether, analyze the impact on local spinning mills, and strengthen safeguards against unfair competition from imports.		X		
I.B. PRICES, MARKETING AND TRADE: Fertilizer: I.B.1. Reduce the tariff on nitrogen fertilizer (ammonium nitrate and urea) from 30% to 10%.			X	
I.B.2. Review ex-factory prices and set them in light of border prices, adjusting the price at least once per season. The definition of border prices will be according to the monitoring plan.			X	
I.B.3. Eliminate government quota allocations of fertilizer, except in the case of market failure.			X	
I.E.2. Reduce the tariff on 40-85 HP tractor imports from 40% to 30%.	X			
I.E.3. Conduct a study to identify non-tariff barriers to imports and exports of agricultural inputs and commodities, and develop a time-phased plan for eliminating these barriers.		X		

Benchmark	Level of Accomplishment			
	Exceeded Full*	**Accom-plished**	**Partial**	**No Progress**
I.F PRICES, MARKETING AND TRADE: Government Services in Marketing: I.F.1. Assess the market information needs of an open and competitive agricultural marketing system and develop recommendations for developing a marketing information system.		X		
I.F.3. Assess the market regulation services needed to be carried out by the GOE and develop recommendations pertinent to a system for regulating non-competitive behavior in agro-industries and marketing of agricultural commodities.		X		
II.A. PRIVATE INVESTMENT AND PRIVATIZATION: Cotton: [Privatization means selling 51% of the assets to the private sector, private management, or leasing.] II.A.2. Privatize at least one of the profitable cotton spinning companies (KABO, STIA, UNIRAB, Shebin, and Alexandria), and show verifiable progress toward privatization of the remaining four by September 1996. Privatization will include a successful solution to labor and debt issues.	X			
II.A.3. Privatize at least one cotton trading company.		X		
II.B. PRIVATE INVESTMENT AND PRIVATIZATION: Fertilizer: II.B.1. Based on the study of fertilizer production to be completed by February 1996, the GOE will adopt a time-phased liberalization and privatization plan for fertilizer production, marketing, and international trade.		X		
II.B.2. Privatize one fertilizer plant by September 1996.	X			
II.D. PRIVATE INVESTMENT AND PRIVATIZATION: Rice: II.D.2. Begin implementing the privatization and liberalization plan for rice mills, privatizing one rice mill.		X		
II.D.3. Complete the liberalization of the sub-sector by September 30, 1996.		X		
II.E. PRIVATE INVESTMENT AND PRIVATIZATION: Seed: II.E.1. Continue to implement the privatization of all seed processing plants. Offer, at reasonable prices, at least 50% of the seed processing plants for sale to the private sector by September 30, 1996.		X		
II.E.2. Continue to develop delinting plants for cottonseed and develop a plan to privatize these plants.		X		
III.A PUBLIC INVESTMENT POLICY AND SUSTAINABILITY: Land and Water: III.A.1. Develop a revised, integrated land and water plan on the basis of: a) the comprehensive study of the socioeconomic viability of new land development schemes completed in October 1994, and b) a socio-economic water map being developed in the Strategic Thinking and Planning Unit Program of the MPWWR.		X		

Benchmark	Level of Accomplishment			
	Exceeded Full*	**Accom-plished**	**Partial**	**No Progress**
III.A.3. Conduct a study of land tenure policy.		X		
III.B PUBLIC INVESTMENT POLICY AND SUSTAINABILITY: Water Management Policy: III.B.2. Develop an implementation plan for a cost sharing program, based on the output of Benchmark III.B.1.		X		
III.C PUBLIC INVESTMENT POLICY AND SUSTAINABILITY: Investment in Research, Extension & Other: III.C.1. Analyze research and extension institutions during 1995, with the aim being to develop a plan for improving institutional arrangements, improving the efficiency of investment, and reducing budgetary pressures where possible. Include a review of mechanisms for contracting out services to private sector firms. Develop a benchmark for the 1996/97 MOU which will call for the initiation of institutional reforms that may be identified by the analysis.		X		
III.C.2. Conduct a study of phytosanitary controls on imports of agricultural raw materials and develop a plan to remove unnecessary restrictions to free trade in agricultural raw materials and inputs.		X		
III.D PUBLIC INVESTMENT POLICY AND SUSTAINABILITY: Farmer Cost Sharing: III.D.1. Define and finalize administration and institutional procedures required and begin recovering capital costs from farmers who benefited from mesqa improvements completed under the Irrigation Management Systems Project, in accordance with Law No. 213 (1994) amendment to the Irrigation and Drainage Law.		X		
III.D.2. Develop an implementation plan for allocating and recovering O & M costs.		X		
TOTALS	5	18	7	

* Those benchmarks for which the accomplishment exceeded full accomplishment per the July, 1997 verification report are included in this table; the analyses for those benchmarks are available in that report.

I. PRICES, MARKETING AND TRADE

I.A. <u>Cotton:</u>

1.e. Cotton price controls, including export prices and prices to mills, and all allocation systems currently in use (e.g., lint allocation to spinning mills and seed cotton allocations to gins) are abolished (beginning with the cotton planted in CY 1994.)

<u>Interpretation of benchmark for verification purposes:</u>
This benchmark calls for the removal of administered prices on cotton lint and quantity controls on both lint and seed cotton. The administered prices to be freed are the minimum export price and the often related price to spinners.

<u>Sources of Information/Method of Analysis:</u>
MVE carried out structured informal interviews of domestic cotton traders, exporters, ALCOTEXA, spinners and weavers and other key subsector participants. These interviews were done first in collaboration with the MALR/GTZ CSPP from March through May, 1997 and later in September-December 1997. CSPP developed formal questionnaires for ginners, traders, and spinners with input from MVE in early 1997. MVE developed its own set of monitoring and verification questions for both the first and second Tranche I Verification Reports.

In addition to the interviews of subsector participants, MVE conducted in-depth interviews with knowledgeable observers of the cotton subsector and selected public officials, including representatives of the Textile Consolidation Fund and one of the three cotton holding companies. RDI interview notes for other key officials also proved to be very useful.

<u>Analysis and Findings:</u>
This benchmark encompasses both price controls and administrative allocation systems, which are influenced, but not determined by, price controls.

Price Controls. The GOE paid growers high floor prices for seed cotton, above lint equivalent world prices, for a second straight year. This was a constraint to private traders' competing in the local market. The GOE issued Decree No. 931, which was signed by three Ministers in early August, 1997 and set the framework for the 1997/98 cotton marketing season. Among the several important decisions in the decree was a declaration that export prices, set by ALCOTEXA, would be *indicative prices* rather than minimum prices that would be legally binding. This was an important step forward. ALCOTEXA's Management Committee interpreted the decree in light of its perceived mandate and set minimum export prices that went against the spirit of this clause.

ALCOTEXA sets opening export prices at the beginning of each cotton marketing and export season, but MTS is said to wield significant influence in this process. Participants in the cotton export market clearly expected lower export prices for Egyptian cotton in 1997/98 relative to 1996/97. The prices were set lower, and lint exports did expand. Several observers noted, however, that MTS argued for higher opening export prices in late August, 1997 than did the public and private cotton trading companies themselves. MTS recommendations were adopted, and large stocks of this year's output of ELS and LS varieties remain unsold, due to minimum export prices that are high relative to pima prices and given large ELS/LS cotton stocks overhanging the international market. These stocks could be moved faster if ALCOTEXA adjusted export prices downward, which had not happened as of February, 1998 this season.

One development that observers expected would lead to a change in ALCOTEXA's export price setting was the election of a new Management Committee in late 1997. Although there are now more trading company representatives of private companies (7) than public sector companies (5), MTS added two new voting representatives, in addition to their one previous voting member. Hence, the public sector retains control of the Management Committee for another two years; four public sector trading company chairmen have been elected to the key ALCOTEXA leadership and management positions. The public sector company officials who manage ALCOTEXA receive their salaries from the GOE, so they will be influenced by the MTS-suggested opening prices. Under continued leadership of public sector companies, ALCOTEXA may well set export prices that will remain legally binding, as they have been to date during the 1997/98 marketing season.

ALCOTEXA must approve each export contract and hence receives detailed information about each potential shipment. Managers of several public sector companies claim that some private sector exporters have offered modest rebates of 1-2 cents/lb. to foreign buyers in order to capture more market share this marketing season, although these rebates do not show up in any documentation that ALCOTEXA reviews. Despite possible offers of slight discounts, the minimum export prices are largely respected.

It is also important to note that all but one private exporter obtain their lint cotton from public sector trading companies at prices that allow for modest profits once fobbing costs are paid. Their procurement price from the public companies does not allow these private exporters to discount more than 1-2 cents per lb. without losing money on exports. Hence, the ALCOTEXA export prices constrain very much the extent to which private exporters can offer lower prices to foreign buyers, because these ALCOTEXA prices determine what four out of five private exporters' procurement prices are this marketing season.

Into-spinning mill prices have been set in 1997/98 on the basis of the ALCOTEXA export prices. Fobbing costs (transport, handling, *farfara* and pressing) of $.12/lb. are netted out of the export price. While most of the spinning companies say they find this pricing formula reasonable, into-mill prices are not market-driven, as the export price itself is quasi-administratively determined. As noted above, an open export market and pricing environment would lead to lint cotton exports at lower prices, which in turn would lower domestic spinners' prices (assuming the into-mill prices are linked to actual export prices received by Egyptian exporters).

In a liberalized cotton market, spinning mills would pay different amounts for lint cotton to meet the technical requirements of their spinning equipment (and the counts it can produce) and the market requirements of yarn buyers. Mills would search out the cheapest source of supply to meet the technical requirements of particular clients, especially the largely private sector-dominated manufacturers of woven fabric and ready made garments. Mills would purchase lower-grade MLS lint cotton produced in Egypt, especially Giza 80 and 83, as well as various types of imported medium and short staple cotton. In this second consecutive year of surplus domestic cotton stocks, holding companies are privately discouraging public sector spinning mills from buying cheaper medium and shorter staple lint cotton imports.

Administrative Allocation Systems. Formal seed and lint cotton allocation systems have broken down in 1997-98. Public sector trading companies select ginning companies on the basis of several factors: whether ginners provide discounts (from the 17LE/kentar of lint cotton ginning charge) for providing ginning servies; which ginners offer the best ginning service; and which gins are best located for seed cotton delivery. Cotton trading companies are free to sell their lint cotton to domestic spinning companies of their choice. Hence, they seek to supply financially sounder spinners who can pay cash for their lint or pay on short-term credit (which includes interest payments for the capital tied up over the loan period).

Allocation of Seed Cotton to Gins. The ginning charge was adjusted upward to 17 LE/kentar of lint cotton in 1997-98, but there have been some discounts by ginners to capture greater market share. Ginners also offer to share transport costs, provide special services such as storage of lint cotton bales at gins, or provide higher quality ginning services than competitors. One industry participant estimates the cost of ginning, based on output of 1.45 million lint cotton kentars, to be 14.2 LE/kentar. Lower levels of throughput lead to higher per kentar processing costs.

The fact that there are now two private ginning companies has contributed to increased competition in ginning. Nile Ginning Company is now entirely privately owned, but it did not elect to buy seed cotton at sales rings this season. Hence, its ginning output for 1997-98 is significantly lower than it has been during the past few years. The Cotton and International Trade Holding Company's share of Arabia Ginning Company has declined to 19 percent, which has allowed Arabia to operate independently as a private business entity without CAA audits or Holding Company influence in its management decisions. Arabia Ginning bought much of its seed cotton for ginning directly at sales rings; Modern Nile, a private trading firm with overlapping ownership, also uses Arabia Ginning to gin seed cotton procured at Modern Nile sales rings.

The three public sector ginners are competing with the two private ginners for market share. Public cotton trading companies are able to select the gins in which their seed cotton is ginned, based on past gin performance, relations between a trading company and the ginning company management, and discounts or services that different ginners offer. Hence, allocation of seed cotton to gins is no longer administratively determined. All of the ginning companies except Nile Ginning Co. bought seed cotton this season, although the volumes purchased by the ginners are far lower than those of the public sector cotton trading companies.

Allocation of Lint Cotton to Spinning Mills. In 1996/97, the allocation of lint cotton to the public sector spinning mills was partly administratively determined. Holding companies influenced public trading companies' domestic lint sales, intervening on behalf of indebted spinners who were not creditworthy. Furthermore, since no private sector trading companies procured seed cotton in 1996-97, spinners were limited to procuring lint from public sector trading and ginning companies.

In 1997/98, this situation improved. There were three private sector buyers of seed cotton who are able to supply domestic spinners with lint. Modern Nile is buying seed cotton largely for the export market, however, and Arabia Ginning, a buyer of seed cotton, is also supplying Modern Nile with ginned lint cotton for export. Hence, the public sector spinning companies will buy at least 95 percent of their lint from public sector companies (traders and ginners). But public sector trading companies are not forced to sell to particular domestic spinners, although a Committee for Facilitation of Domestic Cotton Trade, run by the CIT Holding Company, can suggest that public traders supply particular spinners. These suggestions are not binding, however, as the financial condition of the buyer is a critical consideration for the trading companies.

