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Industrial Policy in Egypt 2004–2011

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Abbreviations

BDS	business development service
BTI	Bertelsmann Transformation Index
CAPMAS	Central Agency for Public Mobilization and Statistics
CIDA	Canadian International Development Agency
CPI	Corruption Perception Index of Transparency International
DBI	Doing Business Index
DIE	Deutsches Institut für Entwicklungspolitik / German Development Institute
ECES	Egyptian Center for Economic Studies
EGP	Egyptian pound
EIDS	Egypt Industrial Development Strategy
EIU	Economist Intelligence Unit
ETTICs	Egypt Technology Transfer and Innovation Centres
EU	European Union
EUR	Euro
FDI	foreign direct investment
GAFI	General Authority for Investment and Free Zones
GAFTA	Greater Arab Free Trade Area
GCR	Global Competitiveness Report
GDP	gross domestic product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
ICT	information and communication technology
IDA	Industrial Development Agency
IMC	Industrial Modernisation Centre
IMF	International Monetary Fund
ITDA	Internal Trade Development Agency
MENA	Middle East and North Africa
MFTI	Ministry for Trade and Industry
MOF	Ministry of Finance
MOI	Ministry of Investment
MSEs	micro- and small enterprises
NDP	National Democratic Party
NGO	non-governmental organisation
QIZ	Qualifying Industrial Zone
R&D	research and development
SCAF	Supreme Council of the Armed Forces
SFD	Social Fund for Development
SMEs	small and medium-size enterprises
TIEC	Technology Innovation and Entrepreneurship Centre
UNDP	United Nations Development Programme
US	United States
USD	United States Dollar
WEF	World Economic Forum
WGI	World Bank Governance Indicators
WTO	World Trade Organization

Summary

Egypt experienced considerable economic growth during President Mubarak's last term, with annual per-capita growth averaging 6 per cent from 2004 to 2008 and only dropping below 2 per cent after the January 25th revolution of 2011. However, this growth was neither pro-poor nor sustainable. Because it was not labour-intensive, it did not reduce either poverty or unemployment. It was based on windfall profits (high oil prices and high receipts from tourism and the Suez Canal) rather than improvements in international competitiveness. Although foreign direct investments (FDIs) and exports rose, almost all FDIs were in the extractive industries or service sectors rather than manufacturing or agriculture. Imports increased even faster than exports, creating a negative balance of trade – dropping from a surplus of United States Dollar (USD) 3 billion in 2004 to a deficit of USD 5 billion in 2008 that worsened in 2011 and 2012. Since Egypt has to import crude oil and its natural gas reserves are shrinking, it is unlikely that the country's external position will improve. Moreover, current exports are undiversified and have low technological content, and only one-third of all exports are finished goods.

The challenge for the Egyptian economy is to become more productive and diversified through the development of more knowledge-intensive industries and exploitation of inter-firm specialisation. But the question for Egypt and for other low- and middle-income countries is how structural change can be achieved and what the state can do to facilitate it. Increasingly there is a consensus that industrial policies can be decisive in solving market failures – especially regarding the provision of public goods (research and development, (R&D), workers' training, market information, etc.) and the coordination of complementary investments. But uncertainty persists about how and how much a government should intervene, given the risk of government failure (misallocation of funds, political capture and the creation of perverse incentives for investors and bureaucrats). This is especially true for countries with weak political checks and balances – like the Egypt of Mubarak.

Egypt has a long history of strong interventionist, top-down industrial policies. After the 'Free Officers' staged a coup d'état in 1952, the new regime embarked on a statist path of development to promote structural change and growth. It attempted to channel labour and capital into sectors that would help develop the country. But industrial policies were also used to channel privileges and resources to the regime's clientele.

A substantial reorientation took place in 2004 when President Mubarak appointed a new government, which included several former businessmen. It endorsed a new strategy for industrial policy that was considerably more market- and demand-oriented and less interventionist. It was intended to address the market failures that were preventing structural change in Egypt and avoid vertical discrimination as much as possible.

The question is whether the businessmen in Egypt's government were more successful at facilitating structural change without political capture: How did they diversify the economy? What instruments did they use? Were they more effective and efficient than their statist predecessors? Were their policies fair and transparent – or did they serve their own businessmen-minister interests and those of their clientele? What can Egypt's new government, which came to power after the revolution and parliamentary and presidential elections, learn from the industrial policies of the businessmen-ministers?

This study demonstrates that Egypt's post-2004 industrial policies have been comparatively effective in promoting investment and exports but much less so in facilitating structural change. While they have improved entrepreneurs' access to finance, simplified tax rates and procedures and cut away red tape, they have not substantially improved the technology content of exports, firms' business sophistication and technology absorption, or raised the level of applied research and innovation in Egypt. These partial failures can be explained by deficits in the effectiveness, efficiency, fairness and relevance of the instruments of the industrial policy strategy applied between 2004 and 2011:

Effectiveness. The instruments created public goods (R&D, workers' training) and encouraged risk-averse entrepreneurs to modernise. But they did not help overcome the coordination failures that typically prevent structural change. Some instruments even adversely affected structural change. Their generous transfers made it possible for Egyptian exporters to compete on world markets, but also reduced firms' incentive to innovate and become more competitive.

Efficiency. Egypt's industrial policies between 2004 and 2011 consisted of three isolated strategies, each implemented by a different ministry. This led to a duplication of administrative structures, lack of coordination and gaps in responsibility. In addition, there was no independent mechanisms to evaluate the impact of any given instrument.

Fairness. The main instruments focused on medium-size to large, rather than micro- or small, enterprises. Although the latter firms were eligible for support, most funds went to companies that were already exporting or didn't need any government assistance to start exporting. Beyond this, different agencies were individually tasked to promote small, medium-size and large companies so that when a company graduated from one size class to the next it had to work with a new agency.

Relevance. Most instruments did not benefit Egyptian enterprises because they did not tackle the main constraints for business – especially (i) deficits in entrepreneurs' and workers' education and training, (ii) the rule of law, (iii) transparency and competitive fairness, (iv) private sector representation and (v) the availability of affordable land.

Therefore, Egypt's new government should implement reforms in the following five areas: (i) raise the quality and relevance of education and training in the public school system, (ii) establish the rule of law, (iii) make political, administrative and judicial procedures and decisions more transparent, (iv) promote competition on markets, and (v) help small and medium-size enterprises access land.

But the government should also adopt a more coherent approach to private sector development, avoiding duplication of structures and make sure that all enterprises have the same opportunity of support. It should establish a public–private dialogue with private enterprise representatives from all segments to begin a real multi-stakeholder process of drafting, implementing and monitoring a new industrial policy strategy for Egypt.

Although the new government could continue some older programmes, it should also consider becoming more interventionist – at least in promising sectors where investments are not being made because of coordination failure. Since most Egyptian entrepreneurs are reluctant to cooperate because they mistrust each other, the state could help by facilitating – and when necessary, arbitrating – cooperation agreements.

1 Introduction[1]

Productivity growth is necessary to raise living standards and maintain competitiveness in the globalised economy. In developing countries low total-factor productivity is one of the root causes of persistent poverty. The productivity gap separating poor and rich countries has never been as wide as it is today. Low- and middle-income countries must boost their productivity. They are challenged not to only develop more productive ways of doing business in established industries but also to develop new, more knowledge-intensive industries and exploit the advantages of inter-firm specialisation.

While the private sector is clearly the main driver of structural change, it is up to governments to create frameworks that allow for competition, encourage innovation and technological change – and correct market failures. They may have to encourage new activities that do not emerge spontaneously, for example, because several interrelated investments need to be made simultaneously, which exceeds the possibilities of individual entrepreneurs. In addition, governments may also have to support activities that are unlikely to pay off right away for an individual investor but that will probably produce manifold linkages and spillovers in the future and long-term gains for the whole economy. This is what industrial policy is all about.

While the theoretical case for industrial policy is not in doubt, no consensus exists about the right degree of intervention. The controversy is mostly about selective interventions that favour some sectors over others and thus interfere with the price mechanism, which is the main signalling device of market economies. Critics argue that governments are usually not very good at identifying coordination failures or anticipating the future potential of different industries, and their decisions may well end up reducing allocative efficiency and creating perverse incentives for investors and bureaucrats alike.

It is now widely accepted that industrial policy can work well in countries with strong, merit-based public services and political checks and balances. But opinions clash over the role of industrial policies in low- and lower-middle-income countries where financial resources are often limited and core institutions still need to develop administrative capacities and better incentive systems. According to available governance indicators, most low- and lower-middle-income countries lack effective governments that are transparent and accountable and can be counted on. Hence, even if it is clear that they face particularly severe market failures, there is a big question mark as to the ability of governments to intervene in markets to increase public welfare.

In any case, it is unlikely that the appropriate policy mix for low- and lower-middle-income countries would be the same as for rich countries, where the requirements and capacities for public intervention are substantially different. Most empirical case studies of industrial policy focus on the early industrialised countries or the famous success stories of technological catching up (such as Korea, Taiwan, Singapore, Malaysia, Brazil and

1 I am very grateful for my interview partners for the time they took for talking with me and for the information they shared with me. In particular, I thank, the following persons for their comments and invaluable support: Natalija El-Hage (then at GTZ Cairo); Nihal El-Megharbel (then with the Ministry for Local Development in Cairo); Amirah El-Haddad (Cairo University); Mona El-Tobgui (Fraunhofer Society, Cairo); Diane Zovighian (then at the UN Economic and Social Commission for Western Asia, Beirut); and the teams of the GTZ and the German–Arab Chamber of Commerce in Cairo.

Chile). Much less is known about the quality and outcomes of industrial policies in low- and lower-middle-income countries.

This report on Egypt aims to help fill the knowledge gap regarding industrial policy. It is part of a comparative research project run from 2008 to 2012 by the German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE) on 'Industrial Policy in Low- and Lower-Middle-Income Countries'. The project was funded by the German Federal Ministry for Economic Cooperation and Development / Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (BMZ) and supported by the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), now known as the 'Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ)'. In addition to Egypt, the research project studied Ethiopia, Mozambique, Namibia, Syria, Tunisia and Vietnam. A synthesis report[2] was recently published.

Egypt is a particularly interesting country for studying industrial policy. It has a long history of intense government intervention that started in 1952 with the so-called revolution. Manufacturing and service industries were nationalised and the state invested heavily in infrastructure and production in order to create new activities. Later, incentives to invest in Egypt were offered – first to foreign, and then also to domestic, private entrepreneurs. But until the 1990s, central planning, trade protection and administered prices prevailed. The private sector was not very involved in industry – although a relatively small group of entrepreneurs with good connections to the regime benefited handsomely from a combination of tax holidays, subsidised utilities, domestic market protection and privy access to information from political decision-makers.

2004 saw the formation of a new cabinet, one-third of whose members were businesspeople, under a prime minister who was also a businessman. It embarked on a more market-friendly course and intensified efforts to attract foreign investors while also supporting domestic entrepreneurs. An ambitious new industrial policy strategy was designed that relied entirely on market forces and avoided vertical discrimination between sectors.

The January 25th revolution flushed away that cabinet together with President Mubarak. A new parliament and a new president have since been elected, and the new government has the opportunity to redesign Egypt's economic and social policy.

This discussion paper investigates the Egyptian government's industrial policy strategy from 2004 to 2011. It aims to contribute to the debate within Egypt about the country's future industrial policies: what can be learnt from the old policies, what elements should be kept in place and what must be done differently. Certainly, not everything that Mubarak's government did was bad. But much can be improved.

At the same time, this discussion paper addresses a political economy question of more general interest: How do businesspeople act when they control virtually all the ministries responsible for economic policies? How do they facilitate structural change and diversify the economy? What instruments do they use? Are their strategies more effective and effi-

2 Altenburg (2011). In addition, the following country case reports have also been published: Altenburg (2010) on Ethiopia; Chahoud (2011) on Syria; Erdle (2011) on Tunisia; Krause / Kaufmann (2011) on Mozambique; and Rosendahl (2010) on Namibia.

cient than those of their bureaucratic, statist predecessors? Are their policies fair and transparent – or do they promote their own interests and those of their friends and business partners at the expense of less influential entrepreneurs? Would it thus be possible, as Abdel-Latif and Schmitz (2009) argue, to create trustful "growth coalitions" between the state and individual (as opposed to all) entrepreneurs – thereby serving not just the interests of a few Egyptians but society as a whole? Or does such collusion ultimately disadvantage everyone who is not at the table?

Chapter 2 of this paper summarises the most important arguments raised in the conceptual literature on industrial policies in developing countries. Chapter 3 examines the framework and historical background of industrial policy-making in Egypt between 2004 and 2011. Chapter 4 describes the elements of recent industrial policies and Chapter 5 analyses their strengths and weaknesses in terms of effectiveness, efficiency, transparency, fairness and significance. Chapter 6 concludes with policy recommendations. Hurried readers can easily jump to the chapters they find of greatest interest.

It should be noted that, as in other developing countries, reliable data is hard to come by in Egypt and policies are rarely monitored or evaluated. The present analysis and assessment of policy processes and impacts is therefore largely based on qualitative information provided by descriptive literature and interviews conducted with experts on Egyptian economic policies during four research trips to Cairo in 2009, 2010, 2011 and 2012.

2 Industrial policies in developing countries – a conceptual framework

Globalisation forces nation states to become more competitive by improving the efficiency of their production processes or reconfiguring their product portfolios. Since there are limits to how much production processes can be improved, the main task of economic policies is to facilitate structural change – shifting capital and labour to different economic sectors (or to different processes within economic sectors) that allow for greater gains.

Today there is broad consensus that the process of structural change mainly depends on private entrepreneurs identifying new business opportunities and embarking on new economic activities, as well as on incentives set by government industrial policies and the complementary activities of non-state public actors, such as business associations (Altenburg 2011, 7).

Debate about state involvement in industrial policy goes back at least to the days of Alexander Hamilton and Friedrich List who both made a case for active government policies to protect domestic infant producers in their emerging economies (the United States and Germany, respectively) from their more advanced British competitors.

Curzon Price defined industrial policies as *"any government measure, or set of measures, to promote or prevent structural change"* (Curzon Price 1981). Such a broad definition elicits broad consent in contemporary literature about the usefulness of industrial policies.

But there is still dissent about the degree to which a state should pull or push capital and/or labour to *specific* sectors in light of longer-term economic, social or environmental considerations. Such an approach has been labelled a 'selective' or 'vertical' policy – as distinguished from a more 'functional' or 'horizontal' policy, in which the state takes a fairly passive role, leaving decisions about economic industries entirely to market forces – that is, to choices made by the private sector.

Protagonists of selective (vertical) industrial policies argue that the frequency of market failure – which may be due to one or more of the following factors – justifies state intervention:

— *Public goods.* The development of new business activities may require investing in goods that are 'public' because they are non-rival and non-excludable. After someone has paid for them, everyone else can use them. Sometimes the research and invention of new business ideas are referred to as 'non-rival': The competition can profit from a pioneering entrepreneur's innovations that are the fruit of the latter's investment in R&D. As a result, there is no incentive for a private actor to invest in non-rival public goods and the state may have to finance R&D. Entrepreneurs may also be reluctant to invest in the skills of employees who might be lured away by a competitor right after they have been trained.

— *Coordination failure.* Some economic activities depend on complementary activities, meaning that an investment in one activity will not pay off if an investment is not simultaneously made in another. In such cases, entrepreneurs will not invest without having the guarantee of a complementary investment. Some sectors require action to be concerted and monitored by the state.

— *Dynamic economies of scale.* Many economic activities involve learning curves that help reduce the high initial costs of production significantly. Investors may not know the degree of this effect or be reluctant to pay high initial costs that only pay for themselves after some years. In cases like these, the state may consider creating positive incentives for investors.

— *Lack of quality reputation.* Consumers may want assurances about a specific product but lack reliable information about the whole range of selections and so prefer to rely on established brands with good reputations. Since new producers do not have reputations, they have difficulty getting established on the market without state help to create public trust in their products.

— *Access to capital.* Investors tend to know more than anybody else about the risks and opportunities associated with their business activities. So when they start a new activity that requires external finance, banks and other money lenders charge risk premiums on top of market interest rates, which correspond to investment risks that are significantly higher than the effective risk of the new business activity. In such cases the state could consider subsidising bank credit for investments – or offer credit itself.

— *Social and environmental development.* Finally, it may be wise for the state to develop specific sectors in order to create stable employment for the poor (or more decent work than in other sectors), reduce environmental risks or ecologically harmful emissions or produce meritorious goods (goods with positive externalities on other economic sectors, social development or nature conservation) (Altenburg 2011, 13–15; Gill / Kharas 2007, 4–10; Klein 2004, 28–33; Kosacoff / Ramos 1999, 39–45; Nabli et al. 2006, 5–8; Noland / Pack 2005, 2–6).

While opponents of industrial policy do not deny that market failures occur, they argue that government interventions to address them are much riskier. But not all opponents protest policies that generally promote economic development. Most of them accept horizontal policies such as the provision of education and training, communication facilities, public transportation and market information, or general support for research and technological development but they warn of more selective (vertical) industrial policies that the state might not be *able* or *willing* to design or implement in a way that improves social welfare (e.g. Pack / Saggi 2006).

In fact, the *ability to design a good industrial policy strategy* requires fundamentals that governments in developing countries often lack:

— *Information.* They need access to the data used to identify economic opportunities and threats, as well as promising economic sectors.

— *Analytical capacities.* Governments need to be capable of analysing the causes of market failure.

— *Policy formulation.* Governments should be capable of designing adequate measures to address market failure and raise social welfare, determine adequate levels of intervention (e.g. taxes or subsidies) and define criteria for ending or fading out a policy (an exit strategy).

— *Building acceptance.* Governments should be capable of creating a social contract around the industrial policy strategy that aligns all actors (including foreign donors).

Many countries also face deficits in their *ability to implement industrial policies*:

— *Organisational skills:* setting up competent service agencies; devising incentive schemes that ensure effective and customer-oriented service provisions; establishing checks and balances to hold the implementing agencies accountable; and preventing political capture through transparent and rules-based implementation directives.

— *Monitoring skills:* regularly reviewing the performance of implementing agencies; establishing feedback loops between service providers and those affected by their decisions; and sanctioning the misuse of funds and other violations of the rules.

At the same time, governments and bureaucracies sometimes lack the will to design and implement industrial policies to optimise social welfare. Industrial policies involve the distribution of economic rents, which risk being generated and distributed according to other criteria besides economic and social welfare. This may also apply to horizontal strategies. For example, when a country subsidises energy, it provides more support to industries that are energy-intensive than to others. There is thus a risk that rents are generated and distributed on the grounds of other than economic and social welfare criteria.

— *Legitimisation of political leaders:* Politicians seek to demonstrate that they are taking action in order to satisfy their constituencies, regardless of the outcomes.

— *Lobbying by pressure groups.* Politicians also may be unable to resist rent-seeking by vested interests that undermines a well-conceived policy.

— *Self-perpetuating dynamics.* Once a strategy has been initiated, implementing agencies have an interest in setting up new programmes, expanding them and extending their terms in order to increase the agencies' budgets and prerogatives (Altenburg 2011, 17–18 and 46–50; Noland / Pack 2005; Schmitz 2007).

A whole strand of literature has developed about the criteria for successful industrial policies (Altenburg 2011, 28–33; Rodrik 2004):

- *Clear and concrete vision.* The strategy should be based on a clear vision that defines a limited number of realistic, measurable and time-bound goals. The priorities of these goals should be clearly formulated.
- *Customer-orientation.* Implementing agencies must understand how markets and private enterprises operate. They should "speak the language" of businesspeople and behave appropriately.
- *Participatory policy formulation.* Entrepreneurs, experts and the government should co-operate closely in designing an industrial policy strategy, which should be defined as a national project for socioeconomic transformation and growth – so as to ensure the commitment of all relevant stakeholders.
- *Regular impact assessments.* Independent monitoring and evaluation is essential to inform about needed improvements and safeguard against political capture.
- *Clear responsibilities.* If the strategy is implemented by different agencies, the division of labour should be clear from the start. Fragmentation must not lead to leaks or duplication of responsibilities.
- *Effective, non-discriminatory instruments.* Targeted interventions must be carefully designed to challenge entrepreneurs and encourage their learning and innovation – instead of creating a protected environment that suffocates entrepreneurial dynamism and technological learning. In particular, interventions should contribute to overcoming information and coordination problems and similarly benefit all the entrepreneurs in one sector.
- *Well-tailored incentives.* Financial incentives should be employed with great care because they bear the risk of misuse and arbitrage. Some co-financing from customers should be required in any case so that they only use the services they really need. Support should also be temporary and offered just as long as needed for market actors to adjust to a changing environment. Credible exit strategies must be formulated early to signal that support is help for adapting to new challenges – and not a form of unlimited underwriting for inefficient rent-seeking industries. Clear provisions are also needed to terminate failed policy experiments.
- *Rational prioritisation.* The choice to prioritise specific sectors should build on existing comparative advantages – not defy them.
- *Good investment climate.* Industrial policies must be complemented by efforts to reduce the general costs and risks of investment. The effectiveness of industrial policies depends on: (i) a reliable legal framework that protects property rights and ensures contract enforcement; (ii) a well-educated, well-trained and motivated labour force; (iii) a good communications, information and transportation infrastructure; (iv) an efficient financial system that provides entrepreneurs cheap and easy access to capital and insurance; (v) the elimination of unnecessary and burdensome bureaucratic regulations; (vi) transparency in administrative decisions; (vii) economic and political stability; (viii) protection from crime and riots; (ix) a liberal trade and capital-transfer regime; and (x) a transparent tax system.

