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THE IMPACT OF PRIVATIZATION AND POLICY REFORM ON THE COTTON SPINNING INDUSTRY IN EGYPT

Exective Summary

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EXECUTIVE SUMMARY

The spinning industry was almost entirely dominated by public sector companies until 1996/97, at which point privatization got underway and private investments were made in spinning companies, particularly open-end spinners. The last four years have witnessed changes which are evidence that the MPE privatization program, policy reforms affecting cotton marketing and trade, and overall economic liberalization in Egypt are having a positive impact on the spinning industry in Egypt.

As in many parts of the world, the initial steps in liberalization of the cotton subsector and textile industry did not have an immediate impact. Private investors wait a few years until it has become clear that policy reforms are irreversible, there is evidence that the Government is serious about privatization, and the overall business climate encourages private investment. By the end of the 1999/2000 cotton marketing season, there was sufficient progress on these fronts that private investors had entered and were transforming the domestic trade in seed cotton, the ginning industry, domestic and export trade in lint cotton, and cotton spinning. Driven largely by policy reform, these positive changes also responded to domestic and world market trends and conditions for cotton, yarn and textiles.

The major changes in the Egyptian spinning industry over the past four years were as follows:

- Three public spinners (Unirab, Alexandria S&W, ESCO) had become successful privatized spinners, buying 23.5% of the Egyptian lint purchased by all domestic spinners in 1998/99 and 27.7% in 1999/2000 as of 30 June 2000. These companies are spinning better quality yarn than most of the public sector spinning companies, generally medium-count, which has a ready market either domestically or overseas. Two of these companies appear to have achieved higher productivity than before privatization.

- Three spinning units of the Sharkeya Spinning and Weaving Company at Minya el Kamh were leased to private investors. This leased spinning operation did spinning under contract to two companies located in the Tenth of Ramadan.

- One new private ring spinning company came on stream in Sadat City in 1999 (Alcan Manai), which is allied with an Italian partner.

- Three private companies, two in the Tenth of Ramadan, are specializing in twisting of yarn, an operation that follows ring spinning. Perhaps one of these companies will consider expanding into ring spinning.

- Nine companies have started open-end spinning since 1997, making 13 entirely private (not privatized) open-end spinning investments in Egypt. Eight of these companies are using Giza 80 and 83 exclusively or largely as their raw material, which is remarkable given the high cost of this Egyptian lint cotton relative to the cost of waste and cheaper imported lint (which they did not use in 1998/99). While this can be seen as a vote of confidence for the GOE's policy of promoting cultivation of Gizas 80 and 83 in Upper Egypt, the open-end spinners also note that easier importation of cheaper short and medium-staple cotton lint or domestic cultivation of short-staple cotton would lower their production costs significantly.

- In 1999/2000, 29 percent of the Egyptian cotton lint sold to domestic spinners was sold to private firms. If the two joint investment companies (Miratex and Misr Amriya) are considered as private sector firms, this percentage rises to 43.7% (as of 30 June 2000). This is partly due to increasing unutilized capacity in public spinning mills.

Some planned future developments include the following:

- One of the most progressive private open-end spinners in Egypt is adding production lines to do ring spinning, beginning in 2001. It is also reported that a major Egyptian cotton trading company is considering establishing a joint venture ring spinning mill near Alexandria. These tentative first steps in making investments in more technically challenging and potentially remunerative ring spinning of medium-to high-count yarn indicate that the private sector is considering replacing at least some idled public sector capacity. The demise of public ring spinners represents an opportunity for private investors willing to take calculated risks.

- MVE obtained a list of investors who plan to do spinning, weaving, knitting and RMC production in El Obour City. The list includes 17 planned spinning investments of a total of 23 companies (most of whom will do more than one operation).

- Opinions diverge over what GOE policy should be regarding importation of shorter-staple cotton. Privatized and open-end spinners would like to see Egyptian lint, particularly LS and MLS varieties, made available more cheaply. Others note that importation of shorter-staple, cheaper foreign lint should be made easier for those spinners intending to spin low-count yarn. Open-end spinners also support cultivation of short-staple cotton varieties in Egypt to meet their demand for cheaper lint.