Public spinning companies range from quite profitable to highly indebted. The former operate at high rates of capacity utilization and represent attractive privatization opportunities. The latter are operating well below installed capacity and can only produce when they have firm orders. The profitable public spinning companies have much more freedom to procure lint cotton from the trading company with the best quality raw material. Into-mill lint prices are, of course, fixed. These companies tend to procure regularly from a small group of public sector cotton trading companies, with whom they have established close working relations. The public spinners have no experience or expertise in purchasing their own lint cotton.

Accomplishment:
Benchmark partially accomplished

Administrative Allocation: Accomplished. Seed cotton is no longer administratively allocated to ginners. Trading companies choose ginning companies on the basis of particular ginners' efforts to provide quality ginning services and occasional discounts, as well as offers to share some costs, such as transport charges. In addition, allocation of lint cotton to spinning mills is no longer administratively determined. It is largely based on established working relationships between public cotton trading companies and public spinners, as well as the ability of spinners to pay cash or buy lint on short-term credit. Trading companies look for spinners' financial solvency, while spinners with a good financial situation look for traders with particular varieties and grades.

Pricing: Partial accomplishment. The GOE issued Decree No. 931, which declared, among other things, that ALCOTEXA's export prices should be indicative, in August, 1997. This decree was an important step forward for cotton policy. ALCOTEXA's export prices were set lower in 1997/98 than they were in 1996/97, and export commitments are higher this year. This occurred despite the GOE's suggestion of opening export prices for the 1997/98 marketing season higher than those recommended by cotton trading companies.

ALCOTEXA prices have been interpreted by the Management Committee as legally binding. ALCOTEXA export prices have remained unchanged since the opening of the season (with the exception of Giza 86), and they have been largely respected. Some private sector exporters are able to undercut these prices by a cent or two per pound, but they must offer discounts (rebates to buyers) outside of the contracts presented for ALCOTEXA approval.

Another important factor in export pricing is that all but one private exporter procure lint cotton for export from public trading companies. These exporters are constrained to sell at or slightly below ALCOTEXA's export prices, because their margins are fixed administratively by the GOE and fobbing costs must be paid.

Finally, into-mill prices paid by spinners for lint cotton are set in relation to ALCOTEXA export prices. Thus spinners cannot competitively search out the cheapest source of supply.

2.b. No GOE market restrictions will constrain private entities' involvement in cotton domestic marketing, ginning, exporting and importing.

Interpretation of benchmark for verification purposes:
This benchmark is a repetition of the enabling actions that are stated above in benchmarks 1.a-1.f.

Sources of Information/Method of Analysis:
Cotton subsector rapid appraisal, including structured informal interviews with private and public traders, exporters and importers.

Analysis and Findings:
Prior to this cotton marketing season of 1997/98, the Ministerial decree No. 931 signed in August 1997 by H.E. Dr. Wally, H.E. Dr. Ebeid, and H.E. Dr. Goweili, was issued. The decree is attached to the annex of the report. This decree organized cotton marketing for this season.

Before the opening of the marketing season, APRP/RDI met with Mr. Mohamed Gharieb of PBDAC, Mr. Saleh Younes, Director of General Coops for Land Reclamation, Samir Shehata, Undersecretary for Coops, MALR and Amin Abaza, private cotton trader. The information obtained from these informants was as follows:

- Before issuing this decree, several meetings were held at PBDAC and MTS; the participants in these meetings were the private sector, PBDAC, Coops, cotton companies and Dr. Goweili's advisors.

- All parties in the cotton market were initially satisfied with the new decree.

- This system will be the last one proposed by the government. For the season 1998/99, seed cotton marketing will be completely freed to market forces.

- On Sunday, August 24, 1997 there was a meeting with the Director of the General Coops for Reclaimed Land to discuss their performance with the preparation for the beginning of the season and the procedures which will be taken through the Coops and the companies. APRP/RDI also arranged to meet with Mr. Samir Shehata, the General Coops for Land Reform.

After long discussions and negotiations with the holding company, participation in seed cotton marketing ended up as follows: six public trading companies, four ginning companies including one private one, and two private trading companies, Modern Nile Company and the Arab Trade & Investment Company. The participants got their shares in the market according to what they applied for in different locations in different varietal production zones across Egypt; 960 rings were distributed among the cotton producing governorates.

This season, the GOE applied floor prices which vary according to varieties, grades, and ginning out-turn (the cotton price list is attached in the annexes of the report). The floor prices this season were lower than last year, because the Government raised the grades and the out-turn ratio over those of last year in order to effectively lower the prices.

The other private sector registered traders did not participate in cotton marketing this season because of the deficiency payment system, which was not clear. The Ministerial Decree 931 does not explain the mechanism for firms to receive this deficiency payment. Consequently, most of the private sector decided not to participate in seed cotton procurement prior to the opening of the season. The other reason for limited participation was the 10 percent bank letter of guarantee required by PBDAC for private sector involvement in the marketing system this season (as the Ministerial Decree 931 stated).

MVE conducted five mini-surveys in eight governorates to investigate the cotton subsector performance this season, and the different participants involved in the system. These surveys were administered to 296 farmers, 50 PBDAC managers of sales rings, 50 CATGO and 50 buying company representatives at sales rings, and eight governorate level directors of CATGO. A report of the survey findings will be published separately. These surveys revealed that cotton marketing was orderly but not competitive. The system of one buyer per ring and fixed producer prices was essentially an administered system, as opposed to a competitive, market driven one. Virtually no transactions took place outside the rings; registered domestic cotton traders who did not bid for sales rings were unable to participate in seed cotton marketing.

At the time farmers delivered seed cotton to the rings, they were not sure how their cotton was graded, what price they would receive for it, and when they would receive the second payment from PBDAC.

Some important results of interviews with key informants in the cotton trade are as follows:

- The private sector participated partially in the seed cotton marketing season this year, as some of them accepted the rules of the game issued by the government beside the public sector participants. Modern Nile Co. which is one of the main private companies, bought 300,000 Kentars of seed cotton this season. Arabia Ginning Co. bought 90,000-100,000 kentars of seed cotton, too. Through these two companies 400,000 kentars of all varieties were procured all over Egypt this season, 1997/98. The Arab Trade and Investment Co. procured about 30,000 kentars of Giza 80 & 83 this year in their rings in Minia, Assuit, and Suhag.

- Private sector entities were involved in cotton ginning activities through the two main private ginners, Arabia and Nile Ginning Companies. Arabia Ginning will gin 1.25 million kentars this season. Both private and public ginners accrued shares in ginning this season. Ginning charges increased this year from 14.5 to 17 LE/kentar. Both public and private ginners operated this year on the same basis. Nile Ginning, the other privatized ginning company, will gin significantly less seed cotton in 1997/98 than Arabia Ginning and the three public sector ginners. This is in part due to the fact that Nile Ginning Co. chose not to buy any seed cotton in 1997.

- Private entities had received 23.3% of total export commitments as of January 10,1998 as revealed by data of the Information Center of ALCOTEXA. Nasco, Modern Nile, Nefertiti, Talaat Harb, and Al Watani Companies are the private firms that have exported this year (tables are attached in the annexes).

- Imports have been discouraged this year, given the large remaining carryover from 1996/97 and the good 1997/98 harvest. Only Modern Nile Co. has imported lint cotton from Sudan as part of a complex barter deal between an Egyptian fertilizer exporter and a Sudanese company. This lint is being spun by Giza Spinning and Weaving Company.

Accomplishment:
Benchmark partially accomplished. Unlike 1996/97, the private sector did participate in seed cotton marketing in 1997/98, which is an important accomplishment. Nevertheless, only three private firms participated, while all the other registered traders decided not to buy seed cotton for another year.

The signing of Decree 931 by three Ministers was a noteworthy achievement and it had quite a few desirable features. Purchasing of seed cotton was limited by the Government to one buyer per ring, however, which is a market restriction. Furthermore, the requirement that seed cotton buyers had to obtain a bank letter of guarantee and the uncertainty regarding the deficiency payment (particulary the timeliness of transfers from the GOE to private buyers) worked against broader private sector participation. Despite these limitations, three private firms did bid on and buy seed cotton at sales rings in 1997/98.

In addition, the GOE has created an increasingly positive enabling environment since 1994. In 1997/98 two private firms were able to participate in seed cotton ginning, five private firms have exported lint cotton, and one private company has imported cotton. Private exporters other than the Modern Company were obliged, as in the 1996/97 marketing season, to obtain lint cotton for export from public sector cotton trading companies. These companies chose not to participate in seed cotton marketing. Lint cotton imports for use by public spinners have been informally discouraged this year as in 1996/97, given high levels of Egyptian stocks, though Modern Nile has imported lint.

4. Other cotton market recommendations are implemented as follows:

4.b. All cotton pest control direct subsidies will be eliminated (starting with the cotton crop cultivated in CY 1994.)

Interpretation of benchmark for verification purposes:
"Cotton pest control direct subsidies" means the subsidy inherent in the Government's program of cotton pesticide application, namely that farmers are not charged the full cost of these services. This cost does not include the salaries and benefits of government staff directing and carrying out the program and the capital costs of equipment; it only includes the recurring costs of labor and materials (pesticides and/or pheromones) for application.

Sources of Information/Method of Analysis:
MVE conducted a mini-survey of 296 producers who delivered seed cotton to sales rings. Producers were asked about pest control practices and costs in this survey. The results are discussed below. MVE also obtained PBDAC letters relevant to the collection of pest control costs.

Analysis and Findings:
The Government has streamlined the program of cotton pest control it provides automatically to producers. In the absence of price and cost increases, this would decrease the subsidy involved in providing pest control services. In addition, PBDAC received instructions to begin collecting the full cost of the pest control program from the producers in 1997/98. Accordingly, the July, 1997 verification report considered this benchmark fully accomplished. At the beginning of the cotton picking season, however, the Government decided to reduce the amount it collects from cotton producers for pest control to LE 100 per feddan.

PBDAC issued a letter of instructions to the BDAC's in the governorates to charge farmers LE 100 per feddan for the Government's cotton pesticide application costs (see annex). According to the Deputy Minister for Agricultural Extension, it would be politically unacceptable to charge the full cost of this service while the GOE is enforcing the new land rent law and relations between quite a few landlords and tenants have become strained. Another reason not to collect the full cost of pest control services is that lowering cotton prices this season, by raising the grades and cotton out-turn for the floor prices paid to farmers, effectively lowered farmers' revenues.

MVE survey results show that the Government has already collected the LE 100 this season through BDAC's in the cotton producing governorates. The results show that the average pest control charges per feddan in Lower Egypt were LE 109.61, which includes the PBDAC commission, interest and other fees (see Table 1). The average pest control charges per feddan in Middle and Upper Egypt governorates were LE 103.46. The average pest control charges per feddan for Egypt were LE 107.03 including commission, interest, and fees (Table 1).

All producers in the sample, and in cotton producing governorates, applied the MALR pest control practices. The number of producers who responded that they had already paid the pest control charges of LE 100 per feddan were 158 in Behira, Kafr El Sheikh, Sharkia, Dakahlia, Damietta, Beni Suef, and Assuit out of 296 producers, the total number of producers in the sample. Producers in Suhag had not yet paid the pest control costs at the time of the survey. The number of producers who applied private pest control practices was 226 out of 296 producers in the sample, or 76%.

Table 1: Producers' Payments for Cotton Pest Control

Region	Governorate	Sample Size (Number of Producers)	Number of Producers Who Paid MALR Pest Control Charges	%	Average Charges Per Feddan (LE)	Number of Producers Applying Pest Control At Own Expense	%
	Behira	48	40	83	108.36	45	94
	Dakahlia	48	24	50	107.13	48	100
	Damietta	12	6	50	110.00	11	92
	K. El Sheikh	48	11	23	114.58	45	94
	Sharkia	42	27	64	108.00	41	98
Lower Egypt		198	108	55	109.61	190	96
	Assiut	48	22	46	101.25	19	40
	Beni Suef	42	28	67	105.20	16	38
	Suhag	8	0	0	0.00	1	13
Middle & Upper Egypt		98	50	51	103.46	36	37
Egypt		296	158	53	107.03	226	76

Source: MVE mini-survey of cotton producers at sales rings.

Accomplishment.

Benchmark partially accomplished. The GOE increased what it charged cotton farmers for pest control services in 1997/98 to 100 LE/feddan, as compared with 50 LE/feddan in 1996/97. This is a noteworthy accomplishment, although it falls short of the GOE's original stated intention of collecting the full cost of about LE 250 per feddan for pest control services from farmers.