3 The context of industrial policy-making in Egypt from 2004 to 2011

This chapter examines the context of Egypt's most recent industrial policy strategy. Section 1 portrays the framework conditions of economic development in Egypt between 2004 and 2011. It argues that the natural framework conditions were fairly favourable, while the political conditions for economic development were not – at least until the revolution in 2011. Section 2 identifies the main challenges for industrial policy in Egypt. Section 3 sketches the history of Egypt's industrial policy-making from independence until 2004; Section 4 describes Egypt's political constellation in 2004.

3.1 Framework conditions for economic development

Egypt is a lower middle-income country that in 2011 had a gross domestic product (GDP) of about USD 2,600 per capita. With over 80 million inhabitants, it is the most populous Arab country and the fourth-largest economy in the Arab world – after Saudi Arabia, the United Arab Emirates (UAE) and Algeria. Some 43 per cent of the population live in urban areas (World Bank 2011a).

Egypt enjoys a number of conditions that are comparatively favourable for development:

Natural resources. Egypt has limited mineral resources (phosphate, titanium, iron and manganese) but abundant energy resources. Its energy exports (mainly natural gas) exceed imports (mainly crude oil), generating a net annual income of almost USD 5 billion (4 per cent of GDP).[3] The country also annually produces some 15 billion kWh of hydroelectric power (mainly from the Aswan Dam) and has great potential for generating energy in solar power plants (EIU 2008).

External income. In addition to its energy resources, Egypt has another four sources of substantial rents: (i) *Suez Canal user charges* generate about USD 5 billion annually (4 per cent of GDP). (ii) The *tourism industry* benefits from a huge variety of antiquities from the ancient Greek and Roman and Islamic periods, as well as Mediterranean and Red Sea coastlines. In 2010, 13 million foreign tourists spent some USD 13 billion in Egypt (almost 10 per cent of GDP). (iii) Also in 2010, Egypt received about USD 1.3 billion in development and military assistance (the latter exclusively from the United States). (iv) And remittances from migrant workers exceeded USD 10 billion (8 per cent of GDP).[4]

Land. Only 5 per cent of the country is arable land, but a sophisticated system of irrigation and extremely fertile soil enables intensive agricultural practices to produce food and non-food products (e.g. cotton) of very high quality (EIU 2008).

Local market. The country's substantial local market allows for large-scale production. Even industries with high fixed investment costs can become profitable because of the

3 Reserves are estimated at 4 billion barrels of crude oil and 72 trillion cubic feet of gas (EIU 2008).

4 In 2008, revenues from the Suez Canal accounted for 4%, tourism 7%, official development assistance 1% and remittances 6% of GDP. In 2007, a total of 4 million Egyptians were living abroad (Brach / Loewe 2010; Loewe 2012; World Bank 2009b).

large domestic demand. With regards to this criterion, Egypt ranks 26th on the World Economic Forum Global Competitiveness Report (GCR) (see Annex, Table A4).

Trade agreements. Egypt has signed a number of trade agreements that open markets in Europe, North America and other countries to Egyptian products. Egypt has been a member of the General Agreement on Tariffs and Trade (GATT) since 1970 and the World Trade Organization (WTO) since 1994. In 2004, Egypt's Partnership Agreement with the European Union (EU) entered into force and in 2007, Egypt adopted the European Neighbourhood Policy (ENP) Joint Action Plan. That same year, a free trade agreement with the European Free Trade Association (EFTA) came into force. Already in 2004, Egypt had concluded an agreement with Israel and the US establishing Qualifying Industrial Zones (QIZs), from where specific products can be exported to the US duty-free – if they contain at least 12 per cent of value added in Israel (OECD 2007, 20; Salsecci et al. 2008, 23 f.).[5]

Proximity to other markets. Egypt is located at the juncture of Africa and Asia as well as between the Mediterranean Sea and the Indian Ocean. Transportation and communications are thus cheap and easy in all directions (Loewe 2012).

Infrastructure. Although Egypt's transportation infrastructure suffers from limited capacity and several serious constraints, it compares favourably with many other developing countries. The GCR ranks Egypt 64th of 133 countries with regard to infrastructure; its air transport, port and railway infrastructure are rated 'fair' or better. The road quality is below average, but aside from frequent gridlocks in Greater Cairo, entrepreneurs do not consider that the infrastructure hinders business (Loewe et al. 2013).

Demographic change. Egypt is still in the middle of demographic transition and could thus still benefit from a demographic dividend. Its population is growing by about 1.3 million people per annum, although demographic growth has decreased significantly since 1970 (UNDP 2007).[6] The young population – more than one-third of Egyptians are younger than 15 – exerts enormous pressure on the country's educational and health systems, as well as on housing and labour markets. At the same time, only 5 per cent of the population is older than 65 – meaning that most of the population is of the productive age (Loewe 2008; UNDP 2007).

Social cohesion. The population is comparably homogeneous: It consists almost exclusively of Sunni Muslim Arabs. Most of its inhabitants identify themselves with the country rather than supra-national entities (the Arab or Muslim world) or sub-national entities (tribes, clans or minorities) – unlike inhabitants of other Arab countries such as Syria. Even the minority Copts (who make up 10 per cent of the population) consider themselves

5 Egypt also belongs to the Common Market for Eastern and Southern Africa (COMESA), which has 20 members. In 1997, it signed the Greater Arab Free Trade Area (GAFTA) agreement in which 17 signatories reduced their custom tariffs by 10% each year between 1997 and 2000 and 20% between 2000 and 2005 for all manufactured goods (not services). However, the treaty's safeguard provision that allows for exemptions has been used by all the member states – rendering the GAFTA practically irrelevant in real terms. Intra-Arab trade fell from 9.1% of the region's total external trade in 1997 to 8.8% in 2004. That year, Egypt also signed a free trade agreement with Jordan, Morocco and Tunisia (the 'Agadir Agreement') that has however not yet been ratified by the Moroccan Parliament (OECD 2007, 19).

6 Population growth dropped from 2.2% per annum in 1970 to 1.8% today, and the fertility rate almost halved – from 5.9 to 3.2 children per woman (UNDP 2007).

to be Egyptians first. The conflict about the country's future that erupted after the revolution in 2011 is mainly between more religious and more secular groups. Of course, there is also a power struggle between political fractions, as well as a contest between social (socioeconomic) groups – but none of them questions Egypt's national unity.

Yet between 2004 and 2011, Egypt's political framework conditions were far less favourable for economic development, with its political system and societal order largely shaped by neo-patrimonial authoritarian rule[7]:

Presidentialism. In fundamental contradiction to the ideas of rule of law and separation of powers, the president of Egypt initiated and dominated all decision-making in the country. No political decision could be taken against his will, and he could veto decisions taken by every Egyptian political body. Although the government had some room for manoeuvre – within boundaries drawn by the president again – the parliament was a mere rubber-stamping body. Manipulated elections always gave the president's party 75 per cent of the votes in parliament, while the president's *de facto* veto of candidates for his party eliminated any incentive for parliamentarians to oppose his initiatives. Before 1981, the judiciary was the most independent political body; then parliament passed an emergency law allowing President Mubarak to circumvent the courts if, for example, he feared that the court might rule against his interests. From time to time, the judiciary attempted to regain some independence and control the executive. In 2000, the constitutional court declared that a judge must be present in every polling station in order to control for irregularities during parliamentary elections. But when judges tried to enforce this law in 2005, the power struggle escalated (Demmelhuber 2008, 142 f.).

Lack of participation. There were very few formal controls of decision-makers. In 2008 the World Bank Governance Indicator of 'voice and accountability' put Egypt at -1.24 (see Annex, Table A1), and the Economist Intelligence Unit (EIU) Democracy Index ranked Egypt 119th out of 167 countries world-wide.

Informality of rule. Decisions were rarely taken through formal channels in accordance with any rules, and authority was not recognised in formal structures but rather informal hierarchical (pyramidal) networks of bilateral relations based on primordial relations (kinship, neighbourhood) or shared experience.

Centralised decision-making. Even minor decisions were taken at fairly high levels of political power structures.

Patronage. The legitimacy of the president and the ruling elite was based on the strategic allocation of state resources (jobs, housing, etc.) to specific societal groups.

Clientelism. The same mechanism was used at the micro-level to reward individuals for loyalty to the regime or those above them in the pyramid with employment, housing, promotions, and the like. Favouritism, usually referred to as *wasṭa* (connection), was widespread.[8]

7 Cf. Pawelka (1985); Pawelka (1997); Pawelka (2000).

8 For a discussion of the causes and effects of *wasṭa* in Jordan see: Loewe/ Blume / Speer (2008).

Corruption. Not surprisingly, corruption was rampant. Transparency International's Corruption Perception Index gave Egypt a score of just 2.8 on a scale from 1 (high corruption) to 10 (low corruption). The GCR noted that in 2010 corruption was the single most important concern of Egyptian entrepreneurs (see Annex, Table A1). Half of all entrepreneurs must pay regular bribes (Loewe et al. 2013).

Non-existent civil society. The state tried to prevent the formation of any type of non-state organisation. Although trade unions, professional associations, chambers of commerce and charitable societies were allowed, they had to be aligned with the state, which had a representative on their boards and authorised all nominations for board directors. Non-governmental organisations (NGOs) of a political nature were forbidden. A 1999 law on non-governmental organisations prohibited all non-state actors accepting financial transfers from abroad without explicit permission from the Ministry of Social Affairs (Demmelhuber 2008, 114 f. and 149; Loewe 2000, 24).

No authentic private-sector participation. Even the chambers of commerce and industry, professional unions, employer associations and labour unions all served the government more than their members. These bodies have been described as 'neo-corporatist organisations' that inform the government about changes in public opinion, explain government policies to their members and mobilise them for the government – instead of representing their members' interests and opinions to the government. Until 2010, many top leaders were not elected by their members but instead were appointed by the government. They had no veto power (Benhassine et al. 2009, 187; Nabli et al. 2006, 24).

Censored mass media. The regime controlled and censored newspaper, radio and television programmes. In contrast to other Arab countries such as Tunisia or Syria, the media were allowed to question ministers' decisions – but not those of the president, the army or the regime as a whole. After 2002, a few independent newspapers and satellite television stations were licensed. But they were owned and controlled by the same group of people who controlled large parts of the private sector and after 2004, several key ministries, too. The popular journal, *Al Masri Al-Yaum*, is owned by Salah Diab and Naguib Sawiris, two of the most influential tycoons in Egypt, and *Rus al-Youssef,* by steel magnate Ahmed Ezz. The Internet, however, quickly developed into a medium that featured independent reporting and true freedom of opinion (Demmelhuber 2008, 150 f.; Nabli et al. 2006, 24).

Ineffective administration. Egypt benefits from a long history of statehood and a highly developed public administration, which is present in the most remote areas of the country and can monitor and regulate absolutely everything. Even small villages have schools, health stations and public administration offices. But in 2011, the quality of public services was low, the bureaucracy was slow and opaque, administrative decisions were unpredictable, public officials were hired and promoted on the basis of personal connections rather than merit – and they were rarely accountable. The World Bank Governance Indicator for 'government effectiveness' gave Egypt a score of -0.44 in 2008 (see Annex, Table A1).

This combination of factors usually creates situations where economic efficiency and the development of the country are not the real goals of policy-making. Decisions are really taken to help the regime consolidate its power.

3.2 Main challenges for industrial transformation

Egypt's macroeconomic indicators improved considerably between 2002 and 2009, but this was due to windfall profits rather than structural reform, diversification or a rise in productivity. In addition, economic development had only limited social effects.

Between 2004 and 2008, Egypt's real annual GDP growth averaged 6 per cent. It peaked at 7.2 per cent in 2007 but dropped thereafter to less than 5 per cent – mainly because of the global financial and economic crisis. Because in this period the country's population grew 1.8 per cent annually, Egypt's per-capita income increased by less than 4 per cent in real terms each year until 2008, any by about 3 per cent in 2009 and 2010 (IMF 2009b, 4; IMF 2010; Loewe 2012; Salsecci et al. 2008, 20).

Unfortunately, Egypt's growth spurt between 2004 and 2008 was not particularly labour-intensive. Unemployment decreased only slightly during this time, stagnated between 2008 and 2011 and increased considerably after the revolution in 2011. It is very high in comparison with other countries in the world: the official rate was s 13 per cent in 2013, but unofficial estimates put it as high as 25 per cent. Between 2004 and 2008, underemployment rose sharply because most poor people cannot afford to register as 'unemployed': they try to earn at least some income – even if that requires a huge investment of time. With its working age population continuing to grow by around 2.5 per cent each year, Egypt must create almost a half million new jobs annually to keep the unemployment rates constant (Loewe 2009d).

Likewise, Egypt's growth spurt was not pro-poor. The share of wages in national income – already low in 2000 – declined further, from 28 to 25 per cent in 2008. The share of households living below the national poverty line increased from 15 per cent in 2000 to 20 per cent in 2008 (Demmelhuber 2008, 200; Galal 2011, 3).

The growth spurt occurred as a result of considerable improvements in the international economic framework conditions: (i) developing countries had easier and cheaper access to capital on international markets, (ii) commodity prices were increasing and (iii) remittance inflows were rising. In addition, Egypt benefited from a temporary regional effect when, in reaction to increased security regulations in the United States (US) after 9/11, many Arab investments were moved from the West to the Middle East (Brach / Loewe 2010).

Even if these positive framework conditions had continued, Egypt would not have been able to sustain its recent growth rates, which were mostly a one-off effect from changes in commodity and capital prices. Long-term economic growth can only be achieved through a steady rise in economic productivity or productive investment (Hevia / Loayza 2011). But Egypt's total-factor productivity is stagnant, savings rate low[9] and foreign investments, which have almost drought out after the revolution, have flown mainly into non-productive assets even before.

9 Public and private consumption accounts for 82%, savings for 16% of Egypt's GDP (EIU 2008). Egypt's rate of saving ranks 80th out of 133 countries according to the World Economic Forum (see Annex, Table A2).

FDI inflows to Egypt increased by 90 per cent per annum between 2002 and 2008, from an average USD 815 million between 1995 and 2004 to USD 9 billion in 2007. As a result, their share in GDP rose from well below 1 per cent in 2003 and 2004 to almost 10 per cent in 2006 and 2007. Yet this share was still low by international standards, and it fell again to almost zero after the revolution. Even at their peak in 2007, FDI inflows to Egypt accounted for less than 1 per cent of total global FDI flows and 29 per cent of FDI flows to Africa (Demmelhuber 2008, 198; OECD 2007, 14; Salsecci et al. 2008, 31).

In 2008 one-third of Egypt's FDI came from other Arab countries because Gulf investors had large sums to invest after the recent increase in energy prices. Almost three-quarters of the 2008 FDI targeted the energy sector, with most of the rest going to the production of non-tradables (financial services, tourism, telecommunications and real estate) rather than to export-oriented sectors. Only 4, respectively 3, per cent of FDI were assigned to manufacturing and agriculture (Benhassine et al. 2009, 55; OECD 2007, 15; Wurzel 2007, 16f.).

This allocation is an indication for Dutch disease contagion from the oil-exporting Gulf countries through at least three channels: FDI, tourism and remittances. Between 2005 and 2008, Egypt's tourism industry grew annually by more than 30 per cent, the construction and IT sectors by 15 per cent, and manufacturing by only 6 per cent. Remittances tripled between 2002 and 2008 to almost USD 10 billion annually (Benhassine et al. 2009, 55; World Bank 2010).

Unfortunately, domestic investors, who account for almost 58 per cent of investments in Egypt (foreigners 8 per cent and the state 34 per cent), imitated foreign investors: 23 per cent of domestic investments went to the oil and gas sector, 9 per cent to facilities, 15 per cent to traffic and communications and 6 per cent to construction. Only 19 per cent of domestic investments went to the manufacturing sector, including the oil-processing industries (EIU 2008; Ghorfa 2009b; IDSC 2008, 42–44; World Bank 2009b).

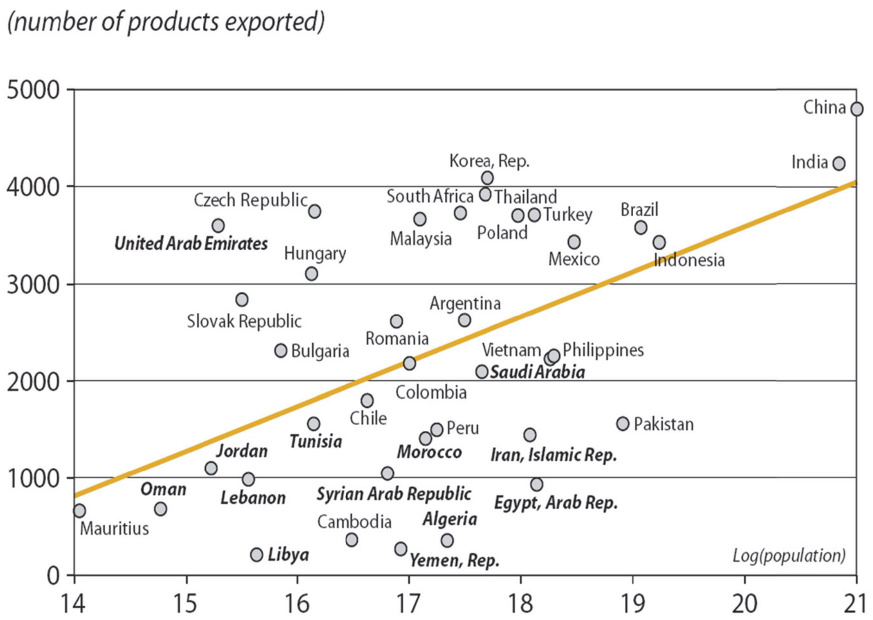
As a result, manufacturing still contributes just 16 per cent to the Egyptian GDP, while mining accounts for 21 per cent, agriculture 14 and services 50 per cent[10] (IDSC 2008, 131; World Bank 2011a).

Dutch disease contagion also explains why inflation rose sharply to peak at 16 per cent in 2008. Consumer prices rose in general but the increase in real estate and tourism was particularly sharp. Other reason of the high inflation rate of the last decade were Egypt's dependency on food imports, which increase every year because of the population growth, and the steep rise in food prices on international markets between 2005 and 2008.

It is therefore not astonishing that Egypt's exports are not very diversified. They include around 1,000 different kinds of products with a respective export volume of at least USD 100,000 (see Figure 1) – while Malaysia exports more than 4,000 products at that volume, the Philippines 2,000 and Tunisia 1,500 (despite its much smaller population).

10 This includes 12% for trade, 7% for transportation, 7% for health, education and other social services, and 4% each for construction, gastronomy and financial services (Marks 2009).

Figure 1: Diversification of Egyptian exports (2004)



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Source: Benhassine et al. (2009, 63, Figure 2.13)

Primary goods continue to dominate Egypt's exports. In 2008, oil and gas derivates and electricity accounted for more than 66 per cent of total merchandise exports, with other raw materials 4 per cent and foodstuffs 9 per cent. The remaining 21 per cent were mainly chemical products and pharmaceuticals (5 per cent), textiles and clothes (3 per cent each) and machinery (5 per cent). Of total exports, only 30 per cent were finished goods. Thailand, with a much smaller population than Egypt, exports 10 times as many manufactured goods (Galal / El-Megharbel 2005, Table 1; EIU 2008).

Although Egypt's exports have risen significantly during the last decade, the country still suffers from a sizeable balance of trade deficit because its imports have also increased.[11] Between 2003 and 2008, total exports grew annually by more than 20 per cent – raising the total export rate from 26 to 33 per cent of GDP. Industrial exports tripled –from the miniscule 1 per cent of GDP in 2003 to 3 per cent in 2008. In 2010, Bulgaria (with 7 million inhabitants) and Luxembourg (with just half a million) each exported more non-energy products than Egypt with its 80 million inhabitants (Benhassine et al. 2009, 61); Noland / Pack (2008); and Salsecci et al. (2008, 25).

In addition, the technological content of Egypt's exports is also low. According to estimates of the United Nations Conference on Trade and Development (UNCTAD), in 2005, resource-based products made up 63 per cent of all Egyptian exports compared with just

11 Of Egypt's exports, 32% go to the United States, 34% to the European Union (with Italy and the United Kingdom accounting for 11 and 6%, respectively), 6% to other European countries, 12% to Arab countries, 8% to India and 7% to non-Arab countries in Africa or Asia. Benhassine et al. (2009, 61); Noland / Pack (2008); Salsecci et al. (2008, 25).

