The challenge of renewal

Liberalisation has brought multiple challenges to Egypt's industrial sector. Minister of Industry and Technological Development Mustafa El-Rifa'i speaks to Aziza Sami on the prospects for the future

photos: Sherif Sonbol

Within the next five years, Egyptian industry will face the challenge of increasingly opening up to foreign competition within both the local and export markets. This will occur in the context of the Egypt-EU Partnership Agreement under which — over a period of 18 years — Egypt's trade with the EU will be totally liberalised, with no customs imposed on imports by either side. Egypt will also implement other tariff reductions on imports, as ordained by the General Agreement on Tariffs and Trade (GATT).

All of this will obviously impact on Egyptian industry which includes a wide spectrum of entities ranging from the long-established industries of the public enterprise sector that are still undergoing privatisation to newer industries recently established by the private sector. In an economy where liberalisation is still being implemented at the institutional and legislative levels, attaining global competitiveness does not promise to be easy.

When Minister of Industry and Tecnological Development Mostafa El-Rifa'i took up his portfolio in October 1999, he had an overall plan in mind, despite the change in his ministry's role due to privatisation. And, his experience in the US in the research and development division of DuPont — the leading chemicals company as well as in Egypt's petroleum sector— would prove invaluable to the challenges of his new position. He spoke about his insights into the future of Egyptian industry.

More than a year has passed since you assumed responsibility as minister of industry. How do you assess the state of Egyptian industry, and what do you feel remains to be done?

The main challenge is the upgrading and modernisation of industries which are — for the most part — over 30 years old. Egypt has a large industrial base which was built from the 1930's and the subsequent decades through to the 1960's. These industrial enterprises are either public sector, private sector or privatised. In many instances their productive capacities were not up to the latest international standards in specifications, quality or design. They have not been competitive in prices, for a number of reasons including technological obsolescence, outdated management practices and overstaffing.

There are the more "current" industries which developed in the new communities in the 1980's and 1990' s as a result of the investment boom based on expatriate remittances. But even these industries, which basically produce consumer goods for the local market, are liable to obsolescence. This is because they have neither the mechanisms nor the institutions enabling them to remain up to date and competitive. With the advent of globalisation, they will have to compete [against foreign products] locally, as well as in export markets, otherwise, they will not survive.

What are you doing to assist industry in rising to this challenge?

Over the past year we developed a plan for the modernisation of industry. We have identified a number of technology-intensive mechanisms which should be established to promote and catalyse modernisation. We must realise that modernisation requires the capacity to design plants and products so as to give results which are contemporary and stylish . For this, we must be creative and imaginative.

We also need to have a knowledge of technology itself. We have identified the types of technological centres needed to avail different industries of the technologies they need.

You had a plan when you first came to office, which pin-pointed several sectors as potentially promising but in need of upgrading. What happened in this respect?

Three technological centres have been established for upgrading the textiles, food and leather industries. This was done on a priority basis for two obvious reasons: one is that these are three critical sectors, economically and socially, and the other is that they lend themselves to modernisation and development. The textiles centre is already operating and has had its management appointed. We are now searching for the proper leadership for the two other centres, godfathers, so to speak, who have the right personality and are resourceful enough to enable them to succeed at their tasks.

We also have to identify the companies — the technology owners — who will be providing assistance to these centres, and who will be coming from the industrialised countries of Europe.

With liberalisation, your ministry's jurisdictions have obviously changed. What is its role now?

Currently, the government does not invest in factories. This is no longer its policy. And so with liberalisation, the function of the ministry is no longer that of contracting the establishment of industria plants. A re-defining has been made of the Ministry of Industry's mission. When we deal with a factory which is hierarchically under our command, it is a different matter than if we were dealing with a factory owned by somebody else. A private investor can avail himself of our assistance. But our role has become a counselling one, much like that of the Ministry of Agriculture in counselling the agricultural sector.

Despite this, people working in industry still seek out the government for assistance , at times, for protection. The ministry extends its protection to them, by virtue of the original mandates of minister of industry.

You have often mentioned the importance of adhering to environmental criteria in Egyptian industry. Is this being realised?

Our mission includes industrial control for the protection of the consumer and society against hazards to safety and health.