I.A.2. Verify that the practice of allocating lint cotton to spinning mills according to an administrative formula and administering prices is not being implemented and mills acquire lint cotton at free market prices.

Interpretation of benchmark for verification purposes:

“Allocating lint cotton to spinning mills according to an administrative formula” means that the Government or its representative determines the amounts of cotton that each spinning mill is permitted to purchase as raw material. “Administering prices” in the context of this benchmark means that the Government sets the domestic price of cotton lint at which spinning mills are forced to buy.

Sources of Information/Method of Analysis:
MVE conducted interviews with managing directors of public spinning mills, holding company officials, and other knowledgeable observers of the textile industry.

Analysis and Findings:
Allocating Lint Cotton to Spinning Mills. In 1996/97, spinning companies could buy from any public sector cotton trading or ginning company if the payment terms were acceptable. Given the indebtedness of many public spinners, this was a critical consideration. The most indebted spinners with the least cash flow have little choice in buying lint; they must buy on credit, backed by a credit guarantee made by their holding company. Private traders have no interest or incentive to sell to indebted public spinning companies in light of repayment delays and risks. The time value of their money tied up in the spinning company stocks and spun/woven products might not be recouped, as lint cotton prices to spinners are fixed and interest payments to the supplying trading companies may not be high enough.

In 1997/98, there is no longer any administrative allocation of lint cotton to spinning mills. The Cotton and International Trade Holding Company has a “Facilitating Committee” for domestic trade in lint cotton that can make suggestions to public sector trading companies to supply particular spinners. These suggestions are not binding, however, particularly during a period of surplus supplies. Public sector trading companies, like their private sector counterparts, seek to sell their lint to the most creditworthy and reliable public spinners who can pay upfront or within a 2-3 month delay (with the repayment including interest).

Into-Mill Pricing. During the 1996/97 cotton marketing season, the GOE priced lint cotton to spinners according to an export price less fobbing costs (of $.12-.17/pound) formula. The fobbing costs depended on the variety. During the 1997/98 marketing season, prices to spinners followed a similar formula, using opening ALCOTEXA prices (as of September 1, 1997) as the base prices from which into-mill prices are calculated. The minimum export prices for different lint cotton varieties, set by ALCOTEXA, reflect world market conditions and prices, although quite a few cotton traders noted that opening prices were set too high this year (for all varieties except Giza 86) and have not been adjusted downward, despite the large uncommitted stocks.

Even though there is a relationship between into-mill prices and world prices for Egyptian and competing fine lint cotton, the domestic into-mill prices have no relationship to domestic seed cotton prices, which were set artificially high for both the 1996 and 1997 crops.

One textile industry manager suggested that into-mill prices paid by spinners should not be based on ALCOTEXA minimum export prices, received for approximately one-fifth of the 1997/98 crop, but according to what the international prices for different Egyptian lint cotton varieties would be if the entire crop were exported. This is an interesting hypothetical notion;

certainly, export prices for lint would be much lower if Egyptian companies priced all their lint cotton to sell in foreign markets. Since Egypt will not try to export its entire crop, the prices for different varieties are unknowable. Nevertheless, analysts could model the world cotton market and run the scenario of Egypt exporting its entire crop in order to estimate what export prices would be.

Ideally, market forces should set the prices of lint cotton paid by spinners. As long as the vast majority of lint cotton sold to Egyptian spinners, who are all public companies or recently privatized ones,[1] is supplied by public trading companies, the GOE will most likely continue to set into-mill prices administratively. The levels at which into-mill prices are set will determine which set of companies (spinners vs. traders) or institutions (public sector banks or the GOE Treasury) bears the financial losses resulting from a too high producer support price.

Accomplishment:
Benchmark partially accomplished.

Allocation of Lint: Accomplished. *Explicit, formal allocation systems or quotas for Egyptian lint cotton no longer exist.* Holding companies often have to intervene on behalf of the more highly indebted public sector spinning companies to ensure that the spinners receive lint cotton from public trading companies. Public sector trading companies prefer to sell lint cotton to spinners with cash or excellent credit. They will agree to wait for payment when spinners agree to pay prevailing interest rates on the money tied up in lint cotton (being used to spin yarn) before the yarn or final textile products are sold.

Pricing: Partially accomplished. *The GOE continues to set into-mill prices in relation to the minimum export prices according to a formula.* The into-mill price has no relationship to the seed cotton floor price, though it is related to world market prices for competing growths, particularly pima. As public spinning companies become privatized and affected more by international market forces, they will have a greater interest in searching out the least costly sources of supply that meet their spinning requirements. In some years, importing medium and short staple lint cotton will be the lowest-cost and preferred route.

I.A.4. Eliminate minimum export prices for yarn and woven fabrics.

Interpretation of benchmark for verification purposes:
The intention of this benchmark is generally clear as stated. The benchmark includes only pure cotton yarn and woven fabrics, not cotton/polyester blends.

Sources of Information/Method of Analysis:
MVE conducted interviews with managing directors of public spinning mills, officials of one holding company, the chairman of the Textile Consolidation Fund, and other knowledgeable observers of the textile industry.

Analysis and Findings:

[1] Giza Spinning and Weaving is the only private sector company that spins cotton and cotton-synthetic yarn. Other private spinners spin synthetic fiber only.

Minimum export prices are still in place for yarn and woven fabrics. They are set by a textile industry committee. There are also minimum export prices for standard, internationally recognized and traded "constructions," including the following dimensions: 20 cm. by 20 cm.; 30 by 30, 68 by 68; 75 by 75; and 40 by 40 and 120 by 78 for poplins. There are no minimum export prices for knits or ready-made garments, products for which there are too many different categories to set and enforce minimum prices.

Neither TCF nor any particular GOE agency sets minimum export prices. TCF is the place where the members of an industry committee meet to discuss and agree upon these prices. The committee of textile industry participants that sets prices is comprised entirely of public sector managers of holding companies, affiliated companies, and two joint venture firms. *This is a consensual pricing agreement, where TCF enforces the minimum prices by issuing export permits and licenses.*

The Commercial Committee is chaired by the Chairman of the SW&RMC Holding Company and has representatives from every major exporter of yarn and fabric, as well as the Chairmen of the two other holding companies. It meets periodically, approximately bi-monthly, to review market conditions and set minimum export prices for yarn and fabrics. The specific public sector and joint venture companies represented on the Commercial Committee are as follows:

1. Misr Spinning & Weaving Company, Mehalla El Kobra
2. Misr Shebin El Kom Spinning & Weaving Co., Shebin El Kom
3. Misr Fine Spinning & Weaning Co., Kafr El Dawar
4. Uniarab Spinning & Weaning Co., Alexandria
5. Alexandria Spinning & Weaning Co., Alexandria
6. El Siouf Spinning & Weaning Co., Alexandria
7. Nasr Wool & Selected Textile Co.. STIA, Alexandria
8. Damietta Spinning & Weaning Co., Damietta
9. Misr Iran Spinning & Weaning Co., Suez
10. El Ameria Spinning & Weaning Co., Alexandria
11. Delta Spinning & Weaning Co., Tanta

TCF becomes the implementing agent for enforcing the minimum prices, reviewing export contracts, issuing export visas (as they are called by the US) or licenses (as called by the EU), and applying its stamp of approval. The list of minimum export prices is changed approximately once every six months. The most recent minimum prices were approved in September and are valid from September 23, 1997 to the end of June 1998. A list of cotton and mixed poly/cotton yarn prices appears in Annex 1. Note that the minimum export prices include an assumed 3% brokerage commission. According to Mahmoud Ibrahim, TCF Chairman, the minimum prices were raised 2% on average over the period ending June 30, 1997. (Note: it appears as if these prices were simply extended from the previous period (November-June 1996) through September 22, 1997).

TCF has the tasks of reviewing contracts and observing contract prices under the quota system. There are textile import quotas for Egypt applied by the EU and the US. In the case of any complaints by foreign importers against Egyptian exporters, TCF provides arbitration services. TCF approves every export of textile items under quota. Company shares under the quotas are based upon past performance, with some (unspecified) percentage share left for new entrants to a particular export market niche. It is easier for a new entrant to break into a yarn export category where the export quota is unfilled or underfilled.

The Commercial Committee makes its recommendations on the basis of world market conditions and recent price trends. Exporters who want to export yarn and fabric at prices below minimum export prices can seek Committee approval for this, though it is not likely to be forthcoming. An important rationale underlying the minimum prices is to prevent destructive competition. The Committee takes domestic companies' production costs into account when setting these prices; the minimum export prices are set at levels that ensure that none of the companies get run out of business. Hence, the highest cost, least efficient producers are protected.

Some informants state that these prices may be necessary guidelines for Egyptian (especially public sector) exporters during periods when actual and potential dumping claims by EU countries have been a threat to Egyptian exports. Others argue that the public sector spinning and weaving companies need a committee to set minimum export prices, because they do not know how to price their products competitively and they have a poor and incomplete knowledge of their costs. The public sector firms are also constrained in that they cannot incur losses by selling off their inventories (fully priced as assets on the company balance sheet) at discounted prices (although this may be required to help them restructure).

Some spinning companies sell high quality yarn and fabric at higher prices than the minimum export prices, but as several respondents said, international competition effectively limits the ability to charge premia.[2] Furthermore, several key informants noted that foreign buyers are well apprised of Egypt’s minimum yarn and cloth prices. Hence, the buyers are generally not willing to pay prices higher than the minimum prices, which in effect become fixed prices. Any premia paid appear to be modest. Note that it is possible to change the effective export prices of yarn and fabric at the margin through strict or liberal payment terms (cash payment required vs. up to six months to pay) and currency payment specifications and movements.

For yarn exports, dominated by public sector companies, it is difficult for public sector companies to undercut the minimum export prices. This is due to several factors: 1) managers of these firms are public sector employees, whose behavior is closely scrutinized by their holding companies, heads of other public sector spinning and weaving companies, and the MPE; 2) the public sector companies (and the private sector dominated ones which have at least 20 percent public sector ownership) have their accounts audited each year by CAA and therefore cannot overinvoice; 3) appeals made to managers’ national interest in not trying to undercut minimum export prices, as it will run weaker public sector firms out of business.

For fabric exporters, there are many private sector weavers whose export pricing cannot effectively be policed. According to the RDI *Cotton Subsector Map*, 45.5% of estimated

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[2] Note that lint cotton represents 60-70% of the cost of spinning yarn in Egypt, according to several respondents. Spinning is a highly competitive international industry. The best profit margins in the world are no greater than five percent, according to one respondent.

fabric output in Egypt in 1996-97 was produced by private weavers and knitters. The export share of the private sector may be higher, though there are no reliable estimates.[3] Nonetheless, it is clear that a higher proportion of cloth exports come from the private sector than in the case of yarn exports. Private firms can report to TCF that they intend to export cloth at one price, while actually exporting at another (receiving rebates from foreign importers).

Although the GOE itself is not setting or enforcing minimum prices, the industry appears to be behaving collusively. Whether or not this is a bad thing at this point in the liberalization/privatization process depends upon one's perspective. Industry participants argue that these types of pricing agreements are commonplace worldwide in the textile business and that they are needed in Egypt to keep the public sector spinners and weavers in business.

Liberalization can be viewed as a continuum stretching from complete public sector control of an industry to full liberalization and competitive, open market pricing and allocation. The textile industry in Egypt is of particular strategic importance, because it employs more people than any other agro-industry and the value of its outputs, including exports, is very significant. Given the highly competitive nature of the international marketplace for textile products, the once fully controlled and protected Egyptian textile industry cannot be expected to be liberalized and privatized overnight. Rapid and complete liberalization would lead to numerous bankruptcies among public sector textile companies; many workers would lose their jobs, causing major labor market dislocations, and potentially productive assets would be scrapped or sold to private investors (domestic or foreign) on terms unfavorable to the public companies (and by extension, the holding companies).

In a transitional period of textile industry privatization, pricing of textile products for the domestic and export markets may well have to be done by industry committees until affiliated companies upgrade their management, accounting, production, quality control and marketing systems and learn to operate competitively as an independent business units. In the meantime, what may appear to be collusive industry pricing of tradeable outputs might be tolerated for an interim period of 3-5 years (as the new WTO rules are phased in, reflecting the recent GATT agreement) while public companies are restructured, strengthened and made viable independent operating units (or alternatively divested or closed down). Fear of dumping charges and fines is another reason to retain minimum export prices temporarily, especially when cost accounting is so difficult in public sector companies.