Table 1: **Non-hydrocarbon exports to world trade partners by technology content (1985–2005) (% of total exports)**												
	1985				1995				2005			
	resource-based	low-tech	medium-tech	high-tech	resource-based	low-tech	medium-tech	high-tech	resource-based	low-tech	medium-tech	high-tech
Egypt	56.1	28.0	14.9	1.0	28.8	40.7	28.3	2.2	36.1	22.8	38.9	2.2
South Africa	22.7	56.9	19.2	1.2	25.5	34.0	36.6	3.9	26.4	4.8	62.9	5.8
India	44.9	27.3	22.2	5.6	26.8	34.9	31.7	6.6	20.1	28.6	42.1	9.2
Brazil	52.4	11.6	27.1	8.8	44.2	11.7	34.4	9.7	44.5	6.3	36.7	12.5
Turkey	36.6	32.2	26.2	5.0	25.1	43.7	24.4	6.7	14.7	33.6	38.3	13.3
Morocco	57.5	17.2	24.7	0.6	48.1	24.0	25.2	2.7	33.7	32.7	19.4	14.2
Indonesia	72.5	12.0	13.4	2.2	46.5	32.1	11.5	10.0	40.7	23.7	18.1	17.5
Tunisia	24.0	37.1	33.2	5.6	16.0	53.6	20.7	9.7	16.9	44.7	19.0	19.4
Malaysia	55.3	6.6	12.9	25.2	20.5	11.2	12.8	55.5	13.4	10.3	14.7	61.7
Source: Enders (2007, 32)												

29 per cent from South Africa, 18 per cent from Turkey and 25 per cent each from Tunisia and Malaysia. In the same year, the share of high-technology products was less than 1 per cent of all Egyptian exports but 6 per cent from the Republic of South Africa, 11 per cent from Morocco, 13 per cent from Turkey, 16 per cent from Tunisia and 54 per cent from Malaysia (Benhassine et al. 2009, 60; Enders 2007, Table 6). Even when hydrocarbon products are excluded, the technology content of Egyptian exports is much lower than that of its peer countries Morocco, Jordan and Tunisia. Between 1985 and 2005, the share of high-technology products rose from 1 to only 2 per cent of total Egyptian exports – compared with an increase from 1 to 14 per cent in Morocco, 8 to 15 per cent in Jordan and 6 to 19 per cent in Tunisia (see Table 1).

This phenomenon is a symptom of the low productivity of Egypt's economy. The county's total-factor productivity is just 60 per cent of Malaysia's and 40 per cent of Brazil's, while its labour productivity is 50 per cent of Malaysia's and 30 per cent of Brazil's (Benhassine et al. 2009, 66).

Egypt lacks access to technologies. According to the GCR, it ranks 48th out of 133 countries with regard to the capacity to absorb new technologies and 66th with regard to the availability of the latest technologies. FDI could help reduce this deficit. However, although Egypt ranks just 30th worldwide in terms of technology transfer through FDI, its firms face significant difficulties – partly because of their limited capacity for innovation (see Annex, Table A2). The Philippines, which are roughly the size of Egypt, report more technology royalty payments – an indicator of technology importation – than all the Arab countries combined (Noland / Pack 2008).

Another problem is that the state is still a major player in Egypt's economy. Many state-owned enterprises have not been privatised or shut down despite their high deficits. The private sector's role has grown steadily in the last 20 years, but state-owned enterprises still account for more than 30 per cent of the country's official industrial value-added investment and employment. Furthermore, the military also owns a huge complex of industrial and service companies that are not included in the country's official output or employment statistics. It is difficult to even estimate the size of this top-secret complex: it could make up 15 per cent of Egypt's GDP. However, unlike other state-owned enterprises, Egypt's military companies are fairly well organised and profitable (Benhassine et al. 2009, 15ff.; Djoufelkit-Cottenet 2008, 8, 13).

Finally, Egypt lacks large manufacturing firms that are headquartered in the country, although some foreign companies and a couple of large domestic firms produce there. The vast majority of private manufacturers are small units. In 2006, according to Central Agency for Public Mobilization and Statistics (CAPMAS), Egypt's national statistical office, 99.4 per cent of all private companies had 10 employees or fewer (88.8 per cent of all employees), while only 0.1 per cent of all private companies had more than 100 employees (1.3 per cent of all employees) (CAPMAS 2006; EIU 2008; Loewe et al. 2013).

Almost all Egyptian enterprises are family businesses – both the very big and the very small companies. Entrepreneurs prefer tiny, individual ventures and avoid complementing each another. But a plethora of one-man bands is hampering Egypt's long-term growth. Teamwork is unknown – both in private companies and the larger society.[12] Orascom, founded in 1950 and Egypt's uncontested No. 1 company, was owned, developed and managed for many years by one man, Onsi Sawiris. Then, in 1997, the company was split into three independent holdings, Orascom Telecom, Orascom Construction Industries and Orascom Developments and Hotels, each of which is entirely owned and managed by one of the founder's three sons.

Businesspeople in Egypt tend to be much older and less educated than those in other regions of the world. This is at least partly due to the way the domestic market was protected until 1991 – and after that, from the half-hearted liberalisation that only rewarded insiders and politically well-connected individuals (Benhassine et al. 2009, 99).

Entrepreneurship has a rather negative connotation for large parts of the Egyptian population. Many interview partners stressed that running a small retail or handicrafts shop is widely accepted but that many Egyptians associate any large company with dishonesty and political opportunism. Big businessmen tend to be ranked with thieving and corrupt tycoons.

3.3 The history of industrial policy from 1952 to 2004

Egypt is a particularly interesting case for studying industrial policies because of its long history of selective industrial policies. Right after independence, industrial policy was made a core – if not *the* core – element of national development strategies. All Egyptian governments believed that industrial policies were needed to neutralise the effects of Egypt's colonial place in the world economy. Colonial Egypt had belonged to the periphery, which was supposed to provide cheap primary goods for the factories

12 For a detailed description and analysis of these phenomena see Loewe et al. (2013).

in the countries in the centre of the global trading system and to serve as secure markets for the imperial powers' manufactured goods. As a result, Egypt lived off earnings from agriculture and trade – with handicrafts playing a minor role (even though a bigger one than in most other Arab countries). Living conditions were horrendous; throughout the first half of the 20th century per-capita income stagnated. Health indicators were worse than anywhere else in the world with the exception of sub-Saharan Africa. Infant mortality, for example was 186 per 1,000 newborns. Likewise, 99 per cent of all adults were illiterate (Loewe 2010b).

All post-independence Egyptian governments recognised that economic and social development was contingent on economic diversification. They elaborated strategies to channel investment into new industries and promote structural change, spur economic growth, create employment, reduce poverty and improve the balance of payments. However, none of these strategies was really successful:

> *"Various regimes have been unable to generate either the levels or the quality of investment needed to move the economy away from a dependence upon rents in the form of foreign loans and grants, canal fees, oil earnings, worker remittances and tourism."* (Bromley / Bush 1994, 202)

Roughly five periods can be distinguished from independence until 2004, when the businessmen reform cabinet of Prime Minister Ahmed Nazif was formed: (i) Nasser's early days (1952–1956), (ii) Nasser's statist experiments (1956–1970), (iii) Sadat's open-door policies (1970–1981), (iv) their modification during Mubarak's first 10 years in office(1981–1991), and (v) the period of hesitant adjustment and privatisation (1991–2004).

Some patterns, though, remained constant throughout these periods:

- All the governments viewed Egypt's industrialisation and the diversification of its economy as the main goals of their economic policies.
- To reach these goals, the governments all relied on selective industrial policies. Because they believed that private investors needed orientation, they relied on state planning rather than the market.
- All the governments foresaw a strong role for the public enterprise sector and significant state intervention in economic development (although these decreased somewhat over time – especially after 1971 and again after 1989).
- At the same time, all governments also favoured other goals, such as social equity, economic redistribution and the transformation of society, which sometimes dominated not just social and tax policies, but also industrial policies.
- Egyptian owners of private capital have always been exceptionally risk-averse. They generally hesitated to invest in Egypt, and when they did, they preferred speculative investments that generated quick gains (such as real estate) rather than productive investments (such as manufacturing), which tend to require longer periods of amortisation and therefore bear more substantial risks.
- Neither the private commercial sector nor civil society has ever had independent, legitimate representation that could take part in a genuinely participatory process of elaborating a broadly accepted strategy for industrial development.

The early days of Gamal Abdel Nasser (1952–1956)

Industrial policies were introduced in Egypt as an instrument of the country's social contract *"to correct for a legacy of inequities and poverty"* (Nabli et al. 2006). The arrangement between the state and society implicitly provided for the allocation of material benefits by those in power to selected social groups in return for their recognition of the legitimacy of the former's rule. Other instruments in this contract were land reforms and income redistribution through transfers, subsidies and services such as social housing, free health care, education and social assistance (Pawelka 1993, 73).

Even before independence, Egyptian intellectuals had acknowledged that the country's geographical limits to agricultural expansion made industrialisation unavoidable in order to employ and feed its growing population. Egypt was the first Arab country to have undergone autochthonous industrialisation – starting in the 1920s. Textiles production accounted for most of the country's early manufacturing, but there was also some food processing and a chemical industry (Hill 2003, 86; Zaki 1999, 40).

When the Free Officers staged a coup d'état in 1952, putting an end to the Egyptian monarchy as well as to British dominance, they formed a military junta under Egypt's first President, Muhammad Naguib. Gamal Abdel Nasser soon side-lined Naguib and become president himself in 1956. He created an authoritarian political regime in which he was central to all political decision-making. Nasser constructed four pillars of power: (i) the state party (the Nationalist Union, later the Arab Socialist Union and then the National Democratic Party, NDP), (ii) the state bureaucracy, (iii) mass organisations (trade and women's unions, youth organisations, etc.), and (iv) the army. Little changed in this configuration until Mubarak's resignation in 2011. The army was always the strongest of the four pillars and although Egyptian presidents always had its support they had to be careful to never encroach on its interests. No other single pillar of power could have seriously threatened an Egyptian president.

At first, the military junta had no real economic policy, aside from stressing the importance of industrialisation. But they had no idea how to finance it. Although Egypt had a class of very rich people, their wealth came from large landholdings; only a few of them were willing to invest in manufacturing (Pawelka 1985, 170; Soliman 1998, 11).

Therefore, Gamal Abdel Nasser's aim in expropriating some of the biggest landholdings (for compensation) was not only to redistribute land to rural middle-class families but also to free capital: the government was hoping that landlords would invest their money in industry. Significantly, Nasser's land reform only benefited the rural middle classes and not the rural poor. The government did not want the entire rural population to continue working in subsistence agriculture; instead, the very poor were supposed to move to the towns and become a class of workers for Egypt's new industrial sector (Pawelka 1993, 75).

However, expropriation negatively affected investments by serving to warn Egyptian capital owners to transfer their assets to safety abroad (Pawelka 1985, 222).

At the same time, the government began to establish the first state-owned industrial enterprises to produce basic commodities, leaving the private industrial and service sectors untouched (Soliman 1998, 11).

Nasser's statist experiments (1956–1970)

Egypt has never been a socialist country, although for a couple of years, the state assumed a role similar to that of socialist states in Eastern Europe. The means of production were almost entirely controlled by the government, which strove to comprehensively substitute imports. Collectivism in Egypt was about national development, however, not class struggle. Yet despite high growth and investment rates, the state eventually ran out of liquidity.

Nasser did not alter Egypt's economic policy until the Suez War. Early in 1956, after the United States had withdrawn support for the construction of the Aswan Dam on the Nile, Nasser reacted by expropriating the Suez Canal, which was owned by a French-British company. When France, the United Kingdom and Israel retaliated by attacking Egypt, Nasser began to expropriate foreign banks, insurance companies and manufacturing companies (Richards / Waterbury 1996, 183).

In 1957, Nasser received a generous loan from the Soviet Union and began to build up state-owned heavy industry. That year, the government also adopted Egypt's first five-year-plan. Although the private sector was not invited to elaborate the plan, it was called upon to contribute 55 per cent of the investments needed to industrialise Egypt. While some private investments were granted tax reductions, the state also began to require its approval to establish, expand, change the purpose or location of industrial plants, as well as for many other business decisions (Hill 2003, 86; Pawelka 1985, 222; Richards / Waterbury 1996, 183; Zaki 1999, 60–63).

The private sector contribution to gross capital formation declined from 72 to 26 per cent, while the government steadily expanded its engagement in the manufacturing sector (Zaki 1999, 61).

In 1960, Nasser abandoned hope that the private sector would help speed structural change in Egypt. He nationalised Egypt's two largest industrial complexes, the Misr Group and Abboud Pasha. The following year, he nationalised the remaining banks, insurance companies, transportation and trading companies, public utility providers, hotels and department stores, as well as all industrial enterprises with more than 10 employees. Although expropriated owners were offered government bonds with an annual fixed interest rate of 4 per cent, the country's economic and cultural elite (especially the ethnic and religious minorities) reacted by emigrating *en masse* (Pawelka 1985, 224–231; Pawelka 1993, 75).

At the same time, the state increasingly invested in the import-substituting industries to produce the primary and intermediate goods (chemicals, metals, paper, steel, fertiliser and textiles) needed by Egypt's agriculture and armaments industries, as well as higher technology consumption goods such as automobiles, TV and radio sets, white goods and pharmaceuticals (Galal / El-Megharbel 2005, 15; Pawelka 1985, 232; Zaki 1999, 72).

During this period, industrial policies were very steep: the state not only indirectly influenced flows of labour and investment into different economic sectors through discriminatory incentives (such as differential tax rates) but also very directly as the country's largest investor.

At the beginning, the new strategy was very successful. Egypt's annual 6 per cent economic growth rate surpassed that of most developing regions, while industrial production increased even faster and became much more diversified. Productivity also rose significantly as a result of industrial policies that allowed for the utilisation of formerly unused capacities – including labour that had never been put to work (Galal / El-Megharbel 2005, 6).

However, in 1967, following Egypt's defeat in the Six-Day War, the defect in its statist experiment became evident. While domestic products had been successfully substituted for many imported primary and consumption goods, Egypt had become dependent on imported capital goods to produce its import substitutes. Since Egypt had hardly any products to sell on world markets, it was using up the country's foreign reserves to finance its imports. Between 1948 and 1973, Egypt's share of global exports shrunk from 1.0 to 0.2 per cent of global trade (Weiss / Wurzel 1998, 23; Pawelka 1993, 78; Zaki 1999, 73).

Open-door policies under Sadat (1970–1981)

Shortly after Egypt's 1967 defeat, Nasser prepared to shift economic policies from a statist to a more mixed economy but his plans were only a half-hearted reform and have not been implemented before Nasser died in 1970.

When Anwar as-Sadat succeeded Nasser in office, it had become obvious that Egypt had to export at least some goods in order to finance its imports. But developing new export sectors required investments that the country could not afford. After the 1967 war, Egypt was nearly bankrupt, and the statist experiments had almost eliminated the private sector. Again the challenge was to mobilise funds for investments in new industries. Sadat decided to solicit foreign capital. His plan was to *"harness Arab capital, western technology and Egyptian resources by removing Nasser's statist shackles which were seen to have restricted growth and initiative"* (Bromley / Bush 1994, 202).

Egypt's new *infitāħ* (open-door) policy was largely based on multiple tax holidays and reductions for foreign private investors. All foreign capital was accorded comprehensive legal protection against expropriation as well as the right to be fully re-exported at any time. In 1977, these rights and provisions were extended to domestic private investors (Djoufelkit-Cottenet 2008, 6; Hill 2003, 81; Pawelka 1985, 308 f.; Soliman 1999, 44).

However, the Egyptian government had not abandoned the idea of guiding economic development, including that of the private sector. Although it was unable to drive private investment flows the same way it could allocate public funds into specific sectors, it could differentiate tax, customs and interest rates by sector, product and location (rural/urban) in order to make private investments in certain economic sectors more attractive than in others and channel resources from one sector or from one group of people to another. One example was the food sector: Egyptian farmers had to sell their crops below international market levels to the state, which resold the items abroad at much higher prices, thereby generating revenue that was used to finance the subsidisation of food, water and energy for urban households: the state thus transferred income from farmers to the urban lower and middle classes (Pawelka 1985, 158; Pawelka 1993, 76). In addition, the exchange rate was divided into three tariffs: the most favourable was for state-owned enterprises in strategic areas (petrochemicals, textiles and processed food), the second was for other state-owned enterprises and the least favourable was for private enterprises (Djoufelkit–Cottenet 2008, 8; Zaki 1999, 87).

These industrial policies were even more vertical and preferential than Nasser's because they artificially created winners and losers within a single private economic sector. Some entrepreneurs in large traditional sectors such as agriculture lost out, but others benefited. Some understood that they could make substantial gains in certain economic niches from favourable combinations of low tax rates, low customs tariffs for imported inputs, heavy protection against foreign competition and reduced red tape. Businesspeople with good connections (*wasṭa*) to the regime – the so-called parasitic entrepreneurs – made fortunes. Some used their connections to policy-makers to circumvent restrictions and controls and obtain permits and licences before their competitors, or to learn about changes in regulations, tax rates, trade rules and new profitable business opportunities early. Others benefited from the state's inability to implement its development plans: it depended on private contractors to expand infrastructure (including roads, telephone lines and sewage systems), construct social housing and public buildings, and import essential goods. Only well connected investors had a prayer of getting these kinds of public contracts. Some who did were able to build business empires from scratch; in fact, many of today's Egyptian business stars rose as 'parasitic entrepreneurs' during the 1970s (Wurzel 2007, 18 f.).

The macro-economic results of Sadat's *infitāḥ* policy were disappointing. Egypt was unable to attract significant amounts of foreign investment, and owners of local capital were hesitant to invest in domestic industry. Nevertheless, a few of the most heavily protected manufacturing industries – food, leather, wood, textiles and construction – did manage to attract some private investment. But the state continued to be Egypt's largest investor, making 75 per cent of all investments (Djoufelkit–Cottenet 2008, 14 and 19; Galal / El-Megharbel 2005, 16; Hill 2003, 81).

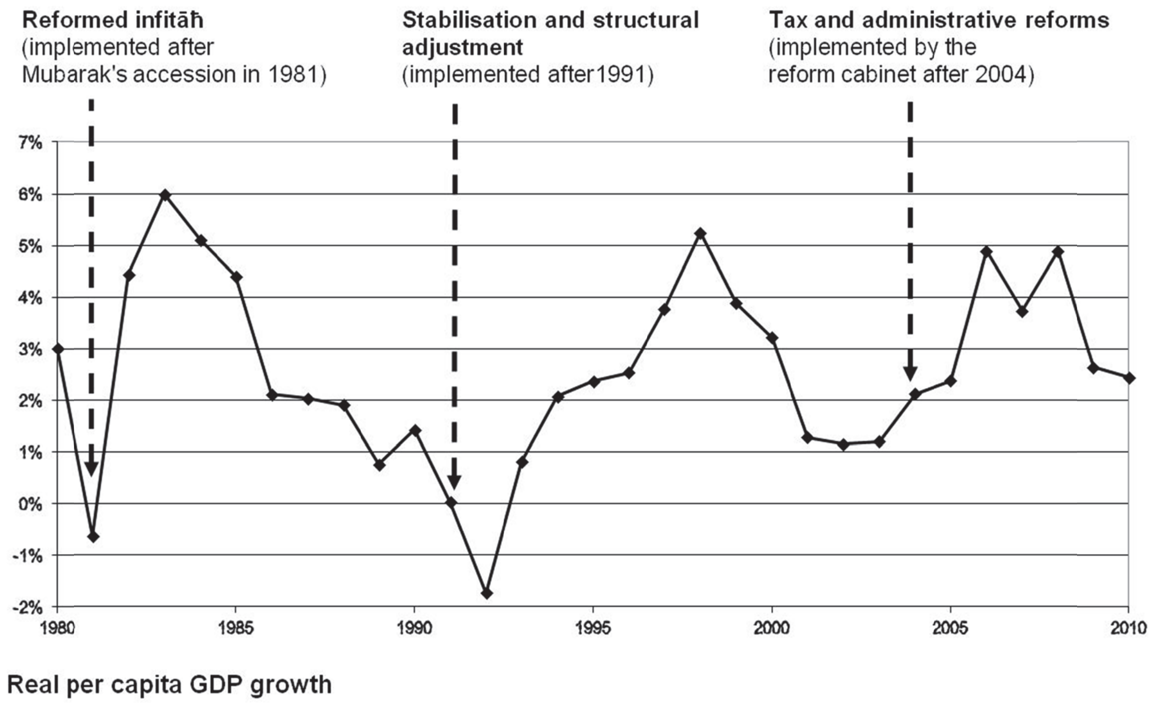
Egypt's state-owned enterprises were always in the red despite the fact that (or because) they were heavily protected from competition. More and more state-owned enterprises had to be subsidised because they were unprofitable. Throughout the 1970s and 1980s, Egypt's manufacturing sector deteriorated: the overall level of investment stagnated at 25.5 per cent of GDP, manufactured exports declined from 4 to 1 per cent of GDP and imports rose from 10 to 15 per cent of GDP (Beblawi 2008, 23; Pawelka 1993, 129; Weiss / Wurzel 1998, 35).

Even worse, full employment – a cornerstone of Egypt's social contract – was more and more difficult to realise. Until the late 1970s, the public administration had absorbed large numbers of the unemployed. Thanks to rising external income from oil and gas exports, Suez Canal user fees and taxes on remittance inflows, the government was able to finance swelling public-sector employment for quite a while. But when international energy prices collapsed in the 1980s, it had to abandon this policy. There was more unemployment in Egypt and some other Arab countries than anywhere else (Nabli et al. 2006).