We have an obligation to maintain high quality standards for industrial products. This endeavour will be enforced by various means; some of which will be incentives and others will be regulatory. We also consider that environmental industries [ie those for recycling] deserve special attention. And so, over the past year we have established a group which monitors industry worldwide, acquires technical information and studies on the industries and technologies capable of converting agrifibres into useful products. The sources of these fibres include rice straw, cotton stalks, and midribs of palm leaves.

But some of the environmental problems related to agriculture are still manifest, such as farmers continuing the practice of burning rice straw as was the case last October. You specifically cited the resolution of this problem as one of the items on your agenda of over a year ago.

The Ministry of the Environment is giving special attention to this issue. We are all able to identify the appropriate technologies. The problem now is the cost of collecting and transporting rice straw.

How, then, will you promote the modernisation of industry?

We shall organise a very important international conference this month from 27-29 January, entitled "The Modernisation of Egyptian Industry." The conference will cover the three critical industrial sectors which we have selected for modernisation. International figures and authorities will be invited to address participants. Every session will be followed by a round table discussion that will aim at reaching a consensus on a modernisation plan for each sector. We believe that the conference will be a very important event . Leaders in technology from the US, France, England, Italy and Denmark will attend.

You have mentioned the textiles sector as a strategic industry which is in need of upgrading. What is your prognosis, why are its problems chronic, despite its vast potentials?

We have been reviewing the situation with the textiles industry which is an old one that is both labour-intensive and a dominant industry. We've identified a number of deficiencies requiring remedial action. Most of these have resulted from the inability of management — both private and public sector — to cope with the current technological changes [related to this industry]. Moreover, there are numerous other problems such as the obsolescence of spinning machines, overstaffing and poor quality control.

There is also the lack of skills in fabric design for prints appropriate for fashion garments . We have identified a number of other deficiencies as well. The dyeing and finishing are really behind. It is a step in a chain of processes which if remedied could have excellent returns. That is why the textiles technology centre began with dyeing and printing. The plan in 2001 is to modernise seven plants for dying and finishing. If we succeed in this endeavour, this should enhance the quality of Egyptian textile products. Another problem that requires attention and a change in strategy is capitalising on the unique qualities of extra long-staple Egyptian cotton. This is where we have a natural advantage. We need to use Egyptian cotton to produce superior textiles and garments which — with modern techniques — can match the best qualities of natural and synthetic fibres.

What is the extent of coordination between yourself and the ministries of agriculture and public enterprise in rehabilitating the textile industry?

We have direct access to the public enterprise companies and part of our mission is to modernise the textile factories. There is no conflict of jurisdiction there. We meet regularly with officials of the Ministry of Agriculture to exchange information.

The inability of Egyptian industrial products to compete in export markets — especially the US and the EU — has not only been a result of fierce foreign competition, but has also been due to the poor quality of these products. How, then, will Egyptian industry perform in the face of complete liberalisation of trade starting in the year 2005?

Egyptian industry is becoming increasingly aware of the consequences and limitations of protectionism. There are manufacturers who are already able to compete internationally and have succeeded in penetrating European and US markets. These manufacturers (do not feel jeopardised) because they have secured their survival. There are others, though, who are more complacent and do not appear to rise to the challenge. We must realise that a large number of plants will go bankrupt and close completely. A low estimate would be 1,570 companies, mainly in the food industries and textile sectors.

How will the economic and social costs resulting from this be dealt with?

The only solution will be to create new ventures which can provide employment and investment opportunities. And so, of course, we encourage foreign investment. Egypt has traditionally been a potentially large and attractive market for such investments. But we must also realise that foreign investment is attracted to a market which is protected by duties. With liberalisation this protection [for foreign investment] will no longer be afforded. Therefore, we must also study what the impact of free trade agreements — such as the Egypt-EU partnership agreement — will be on the flow of foreign direct investment.

What then, do you think will be the impact of the Egypt-EU partnership agreement on industry?

We have undertaken a detailed analytical study of the effects of the association agreement on Egyptian industry by sector. The results of the study have not been disclosed. However, we hope that a massive restructuring will be feasible and that industry will respond to the modernisation initiative in order to become increasingly competitive. When this happens, the strong private sector will survive and possibly flourish.

An obvious lack of planning has characterised investment patterns in Egypt. In the automotive sector, for instance, [illegible] factories producing several models, although the trend worldwide is towards merging and consolidation. Where is the Ministry of Industry's "counselling" role here?