Accomplishment:

Benchmark accomplished. Minimum export prices are set by an industry committee dominated by public sector spinners and weavers. TCF is charged with enforcing the minimum export prices through the quota system applied to Egyptian textile exports to the EU and the U.S. TCF is not an official GOE agency; it has a quasi-autonomous status and it generates its own funds through issuing export permits, performing tests for textile

[3] Public sector weavers exported approximately 15,800 mt of fabric in 1996-97, 24 percent of their total output. Private sector weavers are reported to export a higher proportion of their fabric, which may mean that their exports are greater than those of public companies.

manufacturers, and earning interest on investments. There are a number of indirect pressures on public sector spinners to respect minimum yarn prices. In addition TCF can refuse to issue export approvals (under quota systems) to companies that try to export at lower prices. Nevertheless, the GOE itself is not setting minimum yarn and fabric export prices.

This benchmark is somewhat premature when one takes the broader view of textile industry liberalization as a complex restructuring and privatization process. This process requires careful sequencing of measures to restructure the technical operations and finances of individual textile firms, as well as supportive policy and regulatory adjustments. Progressive changes in import duties on imported yarns, fabrics, apparel and made-ups provide a backdrop of urgency against which domestic textile companies, especially public sector spinners and weavers, need to become more efficient quickly.

Finally, this benchmark is hopelessly unclear. Because the benchmark sentence has no subject, it is not clear who is supposed to do what. Is the GOE supposed to remove minimum export prices? If so, which agency should do this, and what should be the legal or regulatory mechanism by which this happens? Does the benchmark imply that the industry itself should do away with minimum export prices? As an implementing agent, what should be the role of TCF? Future benchmarks should state as clearly as possible which agency or ministry must take action and what specific actions are required to achieve a specified desired outcome.

I.A.8. Study the feasibility of eliminating the tariff on imported cotton yarn altogether, analyze the impact on local spinning mills, and strengthen safeguards against unfair competition from imports.

Interpretation of benchmark for verification purposes:
This benchmark consists of completing a study only.

Sources of Information/Method of Analysis:
Obtain a copy of the study.

Analysis and Findings:
This study is complete and the team's findings were presented at a well-attended workshop at MALR on December 15, 1997. The study has been issued as APRP/RDI Report No. 18, *Feasibility of Eliminating Tariff and Non-Tariff Barriers on Imports of Cotton Yarn*, written by ElSayed Dahmoush, Waheed Mogahid and Edgar Ariza-Nino.

The study shows that reducing the tariff on imported yarn from 30 percent to 10 percent would have a decidedly negative impact on the local spinning industry. The GATT agreement calls for reducing the tariff to 15 percent on imported yarn by January 1, 2005. The tariff rate can remain in place at the level of 30 percent under WTO through the year 2000; beyond that, it must be progressively reduced, by three percentage points a year, to 15 percent by 2005.

Accomplishment:
Benchmark accomplished

I.B. Fertilizer:

I.B.1. Reduce the tariff on nitrogen fertilizer (ammonium nitrate and urea) from 30% to 10%.

Interpretation of benchmark for verification purposes:
The intention of this benchmark is clear as stated.

Sources of Information/Method of Analysis:
MVE contacted knowledgeable individuals in MALR and MTS.

Analysis and Findings:
Presidential Decree No. 38 for the year 1994 was issued in February, 1994. Under this harmonized tariff, imports of nitrogenous fertilizers (urea and ammonium nitrates) are subject to a duty of 30%. In Presidential Decree No. 304/1996, different customs tariff categories have been reduced by different amounts. Nevertheless, that reduction did not include the 30% tariff category and less, thus excluding any custom tariff rate reduction for nitrogenous fertilizers (urea and ammonium nitrates). (Copies of decrees are attached in the annex.) Thus, as of January 1, 1998 the tariff on imports of nitrogenous fertilizer was still 30%. However, His Excellency the Deputy Prime Minister and Minister of Agriculture and Land Reclamation is reportedly in favor of the tariff reduction.

During the fertilizer "shortage" (beginning in the summer of 1995), there was an exemption from duty given to import 1 million tons (later expanded to 1.5 million tons). This exemption had an expiry date; it was temporary. It did not constitute a change in the tariff. It did, however, accomplish the short-run objective of allowing fertilizer to enter the country without payment of duty.

Accomplishment:
Benchmark partially accomplished. The intention of benchmark was accomplished temporarily by the exemption, but the permanent reduction of the tariff implied by the benchmark has not.

I.B.2. Review ex-factory prices and set them in light of border prices, adjusting the price at least once per season. The definition of border prices will be according to the monitoring plan.

Interpretation of benchmark for verification purposes:
This benchmark addresses the issue of fertilizer prices during a transition from administered prices to free-market prices. An ex-factory price for each grade of fertilizer is set by the MPE and the managers of the public production companies together. The concept of border price is clear in economics, although data requirements and specific commodities may present problems in some cases. However, setting prices in light of market-driven prices is not clear. Since there is no clear definition of in light of, verification will consist of comparing the set prices to border prices. The analysis will examine whether set prices are drawing closer to

border prices (a long-run goal) and whether there is any correlation in the movement of the two price series. It will be difficult to assess Accomplishment with this benchmark.

Adjusting the price at least once per season means that fertilizer prices are changed at least once per cropping season. There are two cropping seasons per calendar year in Egypt.

<u>Sources of Information/Method of Analysis:</u>
In December 1997, the fertilizer consultant analyzed secondary data and conducted interviews with Mr. Mamdouh Abdel-Baki, Chairman, Board of Directors, AFRO-ASIAN Company for Development; Mr. Fouad Abdel-Moneim Hagrass, Chairman, Board of Directors, HAGRPOTA Company, and chairman of the Egyptian Association of Fertilizer Distributors; Mr. Yousri El—Khayat, Director of the Marketing Section, Abou Qir Company; and Mr. Farouk Abdel-Latif, Chief, Commercial Section, and Mr. Mahmoud Dawood, Head, Marketing and Exhibition Section, El-Nasr Company for Fertilizers and Chemical Industries, and others.

This was a focused follow-up to a more extensive set of interviews in April-May 1997 (see July, 1997 Verification Report).

<u>Analysis and Findings:</u>
Ex-Factory Prices. During the period under investigation (from July to December, 1997), the local prices, whether ex-factory or retail prices were not changed in general. Certain quantity discounts ranging from 4 to 5 percent were given to a few dealers by El-Nasr Company (Talkha Company) to encourage the withdrawal of their contracted quantities due to the increased stocks at the factory. But this was a special case by this factory, as Abou Qir Company did not provide any such price discounts. On the other hand, Abou Qir eliminated the LE 25/ ton discount that was provided to PBDAC by the end of December, 1997, so PBDAC received fertilizer at the same prices paid by all other distributors. By the beginning of August, 1997, the price of natural gas had been increased, adding about LE 15/ton of fertilizer produced, but the ex-factory price did not increase to match this increase in the production costs. Therefore, it can be concluded that the ex-factory prices have been relatively constant during the period under investigation.

Similarly, prices of PBDAC fertilizer sold to farmers did not change during the last six months. By the first quarter of 1998, however, PBDAC is expected to raise its prices due to the elimination of the discounts that used to be offered by Abou Qir company. Due to the declining international prices of nitrogen fertilizers, with greater possibilities of importation of these fertilizers, especially from Libya and to some degree from Saudi Arabia, at much lower prices than the local prices, local producing factories are expected to lower their delivery prices in order to compete with the prices of imports.

International (Border) Prices. Since July, 1996, international prices of nitrogen fertilizers have been declining, reaching a very low level by the end of December, 1997, as compared with the prices of the same fertilizers a few months before, as indicated in Tables 2 and 3. From April to December, 1997, the international price of urea declined drastically, by 29.8 percent in the Middle East market and by 26.2 percent in the Eastern European market. The international price of ammonium sulfate declined by 28.6 percent in the West European market and by 44.4 percent in the East European market. This decline is a continuation of the declining trend in the international price of the nitrogen fertilizers that started in the beginning of 1996, when the price per ton amounted to $240 - 245 for urea in the Middle East market and $210 - 215 in the Eastern European market.

Price Gap. This downward trend in the international prices, accompanied by constant nominal local ex-factory and retail prices for fertilizers, more than eliminated the gap between the local prices and the international prices. Table 4 compares the local ex-factory prices with cif (border) prices of nitrogen fertilizers, imported from East European markets, as of December, 1997. Local ex-factory prices are higher than border prices by amounts varying from about 18 percent in the case of urea to 102 percent in the case of ammonium sulfate.

When the international prices were higher than the local set ex-factory prices, the difference was an economic subsidy, and the Egyptian Government increased these local prices in order to eliminate this subsidy and let farmers pay higher (economic) prices for fertilizers. Currently, the relationship between the two prices has been reversed. The difference between the higher local price and the lower international price is implicit taxation. This difference is partly due to the 30-percent tariff on the import of nitrogen fertilizer.

Table 2: International Fertilizer Prices, As of December 22, 1997

Fertilizer and Source	U.S. $ / ton
Urea - fob bulk	
W Europe	100 - 105
Med c+f	125 - 135
Baltic	87 - 89
Black Sea - Yuzhny	89 - 91
Black Sea - Bulg/Romania	105 - 110
Middle East	100 - 102
Indonesia	97 - 99
U.S. Gulf (p.s.t. barge)	95 - 98
U.S. Gulf granular (p.s.t. barge)	101 - 104
Venezuela	105 - 109
Trinidad granular	115 - 120
Urea - fob bagged	
East Europe (Black Sea)	110 - 115
Middle East	112 - 114
Indonesia	110 - 112
Ammonium Sulfate - fob bulk	
West Europe	45 - 50
East Europe	22 - 25
U.S. Gulf	75 - 80
Ammonium Sulfate - fob bagged	
West Europe	60 - 65
East Europe	35 - 40
Japan/S. Korea	70 - 80

Source: Fertilizer Market Bulletin, International Price Guide.

Table 3: Decline in the International Price of Fertilizer, April - December, 1997

Item	Price US Dollars/ton April	December	% Change
Urea (bagged):			
Middle East	160 - 162	112 - 114	-29.8
East Europe	150 - 155	110 - 115	-26.2
Ammonium Sulfate (bagged):			
West Europe	85 - 90	60 - 65	-28.6
East Europe	65 - 70	35 - 40	-44.4

Source: Calculated from the FMB International Price Guide data.

One way to reduce the gap between the international and local fertilizer prices is to open foreign trade in fertilizers. As a matter of fact, this has occurred since early August, 1997, when the local fertilizer market indicated some degree of stability. The revised government policy allowed for imports up to 10 percent of the private sector share. Local distributors of chemical fertilizers have exported, during November and December, 1997, about 40,000 tons of urea (produced by El-Nasr Company at Talkha) at $98 - 102 per ton bulk fob, and 30,000 tons of ammonium nitrate (produced by Abou Qir Company) at $97 - 98 per ton fob jumbo size (500 kilogram per bag). These prices are about 32 percent lower than the local price of $145 (the equivalent of the ex-factory price of about LE 495 per ton for both urea and ammonium nitrate. Among the local traders who exported ammonium nitrate are Unifert - Egypt, who exported 12,000 tons and Fair Trade - Hagrpota, who exported 8,000 tons. These exports were often on behalf of the fertilizer producers, who were eager to regain their previous customers after being forbidden for some time to export. The fertilizer exported was thus new production in the off-season, not older stocks.

Table 4: Local Ex-Factory and Border Prices of Selected Nitrogen Fertilizers, From Eastern European markets, as of December, 1997

(US dollars per ton)

Type of Fertilizer	Ex-factory Price	Border Price, cif from Eastern Europe	Difference US $/ton	Difference Percent*
Abou Qir Company:				
Urea (bagged)	154.7	131.0	+ 23.7	18.1
El-Nasr Company:				
Urea (bagged)	147.1	131.0	+ 16.1	12.3
Ammonium Sulphate	113.0	56.0	+ 57.0	101.8

*Percent of the Border Price.

In the meantime, a local distributor (Abou Donkol Company) imported 10,000 tons of urea from Libya at $90 per ton bagged - fob (LE 306), which have been sold at the retail level at LE 450 per ton, as compared with LE 550 per ton for urea from Abou Qir and LE 520 per ton from Talkha. Therefore, imported fertilizer is distributed locally at the farm level at a price 20 percent lower than that of Abou Qir and about 13 percent lower than that of Talkha. This low price of imported fertilizer affected negatively the local distribution of the fertilizer of Talkha factory. Imports from Libya and Saudi Arabia are tariff-exempted due to certain agreements among these Arab countries. Importation of nitrogen fertilizers from such Arab countries is open to any trader; this may lead, in the long run, to a reduction in the local prices of fertilizers.

Accomplishment:

Benchmark partially accomplished. Ex-factory prices of locally produced chemical fertilizers have not been adjusted during the last six months. However, the Government has allowed freer trade in fertilizer to play a part in balancing domestic supply and demand. This partially accomplishes the intention of this benchmark, which is to bring international price information into the formation of prices in the domestic market.

I.B.3. Eliminate government quota allocations of fertilizer, except in the case of market failure.