Open-door policies under Mubarak (1981–1991)

In 1981, when Hosni Mubarak succeeded Sadat, who had been assassinated by an Islamist, he indicated little interest in economic policies. He knew that Sadat's *infitāḥ* policy had failed to attract additional investment and bring about structural change. But he was afraid of distorting Egypt's power balance, which largely depended on the generation of rents for specific social groups. Mubarak viewed economic and social issues through a security lens (Wurzel 2007).

Figure 2: Egypt's three growth spurts (1980–2010)



Source: own design, data from IMF (2009a); IMF (2010)

Mubarak continued Sadat's efforts to deregulate domestic markets and create incentives for investments in Egypt's manufacturing sector through tax holidays and the creation of economic free zones. He also abandoned central planning and devalued the Egyptian pound (EGP) in order to make Egyptian products more competitive on world markets (Djoufelkit–Cottenet 2008, 6; Soliman 1998, 6 and 49–52).

For some years, Mubarak's policy appeared to be successful. Real economic growth reached an annual 7.5 per cent during the early 1980s (see Figure 2), the share of manufacturing on total GDP rose from 13.5 per cent in 1981 to 18.0 per cent in 1987, and the productivity of Egypt's industrial workers increased by more than 3 per cent each year. Private manufacturing output rose by 13 per cent per year and public sector output rose by 6 per cent (Djoufelkit–Cottenet 2008, 13; Soliman 1998, 16).

But Mubarak continued to distinguish between levels of price, customs and interest rates – increasingly using the differentials to support and protect public sector companies, not promote structural change. Each time a firm in the private sector began to seriously compete with one in the public sector, the incentive structure was altered to benefit the public sector (Nabli et al. 2006, 16).

A third enterprise sector belonging to the Egyptian military emerged alongside the private and public sectors. Although the army had always been at the heart of the Egyptian republic, Sadat and Mubarak tried to limit its influence on politics. In 1989, Mubarak dismissed the popular and powerful Minister of Defence, Abd al-Halim Abu Ghazala but left the military's privileges untouched. In order to co-opt the army's higher ranks, he even supported the military's development of commercial activities in different sectors (including tourism, construction, white goods, vehicles, fertiliser, mineral water, olives and bread), which were partly financed by the sale of valuable land around Cairo and along the coasts to private investors. National accounting reports do not include information about the military economic sector but some observers believe that it has swollen to a fifth – some even say a third – of Egypt's GDP (Clover / Khalaf 2011; Demmelhuber 2011; Ginsburg 2011; Jacobs 2011).

In any case, after 1985, Egypt's manufacturing sector remained too small and too weak to compensate for the decline in world oil prices, which severely affected Egypt's income from hydrocarbon exports, remittances and Suez Canal user fees. At the same time, global interest rates rose. These two factors created a crisis in the Egyptian economy: the state ran out of money and could not invest in manufacturing, so output stagnated. Although the private sector continued to grow by 8 per cent per annum, in 1990, it accounted at most for 23 per cent of Egypt's manufacturing sector output, 25 per cent of its employees and 45 per cent of its exports. The national economic growth rate dropped to 1.9 per cent, decreasing annual per-capita income by 0.6 per cent. For the first time ever, the official unemployment rate rose above 10 per cent. In 1989, the Egyptian state was bankrupt (Albrecht / Pawelka / Schlumberger 1998, 141; Soliman 1998, 16; Weiss / Wurzel 1998, 36).

Hesitant adjustment and privatisation

The regime was forced to accept International Monetary Fund (IMF) and World Bank conditions in order to be granted a stand-by credit, an extended fund facility, debt relief from the Paris Club and a World Bank loan to finance a comprehensive stabilisation and structural adjustment package. In return, it promised to cut back government spending, privatise state-owned enterprises, deregulate markets and liberalise trade (Abou Shnief / Handoussa 2001, 156; Zaki 1999, 89).

In the following years, the government (i) reduced public spending in all areas (especially subsidies for energy and food, and in the social sectors), (ii) extended tax holidays for private investors, (iii) began to liberalise the financial sector, (iv) decontrolled most commodity prices, (v) reduced customs duties, non-tariff trade barriers and capital transfer restrictions, and (vi) pegged the Egyptian Pound (after a 10 per cent devaluation) to the US dollar (Albrecht / Pawelka / Schlumberger 1998, 144f.; Djoufelkit–Cottenet 2008, 7–8; Wurzel 2003, 106)

However, little progress was made in privatising public enterprises. The entire public manufacturing sector was restructured, and several enterprises were granted more autonomy and the right to compete. The government also prepared 314 state-owned enterprises (15 per cent of their total), with a book value of USD 80 billion, for privatisation. Not included were military businesses, with a book value of at least USD 200 billion and probably much more. They are said to be much more efficient than government enterprises, but no one – in or outside the regime – has ever proposed privatising them. Then, shortly after being announced, the privatisation of public enterprises lost momentum. Every now and then, the government publicised its intention to sell one or another of the 314 earmarked enterprises, but very few were actually sold before 1996. In 1999, when donors called on the Egyptian government to make more efforts, the privatisation process regained some momentum. By 2004, however, only 93 state-owned enterprises had been sold; another 110 had been partly privatised (Jacobs 2011; Kienle 2003, 152; Weiss / Wurzel 1998, 68–72; Wurzel 2003, 106).

Nevertheless, the economic reforms of the 1990s triggered a second growth spurt after 1980 (see Figure 2). GDP per capita increased annually by 3 per cent and the manufacturing sector's total-factor productivity rose by 1 per cent. These developments allowed the government to reduce its budget deficit from 20 to 1 per cent of GDP, lower inflation from 21 to 6 per cent and cut debt-service spending from 49 to 13 per cent of total government spending between 1989 and 1997 (Enders 2007, 3; Galal / El-Megharbel 2005, Table 3).

Growth was mainly due to an increase in the country's external income (from remittances and Suez Canal user fees) and a private investment boom that was triggered by the liberalisation of markets and prices, reductions in tax and customs tariffs and the deregulation of the financial sector – as well as the provision of cheap land with good low-cost infrastructure around Cairo and Alexandria. Private investments swelled from less than EGP 500 million annually during the 1980s to EGP 5,000 million in 1996. Private-sector manufacturing output increased by 14 per cent per annum between 1990 and 2002 while public-sector manufacturing output decreased by 2 per cent per annum. In 1997, the share of total exports of the private sector rose to 36 per cent. In 2003 its share of total industrial value-added and employment reached 70 and 60 per cent, respectively (Weiss / Wurzel 1998, 40 and 53; Zaki 1999, 101).

At this time, well-connected businesspeople got new opportunities to bloat their fortunes. Some received preferential access to land sold by the state for housing and private-sector development projects. Others were the first to learn about the deregulation of specific Egyptian markets or their opening to private investors – and as a result were able to get a head start in these sectors (telecommunications, TV, ports, airports, power plants and cement). Others again benefitted from the development of new sectors such as software production or the tourism industry on the Sinai. And some who had started one economic activity in the 1970s were able to diversify in the 1990s and grow immensely large within a very short time. Skafianis (2004) has named them the 'whales of the Nile' (Benhassine et al. 2009, 29 and 183; Chekir / Diwan 2013, 3; Wurzel 2007, 15).

At the beginning of the new millennium, Egypt's economy consisted of five distinct segments. (i) Government-owned enterprises continued to monopolise some strategic sectors like energy and to be active in others such as heavy industry. (ii) The army's companies produced consumer goods for the domestic market and military supplies, and became active in profitable, growing branches such as tourism. (iii) Traditional private companies produced handicrafts and import-substitutes. (iv) Foreign-owned companies mainly produced for world markets. (v) Modern domestic companies served the domestic and export markets. Many of these had been built up in the era of Sadat's policies of market protection, tax holidays and preferential access to relevant market information.

After a few years, however, Egypt's second growth spurt slumped (see Figure 2). Annual per-capita growth fell to 1.7 per cent, manufacturing exports decreased from 2 to 1 per cent of GDP and FDI stagnated at 0.7 per cent of GDP. The government budget deficit increased again, the gross investment rate dropped to 16.5 per cent and poverty levels rose (Djoufelkit–Cottenet 2008, 8 f. and 13 f.; Enders 2007, 3).

Table 2: Nominal and effective protection of selected manufacturing sectors in Egypt (2004)		
Manufacturing sector	**Nominal**	**Effective**
Leather and leather products	29.5	36.1
Clothes and footwear	26.7	31.6
Rubber	13.6	14.9
Textiles	9.2	10.3
Paper and printing	10.2	9.7
Food	7.8	9.3
Wood and wood products	7.3	6.9
Basic metals	5.9	3.7
Chemical	4.8	3.2
Source: Galal / El-Megharbel (2005, Table 4)		

Despite the government's decade-long effort to diversify the economy, exports were still as concentrated in 2004 as in the early 1960s. Nasser's import-substitution strategy had invigorated a number of new industries, many of which still exist: However, after 1980 at the latest, the diversity of manufacturing exports had decreased again: in 1983, the 12 most important groups of export products accounted for 30 per cent of total exports, then rose to 37 per cent in 1992 and a whopping 59 per cent in 2003. This was partly due to the steep growth of the share of hydrocarbon products between 1987 and 2003; the share on total exports of the 11 other most important product groups rose from 15 per cent in 1983 to 33 per cent in 1992 before dropping to 25 per cent in 2003. In 2003, the main export products were almost the same as in 1983. Only four product groups had been added to the group of 12 most important export products: rice (2 per cent of total exports), organic chemicals (2 per cent), coal and briquettes (1 per cent) and sanitary products (less than 1 per cent) (Galal / El-Megharbel 2005, Table 1). And Table 2 shows that the effective protection rates of some manufacturing sectors were still substantial in 2004.

3.4 The political constellation between 2004 and 2011

In 2004, Egypt's economic policy was more radically modified than at any time since the days of Gamal Abdel Nasser. President Mubarak understood that another reform package was necessary not only to sustain a level of economic growth that could provide employment for the growing population but also to appease the market-friendly wing of the ruling National Democratic Party (NDP) and extend his power base. He appointed businessman Ahmed Nazif prime minister and charged him with fundamentally revising economic policy. Nazif formed the first cabinet that was dominated by entrepreneurs (Djoufelkit–Cottenet 2008, 10–11; ESCWA 2008, 5; Salsecci et al. 2008, 18).

The significance of this act can be understood in the history of the republican Egyptian regime, which had not come to power through a revolution of the masses but through a coup d'état. The army had always been the dominant pillar of the regime. Nasser, Sadat and Mubarak all had military careers. Each of them had used a ruling party and the state bureaucracy as the second and third pillars of power, with the army always at the centre – especially after Sadat's assassination, when Mubarak invoked martial law (Pawelka 1985, 38 f.).

Traditionally, most Egyptians in the army, bureaucracy and ruling parties have come from the middle class: some were intellectuals or artists, while others came from worker, small trader or craftsman families and sought to use the army, party and public administration as vehicles for social advancement. This group tends to favour a statist mode of development, some protection for the domestic market, and social benefits for the middle classes and poor (food and energy subsidies, social housing, public employment, free health care, etc.). The regime must pay to legitimise its rule through a 'social contract' – the leaders' offer of material goods to the population in exchange for its political consent.

This type of exchange was possible because Egypt had – and still has – substantial sources of external income, including gas exports, Suez Canal user fees and development assistance (see Chapter 2). When these financial inflows were abundant (as in the late 1970s), the government could easily offer a job in the public administration to every university graduate (Pawelka 1997, 7).

Unfortunately, it became increasingly difficult to finance this policy. After 1985, income from external sources shrunk with the collapse of world energy prices, while the number of recipients of social benefits increased as a result of Egypt's steady demographic growth. The government was forced to reduce the benefits, and risked losing its legitimacy in the ensuing social unrest. Partly to compensate for its loss of consent from the poor and middle classes, the regime attempted to appeal to private businesspeople. During Nasser's statist experiments, entrepreneurs had largely disappeared, while the few who had managed to remain in business shunned attention. Some rose up (again) with Sadat's open door policies but many more with Mubarak's adjustment and liberalisation programmes (Demmelhuber 2008, 104 f.).

A number of top bureaucrats went into business at this time, in some cases using their access to information about political decisions or market conditions to enter profitable niches. Others purchased privatised enterprises at bargain prices. As a result, members of the regime began to analyse economic policies in entrepreneurial terms and better understand business. Bureaucrats-turned-businessmen and newly-sensitive-to-business-politicians began to form alliances – in many cases underpinned by personal ties such as marriage (Benhassine et al. 2009, 187; Chekir / Diwan 2013, 3; Pawelka 1997, 9).

President Mubarak's sons exemplify this trend: The elder Alaa developed extensive business activities, including banking and media (Roll 2006, 19), while the younger Gamal worked as an investment banker in London between 1988 and 1996, before returning home to launch his political career. He established himself as a moderniser in the Political Secretariat of the NDP, the party's heart, but remained well connected to the business world. After building a media holding company, he acquired shares of EFG-Hermes, a private equity firm located in Cyprus that started buying up shares of Egyptian companies at that time (Demmelhuber 2008, 106).

From the mid-1990s, ever more Egyptian businesspeople joined the NDP and made their parliamentary débuts. Prior to 2000, only 8 per cent of all deputies were businesspeople; after that year's elections, their share was 17 per cent. This was partly due to the fact that the business elite had generously funded the NDP electoral campaign. Although their influence in the parliamentary plenum was not particularly strong, they had a near monopoly of some key committees (Al-Ahram Weekly 831/2007; Demmelhuber / Roll 2007, 21).

The businessmen-deputies did not all share the same goals; in fact, they clashed on several topics. For example, a group of entrepreneurs around Ahmed Ezz who benefited from the remnants of Egypt's market protection, worked with the NDP's left wing and labour unions to successfully block all the initiatives to further liberalise foreign trade that were introduced by more liberal (free-market) deputies around Youssef Boutros-Ghali and Rashid Mohamed Rashid. Some businesspeople entered parliament not because they wanted to do politics but because they wanted to enjoy parliamentary immunity. Despite the dissent among these groups, Gamal Mubarak was able to gather them behind himself.[13] Soon, this group dominated not just Egyptian business associations, Egyptian economic-policy think tanks and chambers of commerce but also the Political Secretariat of the NDP and all party and parliamentary committees charged with developing economic policy. His group greatly influenced the NDP agenda as well as the national discourse.

By 2002, Gamal had convinced his father and other influential NDP members that the regime had no choice but to more radically privatise and liberalise the economy. He took it on himself and his friends to define a new agenda for Egypt to be implemented by a new government that was to be dominated by free-market economy oriented business-friendly ministers or even businessmen themselves (Demmelhuber 2008, 106 f. and 203 ff.).

Of course, both in- and outside the regime there was also opposition to Gamal & Co. and the implementation of their political ideas. In particular, members of mass organisations (the women's, labour and professional unions) and the public administration, as well as the army, viewed the entrepreneurs' plans as threatening the country's achievements, especially those made under Nasser: greater political and economic independence, land reform, redistribution of wealth, the strengthening of workers' rights, etc. But the opponents in the regime were weak and less well organised than the free-market wing. The army made a tacit deal to tolerate the reforms as long as the regime left its privileges intact and barred all competition to its economic activities, and President Mubarak – who occasionally played arbitrator by vetoing the free-market wing

13 The core group around Gamal Mubarak probably consisted of 20 people, the most important of whom were: (i) *Onsi Sawiris* and his three sons, *Naguib, Samih and Nassef*. By far the richest family on the African continent, the Sawiris own the leading Egyptian companies in telecommunications, tourism and construction. (ii) *Ahmed Ezz*, steel magnate and member of parliament, who headed the parliamentary budget committee for some years (see Section 5.2.4). (iii) *Rashid Muhammad Rashid*, owner of Fine Foods, a food-processing company and joint venture with Unilever, and major shareholder of EFG-Hermes, a leading investment bank with headquarters in Cyprus that made a lot of money by purchasing Egyptian firms. (iv) *Mohammad Lutfi Mansour*, top entrepreneur in the Egyptian automobile and machinery industry, who bought large landholdings after the 1997 land reform and invested in construction, tobacco, large retail, also holds Egypt's McDonalds franchise. (v) *Salah Diab*, owner of media and raw-materials companies and Egypt's Halliburton partner. (vi) *Shafik Ghabr*, principal shareholder in steel, construction and transportation companies, Egypt's Skoda distributor and head of the American Chamber of Commerce in Cairo. (vii) *Ahmed Maghraby*, Accor Egypt shareholder who bought large landholdings after the 1997 land reform and was appointed Minister of Housing in 2005. (viii) *Ibrahim Kamel*, owner of Kato Invest and shareholder in many food, tourism, construction and airplane-construction companies. (ix) *Hussein Salem*, active in tourism and gastronomy. (x) *Ahmed Nazif*. (xi) *Sameh Fahmi*. (xii) *Mahmoud Mohieldin*. (xiii) *Hossam Badrawi*, owner of a private health insurance company and one of Cairo's biggest private hospitals. (xiv) *Ahmed Heikal*, founder of Citadel Capital and director of EFG-Hermes, a leading investment bank that supervised many privatisations and was partly owned by the Mubarak Family. (xv) *Mohammed Abul Enain*. (xvi) *Ahmad Bahgat*, owner of large real estate, tourism and media companies (Chekir / Diwan 2013; Demmelhuber 2008, 105–106 and 203–205; Demmelhuber / Roll 2007, 21).

initiatives that offended too many Egyptians – was able to appease all other sceptical groups in the regime and society.

When the Egyptian pound was floated in 2003, it immediately depreciated by more than 25 per cent, which caused Egyptian exports to become more competitive but inflation and poverty rates to shoot up. This unpopular measure was enacted before the formation of a new cabinet to protect it being culpable from the start (Demmelhuber 2008, 104 f.).

The new cabinet, appointed in 2004, was in the end headed by Prime Minister Ahmed Nazif, the former Minister for Communications and Information Technology who had overseen the modernisation of Egypt's information and communication technology (ICT) sector. Nearly half of the 37 ministers belonged to the market-friendly wing[14] of the regime led by Gamal Mubarak, while only about one-third came from the old wing of military-bureaucrats[15]. The cabinet's make-up was meant to signal a new beginning in economic policies (Chekir / Diwan 2013, 3).

Did this signal reflect reality? For decades, Egyptian government ministers had come from the state bureaucracy or the military – or possibly from a trade union or a farmers' or professional association. Then in 2004, for the first time ever, most ministers were businesspeople. Did they change the course of Egypt's industrial policy? When the new government was appointed, Egypt's economy was still comparatively closed in terms of export and import and cross-border capital-transaction rates, and the share of its medium- to high-tech manufacturing exports was very low – not only compared with countries in East Asia, Latin America or southern Africa but also with the rest of the Arab world. Could a cabinet with experienced entrepreneurs and economic experts make a difference in the drafting and implementation of economic development policies? Would it help make industrial policies more effective and more efficient because its members could better understand the problems and needs of businesspeople? Would it have positive – or at least neutral – effects on fairness and transparency in politics and policies? Or would the entrepreneurs in government favour themselves and their friends? Could the owner of a large hotel company who also ran the Tourism Ministry resist the temptation? What about the owner of an automobile import and assembling company who serves as Minister for Transportation? The owner of a food-processing company, which exports large shares of its products to Europe, who doubles as Minister for Trade and Energy? The Minister of Housing who also owns a construction company? The Minister of Health who works in the medical business?[16]

Chapter 4 attempts to answer these questions.

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14 They included: *Tareq Kamel*, Minister for ICT; *Youssef Boutros-Ghali*, Minister for Finance; *Rashid Mohamed Rashid*, Minister for Trade and Industry. *Ali El-Sayed Ali Al-Moselhi*, Minister for Social Solidarity; *Mahmoud Mohieldin*, Minister of Investment; *Sameh F*ahmi, Minister for Petroleum; *Mohamed Zohair Garana*, Minister for Tourism; *Alaa Ed-Din Fahmy*, Minister for Transportation. *Ahmed Alaa E-Din El-Maghrabi*, Minister for Housing. *Hatem Mostafa El-Gabali*, Minister for Health and Population; and *Amin Abaza*, Minister for Agriculture.

15 They included: *Mohamed Hussein Tantawi*, Minister of Defence; *Ahmed Shafiq*, Minister for Civil Aviation; *Habib El Adly*, Minister of the Interior; *Mohamed Mahgoub*, Minister for Local Development; and *Omar Suleiman*, Minister Without Portfolio.

16 Information from an interview with Angus Blair, head, Beltone FinancialJune 2009.

4 Strategies and instruments of industrial policies in Egypt from 2004 to 2011

The 'businessmen cabinet' of Ahmed Nazif rushed to give new impetus to economic reforms in Egypt. On its first day in office, it resumed the privatisation of state-owned enterprises, deepened customs, tax and administration reforms, liberalised the financial sector and rationalised market regulations. It also launched several strategies for private sector development that would constitute the core of industrial policy between 2004 and 2011.