Egypt's automotive sector developed under substantial tariff exemptions. It has become, consequently, a large engineering industry producing international models at acceptable standards. But it still is a sector which does not possess the capacity to either design or manufacture engines. The owners of these plants — which number around 16 factories — know that they are owners in a peripheral car-assembly industry where the number of cars produced is not economically viable and where production capacities not fully utilised. Egypt's competitive edge is in manufacturing car components for export.

The government has decided that Egypt should have a free market economy depending entirely on private sector investments in industry. Is it not time that autonomy were given to the Federation of Industries which represents this sector? Why the insistence that it be subject to the control of the Ministry of Industry?

This is a total misconception. As the Ministry of Industry, we maintain a unique position in being totally neutral because we do not own any industry. Our sole duty is to sponsor policies that promote industrial growth. At the same time, we are not divorced from the industrial community because unless we interact closely with it, we cannot fulfill our mission. We interact with all of the industrial associations — and there are many — without meddling in their affairs.

As for the Federation of Industries it is totally independent. It is managed entirely by its board of directors.

But the federation is legally affiliated to the ministry.

Of course, just as the different professional syndicates are affiliated to the different ministries. The Ministry of Industry is represented by one board member. We have always respected their autonomy. They invite me for an annual meeting in Ramadan where we exchange views on general issues important to industry. The chambers often come to me and meet with me to seek assistance to solve problems related to their industries.

But you must admit that it is a different situation from that prevailing in strong industrial federations in the advanced economies which are independent of government administration.

I have told people [who have raised the issue] that when we have an industry which is "institutional" as in the advanced industrial economies, then we will have truly autonomous industrial associations. This will happen when we develop a proper entrepreneurial approach to investment and go beyond the effects which arose from the initial phase of the 1970's where there was an "urge" to create a new breed of Egyptian businessmen or capitalists. To have strong independent associations, as well, we must have companies listed on the stock exchange which adhere to the principles of transparency and disclosure, not just a few closed family companies as is now the case. Strong associations will exist when the private sector conforms to the accepted rules and norms of the market.

The government has often cited the importance of foreign direct investment in fostering economic growth. What is your outlook on foreign investment in relation to the industrial sector?

Right now, what we need is a new breed of industries which capitalises on top skills in management to penetrate export markets and provide management technologies. Egypt will provide the infrastructure, labour and technicians, at very competitive wages, and a home-based market. Yet, despite the fact that over the years we have provided unique tax exemptions and incentives compared to other countries — this type of investment has not been forthcoming at the levels we desire.

How do you think the current liquidity shortage and recession will affect the private sector's ability to undertake the important task of modernising industry?

We must admit that excessive investments were made by the private sector in real estate over the past decade under the false assumption that such investments would somehow promote economic growth. Their effects are now all too well-known. But there were also others who had the courage to invest in industry — with all the risks this entails — and we thank them for this. As for the liquidity shortage, it will not last.

How can an investor — Egyptian or foreign — who wants to put his money in industry, assess the feasibility of his projects, and future profits — for instance those in five years time — given the fluctuations in the exchange rate, the continual depreciation of the pound versus other currencies and the lack of accurate data concerning inflation?

Any specialised bank can give information to an investor on the prospects for his investment. Concerning forecasts of profits etc., this is a matter of an investor's intelligence or intuition. As for the exchange rate, it is natural that it should fluctuate; there is no government guarantee against that. The fact is that is the exchange rate — ranging between LE3.45 and LE3.50 — has been stable during recent years as never before. We have never experienced a runaway devaluation as happened in Latin America. The dollar's recent rise is not very serious and perhaps is healthy. It is conducive to the promotion of exports.

***But how can an expensive dollar promote Egyptian exports?* A major complaint by exporters, concerning the EU in particular, is that one of the reasons their products are not competitive is that they are expensive because the pound is pegged to the dollar.**

We need a comprehensive approach to export promotion here, where reducing production costs will also be a factor.

There has been ambiguity and perhaps some confusion among investors concerning the funding of the industry modernisation programme in the context of the impending Egypt-EU partnership agreement. There is talk of a disagreement arising from the fact that the EU is setting the condition that it should approve the sectors to which the funds will be directed whereas Egypt has a different point of view.