Interpretation of benchmark for verification purposes:
The allocation referred to in the benchmark is from the factories to the distribution agents, including PBDAC, cooperatives, and the private sector.

Not every shortage and ensuing price escalation is caused by a market failure. True market failure often occurs when there are essential elements of a market, like information or infrastructure or access to capital, that are missing or underdeveloped. These deficiencies or collusion may lead to insufficient competition. If some part of the marketing system is restrained by policy, however, e.g. if imports are not allowed, then the cause of a market problem may not be a market failure.

Sources of Information/Method of Analysis:
The fertilizer consultant reviewed and analyzed secondary data and conducted interviews with Mr. Mamdouh Kamal Abdel-Baki, Chairman, Board of Directors, AFRO-ASIAN Company for Development; Mr. Fouad Abdel-Moneim Hagrass, Chairman, Board of Directors, HAGROPOTA Company; Mr. Fathi El-Halwagi, Head, Department of Chemical Fertilizers, Ministry of Agriculture and Land Reclamation; Mr. Samir Fahmy, Chairman, Board of Directors, Samir Fahmy Group, Sam Trade, Unifert Misr, Unifert Alexandria, Tibah for chemicals, and United for Cereals; Mr. Yousri El-Khayat, Director of Marketing Sector, Abo Qir Fertlizer Factory; Mr. Abdel-Monem Aukeil, Chairman, Board of directors, El-Nasr Company for Fertilizers, Talkha Plant; Mr. Abdl-Salam El-Gabaly, El-Dawliah (International) Company for Fertilizers and Chemicals, and others.

Analysis and Findings:

Brief History. PBDAC monopolized the receipt and distribution of locally produced and imported chemical fertilizers before 1990. These fertilizers were distributed to farmers through farmer cooperatives on the village level at prices predetermined by the government. The geographical pattern of fertilizer use was governed by the allocative decisions of the Ministry of Agriculture and Land Reclamation (MALR) rather than farmers' decisions in response to price signals in a market economy. The high level of fertilizer use was achieved without market- oriented systems. The prices paid by farmers for these fertilizers were highly subsidized until 1988, when the Egyptian government began a policy of gradual reduction of the fertilizer subsidy, which was completely eliminated by 1992.

Even though economic reform in the Egyptian agricultural sector began in 1986, the Economic Reform and Structural Adjustment Program (ERSAP) for the whole economy started later in 1990. One of the policies included in the ERSAP was the limitation of the functions of the PBDAC in the trade of agricultural inputs including chemical fertilizers, with a greater role to be played by the private sector. By 1993/1994, PBDAC received and traded only 0.3 million tons of fertilizers out of about 6.0 million tons of local production.

A "fertilizer crisis" occurred by mid-1995, due to greater shortage of fertilizers. This shortage was caused by several factors (see July, 1997 Verification Report), but mainly due to the major repairs and maintenance made by two (out of five) factories at the same time.

By August 1,1995, the GOE instructed the producing factories to deliver all their production to PBDAC, thus returning to PBDAC monopolization of distribution of chemical fertilizers. The private sector was asked to import about one million tons of nitrogen fertilizer with the tariff exempted. Fertilizer exports were curtailed.

On January 15, 1996, instructions were given by H.E. the Minister of Agriculture and Land Reclamation determining the distribution of local production as follows:

PBDAC	87 percent
General Cooperative for Agrarian Reform	8 percent
General Cooperative for Land Reclamation	5 percent

This eliminated the role of the private sector in the trading of locally produced fertilizers.

By the time of arrival of the imported fertilizers, local factories had returned to their normal production pattern, with decreased seasonal demand for fertilizers, causing an accumulation of stocks of fertilizers with PBDAC and the private sector, whether from the locally produced sources or imported fertilizers.

On July 15, 1997, H.E. the Minister of Agriculture wrote to H.E. the Minister of Public Enterprise and in the same month the Minister of Public enterprise gave instructions to redistribute the share of the locally produced fertilizers delivered to PBDAC (87 percent) as follows, effective on August 8, 1997:

PBDAC	49 percent
The private sector & cooperatives	38 percent

The private sector was allowed to export not more than 10 percent of its share.

On August 11, 1997, a letter was sent from H. E. the Minister of Agriculture and Land Reclamation to H. E. Dr. Atef Ebeid, Minister of Public Enterprise, reconsidering the quota system that had been in effect since August 1, 1997. This was based on a memorandum submitted by Dr. Hassan Khedr, the Chairman of the Board of PBDAC, due to the accumulated stocks of fertilizers with the bank. It also reflected the Egyptian Government's move to increase the role of the private and the cooperative sectors in the distribution of fertilizers, and as a result, stability in the local markets of chemical fertilizers. The proposal was to reduce the PBDAC share from 49 percent to 25 percent, with the remaining quantities to be redistributed by the private and cooperative sectors. In November, 1997, the Minister of Public Enterprise gave instructions to this effect. As a matter of fact, PBDAC was unable to sell its available stocks of nitrogen fertilizers, especially those produced by El-Nasr Company (Talkha), as its production was considered of low quality compared with that of Abou Qir company. PBDAC declined to receive its 49 percent quota from Talkha production any more, indicating that the quota is not strictly binding. *Currently, PBDAC receives only about 25 percent of Abou Qir production, which is only about 14 percent of national nitrogenous fertilizer production..*

[The narrative above addresses the issue of the quota, which is the core of the benchmark. What follows is additional analysis that is relevant to understanding the functioning of the fertilizer market.]

The Current Situation. By the end of December 1997, the distribution of local production of fertilizers was as follows:

Abou Qir Company:
(55.2 percent of local production of nitrogen fertilizers)

During December, 1997, the Abou Qir Company signed contracts with the above-mentioned distributors and dealers for deliveries in 1998. PBDAC contracted for the delivery of 120,000 tons of urea and 160,000 tons of ammonium nitrate, which represents about 25 percent of the company's annual production. The various central and local cooperatives will receive a similar amount to those of PBDAC (25 percent). The remaining 50 percent of Abou Qir's production will be delivered to the different public and private trading companies, with quotas varying between 5 to 10 percent of the annual production of the company for each of these traders.

Table 5: Distribution of Nitrogenous Fertilizer Production, Abou Qir, December, 1997

Dealer / Distributor	Share (Percent)
A- PBDAC	252550
B- Cooperatives:	
1. The Investment Fund for the Coop Union	
2. The General Coop for Land Reclamation	
3. The General Coop for Agrarian Reform	
4. El-Fayoum Governorate Coop.	
C- Public and Private Trading Companies:	
1. The General Co. for Plows and Engineering.	
2. The General Co. for Trade and Chemicals.	
3. Midi Trade Company.	
4. Multi Trade Company.	
5. El-Borsa Company.	
6. Hydro Agri Trade Egypt.	
7. Unifert Egypt.	
8. Polyserve (fertilizers and chemicals)	

It should be noted that the first five companies listed under C in Table 5 are public companies affiliated with different ministries. The arrangements between Abou Qir and another two companies cannot be considered as purely private; the international partners of these local companies are able to influence Abou Qir to deliver certain amounts of local production to the local companies. Hydro Agri Trade Egypt is affiliated with Hydro Trade International, which is the main provider of technical advice to Abou Qir company. Hydro Agri Trade Egypt will receive 2,000 tons of urea and 2,000 tons of ammonium nitrate monthly. Unifert Egypt is affiliated with Unifert International, which is investing in the construction of a shipping terminal in El-Dekhila (Alexandria) to facilitate exports for Abou Qir Company. Accordingly, Unifert Egypt will also receive some of the production of Abou Qir factory. Only the last company (which is a subsidiary company of El-Dawliah Company) can be considered as a private company that was accepted as a customer by Abou Qir factory due to its institutional structure and the wide geographical coverage of its branches. It will receive a monthly allotment of 2,000 tons of urea and 2,000 tons of ammonium nitrate.

Actually, the five public trading companies do not handle the fertilizers at all. Instead, they just take a commission (of about 2 percent) for the transfer of the fertilizer to private dealers. The fertilizer is delivered directly from the factory to the private dealer and not to the public company.

Thus about 30 to 35 percent of the production of Abou Qir is planned to be delivered to cooperative and private dealers while 65 to 70 percent will be delivered to public companies (including PBDAC).

El-Nasr Company (Talkha):
(34.4 percent of local production of nitrogen fertilizers)

The fertilizer produced by El-Nasr Company has been distributed through three public trading companies, four cooperatives, and five private companies. The three public companies were: the Agriculture Company (Graduate Project), the General Company for Trade and Chemicals, and the Multi Trade Company. The four cooperatives were: The General Cooperative of Agrarian Reform, the General Cooperative for Land Reclamation, the General Agricultural Credit Cooperative, and the Agricultural Cooperative Union. The private companies are: El-Rowaa Company, El-Salhia Company, Samad Misr Company, Polyserve (El-Dawliah) Company, and Hagrpota Company. However, as PBDAC did not receive its quota from the production of El-Nasr Company, the stocks began to pile up with El-Nasr Company. Special discounts were given to only two dealers, mainly Samad Misr and El-Dawliah, which resulted in retaliation by the other three companies, which stopped receiving their contracted quantities, increasing the burden of bigger stocks at the factory.

Qema Company:
(8.7 percent of local production of nitrogen fertilizers)

Qema Company delivers its production to four companies, namely El-Rowaa Company, El-Dawliah Company, El-Saeed (Upper Egypt) Sons, and Atef Abdel-Kader Company.

El-Coke Company:
(producing 1.7 percent of local production of nitrogen fertilizer)

El-Coke Company delivers its production to Hagrpota Company.

Summary. Assuming that PBDAC received 87 percent of Abou Qir production in July 1997 and 49 percent for the remaining five months, then its share of *national* production during the period from July to December, 1997 would be estimated at about 30 percent, while the remaining quantities would have been distributed nearly equally between public trading companies, cooperatives, and private trading companies. However, with the quota of PBDAC declining to 25 percent of total production, and its limiting of its purchases to 25 percent of Abou Qir's production only (according to the contract signed with Abou Qir factory in December, 1997), in 1998 PBDAC is likely to be distributing only about 14 percent of the nitrogenous fertilizer produced in Egypt. The remaining quantities would be handled in roughly equal shares by the public sector trading companies, the cooperatives, and the private sector.

It should be kept in mind that the public sector distributors and the cooperatives deal mainly with the high-quality fertilizer of Abou Qir, while the private sector deals mainly with the low-quality of fertilizer produced by El-Nasr Company. Even though the private sector has had an opportunity to deal with a large share of the national production of fertilizers in the last few months, there is evidence of discrimination against that sector in distribution of the high-quality fertilizer of Abou Qir factory. However, it has been indicated that Abou Qir factory would like to deal with a small number of traders, each handling a large volume. Therefore, a large number of private traders procure their required fertilizer from Abou Qir through the public trading companies, who collect a 2-percent commission.

Most of the public trading companies do not handle fertilizer, but simply transfer them to smaller dealers. Only PBDAC has branches at the village level, while the public trading companies do not. Accordingly, if PBDAC continues to limit its purchases to 25 percent of Abou Qir's output, the majority of fertilizer (about 85 percent) will be distributed at the village level by either the cooperatives or the private (relatively small) traders.

Finally, it should be kept in mind that the current increased role of the private sector in the distribution of chemical fertilizers is not necessarily an accurate measure of increased competition and more efficient performance in the fertilizer market. Even though there is a large number of fertilizer dealers and distributors, only a few of them handle the big share of the private sector's quota of local production. Due to this limited number of big traders in this commodity, the wholesale fertilizer market can be considered as an oligopoly with some signs of market sharing and price leadership practices. This of course might lead to some anti-competitive behavior in the market.

In theory, only when the market is "perfect" can competition prevail. Perfect competition requires large numbers of buyers and sellers and perfect market information. In practice, an industry is judged to be workably competitive when there are a sufficient number of buyers and sellers who compete for market share and do not collude on pricing or assignment of exclusive buying/selling zones.

Some small fertilizer traders still prefer to deal with public sector trading companies due to non-price preferences, i.e., the greater reliability of delivery and constant prices they expect from the public sector. In the end, the benefits of an increased role for the private sector will only be known through a careful examination of the gradual evolution and changes in the structure, conduct, and performance of the fertilizer market.

Accomplishment:

Benchmark partially accomplished. The remaining quota allocates a minority portion of domestically produced nitrogenous fertilizer to PBDAC, but there has been very significant progress toward eliminating even this quota. In August and November, 1997, ministerial instructions reduced the PBDAC quota from 87 percent to 49 percent, and then to 25 percent, with the remaining quantities to be distributed by both the private and cooperative sectors. Since the quota is not binding on PBDAC, it is currently taking only about 14 percent of national nitrogenous fertilizer production. Thus, there has been major progress toward the elimination of quotas in fertilizer distribution, and the public sector share in fertilizer distribution is declining. The private and cooperative sectors are taking a larger share of distributing locally produced fertilizers and are participating in exports and imports.