As this chapter will show, these strategies were an improvement over earlier attempts to promote structural change because they had (i) a vision of Egypt's economic development and (ii) were oriented to markets and demand.

However, the strategies also suffered from a number of familiar weaknesses: (i) They were designed by a government that included influential entrepreneurs but had no broader private sector participation. (ii) Their achievements were not well monitored. (iii) The division of labour between implementing agencies remained unclear. (iv) The business development services (BDSs) that were offered did not meet real needs. (v) Several programmes favoured some enterprises over others, and although in principle discrimination can help direct investments in a specific direction, this was not based on any kind of rational analysis. (vi) Some programmes provided very generous financial support with no conditions regarding recipient performance or behaviour.

Section 4.1 sketches the general shift in economic policy under Nazif. Sections 4.2, 4.3 and 4.4 portray the strategies used by the three main industrial-policies players: the Ministry for Trade and Industry, the Social Fund for Development and the Ministry of Investment. Section 4.5 summarises the strengths and weaknesses of the strategies.

4.1 General economic policy reforms

After just one year in office, the new government had privatised 87 state-owned enterprises, including companies in economic branches that had never been considered for privatisation because of strategic considerations. Between 1994 and 2004, only 21 companies were privatised each year. During that period, the average annual earnings from privatisations were EGP 1.7 billion; in 2005, they jumped to EGP 15.1 billion. The receipts partly had to compensate for the government's budget deficit (Demmelhuber / Roll 2007, 10).

In 2005, a new income-tax law was approved that (i) reduced marginal tax rates, (ii) broadened the tax base, (iii) uniformly assessed all kinds of income, (iv) introduced administrative improvements in tax collection and (v) created a number of tax incentives for investors (Ghorfa 2009b, 87).

In 2004 and 2007, customs tariffs and procedures were reformed in two steps 2004 and 2007. Customs clearance was simplified by reducing the necessary steps from 26 to five and customs duties were lowered from an average of more than 14.6 to less than 7 per cent – while the number of customs-duty rates was cut from 27 to six (Demmelhuber 2008, 192; OECD 2007, 42).

The regulatory framework for investors was also greatly simplified. For example, the number of administrative steps for starting a business was reduced from 10 to six, the duration of the procedure from 22 to seven days and its cost from 105 to 16 per cent of per-capita income. The minimum amount of capital needed to start a business was slashed from 740 per cent of per-capita income to virtually zero (see Annex, Table A1).

Perhaps even more important, the financial sector was liberalised and most of the remaining obstacles to foreign investment were removed. At the same time, mergers and acquisitions, privatisations and reorganisations in the name of efficiency helped make some domestic banks and insurance companies fit to compete with international providers. For the first time, a state-owned bank, the Bank of Alexandria, was sold – to the Italian investment bank Sanpaolo IMI. The Central Bank of Egypt was authorised to supervise all financial transactions. Cross-border capital flow was deregulated and regulations for financial service provisions within Egypt were rationalised. As a result, both households and businesses could more easily access credit (Demmelhuber / Roll 2007, 11; Demmelhuber 2008, 191).

Some sectors, however, remain closed to foreigners: maritime traffic, aviation, legal advice, architecture, engineering services, accounting, international trade intermediation, energy production, fixed network telephony, railway traffic, postal services, steel and aluminium production, fertiliser production, construction (minority participation is permitted) and insurance (foreign firms may only operate in the free zone) (OECD 2007, 31–33).

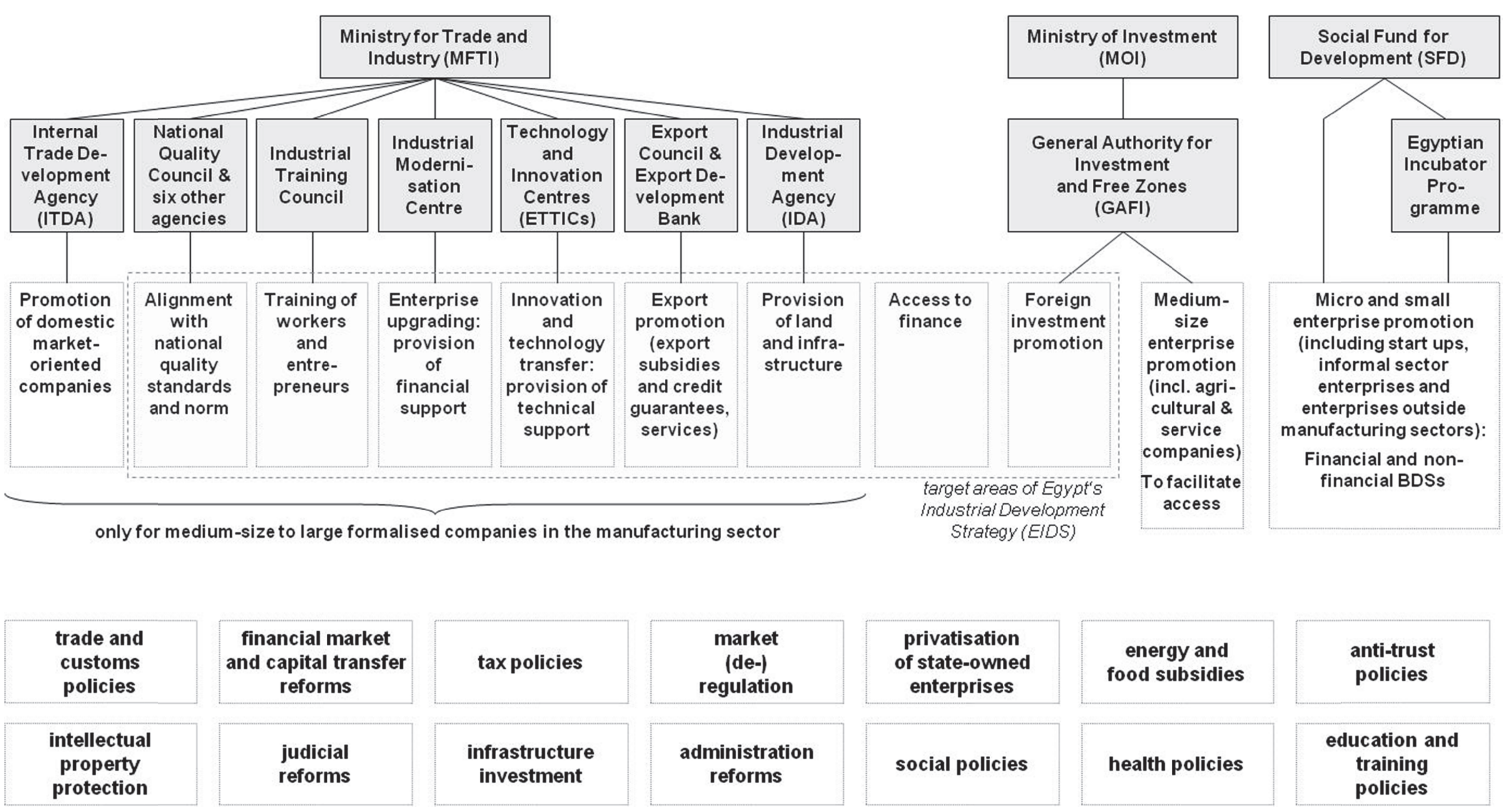
A competition law was drafted and an ‘Egypt Competition Authority’ was established with reasonable instruments to check for a provider’s market dominance. But the authority has hardly any instruments to prosecute and punish violations of the competition law; only the prime minister can initiate prosecution. In addition, some sectors – such as the telecommunications industry – were excluded from its purview (Demmelhuber / Roll 2007, 12).

For the first time since Nasser, commodity subsidies were cut significantly: the price of petrol rose by as much as 50 per cent, electricity by 19 per cent and water by 100 per cent. This helped push consumer price inflation to 18 per cent in 2008 (Brach / Loewe 2010, Table 5; Demmelhuber 2008, 195).

4.2 The ‘Egypt Industrial Development Strategy’ of the Ministry for Trade and Industry

After being appointed prime minister in 2004, Ahmed Nazif created the Ministry for Trade and Industry (MFTI) to unite the three ministries for trade, state-owned enterprises and industry under one roof. The MFTI became the principal player in industrial policy – along with the Ministry of Investment (MOI) and the Social Fund for Development (SFD). An overview of the agencies that belong to these three ministries and their activities is shown in Figure 3.

Figure 3: Egyptian industrial policy: The actors and their responsibilities



Source: own design

In 2006, the MFTI issued the 'Egypt Industrial Development Strategy' (EIDS), the Nazif government's main policy document for private sector development. It explicitly excludes (i) companies in the tourism and hydrocarbon sectors, (ii) micro-enterprises (with fewer than 10 employees) and (iii) small companies (with fewer than 50 employees) – as well as (iv) non-manufacturing companies.

The EIDS was drafted between 2004 and 2005 by a group of experts appointed by the MFTI.[17] Although it included some businesspeople in addition to top bureaucrats and academics, the private sector was not formally involved. The entrepreneurs in the expert group – who were authorised to speak on behalf of all private companies in the relevant sectors – had been neither democratically elected nor appointed in a transparent procedure to speak on behalf of all private companies in the relevant sectors. Many of them belonged to Gamal Mubarak's group (Demmelhuber 2008).

The EIDS sets clear implementation targets and indicators, with the main goal of sustaining growth and providing employment through *"a significant increase in gross domestic investment"* (MFTI 2006, 13). However, it is not concerned about poverty or inequality and includes very few references to environmental sustainability.

Nevertheless, the document is still effective – de jure and de facto.

The EIDS takes a *vertical* approach to industrial policy, focusing on selected manufacturing sectors that the government should support. It also recommends that a development strategy be drafted for each sector. However, its long list includes almost all the important manufacturing sectors – which makes the policy based on this document resemble a *horizontal* approach.[18]

The EIDS defines eight fields of action (to be portrayed in detail below): (i) human resources and entrepreneurship, (ii) access to finance, (iii) infrastructure, (iv) innovation and technology, (v) quality assurance, (vi) enterprise competitiveness, (vii) exports and (viii) FDIs.

Three years after the EIDS was drafted, the Internal Trade Development Agency (ITDA) was created for enterprises that produce for the domestic market, a ninth field of action.

A separate 'board of trustees' was named to monitor progress in each field. But nearly the same names appear on all the boards. It is the same group that drafted the EIDS document

17 The group was chaired by Samir Radwan, then managing director of the Economic Research Forum, who became Minister of Finance for a couple of months after the revolution in 2011. The IMC was represented by Nihal El-Megharbel. Other members included Helmy Abu-Laisch, Hany Barakat and Adham Nadeem (interview with Hany Barakat, first undersecretary, MFTI, 17 June 2009).

18 The strategy focuses on eight traditional sectors as well as six new ones, referred to as 'target niches'. The traditional sectors include (i) engineering and electrical machinery, (ii) food processing, (iii) chemicals and pharmaceuticals, (iv) textiles and garments, (v) building materials, (vi) furniture, (vii) paper and paperboard and (viii) leather. The new sectors are (i) engineering machinery and equipment (including those for generating renewable energies), (ii) labour-intensive consumer electronics, (iii) automotive components, (iv) life sciences, (v) biotechnology and (vi) ethnic products. (Cf. MFTI (2006, 16)

– a small group of academics, entrepreneurs and top bureaucrats with good connections to one or more of the Nazif cabinet businessmen-ministers.[19]

Human resources and entrepreneurship

The target of the first component of the EIDS was (i) to provide on-the-job training for workers upon the request of their employers and (ii) to strengthen the technology focus of such training (MFTI 2006, 21).

The Industrial Training Council was established to assess current and future training needs and to plan and coordinate the national training offer in cooperation with other state agencies and the Federation of Egyptian Industries (ibid.).

Meanwhile, competing public and private providers have begun to offer on-the-job training, and can provide entrepreneurs with free assessments of their employees' training needs. The training is not free, but employers can apply for a cost refund of as much as 90 per cent (95 per cent in Upper Egypt) from the Industrial Modernisation Centre (IMC, see below) for training institutes accredited by the Egyptian Accreditation Council (MFTI 2006, 22 and 36).

Access to finance

The second component of the EIDS aimed at facilitating private investors' access to capital. While the strategy document lists many measures that were needed, its final version did not name any specific government actions (MFTI 2006, 31 f.).

Provision of land infrastructure

The third component aimed at improving the accessibility and quality of the physical and digital infrastructure for enterprises. The Industrial Development Authority (IDA) was assigned to (i) manage the state-owned industrial zones, (ii) provide land and infrastructure to enterprises in these zones (or elsewhere), and (iii) facilitate cooperation between the zones so as to encourage formation of industrial clusters.[20]

The IDA regularly announces plots that are for sale in government-owned industrial zones. If there is more than one bid (on average, there are two), the first applicant gets the land unless another bidder already owns a plot in the same zone.

Between 2006 and 2009, 21 million m^2 of land were sold to 2,335 companies – in the automobile, textile, medical devices and shipbuilding industries – for a total of EGP 32 billion (IDA 2009b).

The IDA is not responsible, however, for the heavy industries (aluminium, steel, cement, etc.), which have industrial zones administered by the Ministry of Housing. This exception is because heavy industries consume more energy and pollute more than other industries. They were intentionally located near the Aswan Dam, which supplies them with power.

19 Interview with Hassan Omar, MFTI, 17 June 2009.

20 The IDA section is based on information from IDA (2009b) and MFTI (2006, 33 f.) as well as interviews with Ashraf Dowidar, IDA, 21 June 2009 and Steven Lee, consultant, 2 May 2010.

IDA is monitored by the MFTI on the basis of monthly reports on output indicators such as the number of plots sold or the number of customers. But it is not controlled for effectiveness (impact), efficiency and transparency or fairness of land allocations.

Innovation and technology transfer

The objective of the fourth EIDS component was *"to upgrade the Egyptian industrial sector from being technologically excluded to being a technological adopter in the medium term"* (MFTI 2006, 24). Its main instrument is the Egypt Technology Transfer and Innovation Centres (ETTICs): 12 non-profit organisations that, for a price, provide Egyptian companies with appropriate technological solutions and know-how – either by putting the companies in contact with Egyptian universities and research centres or by purchasing the technology abroad (MFTI 2009c, 4).

On one hand, companies can request these services from the ETTICs and on the other, in order to identify private sector needs, the ETTICs also regularly conduct demand surveys in collaboration with export councils, new industrial clusters and the Federation of Egyptian Industries (MFTI 2006, 25f.; MFTI 2009c, 4).

The ETTICs' performance is assessed on the basis of monthly reports about output indicators such as the number of companies served, products certified and technology-transfer contracts.[21]

Ten of the ETTICs have sectoral or sub-sectoral orientations in: (i) engineering, (ii) food processing, (iii) furniture production, (iv) jewellery, (v) leather processing, (vi) leather tanning, (vii) marble and granite, (viii) plastics, (ix) textiles and clothing, and (x) fashion and design. Each is monitored by the board of the chamber of commerce or industry of its respective economic sector.

The remaining two ETTICs – the Egypt National Cleaner Production Centre and the Kaizen Productivity and Quality Improvement Center, an Egyptian-Japanese initiative – have crosscutting tasks.

Other actors have also established technology centres: The SFD runs technology centres for micro- and small enterprises (MSEs) (see below). In cooperation with private enterprises and universities, the Ministry of Interior founded R&D Centres of Excellence, which focus on the ICT sector. The United Nations Industrial Development Organization (UNIDO) established the Egyptian Traceability Centre for Agro-Industrial Exports (e-Trace) to promote new technologies in Egyptian agriculture and agro-industries. In 2010, the Ministry of Communication established the Technology Innovation and Entrepreneurship Centre (TIEC) to compensate for the lack of R&D in MSEs in the ICT sector.[22]

21 Interviews with Ahmed Fouad Mandour, Food Technology Centre, 22 June 2009 and Hassan Omar, MFTI, 17 June 2009.

22 Interviews with Alaa Fahmy, director, Agriculture and Agro-Industries Technology Centre (UNIDO/ETRACE), 22 February 2012 and Dalia Gamal, Technology Innovation and Entrepreneurship Center (TIEC), 4 March 2012.

National quality system

The EIDS has also established a national quality system to align Egyptian manufacturing with international norms and standards, thereby facilitating Egyptian exports. Not less than six institutions have assumed tasks within this system.[23]

Enterprise competitiveness

The Industrial Modernisation Centre (IMC) is the core of the EIDS. It provides funds to companies for the following modernisation efforts:

- on-the-job training for workers (e.g. functional language courses and IT)
- training for entrepreneurs (e.g. foreign trade)
- quality management (establishing standards, calibrating, laboratory upgrading)
- information and communications technology systems upgrades
- innovation and R&D
- technology transfer
- export development (e.g. market research and export strategies)

Until 2008, the IMC refunded up to 80 per cent of the total costs for modernisation in Lower Egypt and as much as 90 per cent in Upper Egypt. In reaction to the global economic and financial crisis, the respective shares were further raised to 90 and 95 per cent, respectively.[24]

The IMC can provide a subsidy of 10 per cent for the total costs of urgently needed equipment (up to EGP 100,000) (MFTI 2006, 36; IMC 2008, 5).

These services are restricted, however, to formal private-sector industrial entities with at least 10 full-time, socially insured workers and rising sales in the previous three years.[25] This means that enterprises with fewer than 10 employees and informal enterprises (which have not registered their employees with the National Social Insurance Organisation, NSIO) are not served by the IMC. Additional conditions for participating stipulate that the

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23 The National Quality Council monitors all the activities of the national quality system. The Egyptian Organization for Standardization and Quality is supposed to bring Egypt in line with international standards. The Egyptian Accreditation Council is responsible for accrediting bodies that assess conformity (including calibration and testing laboratories). The National Institute for Standards checks that the results of calibration and testing do not significantly deviate from international norms. The Industrial Control Authority monitors the products of industrial firms to ensure compliance with national and international standards, and the National Quality Institute raises awareness about existing standards and norms and explains their significance for individual and collective economic development. Cf. MFTI (2006, 27–30).

24 Since the global economic and financial crisis started, firms in Lower and Upper Egypt have been reimbursed for 90 or 95%, respectively, of their upgrading costs, provided these were less than EUR 5,000; 87.5 or 93.75% for costs below EUR 20,000; 85 or 92.5% for costs below EUR 30,000; 72.5 or 91.75% for costs below EUR 40,000; 80 or 90% for costs below EUR 50,000 and a lump sum of EUR 400,000 or 450,000 in other cases. The maximum support equals 10% of annual sales (turnover) for BDSs, plus 10% of annual sales for R&D and 4% of annual sales for consultancies by resident experts (IMC 2009, 13f.; interview with Ahmed Wahab, Engineering Export Council, 25 June 2009).

25 This includes 12,355 companies, 1,315 of which have more than 200 employees, 2,718 with 50 to 200 employees and 8,302 with 10 to 50 employees (interview with Hassan Omar, MFTI, 17 June 2009).

company must (i) have been operating for at least two years, (ii) have an industrial or commercial registry (if applicable), (iii) have growth potential, (iv) operate transparently, (v) belong to the Federation of Egyptian Industries (if applicable), (vi) undergo a full assessment prior to implementation and sign a memorandum of understanding about the company's development plan (IMC 2008, 3; Salsecci et al. 2008, 41).

The IMC also runs three more specialised programmes:

The National Supplier Development Programme takes a value-chain approach to upgrading the local suppliers of the top 100 Egyptian manufacturing companies with high export potential. Each of these 'mother companies' may invite five to 20 of their local suppliers to join the programme if they prove serious commitment to the programme's goal of technical upgrading and their desire to grow through exporting, and contribute to their technological upgrading costs.

In this case, the IMC can:

- provide an individual analysis of each supplier's technological gaps and upgrading needs to meet the standards defined by its 'mother company';
- provide the supplier with technical assistance to close its technological gaps; and
- consult the supplier about financial matters and provide credit, if needed.

In the first round, the programme provided support to 20 suppliers of General Motors. In the second round, it assisted another 220 suppliers of 30 mother companies (many of them also in the automobile sector) with their technical upgrading efforts. Mercedes reported that after taking part in the programme, its Egyptian suppliers' average productivity increased 35 per cent and waste was reduced by 45 per cent. One supplier confirmed that after participating in the programme its productivity had increased by 25 per cent and its costs decreased by 40 per cent.[26]

The Clusters Development Programme supports SME clusters with their collective technical upgrading efforts. It provides technical and financial assistance for innovation and export promotion, starting with one cluster in the dairy sector and one cluster in the automobile industry (IMC 2008, 43 f.).

The 1,000 New Factories Programme provides training, marketing assistance and technical support in product design to 1,000 medium-size companies during start-up and expansion (IMC 2008, 40f.; IMC 2009, 71).

For the period between 2005 and 2010, the IMC budget was EUR 426 million, 250 million (59 per cent) of which were contributed by the EU, 103 million (24 per cent) by the Government of Egypt and 73 million by the private sector (17 per cent from user fees). In 2009, the IMC had exhausted its funds from the EU, but the MFTI mobilised new sources of funds to help the IMC continue to function. Today, the IMC has 17 offices with 85 customer service agents.[27]

26 Interview with Mohammed Ismail, project manager, IMC, 3 May 2010.

27 IMC (2008, 3); MFTI (2006, 36); Salsecci et al. (2008, 41); interviews with Ahmed Abd-el-Fattah, Contistahl Group, 29 April 2010 and Hany Barakat, first undersecretary, MFTI, 17 June 2009.