Within the framework of cooperation between Egypt and the EU, a programme was agreed to assist small industries. This would use funding from the Egyptian government, the EU and private enterprise beneficiaries; the contribution from the Egyptian side would be at least 40 per cent. We hope to make use of this programme as part of the national industry modernisation programme. The agreement was structured, in our opinion, in a very rigid manner and filled with overly detailed procedures and bureaucratic regulations which required approval from the EU on matters which actually relate to the [Egyptian] Project Council. We have complied with the signed agreement and will soon hold discussions with our European friends which should introduce vitality and flexibility to this programme.

A lot of trepidation and protest have been manifested recently by Egyptian industries vis-a-vis the Egypt-EU Partnership. This is in spite of the fact that the agreement has been five years *in the making.* Did industries not know of its terms? How do *you* explain this.

Since the appointment of the new cabinet, and under instructions from President Hosni Mubarak, we have shared the details of this agreement with the various chambers [of industry] and public sector enterprises. This has resulted in considerable opposition to the agreement within the ranks of local industries. We are weary of the consequences and are walking voluntarily into a situation which could severely undermine our industry, society and the quality of life for the average citizen. It is natural, therefore, that the industrial sectors and enterprises who will be most directly affected by the outcome of the agreement should feel trepidation.

Crux of the matter

Prime Minister Atef Ebeid's announcement on Monday that the Central Bank has been authorised to set "safe and defined limits" within which the Egyptian pound will be allowed to fluctuate constitutes the first official acknowledgment of what many have suspected for months — that the government is engineering a managed flotation of the Egyptian currency.

However astute the management skills involved, though, the flotation means only one thing — a steady devaluation of the pound against the dollar to which, for a decade hitherto, its value has been pegged. And while there is as yet no indication as to the baseline to which the government will allow the pound to sink in the long run, its de facto devaluation has been welcomed by the market.

According to what the Prime Minister announced in the cabinet's annual policy statement infront of the People's Assembly, the Central Bank will determine the exchange rate based on the average market rate over the past three weeks. It will "ensure that banks and exchange bureaus respect the limits within which the dollar rate will be allowed to rise" in a step that is clearly intended to inhibit levels of speculation and in doing so bring at least some semblance of stability to the foreign exchange market.

Whether or not the government's belated admission of a policy it has evidently been following for several months now will be enough to counteract further pressure on the pound, though, is by no means clear. Running a trade deficit of over $11 billion, with desperately poor productivity figures, a weak savings ratio and deteriorating export performance, the government really has very little room for manoeuvre.

Traditional sources of hard currency — tourist and oil revenues, expatriate remittances and Suez Canal dues — have declined over the past two years and are at best precarious.

The downward pressure on the pound is unlikely to abate: the most optimistic commentators predict that by the end of the year it will have sunk to LE5 per dollar, though realistically it may well be closer to LE6.

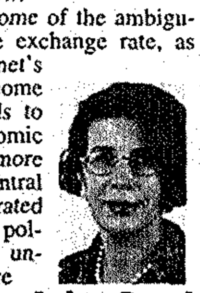
The government, then, finds itself in a double bind. Having instructed the Central Bank not to make further injections into the market from its foreign currency reserves — depleted, now, to $14.6 billion — it has now charged the same institution to "determine the rate of exchange for the Egyptian pound." The pound, even if it is not going to be allowed to go into free fall, is likely to be steadily devalued, which is hardly conducive to promoting the increase in savings necessary to finance investment. Nor is it at all clear what the inflationary pressures involved in devaluation will be: certainly there will be a degree of fall out, and higher inflation figures, again, are going to inhibit savings.

The one certainty is that pressure will continue to be exerted on the exchange rate and it is a situation that will continue until the structural imbalances inherent in the Egyptian economy have worked themselves out.

Hand in hand with managing the devaluation of the Egyptian pound, then, must come a platform of policies capable of tackling the yawning trade deficit. The only long term solution to the dilemma is to turn around productivity levels, though achieving this is likely to prove a long and difficult haul. Tweaking with the exchange rate mechanism, while it is a necessary step, is not going to help solve the underlying weaknesses that beset Egypt's economic performance.

Low savings, an overvalued currency, disastrous levels of productivity, an inflation rate that could easily overheat: it is an unenviable position from which to be working. To avoid the pitfalls will require enormous clarity of vision and a greater degree of political will than has been shown until now.

The removal of some of the ambiguity surrounding the exchange rate, as spelt out in the cabinet's statement, is a welcome first step if it leads to the cabinet's economic group working more closely with the Central Bank on an integrated fiscal and monetary policy. There is, unfortunately, no more time for fudging.



Aziza Sami