I.E. Tariffs and Trade:

I.E.3. Conduct a study to identify non-tariff barriers to imports and exports of agricultural inputs and commodities, and develop a time-phased plan for eliminating these barriers.

Interpretation of benchmark for verification purposes:
This benchmark consists of completing a study and developing a plan.

Sources of Information/Method of Analysis:
Obtain a copy of the study.

Analysis and Findings:
A study conducted under the marketing component of the RDI Unit addressed the issue of constraints to exports of cotton lint. The study concluded that the minimum export price announced weekly by ALCOTEXA is a major barrier to increased exports of long staple cotton lint. It has also functioned as a barrier to imports of short staple cotton, as dampened exports have led to accumulated domestic inventories. Tranche II includes two benchmarks to remove non-tariff barriers to trade in cotton and textile products. The first is to reduce minimum export prices to non-binding indicative prices; the second encourages the government to dispose of excess inventories of textile products, a necessary step to allowing traders, both private and public, to trade freely in international markets.

RDI and GTZ/CSPP also jointly examined phytosanitary controls on imports of cotton lint, which have the potential to constrain trade. Under Tranche II, a benchmark specifies that the GOE must codify, publish and disseminate current phytosanitary regulations with respect to cotton lint imports. This will clarify import procedures for those cotton traders and spinners who might consider importing lint.

The MVE Unit conducted a study that revealed various obstacles to rice imports and exports. The study concluded that there are quantity and quality restrictions on imports and excessive regulatory procedures which constrain rice trade. As is the case with cotton, APRP's tranche II includes a benchmark to remove these constraints, thereby increasing the potential for free trade in rice.

Finally, ATUT, SPR and APRP have all identified government constraints to imports of seed. APRP Tranche II benchmarks include three targeted reforms to remove non-tariff barriers to seed imports. The first commits the GOE to establish internationally approved measures to permit private traders to import annual vegetable and fruit seed if the seed are consistent with phytosanitary regulations. The second requires the GOE to eliminate the registration fee for importers of registered seed. Third, the People's Assembly will pass the draft seed law, a necessary condition for the expansion of the seed industry in Egypt.

Over the next four years, the APRP will continue to identify tariff and non-tariff barriers to trade in agricultural products and inputs. APRP is itself a phased plan to reform policies, including those that are barriers to trade.

Accomplishment:
Benchmark accomplished. Several studies carried out by APRP, GTZ/CSPP, SPR and ATUT have identified non-tariff barriers to imports and exports of agricultural inputs and commodities. Based on these studies, APRP formulated benchmarks under Tranche II that address and attempt to relax or remove these barriers. These benchmarks are included in an APRP MOU, which is a time-phased plan.

I.F. Government Services in Marketing:

I.F.1. Assess the market information needs of an open and competitive agricultural marketing system and develop recommendations for developing a marketing information system.

Interpretation of benchmark for verification purposes:
This benchmark consists of completing a study only.

Sources of Information/Method of Analysis:
Obtain a copy of any study. Check with ACDI on its horticultural market information project in cooperation with the extension service.

Analysis and Findings:
RDI has completed a study on this topic. It is report number 23 entitled, "Assessment of the Market Information Needs of an Open and Competitive Agricultural marketing System: Market Information Sources for Selected Agricultural Products and Inputs in Egypt."

The study gives current sources of market information by commodity and makes recommendations for sustaining and improving the provision of this information by the Government.

Accomplishment:
Benchmark accomplished

I.F.3. Assess the market regulation services needed to be carried out by the GOE and develop recommendations pertinent to a system for regulating non-competitive behavior in agro-industries and marketing of agricultural commodities.

Interpretation of benchmark for verification purposes:
This benchmark consists only of completing a study about regulating non-competitive behavior.

Sources of Information/Method of Analysis:
Obtain a copy of the study. Telephonic and email communications with Dr. Hamdy Salem/MoTS, and with Paul Mulligan and David Jessee/USAID and Cynthia Clement/IRIS.

Analysis and Findings:

From July, 1995 to December, 1996 a team of experts from IRIS worked with a group of Egyptian colleagues on drafting a law to protect competition and limit monopoly. A draft law (copy in annex to July, 1997 verification report) is under review by the cabinet. There is also a proposal for a new agency to implement the law.

IRIS completed a report on these issues. The MVE Unit has a copy.

Accomplishment:
Benchmark accomplished

II. PRIVATE INVESTMENT AND PRIVATIZATION

(Privatization means selling 51% of the assets to the private sector, private management, or leasing.]

II.A. <u>Cotton</u>:

II.A.3. Privatize at least one cotton trading company.

<u>*Interpretation of benchmark for verification purposes:*</u>
The intention of this benchmark is clear as stated.

<u>*Sources of Information/Method of Analysis:*</u>
MVE collaborated with CSPP in interviewing the chairmen of each of the six public cotton trading companies in March-April 1997. MVE re-interviewed three chairmen of the public trading companies in November-December 1997, as well Cotton and International Trade Holding Company officials.

<u>*Analysis and Findings:*</u>
Early steps in the privatization process have been undertaken. Valuations of the Misr Cotton Export Company and Eastern Cotton Company were completed in October and November, 1995. Alexandria Commercial Company presented a proposal to the CIT-HC for an employee buyout in late 1997. The CIT-HC has not yet responded to this proposal. Privatization of public sector cotton trading companies has proven difficult for reasons discussed below.

The Government of Egypt is committed to the privatization of state-owned industries. This is evident from the almost daily public announcements of the government's intention to privatize and the many successful privatizations which have taken place to date. The government has shown willingness to privatize agricultural industries as well as companies in other sectors. For example, in the last week of November, 1997, the government announced its target of beginning the privatization of three spinning and weaving companies, and to continue with the privatization of the public sector wheat mills.

Successful privatization depends on a willing seller (the Government) and a willing buyer (the private sector). The Government has proven time and again its willingness to sell even profitable companies, and profitable companies are of course those that are attractive to investors, either foreign or local. However, companies that have little market value and little chance of success in a liberalized, competitive market, or those companies that are burdened with excessive debt and have few productive assets, are not attractive candidates for privatization. This is the case of cotton trading companies.

Privatization of at least one cotton trading company is not likely to be achieved, because it assumes unrealistic investment behavior of private sector companies. Cotton trading companies, that is, those which only trade, are companies with few productive assets. Those assets include a few trucks, perhaps some storage space, an office building, and employees who are accustomed to working for a government organization. After the GOE forgave most of these companies’ debts, they still hold large stocks of cotton, which they will have trouble liquidating. Under these circumstances, these companies are of little interest to the private sector. The purchase of one of these companies would constitute little more than the purchase of a name and hard-to-move stocks. Private sector companies interested in trading cotton can easily and relatively cheaply invest in new trucks, storage space and an office to begin a new company with a clean slate. This would be more normal investment behavior. Thus, no matter how willing the Government is to privatize a cotton trading company, because the private sector is not willing to purchase any public companies, privatization will not occur, and the benchmark will not be met.

Yet this does not mean that the Government maintains complete control of cotton trading. In the past few years, there has been an increase in the number of private sector cotton traders. During the 1997/98 cotton trading year, these companies will export close to 25 percent of the total cotton sold abroad. As the Government continues to liberalize the cotton market, the private sector is likely to obtain more market share in cotton trading. Thus, a liberal market environment can be achieved without the privatization of cotton trading companies. This scenario is similar to the liberalization of the rice market, which occurred without privatization of public sector rice mills.

The private sector cotton trading companies have hired managers who have retired from or left public sector cotton trading companies. Their knowledge and contacts are an important form of human capital that are more valuable assets than the limited physical capital of the public trading companies.

As more private firms enter the domestic cotton trade and export business, the public companies are becoming an artifact of an earlier era of state control. Their predominant role in the domestic cotton trade in 1996/97 and 1997/98 was due to cotton subsector price policies and uncertainties regarding GOE payment of the difference between producer prices and export prices.

Accomplishment:
Benchmark accomplished. Significant private sector investment has taken place in cotton trading; privatization of a public trading company remains problematic. Prior to the first Tranche I Verification Report, issued in July, 1997, privatization of public sector cotton trading companies was not feasible, given the debt situation, redundant labor, and limited assets of those companies. Shortly after July, 1997, a large part of the debt of the trading companies was forgiven, though the problems of redundant labor, managers ill-adapted to the demands of a competitive private sector trading environment, and limited assets remain.

What is most important is that the GOE has allowed private sector trading companies to form and operate, especially in the export market, since 1994. This season five private firms have received offers to export 23.3 percent of the total exports (commitments as of January 11, 1998), and three private firms bought approximately 7 percent of the seed cotton crop (of an estimated 6.048 million seed cotton kentars). One of the major private sector buyers of seed cotton was Arabeya Ginning Company, a privatized ginning and trading company.

II.B. Fertilizer:

II.B.1. Based on the study of fertilizer production to be completed by February 1996, the GOE will adopt a time-phased liberalization and privatization plan for fertilizer production, marketing, and international trade.

Interpretation of benchmark for verification purposes:
Privatization of fertilizer production is addressed specifically in benchmark II.B.2. This benchmark calls for the adoption of an overall plan based on the analysis and recommendations of the referenced report. "Adopt" means develop and initiate implementation.

The word "liberalization" can be ignored in this benchmark, as fertilizer pricing and marketing issues are referenced in previous benchmarks (I.B.2 and I.B.3).

Sources of Information/Method of Analysis:
The MVE Unit interviewed Dr. Sabry Aglan, consultant to MPE, and Dr. Mokhtar Khattab, of the PEO.

Analysis and Findings:
The GOE has established a process for privatization in the entire economy. It proceeds from getting political approval for a wide array of companies to listing a subset of these companies on a specific privatization agenda for specific time periods. This process is flexible, in that it allows the Government to add to the implementation list those companies in which it detects interest from the private sector. The fertilizer industry is included in this process.

In the upcoming quarter, April-Jun, 1998, Abou Zaabal Fertilizers is scheduled for privatization. Valuation and a business plan are complete. Other fertilizer companies like El Nasr (Semadco), often referred to as Talkha, are also included in the plan. Kima and Talkha are currently scheduled for privatization in 1999. The remaining (minority) of the shares of Kafr El Zayat are also scheduled for sale by June, 1998.

The GOE is thus proceeding with various steps that increase the share of the private sector in fertilizer production and marketing. Kafr El Zayat Insecticide and EFIC have already been privatized. In addition the Government has approved private investments in fertilizer production.

Accomplishment:
Benchmark accomplished. The GOE has an overall privatization strategy for a broad range of public sector dominated industries. The fertilizer industry is included in this plan, and the privatization of fertilizer producing companies is proceeding. Significant progress has been made in privatizing several companies in the fertilizer subsector and in including others for privatization in the near future. Private investment in fertilizer production has also been approved.

II.D. <u>Rice</u>:

II.D.2. Begin implementing the privatization and liberalization plan for rice mills, privatizing one rice mill.

Interpretation of benchmark for verification purposes:
The general thrust of the benchmark "privatization of rice milling"is clear. Privatization of one rice mill as a specific requirement is also clear. There is no other requirement of this benchmark ("liberalization" can be ignored).

Sources of Information/Method of Analysis:
MVE interviewed the Chairman of the Holding Company for Rice and Flour Mills and consulted the APRP/RDI privatization staff. As part of a rapid appraisal of the rice subsector in April-May 1997, MVE interviewed five managing directors of public rice milling companies.

Analysis and Findings:
MPE and the holding company have made attempts to offer several public mills for sale to potential anchor investors during 1997. Since the public mills are operating well below capacity, losing money, and are therefore unprofitable, they cannot be privatized via IPOs. However, significant private sector investment has substituted for and superseded privatization. Public sector milling capacity was only about 21 percent of national capacity in mid-1997, and actual public sector milling of paddy in 1996/97 constituted only about 2 percent of the 1996 crop. (For more details on the private sector's share of rice milling, see also the analysis for benchmark II.D.3.) Thus, privatization of increasingly redundant public sector rice milling capacity is not necessary to attain the objective of this benchmark, namely a strong, vibrant rice milling industry, which has already emerged.

Employee Buyouts. In mid-June, 1997 the Minister of Public Enterprises, Dr. Atef Ebeid, announced that the employees of the public rice mills would have an opportunity to acquire ownership. This privatization option is being considered for the Sharkeya Rice Milling Company. The employees want to acquire the company at a price that is about half the book value. The MPE has not yet made a decision.

APRP's RDI Unit is working with the managers of Sharkeya Rice Milling Company to develop a business plan for an agro-industrial complex that would add feed mixing and cattle feeding to rice milling (rice bran from milling could be used as an important "energy" ingredient in feed).