The IMC is required to report monthly to the MFTI about its activities: inputs and outputs. It also monitors client development on the basis of four indicators: total sales, total exports, investments and number of employees.[28]

Export promotion

The aim of the seventh component of the EIDS is to help Egypt export more manufactured goods. The Export Council grants subsidies for textile, engineering, chemical and food exports. The initial subsidy was 10 per cent of the value of the exported goods but it was raised to 15 per cent after the start of the global economic and financial crisis.[29]

Politicians, entrepreneurs and researchers in Egypt see no problem with export subsidies violating international trade agreements:

> *"Of course, export subsidies are against WTO rules in theory. However, in practice as you know, all countries are now subsidising their exports – especially after the crisis. Also, I would not say that this subsidy is distortive. Exporters get the refund only after they have successfully exported."* (Hanaa Kheir el-Din, then Executive Director, Egyptian Center for Economic Studies, 2 May 2010)

The Export Council also provides financial and technical support to help exporters develop strategies and present their products at fairs and exhibitions. Every now and then it organises its own fairs and exhibitions or presents national products at an Egyptian stand in an international fair. In 2008, the council provided 1,960 services to 1,138 exporters, enabled entrepreneurs to participate in 69 international fairs and hosted six trade missions in Egypt (IMC 2009, 10).

FDI promotion

The eighth component is intended to attract FDI to Egypt. However, this goal is beyond the MFTI's competence, which is why the EIDS does not propose any concrete measures for its achievement. Activities of the MOI in this area are presented below.

Promotion of non-exporting companies

In 2009, the MFTI decided to become active in a ninth domain that was not originally part of the EIDS: the promotion of enterprises that are not (yet) exporting their products. This decision was based on the consideration that most exporters have grown *"and made their speed"* (Steven Lee, consultant, 2 May 2010) on the home market before they manage to sell their products abroad.[30]

28 Interview with Mohammed Ismail, project manager, IMC, 3 May 2010.

29 Although responsibility for these export promotion activities was transferred from the IMC to the Export Council, the IMC remains involved. Information on export promotion from: IDSC (2008, 130); MFTI (2006, Box 7); OECD (2007, 29 and 44); and interviews with Wolfgang Klos, National Automotive Co., 15 June 2009 and Ahmed Wahab, Engineering Export Council, 25 June 2009.

30 Interview with Steven Lee, consultant, 2 May 2010.

4.3 Micro- and small enterprise promotion by the Social Fund for Development

Since 2005, the Egyptian Parliament has passed several legal reforms to promote micro- and small enterprises (MSEs) in Egypt:

- It reduced the minimum amount of capital needed to start a limited liability company from EGP 50,000 to EGP 1,000.
- It passed the Law on Intellectual Property Rights that prohibits clauses in contracts between foreign and Egyptian companies restricting the Egyptian partner's use of imported technologies.
- Most importantly, however, in 2004 the Egyptian Parliament passed a Law on the Development of Small Enterprises that the SFD had drafted under pressure from SME organisations. The law stipulates that (i) at least 10 per cent of all government bids must be assigned to small and medium-sized enterprises (SMEs) and (ii) at least 10 per cent of all privatised land must be sold to SMEs.[31]

Nevertheless, the Social Fund for Development (SFD) is still the main actor of micro enterprise promotion in Egypt. It was founded in the 1980s to cushion the negative impacts of structural adjustment but later shifted part of its focus to MSE development activities.

Today, the SFD offers MSEs a comprehensive range of financial and non-financial BDSs that resembles what the MFTI and its subsidiary agencies offer to formal medium-size and large enterprises.

SFD financial services include:

- micro-credits (EGP 50,000–2 million) issued by SFD regional offices, contracting banks and SME associations (total annual volume: EUR 120 million);
- credit-failure, life and fire insurance; and
- funds to attend national and international fairs and exhibitions.[32]

Its non-financial services include:

- training for quality management, adherence to global standards, customs clearance, accounting, micro-finance and human resources management;
- consultancy about how to benefit from the SME law and how to organise chain management, production technologies and procedures for exporting;
- special one-stop-shops for registering MSEs; and
- support for technology adaptation (provided by the SFD technology centres that were opened long before the MFTI technology centres).[33]

The SFD also runs an 'incubator programme' to finance construction and rehabilitation of selected incubators, and also their management costs until they are financially viable.[34]

31 OECD (2007, 29); SFD (2007, 28 and 37).

32 In cases of insolvency, the insurance covers 80% of the losses, with the SFD and the lending bank each bearing 10% (SFD 2007, 37).

33 The leather and footwear-technology centre was the first of these centres. The second was the furniture centre, which has since been transferred to the MFTI.

4.4 The Ministry of Investment and the General Authority for Investment and Free Zones

Established after Ahmed Nazif became prime minister in 2004, the Ministry of Investment (MOI), was charged with improving Egypt's investment climate and attracting foreign investment through reforms in five areas: investment legislation, tax administration, and monetary, trade and investment policies.

Its main instrument is the General Authority for Investment and Free Zones (GAFI), which existed already when the MOI was created but was beefed up and transformed from a regulatory to an investment-promotion body.

Since 2005, GAFI has had four main tasks:

- attract foreign direct investors
- simplify the registration and licensing of new establishments
- promote and manage the free zones and the Qualifying Industrial Zones (QIZs)
- (since 2009) promote small and medium-size enterprises (SMEs).[35]

GAFI is also very helpful in facilitating conflicts between public authorities and private investors:

> *"Generally when penalties occur or if there is a problem with the governorate, we approach GAFI and generally they agree with us… GAFI responds quickly, and at the same time they don't rush people. Their next step is always to go and see the governor to resolve the problem in a friendly manner. GAFI is an 'intermediary' between the two parties."* (Egyptian entrepreneur quoted in Yousfi/ Humphrey 2008, 30)

GAFI operations can be seen as attempts to neutralise the arbitrary nature of preferential relations between bureaucrats and businesspeople. GAFI supports a more transparent system and also institutionalises dialogue between investors and the government, which creates trust and confidence among investors.

GAFI's performance is evaluated by a board of directors on the basis of impact criteria such as the number of new projects it attracts, the volume of inward FDIs, the number of jobs created or the volume of exports from free zones (OECD 2007, 37 f.).

GAFI's main activities include (i) the one-stop-shops, (ii) the free zones, (iii) the Qualifying Industrial Zones, (iv) the MOI's efforts to develop Egypt's infrastructure and (v) the SME promotion programme.

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34 So far, the programme has provided support to 82 incubators. Information about the incubator programme is from SFD (2007) and an interview with Azmy Aly, SFD, 17 June 2009.

35 Cf. Demmelhuber (2008, 194); Ghorfa (2009b, 86); OECD (2007, 37 f.); and interview with Hassan Omar, MFTI, 17 June 2009.

One-stop-shops

GAFI established and administers 'one-stop-shops' that bring together representatives of different organisations (the Ministry of Housing, the Ministry of Labour, the IDA, the Ministry of Health, etc.) to help facilitate the registration and licensing of companies.

However, these shops are nicknamed 'one-stop-shores' in Egypt because they merely assemble representatives of various organisations under one roof instead of coordinating the procedures. Investors still have to visit the representative of each organisation to obtain all the necessary permits.[36]

Free zones

The first free zones in Egypt were established in the 1970s. Today, the country has 10 public free zones and 32 that are privately administered, many of which include just one company. If no appropriate land is available in a public zone, GAFI is authorised to issue a licence for a private zone if it has the necessary infrastructure (water, electricity, transport, etc.).[37]

Companies may settle in a free zone (or establish their own free zone) if they belong to one of the branches specified in the Investment Law and export at least 50 per cent of their products. They must pay a user charge amounting to 1 per cent of their net profits. In return, they are exempted from all taxes and customs and all import and export regulations – as well as from some provisions of the labour law. Land in free zones is much cheaper than in most of Egypt (ESCWA 2007, 43; Ghorfa 2009b, 18).

GAFI promotes clustering in free zones as a means of facilitating technology transfer. As a result, some zones concentrate enterprises from the same manufacturing sector (e.g. automotive) or from the same country (e.g. China or Russia) (ESCWA 2007, 43).

The Qualifying Industrial Zones (QIZs)

The Qualifying Industrial Zones (QIZs) were more recently established under a protocol signed by Egypt, Israel and the US. The protocol offers quota-free and duty-free access to the US market for products from any company that were manufactured in a QIZ in Egypt – provided that the combined value added in Israel and in the Egyptian QIZ is at least 50.5 per cent[38], with a 10.5 per cent minimum of local-Israeli content (Ghorfa 2009b, 19; Salsecci et al. 2008, 24).

Egypt now has four QIZs with a total of 760 companies in (i) Greater Cairo, (ii) Greater Alexandria, (iii) the Suez Canal area including Port Said, Ismailia and Suez; and (iv) the central Delta governorates Gharbiyya, Minufiyya, Dakhiliyya and Damietta (Ghorfa 2009b, 19; Bergmann 2009; Salsecci et al. 2008, 24).

36 Interview with Ashraf Dowidar, IDA, 21 June 2009.

37 Ghorfa (2009b, 87); Salsecci et al. (2008, 39); and interview with Ashraf Dowidar, IDA, 21 June 2009.

38 Egypt and the US have agreed that cutting, sewing and packaging account for 60% of added value – and automatically qualify a product to be exported to the US.

Jordan has a similar QIZ arrangement with Israel and the US. Although Jordan's QIZs have attracted more investment than the Egyptian ones, Egypt has created more employment for domestic workers. Despite the global economic crisis, between 2008 and 2009, exports from Egypt's QIZs rose by about 11 per cent, 90 per cent of which were clothes, mostly cotton trousers with Israeli-made zippers. QIZs also export dairy products, pharmaceuticals, cosmetics and dried vegetables. Especially Turkish, Indian and Italian companies manufacture in Egyptian QIZs but Chinese enterprises are have recently become interested as well. By international standards, 90 per cent of QIZ exporters are SMEs with fewer than 500 workers.[39]

Infrastructure development

The MOI has also taken the initiative to upgrade the parts of Egypt's infrastructure that represent the most serious constraints for foreign and domestic investors. It has pre-financed a 275-kilometre-long highway linking one of Egypt's poorest governorates in the Upper Egypt Nile Valley, Sohag, with the Red Sea port of Sahaga. The new road should ease the export of goods from Upper Egypt and attract investors to the desert hills between the Nile Valley and the Red Sea – in particular for mining (the region along the road is rich in minerals), energy-intensive industries, such as cement or container production, and solar power projects, for which 100-metre-wide strips along both sides of the road have been reserved. New farming areas, tourism resorts and housing projects are also planned in the region. Other infrastructure projects include expanding ports, extending railway lines and establishing tourist zones near archaeological sites, at lakes and along Egypt's coast, as well as creating a medical town near Alexandria and several R&D centres (MOI 2009c; FAZ 28 July 2010).

SME promotion

Since January 2010, GAFI has also been active in SME promotion, with the aim of uniting SME development activities in a more comprehensive strategy that targets companies with capital between EGP 2 and 25 million – companies that are somewhat larger than the SFD's normal targets and smaller than most IMC beneficiaries.[40]

The strategy includes three elements: (i) business development services (BDSs), (ii) access to finance and (iii) skills development. A fourth element – cluster development – was put on ice after the revolution in January 2011.

All three pillars focus on industries that have high potential to create jobs and increase output but that suffer from significant gaps in know-how and access to capital. These industries include agriculture and food processing, logistics, health and education services, lab analyses, renewable energies and water-conservation instruments, such as sprinklers.

Business Development Services. In cooperation with the Canadian International Development Agency (CIDA), GAFI has started developing 18 service centres across the country

39 ESCWA (2007, 43); Bergmann (2009); and interview with Hassan Omar, MFTI, 17 June 2009.

40 Information from Samer Radwan's presentation in the GAFI head office, 24 June 2009, as well as interviews with Reem Elsaady, GAFI, 5 May 2010 and Emran Omran, CIDA, 22 June 2009.

under the name *Enterprise Egypt* or *Bedaya* ('beginning') *Centre for Entrepreneurship and SME Development*. These centres are meant to be reference service points for SMEs to get training, legal consultancy and information about investment and marketing opportunities, as well as finance and insurance. GAFI does not provide or pay for BDSs, but rather facilitates demand-and-supply matching in the BDSs. GAFI follows the model of the CIDA, which has cooperated with NGOs on Egyptian SME development for many years.

Access to finance. GAFI mainly sees itself as a facilitator of SME financing. It analyses SME investment projects, facilitates contact to banks and locates alternative sources of finance. In order to help SMEs overcome their scepticism vis-à-vis banks, GAFI has developed an inventory of finance providers with their respective product portfolios (credit, leasing, private equity) and conditions. Many SMEs mistrust banks, which have very severe penalties for borrowers who default. GAFI explains to SMEs that finance is not always the answer to their problems: sometimes BDSs are needed instead of a loan. GAFI helps banks better understand SMEs, and their needs and problems, as well as to develop better products and reduce the costs of SME transactions.

GAFI has also established a private equity fund with other stakeholders that provides equity capital to SMEs that are selected according to specific criteria: (i) demonstrable corporate social responsibility, (ii) labour-intensive production, (iii) environmental friendliness, (iv) economic sectors that are essential for the Egyptian economy but lack access to financial products, (v) location in underserved governorates and (vi) risk orientation (50 per cent high risk, 50 per cent medium risk).

Skills development. Before the revolution, GAFI also wanted to build up a post-graduate training programme as a third pillar to provide management skills, personal skills (communications, risk-taking, behaviour, etc.), financial-instruments know-how, and exercise in developing and exploiting business ideas for junior and senior SME managers. Although the programme was supposed to be highly subsidised GAFI was planning to charge a fee to ensure participants' commitment. However, this plan has not been implemented so far.

To avoid duplicating efforts, GAFI signed an agreement with the SFD stipulating that GAFI would not serve companies with profits under EGP 2 million while SFD would refer firms that were earning more than that to GAFI.

However, there is a great deal of overlap between the activities of GAFI and the IMC. The IMC serves only manufacturing companies but it provides services to medium-size and large ones with the effect that manufacturing companies with profits below EGP 25 million are eligible for support by both, GAFI and the IMC.

4.5 Strengths and weaknesses of the strategies and instruments

The industrial policy instruments implemented by the Egyptian government between 2004 and 2011 remain effective, even after the January 25th revolution in 2011 and the Muslim Brotherhood coming to power in 2012.

They are better than earlier policies in two respects:

Clear and concrete vision. The instruments are based on a realistic analysis of the Egyptian economy's strengths and weaknesses and chances and challenges for structural change. They have a clear vision of industrial transformation with precise and realistic goals, relevant indicators of progress and priorities for intervention. They also include a manageable set of effective instruments.

Customer orientation. The state has the role of facilitator rather than regulator or entrepreneur as in earlier industrial policy strategies. All services are to be provided only on demand by public agencies instead of the government itself – in order to prevent politically motivated interventions in routine procedures. For the first time ever, industrial policies in Egypt are thus market- and demand-oriented rather than state-interventionist and redistributive.

However, the industrial policies implemented between 2004 and 2011 still suffer from significant flaws in design with regard to several other of the 'criteria of success for industrial policies' identified in Chapter 2:

No participatory policy formulation. None of the programmes was designed and implemented with broad private sector participation. The government consulted a limited number of handpicked people from the private sector and academia, many of whom were already in regular contact with members of the new government. (Many of the businesspeople belonged to Gamal Mubarak's market-friendly wing.) The private sector as a whole was not involved. Admittedly, this would have been difficult because at that time the Federation of Egyptian Industries and the chambers of commerce and industry were not independent and could not voice any criticism. Egypt's business associations were small and dominated by a couple of big and well-connected enterprises (see Section 3.1).

No regular impact assessments. Although each programme has a mechanism for regular monitoring, it is based on reports drafted by the implementing agencies rather than by independent evaluators. The reports are only submitted to the responsible line ministry that elaborated the programme itself and is also responsible for the respective implementing agency. Furthermore, the reports only contain input and output indicators only, while outcome and impact indicators are not measured. Finally, the lack of a standard sanctioning mechanism means it is not obvious if the implementing agency has done its job properly – or not.

No clear responsibilities. The division of labour between line ministries and implementing agencies is also an issue. From the beginning, some ministers attempted to extend their competencies at the expense of others. Some of them did so in order to increase their influence – like the Minister of Finance, who sought to acquire competencies in the field of SME promotion – while others were motivated by the idea of providing a more comprehensive approach – like the Ministry for Trade and Industry that wanted to integrate foreign investment promotion and the provision of micro-credit into its industrial development strategy. Remarkably, the government learnt that it had to draw clearer lines and to assign unambiguous responsibilities to all ministries – however at the cost of isolating the programmes of different ministries and further exacerbating their coordination (see Figure 3).

No effective, non-discriminatory instruments. The programmes employ a remarkable variety of business development instruments. Some market analysts interpret this as an expression of governmental insecurities:

> *"I would describe it as fireworks. The government is starting every rocket it has wherever it might go to. On the one hand, the government wants to demonstrate that it is doing all it can do to attract investors. On the other hand, it has no idea which instruments and sectors are most promising for Egypt."* (Angus Blair, head, Beltone Financial, 22 June 2009)

Still, the programmes are centred on FDI promotion and business development services (BDSs), and neither, the cluster nor value-chain approach play an important role.

The cluster approach is used by only one component of each, the industrial development and the SME promotion strategy. This may be due to the fact – but also at least partly explain it – that only very few Egyptian companies belong to a functional cluster:

> *"The problem in Egypt is that we don't have clusters, only industrial zones."* (Mohamed Abo El Wafa, USAID, 21 February 2012)

The few exceptions include a furniture cluster in Damietta (already founded by the late King Farouk), an information and communications technology cluster in Smart Village near Cairo, a marble and granite cluster in Sha'a El Te'aban, a leather-manufacturing cluster in Robiky, a honey cluster in Al-Minya, a textiles and garments cluster in Mahalla al-Kubra, handicraft clusters in Siwa and Upper Egypt, and tourism clusters in Sharm El-Sheikh and other seaside resorts.[41]

As for the value-chain approach, it is used in just one IMC programme, which helps suppliers of large exporting companies (especially in the automobile, food processing and traditional handicrafts sectors) become more efficient. Some observers believe that Egypt is not yet ready for the value-chain approach because of the low quality of products manufactured by SMEs. They recommend that exporters integrate the whole value chain into their companies so they can control every step.[42]

No well-tailored incentives. Financial support plays a very important role in Egypt's industrial policy, and it is neither conditioned to the performance nor to a specific behaviour of the recipients. In addition, the beneficiary's level of co-financing is also low. For example, energy and water are still highly subsidised – in 2008 they cost the government more than 7 per cent of GDP. In some branches, firms are granted subsidies of 15 per cent of the net value of their exports. And private enterprises receive refunds up to 95 per cent of their costs for workers' training, technical upgrading and the like.

No rational prioritisation. At first glance, the Nazif government's industrial policies appear to be horizontal and they are backed by a general open-door policy. While some pro-

41 Interviews with Emran Omran, CIDA, 22 June 2009; Samir Radwan, then advisor to GAFI, 24 June 2009; and Selçuk Tanatar, IFC, 21 June 2009. See also El-Megharbel (2008, 19–21).

42 Interviews with Azmy Aly, SFD, 17 June 2009; Natalija El-Hage, GTZ, 23 June 2009; Ahmed Geneidi, Friedrich Ebert Foundation, 15 June 2009; Nader Riad, CEO, Bavaria Egypt, 23 June 2009; and Selçuk Tanatar, IFC, 21 June 2009.

grammes like the IMC are formally targeted to selected economic sectors (a vertical approach), there are so many sectors that the strategy has the effect of a horizontal approach.

Yet close examination reveals that the industrial policies are actually quite selective – yet for different reasons. They discriminate between enterprises using several criteria, most of which are incompatible with a 'rational' prioritisation:

- *Firm size.* The programmes employ three different strategies (i) for medium-size to large formal-sector manufacturing enterprises (IMC), (ii) for other small to medium-size enterprises (GAFI) and (iii) for micro- and small enterprises (SFD) – with leakages in and duplications of responsibility between the programmes.
- *Export orientation.* In some sectors, exporters are granted subsidies by the Export Council. In addition, companies that export 50 per cent or more of their products may settle in a free zone, where they benefit from tax and customs reductions.
- *Sector:* Textile, automobile feeding, IT and food-processing companies enjoy privileges over producers in other branches – for example, with respect to subsidies granted by the Export Council. This differentiation is particularly remarkable because the selection of target branches is based on arbitrary decisions in all programmes rather than a sound analysis of current and future comparative advantages on world markets. Egypt's textile industry, for example, can only compete with other countries because of its possibilities of preferential access to the US market. Without it, most of the sector would have folded because of the products' low quality and rising costs.
- *Geographical location.* Many programmes are aimed at reducing spatial inequalities and therefore privilege entrepreneurs in Upper Egypt. The IMC, for example, pays much subsidies for modernisation efforts made by companies in Upper Egypt than by those in Lower Egypt.
- *Ownership.* Army-owned companies continue to enjoy numerous privileges (see Chapter 5).