- The future of the GOE's privatization program for the numerous remaining public sector spinning companies is uncertain. Privatization stalled in 1998/99 and 1999/2000. Leases were signed with private operators to run three spinning units in Minya El Kamh and one at Al Alameya, but there was no transfer of ownership. Efforts to privatize Shebin El Kom and STIA, two well-regarded public spinners of medium and some high counts, were unsuccessful. In the meantime, yarn and other textile inventories mounted and many public companies were forced to operate well below capacity. MPE and the SWRMC Holding Company need to make strategic decisions about preparing public companies for privatization. Clearly, some public spinners can and should be privatized. These companies require some restructuring, labor force reduction, and debt resolution, after which they represent reasonably attractive investment or leasing opportunities. The difficulty lies in deciding what to do about the most highly indebted, overstaffed, and poorly performing companies, which are operating at low rates of capacity utilization. Is some form of triage required to concentrate limited resources for restructuring public spinners on the companies with the best medium- to long-run prospects of surviving?

- The involvement of foreign partners may be necessary to increase investment in ring spinning. Such investments are costly, and ring spinning requires technical know-how and market access. Domestic and partner foreign investors will likely be hesitant to invest in the troubled Egyptian spinning industry, where there is excess capacity, so this will lead to a rather slow increase in private ring spinning capacity. The future status of the more competitive public sector spinning companies who do ring spinning–Shebin El Kom, STIA and Misr Mehalla–is uncertain and will affect private investors' decisions. Nonetheless, increased private sector capacity in ring spinning for export is where many see the future of Egypt's spinning industry moving.

In order to promote private investment in the spinning industry, the GOE needs to do the following:

- Promote leasing and management contracts of potentially better performing spinning units of public sector companies to qualified foreign investors or joint foreign-domestic partners. Note that APRP/RDI is working with the MPE and the textile holding companies to do this.

- Resolve the redundant labor problem in public companies, such as Shebin El Kom and STIA, that would otherwise be attractive privatization buying or leasing opportunities for private investors.

- Reduce MPE expectations of getting offer prices that fully cover high GOE valuations of public companies ready for privatization in order to facilitate private investment. This can be most directly accomplished through preparing reasonable valuations for the land and other assets. As in the case of public sector ginning companies, reducing land valuations (and asking prices) needs to be accompanied by promises that private buyers intend to invest any proceeds from land sales in the spinning industry, preferably in upgrading those privatized plants that can be rehabilitated.

- Facilitate importation of shorter-staple lint cotton from countries such as Syria, Greece, and the Southeastern U.S. Egyptian spinners are facing very tight supply conditions in 2000/01, given reduced planting of seed cotton and a small harvest. Uncertainty regarding the importation of lint cotton and private spinners' access to imported lint (particularly lint imported by the Holding Company) will likely constrain the operating levels and output of private spinners in 2000/01. Not resolving this issue in the short run could stall further private investment and undercut privatization efforts. Egyptian lint is costly raw material for open-end spinning and ring spinning of low to medium counts of yarn.

Related to this last point, the MALR/CAPQ is advised to provide clear guidelines for assessing phytosanitary risks associated with lint imports from selected cotton-producing countries, disseminate these guidelines widely to prospective importers, and certify selected producing regions as being very low risk or risk-free. This is an important step in the unfinished agenda of providing prospective importers of foreign lint cotton with transparent and consistently applied phytosanitary regulations.

While the cotton/textile subsector policy reform agenda is still far from complete, private investments in spinning since 1994/95 are encouraging. The improved performance of the privatized spinning companies, particularly Alexandria Spinning and Weaving and DIP Egypt, offers hope for further privatizations, provided that current barriers to further privatizations can be overcome. High sales taxes on domestically sold yarn and high tariffs and sales taxes on imported textile machinery also need to be lowered to improve the competitiveness of the Egyptian spinning industry.