1997 Bids for Seven Mills. The MPE advertised seven rice mills for bids in 1997. Bids well below valuations of the mills were received by the holding company. The HC-RFM studied the bids, but decided not to accept them. The bids for the seven mills remain on the table, and some of these offers could be accepted if the Cabinet-level Committee for Privatization makes the decision to sell these mills. The bidding will not be re-opened, though existing bidders might find themselves in negotiations to up the ante on their original bids. The holding company has already tried to get bidders to increase their offers. Even with somewhat higher offers, the bids will be below the valuations.

The Kafr el-Sheikh Rice Milling Company was publicly offered for sale, first on February 9, 1997 and through an extension on May 27 to June 7, 1997 (see annex for both the original announcement and the extension). The extension modified the initial public offer by offering either the company in its entirety to an anchor investor or the individual mill units separately to different investors. The two bids for Kafr el Sheikh came in well below the expected level, based on asset valuation of the HC-RFM. The land of one of the mills of this company has been used to store imported fertilizer for several months.

Leasing Option. None of the public sector mills are currently being leased.

Some Constraining Factors. Prospective investors in the rice milling and exporting business report that interest rates charged by commercial banks are high (14-15%) and will constrain offers for those bidders who need to borrow funds to put in a credible bid. Most mills could represent attractive investments at the right price (meaning lower valuations), because they are located on high-value urban land. Some informants report that many of the prospective bidders are interested in the land rather than the mills and other facilities (storage warehouses).

The overall installed capacity of the public rice mills is 1.2 million metric tons per year. The public milling companies have significant long-term debt and redundant labor. Private investment has led to excess milling capacity, which bodes ill for privatization. In the past, it was argued that export-grade milled rice could only be produced by public sector mills. Given the significant recent investment in commercial milling capacity, this argument no longer seems valid. Even if this is partially true, the scale of the public mills and the cost of their modern milling technology are potential deterrents to investors, as are the very high land values. Many private sector mills are located on lower-value land, often in one of the new industrial cities on desert land with a low opportunity cost. In these industrial cities, private rice millers can set up mills and not pay any taxes for the first five years of operation. Private sector mills tend to be far lower capacity than public mills; hence, their breakeven levels of operation are much lower.

The Prime Minister decided to offer mills for sale (plants plus equipment), while the land would be leased over a 25-year period, with the annual lease payment equal to four percent of the land value according to a (rather low) valuation by the Ministry of New Communities. Hence, the land will be decoupled from the mills so that investors "can afford" to make attractive bids on the mills. It is not clear that investors/bidders will accept the condition of no land title when many informants report that high land values are what attract the interest of investors in the first place.

In summary, private offers to acquire mills have been too few and too low for MPE and the holding company to consider selling. The second option of transfering ownership to the employees does not necessarily change management, mill efficiency or competitiveness. Employee ownership may forestall needed changes. Finally and most importantly, privatization of public mills has been superseded by extensive private sector investment in new milling capacity.

Accomplishment:

Benchmark accomplished. The holding company and the MPE have undertaken several steps in the privatization process. In addition, *significant private sector investment has substituted for and superseded privatization.* Privatization of increasingly redundant public sector rice milling capacity is not necessary to ensure a strong, vibrant milling industry, which has already emerged. Hence, the spirit of this benchmark has been accomplished.

One may expect more progress in the Sharkeya experiment to transfer ownership to mills' employees in 1998. The plan to develop an agribusiness complex that would include rice milling appears promising. Clearly, privatization options such as sale of the public rice mills solely as rice milling units through IPOs, sales to investors, or employee buy-outs do not appear to be feasible. Pending the results of the Sharkeya experiment, other public rice mills should consider similar creative restructuring options, leasing, or liquidation of assets at the highest possible salvage values.

II.D.3. Complete the liberalization of the subsector by September 30, 1996.

Interpretation of benchmark for verification purposes:
This benchmark is highly redundant with benchmark I.C.1. Complete liberalization implies no GOE market, trade or regulatory restrictions.

Sources of Information/Method of Analysis:
MVE conducted a rapid appraisal of rice subsector in April-May 1997 (see *Progress and Obstacles in Rice Sector Liberalization in Egypt: A Rapid Appraisal to Verify Policy Benchmarks* by Ismael Ouedraogo and Abdel-Rahim Ismail, MVE Verification Report No. 4, October 1997). Review of various reports on the rice subsector. Discussions with Egyptian experts on the rice subsector and rice processing industry, including the Chairman of the Holding Company for Rice and Flour Mills, Dr. Ragaa el Amir and Dr. Hamdi Salem.

Analysis and Findings:
This benchmark provides no guidance on specific policies required to achieve full liberalization of the sub-sector. Liberalization is a well-understood concept, but not specifically defined.[4] Thus, the importance of this benchmark is diminished by its lack of identification of specific policies required to achieve complete liberalization.

Yet despite lack of specific policy guidance, the GOE has made significant progress in the rice sub-sector. For example, the GOE does not directly intervene to set prices for rice, and farmers are free to sell paddy rice to any of a large number of traders and millers. Furthermore, in the past few years there has been significant growth of private sector participation in this subsector, with large private investments in rice mills. As of the mid-1997, there were an estimated 5,796 rice mills in Egypt, of which all but sixty were privately owned (see Table 6). Estimated installed milling capacity is approximately 5.7 million mt of

[4]Contrast this with the concept of "privatization," which has a specific definition established by USAID and the GOE. Liberalization has no such definition, and thus can include or exclude an entire range of policies and programs related to the production, processing, marketing and international trade of a given commodity.

paddy per annum. National rice milling capacity exceeds actual paddy output of 4.9 million mt in 1996 and 5.48 million mt in 1997. Public sector milling capacity was only about 21 percent of national capacity in mid-1997.

Only 100,000 mt of paddy were milled in public mills in 1996/97, while the private sector mills milled the rest of the 1996/97 crop. Actual public sector milling of paddy in 1996/97 constituted only 2.3 percent of the 1996 crop. This is a remarkable achievement when one considers that just a few years ago farmers were compelled to deliver all their paddy to the Government. This level of private sector investment and development could not have occurred in the absence of a positive enabling environment for rice subsector liberalization.

The July, 1997 Verification Report concluded that this benchmark was almost fully accomplished. The report noted that "major controls of the rice marketing have been

Table 6: Estimated Rice Milling Capacity in Egypt

(Metric tons of paddy)

Mill Category	No. Units	Total Annual Capacity (mill. mt/yr.)	Average Annual Capacity per Unit (mt/year)	Average Daily Capacity per Unit (mt/day)
Public mills	60	1.2	33000	150
Private modern mills	200	0.44	22000	50-150
Private commercial mills	105	0.59	5605	5-40
Other private	22	0.194	8800	40
Village mills	5589	3.32	594	2.7
TOTAL	5796	5.742	NA	NA

Sources: Cereals Industry Chamber, Rice Branch Executive Committee; March 1996 study of Ragaa el Amir et al., *Analysis of Egypt's Rice Marketing System*. APRP/RDI *Rice Subsector Map*, forthcoming.

Notes: Assumptions about capacity: Estimated capacity for the public mills approaches theoretical or installed capacity. Capacity for the private mills is more a "rated capacity" than a measure of theoretical throughput. a) Private modern, commercial and "other" mills are assumed to operate 220 days per year. b) Village mills are also assumed to operate 220 days per year at a capacity of 2.7 mt/day.

abolished, but some potential distortions exist and some issues remain to be clarified." Those potential distortions are identified as the existing export subsidy, an import tariff, and quality standards on imported rice, which could function as a trade barrier.

The Memorandum of Understanding for the Tranche II benchmarks used the July, 1997 Verification Report analysis to establish a benchmark to address the two main policy issues which remain in the rice subsector. Those issues are the import tariff and the quality standards. Benchmark A4 is as follows: "The GOE will establish a schedule for tariff reduction on paddy and milled rice with a minimum reduction from the current level of 20% to 15% by June 30, 1998. The Government will impose no quantity or quality restrictions on such imports, subject to normal public health inspection and certification". By including these issues in a Tranche II policy benchmark, the APRP gives specific guidance to the GOE to accomplish what is needed for complete liberalization.

The issue of the announced export subsidy is not included in the Tranche II benchmark. This is because, as noted in the Verification Report, it is never been implemented. Furthermore, export subsidies are scheduled to be eliminated under WTO rules. It is recommended that the GOE formally announce the removal of the rice export subsidy.

Accomplishment:
Benchmark accomplished. The GOE has achieved the spirit of this benchmark. By allowing private dealers, millers and exporters to operate freely and invest in new equipment and facilities, the GOE has created an enabling environment that has led to the emergence of a vibrant, liberalized rice subsector. Remaining policy issues will be addressed through specific, targeted benchmarks.

The MVE Unit notes, however, that potential distortions exist and some issues remain to be clarified. The export subsidy, potentially a market distortion, is not implemented at present, but it could be at any moment. In a fully liberalized market, such distortions do not exist. The regulations regarding import of rice and paddy, though not transparent, remained untested mostly because of the import tariff, which will be lowered from 20 to 15 percent in 1998. Specifically, the (domestic) quality standards for imported medium-grain rice remain a potentially important barrier to imports.

II.E. Seed:

II.E.1. Continue to implement the privatization of all seed processing plants. Offer, at reasonable prices, at least 50% of the seed processing plants for sale to the private sector by September 30, 1996.

Interpretation of benchmark for verification purposes:
The intention of this benchmark is relatively clear as stated. "Reasonable prices" means that the Government can set a reserve price that bears some prespecified relation to the company's valuation, as completed by an outside auditor**.**

Sources of Information/Method of Analysis:
Review of relevant documents, and discussions with APRP and GTZ staff.

Analysis and Findings:
A Ministerial Decree (691/1997) was promulgated by MALR establishing a committee to develop a program for privatizing seed processing. The members of the committee are ten from MALR and five from the private sector, under the leadership of Eng. Salah Abdel Wanis of CASC.

The Minister of Agriculture and Land Reclamation sent a letter dated September 8, 1997 to Mr. Thomas Schurig, division head in the Ministry of Economic Cooperation and Development in Germany. In this letter the Minister commits the Government to tendering four (of the eleven) seed processing centers for sale to the private sector during 1998/99. Additional points in the letter include:

- The Government has raised the selling prices of seeds to breakeven price, completely removing any direct subsidy. This encouraged the private sector to produce at least 30% of the country's seed.
- The Ministry is planning to remove all indirect subsidies as well and bring selling prices to the real cost in 1998. Commercial management will be applied in the processing centers.

Important legal issues that needed to be addressed have been handled by the new committee, which adopted a study by Mr. Ahmed Hassan as the legal basis for the privatization of the seed processing centers.

Operating the very large seed processing plants that are in the public sector may not be economically feasible for the private sector. This is likely one of the reasons the original offering was not successful. Many of the seeds processed in the public sector plants are from crops that are self-pollinated. Since farmers can save their own seed in these crops, the market for commercial seed may be limited. Indeed there is some evidence that replacement rates for seed have been slowly declining in some such crops. In addition there is less prospect of making a return on breeding, such as there would be for hybrids.

The Government's program, has proceeded on two fronts. Besides moving forward on privatization, the Government has created more of an enabling environment for private investment by raising the prices it charges for seed to cover its full costs. This allows the private sector to compete on a reasonable basis, which they could not do before. Thus, several private seed processing companies are reportedly multiplying the seed of rice and wheat. Significant portions of the seed of these crops are processed by the private sector and cooperatives. The seed sector apparently now contains four or more large seed companies, who have their own plants through recent investments, and about two dozen or so others who are leasing the government facilities to process seed. The Government's commitment to privatization of seed processing is also clear from its work under tranche II in the same area.

Accomplishment:
Benchmark accomplished. Before the MOU there was very little progress toward privatization. The Government, with the assistance of the RDI Unit and GTZ, has recently accelerated the privatization process, which constitutes more than "continuing." Investments and leasing by the private sector are in large measure due to the change in the Government's seed pricing policy and in its overall seed processing policy. Together with the Government's progress in privatization, these meet the spirit of this benchmark.

II.E.2. Continue to develop delinting plants for cottonseed and develop a plan to privatize these plants.

Interpretation of benchmark for verification purposes:
In 1994 CAS arranged for seed to be delinted by a seed crushing firm. This program is important because the use of delinted seed will dramatically reduce the amount of cottonseed needed for planting. Farmers developed some resistance to delinting in 1995 because of cold weather at planting time. GTZ is supposed to be providing an acid delinting plant (construction in 1995/96). It is supposed to be established as a separate firm under the control of MALR until it can be privatized.

Sources of Information/Method of Analysis:
Review of plan. Discussions with staff of RDI Unit.

Analysis and Findings:
An acid delinting plant was constructed in Egypt with GTZ assistance in 1996, and has been operating since March, 1997. This is the first plant out of a total of about four plants enough to process all the cottonseed Egypt requires that have been proposed to be constructed with German assistance. GTZ financed the first plant in collaboration with the GOE. The other plants are to be constructed with KfW financing to private banks for private ownership.