Poor investment climate. The Nazif government stepped up reforms in several fields in order to improve Egypt's investment climate. But major constraints on investors still undercut industrial policy. (This issue will be discussed in detail in Section 5.2.4.)

5 Effects of industrial policies in Egypt from 2004 to 2011

The question is now to what extent the industrial policies that Egypt implemented between 2004 and 2011 did achieve their goal to promote structural change and economic growth and how efficient, transparent, fair and relevant their instruments have been.

In the following, we argue that although this strategy was more efficient and transparent than earlier strategies, its effects on structural change were limited for five reasons:

- The strategy did not effectively compensate for market failures – such as the lack of coordination between investors in a sector or deficits in the provision of sector-specific public goods – which typically prevent structural change. The IMC-subsidised workers' training is one of the few exceptions in this regard.
- The policies had adverse effects because they provided very generous financial support. Thereby, they reduced, for example, Egyptian exporters' incentive to innovate.

- Their multiple inefficiencies reduced their potential impact on structural change. For example, having three separate strategies issued by different ministries duplicates structures and results in a lack of coordination and gaps in responsibility. Overstaffing raises overhead costs. The IMC's broad targeting criteria caused a large error of inclusion. And there was no independent impact evaluation for any of the policies.
- The policies were too focused on large and well-established companies, which were already exporters or could have become exporters even without government support.
- The policies addressed only a small fraction of the structural problems that plague private enterprise development in Egypt – among them, the tax and financial systems, customs procedures and excessive regulations – so that the business environment still suffers from many fundamental constraints: low-quality education and training, distortions in market competition, deficits in the rule of law, a lack of transparency in decisions taken by the government, the public administration and the judiciary, and the private sector's lack of voice and political participation.

This chapter elaborates on these findings. Section 5.1 examines macro-economic data for evidence of the effects of Egypt's industrial policies from 2004 to 2011. Section 5.2 assesses the immediate effects, efficiency, transparency and fairness and relevance of the core policy instruments. Section 5.3 seeks to explain the strengths and weaknesses identified in the two preceding sections. And Section 5.4 analyses, which groups of entrepreneurs benefited the most from the Nazif government's industrial policies.

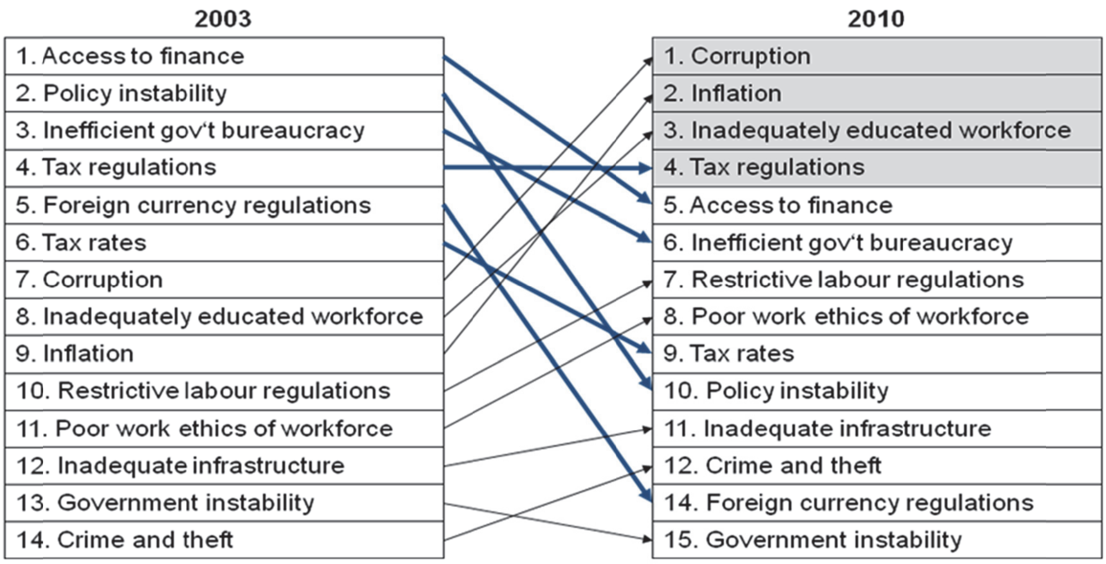
5.1 Macro-level evidence

Any thorough assessment of public policies should be based on an evaluation of their impact. Unfortunately, however, it is difficult to demonstrate the impacts of industrial policies (just like those of many other policies) because it is hard to prove the causality between inputs and impacts. In addition, no rigorous impact analysis has ever been conducted in Egypt. So we can study target indicators, such as economic growth, export quota and diversification indices but we do cannot be sure whether what we observe can be attributed to industrial policies, policies in other fields – or changes in the policy framework conditions.

Egypt experienced very positive economic development after the cabinet reshuffle in 2004, when another growth spurt began. It lasted at least until the global financial and economic crisis reached Egypt in December 2008, and partly until the January 25th revolution in 2011. (Egypt suffered much less from the global crisis than many other developing countries and continued to grow even in 2009 and 2010, see Section 3.2).

For the third time since 1981, a programme of profound and serious economic reform removed some of the most binding constraints on investment and growth, liberating some of the potential of the Egyptian economy (see Figure 2). In 1981 and the following years, central planning, import restrictions and burdensome market regulations had been eliminated. Starting in 1991, price, interest-rate and capital-transfer controls were removed. After 2004, tax and customs tariffs were simplified and reduced, the financial sector was deregulated and bureaucratic procedures were streamlined. As a result, the Egyptian economy grew by 5-6 per cent annually between 2004 and 2010. Annual FDI grew more than six-fold – from about USD 1 billion in 2004 to an annual average of more than USD 7 billion between 2007 and 2010. Exports rose from about USD 8 billion in 2004 to USD 29 billion in 2010 (imports, however, increased even faster).

Figure 4: Main constraints for doing business in Egypt – according to the World Economic Forum Global Competitiveness Reports (GCRs) of 2003 and 2010



Note: This figure compares the results for 2003 (prior to the 2004 cabinet reshuffle) with those for 2010 (right before the revolution) because the 2011 results reflect already the effects of the revolution.

Source: see Table A3 in Annex

According to reports comparing various countries, Egypt has significantly improved in the focus areas of the post-2004 reforms. While in 2003, the GCR listed 'access to finance', 'policy instability', 'tax rates', 'inefficient government bureaucracy' and 'foreign currency regulations' among the top five reasons for businesses in Egypt to be concerned, the problem areas had changed until 2010(see Figure 4).

Other benchmarking reports also support this finding:

— *Deregulation.* For several years, according to the World Bank Doing Business Reports, Egypt ranked among the top reformers. For example, for 'starting a business' between 2006 and 2011 Egypt rose in rank from 124th to 18th and for 'registering property' from 147th to 93rd. Regarding the 'burden of government regulation', Egypt rose in the GCR from 74th in 2006 to 51st in 2010.

— *Financial sector development / access to finance.* Between 2008 and 2011 Egypt rose in rank from 102nd to 72nd in the World Bank 'getting credit' category and from 82nd to 49th in the GCR 'ease of access to loans' category between 2006 and 2010.[43] Egypt also rose in the GCR categories of 'venture capital availability', 'local equity market', 'restrictions on capital flows' and 'soundness of banks'.

— *Customs procedures.* According to the World Bank Doing Business Reports, Egypt rose in rank from 86th to 21st with regard to 'trading across borders'. In the GCR, it rose from 69th (2007) to 50th (2010) in the 'burden of customs procedures' category.

At the same time, of course, difficulties in other areas have become most binding constraints for investors and for economic development in general. According to the GCR, in

43 In 2011 Egypt slipped to the 74th position in the GCR 'ease of access to loans' category – probably because of the revolution in January 2011.

2010 these areas were ‘corruption’, ‘inflation’ and the ‘inadequately educated workforce’, T while ‘tax regulations’ continued to be 4th on the list (see Figure 4).

According to other benchmarking reports (see Tables A2 and A4 in the Annex) , the most problematic areas include the following:

— *Quality and relevance of education and training.* In the GCR, Egypt dropped from 106th to 131st position with regard to the ‘quality of the educational system’ and from 84th to 112th with regard to the ‘extent of staff training’. In particular, Egypt’s position worsened regarding the ‘quality of maths and science education’ and ‘managerial training’.

— *Rule of law (contract enforcement, independence of the judiciary, protection of investors’ rights).* Settling a dispute in Egypt involves lengthy, unpredictable and expensive procedures that on average cost one-fifth of the claim’s value (OECD 2007, 30). With regard to ‘judicial independence’, in the GCR Egypt dropped in rank from 40th to 64th, and from 44th to 67th in the ‘intellectual property protection’ category.

— *Corruption and unfair competition.* Egypt’s position in the GCR slipped from 48th to 63rd with regard to ‘favouritism in decisions taken by government officials’ and fell from 58th to 83rd with regard to the ‘diversion of public funds’. The country plummeted from 55th to 95th with regard to the ‘extent of market dominance’ and from 74th to 106th regarding ‘effectiveness of anti-monopoly policy’.

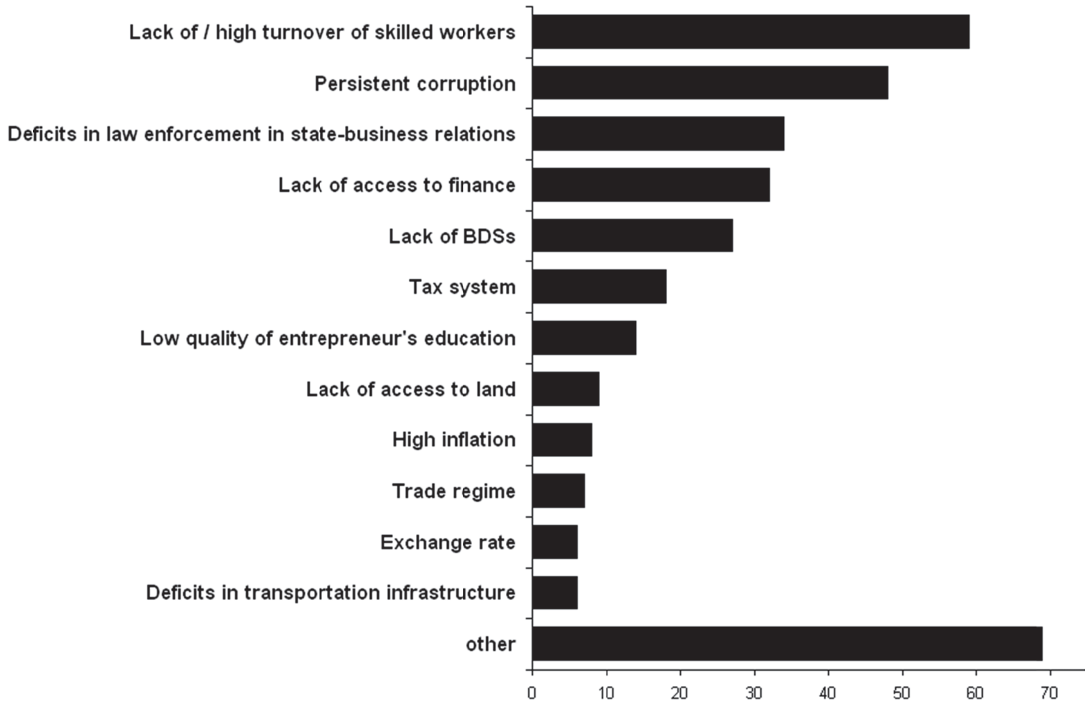
— *Private sector consultation and participation in economic policy-making.* Remarkably, neither the World Bank Doing Business Index nor the World Economic Forum GCR has a category measuring private sector participation in political decision making, although it is an important aspect, which improved only slightly in Egypt under the Nazif government. As we have argued before, some major, well-connected entrepreneurs enjoyed access to and influence on policy-makers between 2004 and 2011, but the mass of micro-, small and medium-size companies still lacked adequate representation. (This issue is discussed in more detail in Section 5.2.4).

— *Availability of land:* Egypt improved in terms of the costs and time needed to register property according to the Doing Business Reports, see Table A2 in Annex). Also, land is for offer to entrepreneurs, but it is often far from where the entrepreneur and workers live, and is becoming more and more expensive. (This issue is also discussed in more detail in Section 5.2.4).

A study on SME upgrading in Egypt conducted in early 2012 by a team of researchers from DIE and the Egyptian Center for Economic Studies (ECES) supports these results. It concludes that the main structural constraints for SMEs in Egypt are (i) the entrepreneurs’ low quality of human capital (education, work experience and international exposure), (ii) the lack and high turnover of skilled workers, (iii) the lack of market information, (iv) difficulties in access to finance, and (v) persistent deficits in the rule of law (including corruption and unfair market competition). Compounding these constraints are (vi) problems accessing land, (vii) inadequate BDSs, and (viii) shabby transportation infrastructure (Loewe et al. 2013; see Figure 5).

But what about the more immediate goals of industrial policies – increased productivity, product diversification, structural change, technological upgrading and export development? How did the Nazif government industrial policy strategies impact them?

Figure 5: Main obstacles for SMEs in Egypt – according to a case study from 2012



Note: Percentages refer to the share of households that mentioned the respective obstacle in open or closed questions.

Source: Own design. Primary data of survey conducted for the study by Loewe et al. (2013)

To answer these questions, we have little besides the GCR ranking lists, which must be carefully interpreted. Although they roughly sketch improvements and degenerations, only major changes should be taken seriously. The lists do not lend themselves to cross-country comparisons.[44]

Investments and exports skyrocketed. Between 2004 and 2008, annual FDI inflows rose by 90 per cent, exports by 20 per cent and manufacturing exports by 30 per cent. In 2008, 20 per cent of all manufactured goods were produced for export. The furniture and wood industry realised the steepest increase in exports (52 per cent each year) – but it accounts for less than 2 per cent of all Egyptian manufacturing. Exports for the chemical industry followed with an annual 47 per cent rise, the engineering industry marked an annual 38 per cent rise and the food-processing industry was up 28 per cent each year. All these industries are dominated by large producers. At the same time, textiles exports only rose 17 per cent annually.[45]

44 For the GCR indices, a small, representative sample of people is interviewed every year in each country. Often, only medium-size and large entrepreneurs are included. In addition, the interviewees tend to compare their situation with the business climate in similar (i.e. often neighbouring) countries: Jordanians, for example, compare themselves with Egyptians or Syrians rather than with Estonians, while Belgians and Italians compared their country with Denmark and Spain not with Jordan or Algeria. A global ranking therefore tends to overestimate variations within regions and sometimes neglects differences between them. This explains, for example, why in some years Italy scored worse than Egypt with regard to corruption or Belgium scored as low as Jordan. Cf. Loewe et al. (2007, 60 f.).

45 IMC (2009, 10) and an interview with Hany Barakat, first undersecretary, MFTI, 17 June 2009.

But again: Can these achievements be attributed to industrial policies or are they mainly due to positive trends in the framework conditions – for example, growing global demand and greater offers of FDI capital? And would Egypt have been able to sustain the higher level of exports without the 2011 revolution that reduced domestic production and exports? To what extent did the increase in exports between 2004 and 2011 result from generous energy, export and modernisation subsidies instead of policy reforms? And what will happen when these subsidies are eliminated? Answering these questions requires more reliable data on how the Egyptian economy has developed in terms of productivity and competitiveness.

The average technology content of exports is still very low, despite modest successes in some sectors. For example, until 2004, Egypt used to mostly export raw marble blocks, and now it mostly exports finished marble products.[46] The share of tanned leather (compared with raw leather) has risen from 20 to more than 50 per cent.[47] But raw materials still account for more than half of Egypt's exports, while another 35 to 40 per cent are semi-finished products (AfDB et al. 2011; EIU 2011).

According to the World Economic Forum (WEF), *production processes* have become more sophisticated: In this regard, Egypt climbed from rank 74 in 2006 to 46 in 2010 – according to the GCR.

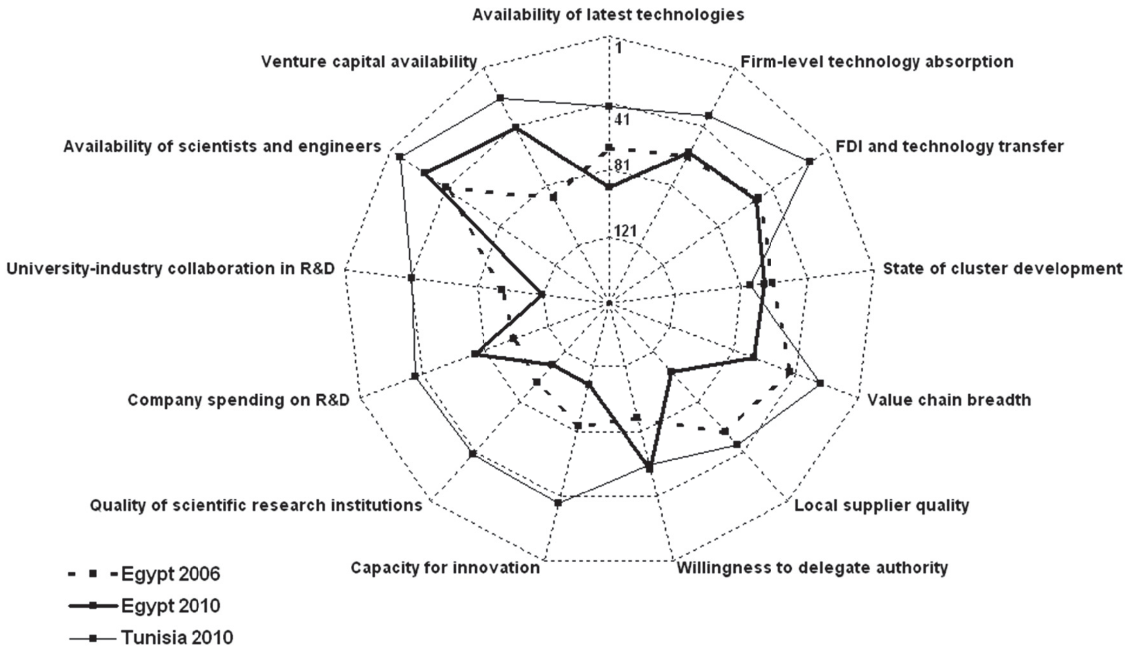
However, in terms of other aspects of technological and business sophistication, despite all the efforts made by the MFTI and its affiliated agencies in the fields of innovation, technology transfer and modernisation, Egypt's GCR rank generally deteriorated between 2006 and 2010:

— *Availability of latest technologies:* 67 to 91
— *Firm-level technology absorption:* 60 to 58
— *Technology transfer through FDI:* 51 to 53
— *Local supplier quality:* 56 to 104
— *State of cluster development:* 61 to 66
— *Value-chain breadth:* 44 to 67
— *Capacity for innovation:* 84 to 109
— *University-industry collaboration in research and development:* 95 to 120
— *Quality of scientific research institutions:* 96 to 110 (see Table A4 in Annex and Figure 6).

46 This is probably the result of very focused government intervention that is not at all typical for its industrial policies in general. In the marble sector, the government created synthetically clusters of cooperation and national value chains between large, medium-size and small companies (interview with Steven Lee, consultant, 2 May 2010).

47 Interview with Hany Barakat, first undersecretary, MFTI, 17 June 2009.

Figure 6: Egypt's ranking in 2006 and 2010 compared with Tunisia in 2010 – based on indicators of structural change in the WEF Global Competitiveness Reports



Source: WEF (2006); WEF (2010)

Most observers believe that many of Egypt's exports can only compete on world markets because of high energy and water subsidies, as well as export subsidies and other artificial competitive advantages such as the QIZ free-trade agreement with the US.[48]

> *"Egypt exports automobile parts such as cable harnesses, screw sets and formworks for the trunk. These products can be produced with limited know-how, you can pile them up, and their production is comparatively energy-intensive. Admittedly, the only reason Egypt can be competitive here is because it heavily subsidises its energy."* (Wolfgang Klos, National Automotive Co., 15 June 2009, German original)

Three rounds of economic reforms have spurred economic growth, attracted FDIs and promoted exports. But there is little sign of technological progress – perhaps at least partly because preferential trade agreements and the availability of cheap energy reduce Egyptian entrepreneurs' incentive to innovate:

> *"Currently, we are strong in the textile sector, but our competition in this field is fading away. The fact that we can still compete is based on artificial trade arrangements with the US, energy subsidies and subsidies paid on exports. Government interference has thus prevented the Egyptian industry from building real competitiveness."* (Akrum Bastawi, MFTI, 21 June 2009)

Other challenges include the Egyptian workforce's low-quality and largely irrelevant education and training, persistent deficits in the rule of law, widespread corruption, unfair market competition, inadequate private sector representation and shortages of affordable land. These issues will be discussed in more detail in Section 5.2.4.