According to an agreement between the two governments, the agencies charged with project implementation will "ensure the organizational establishment and legalization of a private sector oriented company as a legal entity and owner (through purchase, lease, or management contract) of the delinting and seed processing plant."

At the meeting of December 7, 1997, the Board of Directors of the new plant made several decisions, including:

- The composition of the Board will be modified to the reduce the number from eleven to seven, and the balance between public and private sector members will be altered to four public and three private.

- These steps will be recommended by the management committee to the Minister of Agriculture and Land Reclamation for a decree to be issued in the very near future.

With the assistance of the RDI Unit and GTZ, a plan has been developed for the privatization of the acid delinting plant. The plan includes the following key steps:

- A financial analysis of the plant's operations will be conducted in January, 1997. Work on this analysis has begun; it is expected to be complete in mid-February. Based on the resulting cash flow analysis and performance projections, the form of privatization will be determined. These steps will be complete by March, 1997.

- In March and April of 1997, a study will be undertaken of the germination rate of the delinted seeds. Past problems with germination may have been erroneously ascribed to the delinting process.

- An adoption rate study will be conducted from March to September, 1998 on the use of delinted seeds in both 1997 and 1998.

- The Board of Directors will determine the appropriate form of privatization of the plant (at some time between July and October, 1998).

- In October, 1998 a profitability study for the plant will combine the results of all the previous studies to prepare a feasibility study for presentation to the private sector.

- The Board will solicit private bids and proceed with privatization (October - December, 1998).

Once the acid delinting plant is privatized, KfW will resume consideration of funding for the other proposed plants.

Accomplishment:
Benchmark accomplished

III. PUBLIC INVESTMENT POLICY AND SUSTAINABILITY

III.A. <u>Land and Water</u>:

III.A.1. Develop a revised, integrated land and water plan on the basis of: a) the comprehensive study of the socioeconomic viability of new land development schemes completed in October 1994, and b) a socioeconomic water map being developed in the Strategic Thinking and Planning Unit Program of the MPWWR.

<u>Interpretation of benchmark for verification purposes:</u>
This benchmark consists of developing a plan on the basis of studies. Verification will include checking the regular 5-year plan to see if recommendations of the studies were included. The studies referred to are the New Lands studies.

<u>Sources of Information/Method of Analysis:</u>
Obtain a copy of study or plan.

<u>Analysis and Findings:</u>
The RDI Unit has published report number 24, entitled, "Technical Report on Water and Land Resources Planning and Management in Egypt." This detailed report includes:

- Review of Water and Land Policies (including water master plan)
- Current Status of Water and Land Resources (supply and demand)
- Determinant Factors for Water Resources Development
- A Framework for Water Resources Development
- Initiatives of Future Water Policy
- Future Scenarios for Water and Land Development

The report summarizes past and current water and land resources policies in Egypt, discusses their shortcomings, and arrives at a revised and comprehensive water resources policy addressing land use for agricultural production (Chapter 8).

<u>Accomplishment:</u>
Benchmark accomplished

III.A.3. Conduct a study of land tenure policy.

<u>Interpretation of benchmark for verification purposes:</u>
This benchmark consists of completing a study only.

<u>Sources of Information/Method of Analysis:</u>
Obtain copy of TOR and/or study.

Analysis and Findings:
The RDI unit has completed a study of this topic. It is report number 21, entitled, "The Land Tenure Policy Study."

The study details the provisions of the new land rental law (96/1992) and its effects. It mentions problem areas, gives several useful recommendations for follow-up actions. The former include the issuance of *hiaza* cards to landlords, which makes it difficult for tenants to get credit for inputs purchases. The latter include changing the standard contract to three years, to be more consistent with crop rotations.

Accomplishment:
Benchmark accomplished

III.B. Water Management Policy:

III.B.2. Develop an implementation plan for a cost sharing program, based on the output of Benchmark III.B.1.

Interpretation of benchmark for verification purposes:
There is some overlap of this benchmark with benchmark III.D.2. The intention of the benchmark is that the results of the study be discussed put into an implementable form.

Sources of Information/Method of Analysis:
Review of documents provided by MPWWR and EPIQ regarding actions to be taken.

Analysis and Findings:
A comprehensive program to accomplish the objective of this benchmark was proposed by MPWWR and has been included in the workplan of the EPIQ and GreenCom teams. It includes:

- Review of previous studies by IIMI and ISPAN.
- Preparatory activities including development of acceptable options for cost sharing, field survey of farmers' attitudes, selection of potential areas for pilot implementation, and public awareness campaigns.
- Formulations of alternative charging mechanisms, implementation in pilot areas/field testing of charging mechanisms, evaluation and recommendations, identification of institutional, budgeting, and infrastructural requirements for collection and utilization of service charges, and development of a national plan.

Cost sharing is a difficult and sensitive issue. Several steps are required to develop an implementation plan. These steps must be carefully designed and taken at a careful pace to build public acceptance.

Accomplishment:

Benchmark accomplished. The Government has a well-delineated program for developing the required plan, and the first steps are under way. The approval of the technical assistance and their workplan, which includes the steps detailed above, demonstrate the Government's commitment to cost sharing.

III.C. <u>Investment in Research, Extension and Other Services</u>:

III.C.1. Analyze research and extension institutions during 1995, with the aim being to develop a plan for improving institutional arrangements, improving the efficiency of investment, and reducing budgetary pressures where possible. Include a review of mechanisms for contracting out services to private sector firms. Develop a benchmark for the 1996/97 MOU which will call for the initiation of institutional reforms that may be identified by the analysis.

Interpretation of benchmark for verification purposes:
This benchmark consists of completing a study with recommendations.

Sources of Information/Method of Analysis:
Obtain a copy of study.

Analysis and Findings:
A report entitled, "National Agricultural Research and Extension: Looking to the Future," has been completed by Drs. Oteifa, Gomaa, and Osman. It reviews the research and extension systems in Egypt and makes recommendations for their improvement. This report is phase one in a set of activities that will contribute to benchmarks in tranches I and II of APRP.

Accomplishment:
Benchmark accomplished

III.C.2. Conduct a study of phytosanitary controls on imports of agricultural raw materials and develop a plan to remove unnecessary restrictions to free trade in agricultural raw materials and inputs.

Interpretation of benchmark for verification purposes:
This benchmark consists of completing a study and developing a plan. By **"**raw materials,**"** the intention is to indicate potato seed, seedlings, cotton lint (which is also covered in another benchmark), and similar items, some for planting and some for processing, but all with the potential to carry into Egypt harmful pests or diseases.

Note: The MOU includes the language "phytosanitary controls." The July, 1997 verification report and other documents circulating previous to that time in APRP erroneously permuted this language to "non-phytosanitary controls."

Sources of Information/Method of Analysis:
Obtain a copy of study and plan.

Analysis and Findings:
Progress has been made in the spirit of this benchmark despite the fact that it was very broad-gauged and not well-formulated. Reform measures to remove unnecessary phyosanitary controls must be targeted to specific inputs and prioritized. To start this process, the APRP, in tranche II, is working on reforming the regulations regarding imports of horticultural seeds. In addition, reform in this area requires improving and streamlining the operation of the institution responsible for phytosanitary regulations. (Note that all commitments of the GOE under tranche II were made before December 31, 1997.) APRP is committed in tranche II to conducting an institutional audit of the Central Administration for Plant Quarantine.

Tranche II includes a benchmark committing the GOE to establish measures to allow imports of annual vegetable and fruits seeds that are certified free of pests and diseases not found in Egypt. This reform is critical to improving the competitive position of traders of horticulture products, and it is necessary for the development of a domestic seed industry. In addition to this reform, tranche II includes a benchmark to commit the People's Assembly to passing the draft seed law. This law is consistent with the international trade requirements of the WTO.

In the cotton market, the RDI Unit is planning several interventions for phytosanitary reform. Based on a study conducted jointly by GTZ and RDI on technical and economic factors affecting imports of cotton lint, the Central Administration for Plant Quarantine is committed to codifying and publishing phytosanitary regulations with respect to cotton lint imports. This commitment is reenforced by a tranche II benchmark.

The GTZ/RDI report went a step beyond a focus on regulations pertaining to cotton lint imports. In this report, which is co-authored by the Director of CAPQ, the GOE is committed to two further reforms. First, the CAPQ will execute a plan to institute a program of zone certification for cotton imports. Zone certification will include a risk assessment for pests and diseases in export zones, and require that exporters in acceptable zones be responsible for managing of phytosanitary risks. The role of the CAPQ will be to monitor the phytosanitary risk management procedures of exporters to ensure compliance with agreed upon procedures.

In addition, the action plan published in the GTZ/RDI report committed the GOE to: 1) Conduct a thorough review of the Agricultural Quarantine Law; 2) Replace or amend the law; 3) Review phytosanitary regulations for the importation of products on the basis of risk analysis, risk assessment and risk management; and 4) Publish a summary of all regulations articulated in the customs tariff codification of goods. All of these commitments will be accomplished with a view to supporting private sector trade in agricultural commodities, and to ensure that Egypt's phytosanitary regulations and procedures are consistent with the WTO.

One final reform measure relates to the organization and operation of the CAPQ. The GTZ/RDI report recommends that APRP, under RDI, conduct an institutional analysis of the CAPQ and prepare a detailed plan to improve its effectiveness and efficiency. The main feature of this plan will be to reorganize the operations of the CAPQ to support private sector international traders. RDI anticipates that the recommendations arising from this analysis will be contained in tranche III benchmarks.

Accomplishment:
Benchmark accomplished. A specific APRP/GTZ study has been conducted that meets the spirit of this benchmark. Furthermore, a tranche II benchmark also meets the spirit of this benchmark. APRP is itself a plan to reform policies, including those that are barriers to trade, and the GOE is highly committed to APRP.

III.D. Farmer Cost Sharing:

III.D.1. Define and finalize administration and institutional procedures required and begin recovering capital costs from farmers who benefitted from mesqa improvements completed under the Irrigation Management Systems Project, in accordance with the Law No. 213 (1994) amendment to the Irrigation and Drainage Law.

Interpretation of benchmark for verification purposes:
The intention of this benchmark is generally clear. There is some ambiguity about whether all farmers who benefit from *mesqa* improvements should pay toward capital costs, or only those who benefitted after the law was amended to require payment. This issue has not been settled. This benchmark does not refer to the recovery of drainage costs. Verification will include ascertaining whether collection of costs has begun.

Analysis and Findings:
MPWWR has taken many steps to accomplish this benchmark, but has not been able to begin collection from farmers. Beginning in March, 1996, procedures to recover the cost of *mesqa* improvements have been developed and put into place by MPWWR. IIP has accomplished the procedures mentioned in the Pacer report, developed a financial plan and internal control regulations, drated a ministerial decree, and held a workshop. It worked with the Minister's office to issue a decree for a revolving fund. IAS and IIP worked together to prepare a database of WUAs. Registration of WUAs is ongoing.

No further steps can be taken because of the legal issues involved. Initial improvements to *mesqas* under IMS were made at no cost to the farmer. Thus many improvements were completed before the law on cost recovery was passed. Some improvements started before the law and finished afterwards; some started after the law was passed. In some areas there might be some farmers subject to cost recovery and others, not. It is possible that the People's Assembly will decide that there will be no cost recovery from these investments because of these equity issues.

The legal problems encountered by the Government remain. The MVE Unit, in the previous verification report, recommended that the benchmark be considered as accomplished in light of the difficulties that are beyond the control of the Ministry. There has been no change in the situation with regard to this benchmark since the previous report was submitted.

Accomplishment:
Benchmark accomplished. The spirit of the benchmark has been accomplished. MPWWR has proceeded as far as it legally can proceed in fulfillment of the benchmark. The underlying

legal issue is serious and requires the intervention of the People's Assembly. Perhaps this could be a future benchmark.

III.D.2. Develop an implementation plan for allocating and recovering O&M costs.

Interpretation of benchmark for verification purposes:
A study was completed by IIMI in 1995. It provides the basis for developing an implementation plan. The intention of the benchmark is that the results of the study be used rather than left idle by formulating a plan that can be implemented. The entire national irrigation system is referred to by this benchmark, and non-agricultural costs are included. Verification will include examining whether the study has elements that appear to be a plan.

Sources of Information/Method of Analysis:
Please see the corresponding section for benchmark III.B.2.

Analysis and Findings:
Please see the analysis for benchmark III.B.2. As mentioned in the interpretation of that benchmark, there is virtually no practical difference between the two benchmarks.

Accomplishment:
Benchmark accomplished

ANNEX

DECREES AND OTHER DATA

Benchmark I.A.1.e
&
Benchmark I.A.2.b

Benchmark I.A.4

Benchmark I.A.4.b

Benchmark II.D.2

Benchmarks II.E.1
&
II.E.2