48 Interviews with Ashraf Dowidar, IDA, 21 June 2009, and Ahmed Galal, Economic Research Forum, 14 June 2009.

5.2 The instruments and their implementation

In the following, we substantiate our first impressions of the impact of Egypt's recent industrial policies – based on macro-data – by more closely examining the instruments used and their immediate effects. The analysis shows that the instruments used to implement Egypt's industrial policies between 2004 and 2011 – many of which are still being used – may have been effective – at least to some degree – in promoting foreign investment and exports. But they were – and are – much less effective for reaching the main goal of industrial policies: the promotion of structural change, or the shift of capital and labour to new economic sectors that allow for new and higher gains (see Chapter 2). In addition, these instruments are weak in terms of efficiency and significance. They are more transparent and fairer than many other Egyptian government programmes but they also predominantly target the large and some medium-size companies rather than micro- and small enterprises. And they do not really help the latter to upgrade and become medium-size or large companies that can export their products directly.

We explain our conclusions in four separate sections that assess the Nazif government industrial policies with regard to their (i) effectiveness, (ii) efficiency, (iii) transparency and fairness and (iv) relevance for structural change. Box 1 summarises the main results.

Box 1: Main deficits of the industrial policies implemented by the Nazif government (2004–2011)

Effectiveness:

— *The Nazif government industrial policy instruments – most of which are still being used – managed to promote investment and exports until the revolution in 2011. However, they have been rather ineffective in facilitating structural change.*

— *One reason is that these instruments do not properly target the main market failures that usually prevent structural change.* They create public goods (e.g. workers' training) and encourage risk-averse Egyptian entrepreneurs to modernise their firms (mainly by generously subsidising the necessary investment costs). But they do not help overcome coordination failures within sectors, create the public good R&D or direct investments in sectors that are considered important for global competitiveness, social development and environmental sustainability.

— *Some of the instruments adversely affect structural change.* They generate very generous transfers that allow many Egyptian exporters to compete on world markets but at the same time reduce entrepreneurs' incentive to boost their own competitiveness.

— *Some instruments are selective without a reason – and distort markets.* They favour exporters (as opposed to companies that serve the domestic market) and manufacturing enterprises, especially in the textiles, engineering, chemical and food sectors (over those in agriculture or the service sectors), as well as medium-size to large companies (over micro- and small firms).

Efficiency:

— *The coexistence of at least three main strategies leads to the duplication of administrative structures, a lack of coordination and gaps in responsibility.* Overstaffing raises the SFD's overhead costs, while the IMC's broad targeting criteria create huge errors of inclusion. (For example, all exporting companies received export subsidies – even if they had already been very successful on world markets for many years.)

— *The instruments have no mechanism for independent impact evaluations.*

Transparency and fairness:

— *The instruments do not help small enterprises upgrade and grow into large, would-be exporters.* They focus on medium-size to large manufacturing companies that are already exporters or almost ready to conquer export markets – and that are generously supported by the IMC. While MSEs are entitled to assistance from the SFD and GAFI, they receive much less than what the IMC gives to large firms.

Relevance:

— *The instruments can only have limited relevance as long as very serious deficits prevail in the broader business environment* – especially regarding the education and training of entrepreneurs and workers, the rule of law, transparency and fairness in competition, private sector representation and the availability of affordable land.

5.2.1 Effectiveness

The Nazif government's industrial policies tangibly affected investment and export promotion. However, their instruments had little impact on economic diversification because they did not properly address the market failures that typically hinder structural change; some even had adverse effects.

All observers agree that the Nazif government did a comparatively good job in attracting FDI to Egypt. Many people praise the GAFI in particular for making life easier for investors. On the one hand, it tries to make administrative procedures transparent so that (i) investors know what they have to do to register and get licensed, and (ii) public officials have less scope for arbitrary decisions.

On the other hand, GAFI has assumed the role of facilitator between businesspeople and the public administration:

> *"Generally when penalties occur or if there is a problem with the governorate, we approach GAFI and generally they agree with us… GAFI responds quickly, and at the same time they don't rush people. Their next step is always to go and see the governor to resolve the problem in a friendly manner. GAFI is an 'intermediary between the two parties'."* (Egyptian entrepreneur quoted in Yousfi / Humphrey 2008, 30)

Likewise, observers believe that the Nazif government industrial policies significantly helped boost Egypt's exports. The export promotion activities of the IMC and the export councils have enabled many companies to sell their products abroad:

> *"In January 2010, we have declared the goal to enable another 1,000 Egyptian factories to export. And we have already succeeded during the first four months of 2010 in adding 400 newly exporting factories."* (Hesham Dayem, IMC, 27 April 2010)

The IMC also did a good job in modernising and technically upgrading more than 14,000 companies between 2005 and 2009: 53 per cent of its services were used to train workers, 14 per cent to help companies adopt international standards and become certified, 7 per cent to innovate, 6 per cent to participate at fairs and 4 per cent each to pay for financial services and marketing support – with just 0.1 per cent to support R&D. (IMC 2009, 8)

> "*Before we applied for support by IMC, almost all our business was done in Egypt. Then IMC helped us to increase our sales both locally and abroad. The main reasons why we were able to increase our exports were: first, that our product design is much more demand-driven now; second, we now have a new vision of quality and standards. We were given intensive advice by IMC consultants on product standards, environmental standards, quality standards, etc. Third, we were able to further automate our production. IMC has funded advice on the purchase and use of software in our production and of course, the export subsidy of the Export Development Authority was also helpful for us*." (Ahmed Abd-el-Fattah, Contistahl Group, 29 April 2010)

The question remains whether such policies also help overcome the market failures that we have identified in Chapter 2 as the main reasons for implementing industrial policies. In this regard, their contribution appears to be modest since they do not address failures of coordination within economic sectors. They may be slightly more effective in allowing for dynamic economies of scale, establishing quality reputation and easing firms' access to capital. But over-generous financial support that enables recipients to become or remain competitive without making any innovations or adjustments is counterproductive.

Public goods

The MFTI industrial policy strategy contributes to the creation of public goods, and in particular has improved workers' skills by subsidising on-the-job training courses in different economic sectors. Private enterprises often invest less than they should in assets that help an economy develop and diversify because of fears that competitors will benefit from their investments by copying new products or modes of production, or by luring away their newly trained workers. In fact, private sector spending on R&D and training has always been low in Egypt, and the state is smart to provide support in these areas. The effect of training is expected to be considerable: since the IMC declared it would refund up to 95 per cent of the costs, many companies have begun to train their workers.

The actual effect of the MFTI industrial policy strategy on R&D, however, is meagre. Between 2004 and 2008, total spending on R&D actually slightly decreased in Egypt – from 0.27 to 0.23 per cent of GDP, which is even less than the average of all Middle East and North Africa (MENA) countries. Some countries such as Syria or Algeria spend even less on R&D than Egypt. But between 2000 and 2009, spending on R&D in Jordan averaged 0.34 per cent of GDP, while in Morocco it averaged 0.64 per cent, in Tunisia 1.1 per cent and in Israel 4.5 per cent of GDP (Al-Ayouty 2012, 15).

First, this is due to the fact that IMC spends just 0.1 per cent of its budget on R&D services and the ETTICs have served at most 1,000 companies.

Second, the private sector is reluctant to request the services offered by the government. Very few entrepreneurs ask the ETTICs for R&D support. They prefer to receive financial support that helps them at that very moment; research could only help them sometime in the future. Many entrepreneurs are also unaware of the role that continuous research and innovation play in boosting a firm's competitiveness on global markets:

> "*I believe that the lack of laboratories is not the main problem. It is culture! Companies in Egypt are underestimating the importance of innovation. Also, they are not risk takers. They try to do always the same thing again as they have learnt it rather than to do something new.*" (Dalia Gamal, TIEC, 4 March 2012)

Third, many researchers in Egypt are reluctant to conduct application-oriented research. They prefer to collect credits for their academic careers.[49]

The ETTICs – which were explicitly founded to transfer technology and know-how to Egyptian investors – are not very effective, either. Most of the staff comes from the public administration with some employees from the private sector. But all of them are unfamiliar with research and do not understand themselves university studies – although they are expected to use and explain them to their clients.[50]

> "*Once I commissioned one of these institutes with a research project: I placed the order and paid and then ... I've never received anything for my money. One problem is that they are expected to find local providers. Therefore, they offer only what the*

49 Interviews with Akrum Bastawi, MFTI, 21 June 2009 and Mona El Tobgui, senior advisor, Fraunhofer Society, 18 June 2009.

50 Interviews with Natalija El-Hage, GTZ, 23 June 2009 and Mona El Tobgui, senior advisor, Fraunhofer Society, 18 June 2009.

> *country has. But researchers in Egypt are usually not customer-oriented. And the solutions they offer are sometimes even more expensive than the services that you can buy from internationally renowned experts. And sometimes these solutions do not even constitute an improvement over the way you did it before.*" (Nader Riad, Bavaria Egypt, Egyptian entrepreneur, 23 June 2009)

Some of the ETTICs seem to perform better than others: the Food Centre, the Plastic Centre and the Fashion Centre are all quite effective. The Fashion Centre, for example, has hired Italian designers and offers useful know-how to the private sector, while the Engineering Centre has provided the private sector with hardly any services.[51]

Coordination failure

At the same time, industrial policies in Egypt hardly address coordination failures. One of the central arguments for industrial policies is that private entrepreneurs depend on complementary activities in their sectors. For example, investments in power generation only make sense if they are combined with investments into the transmission of power to consumers. The sector cannot develop unless someone coordinates all relevant parties and possibly supplies the missing components. But such engagement requires strategies to develop the sector, such as those the government, business associations and donors elaborated in Jordan between 1998 and 2001 for its eight most promising economic sectors.[52]

Egypt, however, has hardly made any tangible efforts of this sort:

> *"There are always gaps in investment, which constitute an obstacle for the development of basically promising sectors. These gaps will not be filled without a strategy. This requires coordination. You need a plan for that. And you must have a vision. But there is no plan and no coordination in Egypt.* […] *IMC and IDA and GAFI and the others have all just addressed one or two little problems and provided support to whatever company. But if you want to move forward, you must have the entire sector in mind – the entire economy! And you need a deep-going, holistic strategy, which is written by the private sector together with the public sector."* (Steven Lee, consultant, 2 May 2010)

The Egyptian government has focused on large companies in the belief that in the long run they will help small ones. But the SME sector has not taken off because of the lack of business links between large and small companies. The government has not made much effort to establish such links or to supply missing investments in promising economic sectors such as, for example, the production of tools for the engineering industry.[53]

One of the very few exceptions in this regard is the marble and granite sector, which like other sectors, was characterised by large companies co-existing, but not cooperating, with SMEs. The small firms used to sell their products domestically while the large ones mostly exported their products. All Egyptian firms were restricted to quarrying raw marble; the processing was mainly done abroad. Then the government, in cooperation with producers

51 Interviews with Frank Giesel, Chamber of Food Industries, 25 June 2009; Hassan Omar, MFTI, 17 June 2009; and Nihal El-Megharbel, economist, 15 June 2009.

52 Cf. MOPIC (2003); YEA (2000); YEA (2006).

53 Interview with Nihal El-Megharbel, economist, 15 June 2009.

and suppliers in the sector, reshaped the sector and synthetically constructed value chains. Now many SMEs cooperate with larger firms, and a much larger share of Egyptian marble and stone products is processed in the country rather than abroad: the domestic segment of the value chain has been considerably lengthened.[54] Steven Lee, one of the consultants involved in this successful experiment, has drawn the following conclusion:

> "*The big companies always want to work on their own because they do not see the advantage of cooperating with others. They rely on their good relations with influential people to stay in the market and perhaps even dominate it. And the smaller ones are afraid to cooperate with the big ones. They have all heard about bad experiences. So, what you have to do is to connect the development of the sector with the development of industrial zones by promoting clusters where you assemble micro, small and medium enterprises. And you teach them to cooperate. When the state assists, they might become less anxious to sell their products to others. And once you have done this, you must try to extend the local content of their products*." (Steven Lee, consultant, 17 February 2012)

The 2012 DIE/ECES field study on SME upgrading found that very few SMEs cooperate with other firms in clusters or value chains (Loewe et al. 2013) although most experts believe that such linkages would benefit all the partners:

> *"We have to promote these linkages [...] as the large provide know-how, technology, introduce international standard and, guarantee market access. On the other hand, small firms can provide parts at a low price. It is a win-win situation."* (Mona Garf, Cairo University, 19 February 2012)

The reluctance to cooperate comes from the way Egyptian businesspeople tend to mistrust each other. They do not integrate their businesses into value chains or clusters because of their concerns about the quality of inputs bought from other firms, the timely delivery of inputs and buyers' possible non-payment (El-Haddad 2008, 18).

This mistrust was created by huge deficits in the rule of law that persisted in Egypt at least until the revolution in 2011. Even today, entrepreneurs do not rely on contracts because of personal experience or hearsay about how laws and contracts have not been enforced.

The Nazif government industrial policies did not change anything in this regard. They neither addressed the general lack of law and contract enforcement nor did they try to create mutual trust among the relevant actors in selected economic sectors. However, private sector development experts believe that the government could boost the horizontal and vertical cooperation of Egyptian enterprises by offering to arbitrate conflicts about contract interpretation:

> *"Clusters do not work in Egypt because people do not trust each other. They could only work if there was a third party involved that is able to create trust within the cluster."* (Yasser Zaher, Banque du Caire, 26 April 2012)

Dynamic economies of scale

The concept of increasing economies of scale could be used as an argument for several services that the IMC provides to companies that invest in product or process innovation.

54 Interview with Steven Lee, consultant, 17 February 2012.

According to this concept, many innovations do not pay off on the first day because they require learning to help reduce production costs over time. For such cases, it is important to not just fund the consultancy but also part of the equipment required for innovating. The IMC does this.

The problem is that the IMC supports almost any kind of innovation: it does not verify – and in any case, cannot assess – if an innovation actually brings about dynamic economies of scale.

The only alternative to the IMC would have been for the government to target funds to the most promising cases, which would have necessitated criteria for identifying innovations that pay off. But for that, the government would have had to understand – better than the companies it sought to help – just how the markets were going to develop.

In some developing countries, including Egypt, a slightly similar argument can be brought forward: Many Egyptian entrepreneurs are extremely risk-averse: they are loath to make any major investment unless they are sure it will pay off–. Such attitudes reduce their own risks, but limit their firms' long-term development potential as well as the growth potential of the economy at large. In this context, the IMC help in reducing innovation costs and limiting individual risks not only benefits the respective firm but also the Egyptian economy as a whole.

The IMC also helps address another market failure by stabilising the market for training and consultancy services. It gives the providers of these services some security that, at least in the medium term, there will be a demand (and the ability to pay) for their services. In Egypt today, many kinds of professional services are offered that were not available before the IMC became operative. Without the IMC, most providers probably would have different jobs!

Lack of quality reputation

The activities of the MFTI and its subsidiaries regarding standardisation and quality management are helping improve the reputation of Egyptian products on export markets. Retailers on export markets must be sure that their Egyptian suppliers adhere to Egyptian standards, which in turn are based on international standards.

Access to capital

The first draft of the Egypt Industrial Development Strategy (EIDS) included concrete steps to improve investors' access to finance. Although the final draft of the strategy did not include these steps, the EIDS mainly addresses medium-size to large enterprises anyway. This segment of the private sector should not have any more problems accessing finance – thanks to reforms in the financial sector. The SFD provides micro-credits to very small companies and GAFI informs SMEs about potential finance providers.

However, access to capital still constitutes a challenge for innovative SMEs – and the government is doing too little to help them (Loewe et al. 2013). In contrast, exporting companies can request export guarantee credits and also receive a cash subsidy of 15 per cent on their export volume – if they belong to the food, engineering, chemicals and textiles sectors.

Social and environmental development

Furthermore, industrial policies in Egypt are not designed to facilitate socially or environmentally friendly structural change. This may be partly due to the conscious departure from the country's industrial policy strategies of the 1960s and 1970s, which were very focused on social goals and had a distorting effect on the economy. But there is no explanation why the industrial policy programmes do not internalise public costs and future gains by promoting sustainable structural change. The EIDS alludes to the potential interest of wind and solar power plants for Egypt, while GAFI requires compliance with basic environmental standards for inclusion in its SME promotion programme. But these are minor details with no major effects.

In practice, Egypt's industrial policies between 2004 and 2011 had a polarising effect in the private sector because their main programme, the IMC, focused on formal medium-size to large manufacturing companies that are owned by prosperous entrepreneurs. Less affluent entrepreneurs are supported by the SFD, which has a much smaller budget than the IMC, although it is mandated to serve the segment of the Egyptian economy that comprises more than 99 per cent of all enterprises. In addition, , the SFD also mostly funds micro-credits and has little left in its budget for non-financial BDSs, which are at least as important for industrial policy. This means that only a tiny portion of MSEs receives non-financial assistance to modernise and upgrade: their benefits are miniscule in comparison with the generous services provided by the IMC.[55]

Adverse effects

The massive financial support provided by the IMC and export councils may help many Egyptian companies but they also have negative effects.

First, while training, modernisation and export subsidies, and cheap energy and tax holidays help national exports compete on world markets, they do not guarantee that the Egyptian economy will modernise or undergo sorely needed structural change and diversification. This 'help' even reduces entrepreneurs' incentives to further innovate and rationalise their production, thus making exporters more dependent on subsidies:

> *"Sustaining the current high level of subsidies in Egypt could greatly weaken the level of competition in the market. Moreover, it may reduce the attractiveness of the market to investors and hinder the growth of emerging sectors."* (Egypt, Arab Republic 2010, 5)

Second, focusing on exports also distorts the market by driving investments into the export sectors and discriminating against enterprises that produce for the local market:

> *"The instruments of IMC are thus an incentive to export rather than to sell on the local market even though every businessperson knows that if you want to grow and export and become competitive on global markets, you have to make your speed on the domestic market."* (Steven Lee, consultant, 2 May 2010)

Even some of the most successful exporters are unable to sell their products at home.

55 Interviews with Azmy Aly, SFD, 17 June 2009; Natalija El-Hage, GTZ, 23 June 2009; and Tamer El-Meehy, Entrust, 28 April 2010.

Their competitiveness on world markets is due to export subsidies that they do not get for domestic sales.

One of Egypt's most successful producers of ready-made garments admits that his business entirely depends on the export subsidy:

> *"I would have to completely stop my exports without the export subsidies. It is only a small amount but without it, I would not sell anything abroad! You must see that the garment market is extremely competitive: Small differences in price can mean that you are out of the market!"* (Louis Bishara, entrepreneur, 13 March 2012)

Third, massive financial support attracts entrepreneurs who are not committed to upgrading their companies. But the IMC cannot follow-up or even condition its support, for example, on the achievement of agreed goals:

> *"The problem is that they do not implement the recommendations. The rich Egyptian entrepreneurs are not very interested in the follow-up. They are happy about the money they receive from IMC for the modernisation of their company. But often you do not know if they really wanted to modernise. So they continue like before."* (Wolfgang Klos, National Automotive Co., 15 June 2009 , German original)

Fourth, some sectors receive more support than others. Export subsidies, for example, are reserved for food, textiles, engineering and chemical products – but why these sectors were selected is unclear. Except for textiles, their exports have grown more than other sectors – but this could well be a result of, rather than the reason for, the focus of Egypt's export promotion. Some of these sectors are fairly old and probably not especially promising for the future: no longer able to compete on world markets, they suffered from the economic liberalisation that accompanied Egypt's accession to the WTO. Inexplicably, services – considered to be a rising export sector – receive no support.

Fifth, the programmes of the various ministries have serious gaps regarding responsibility. The MFTI and the IMC are responsible for dynamic medium-size to large manufacturing enterprises in the formal sector while the SFD works with micro- and small enterprises. The strategies of these two institutions are completely separate and neither of them targets small to medium-size enterprises or large enterprises outside the manufacturing sector. GAFI has partly assumed this task but does not grant any funds. And there is no agency to assist small enterprises as they graduate, formalise and grow into another size class.

> *"The main problem of industrial policies in Egypt is the missing middle: No one is trying right now to help SMEs come out of their trap and grow or get linked with larger companies. Almost all enterprises are micro, all produce for the local market. There is no middle."* (Emran Omran, CIDA, 22 June 2009)

5.2.2 Efficiency

Industrial policies in Egypt suffer from transfer inefficiencies, targeting inefficiencies and inefficiencies in market allocation (dead-weight losses).

The main reason for transfer inefficiencies is the coexistence of at least three main strategies that have been elaborated by three different ministries and are being implemented with little coordination by at least seven different agencies. There is hardly any consultation between the IMC, the IDA and the ITDA although these three bodies are all supervised by the MFTI, while at least five institutions run programmes in the QIZs: GAFI, the IDA, the IMC, the Export Development Centre and the ETTICs.[56] Such duplications of responsibilities make life difficult for investors and raise overhead costs because every programme needs its own administration.

Furthermore, while the IMC is still a comparatively lean agency, the SFD suffers from overstaffing, which makes its overhead particularly high. The explanation given for this is that the SFD has been misused to provide jobs for relatives of higher-ranking public officials who could not find any other employment. Obviously they are not all qualified for their tasks at the SFD:

> *"The SFD programmes are very expensive because they have too many employees. They have to engage all the sons and daughters of officials. So they ended up with more and more bureaucratic procedures because all these people have to be kept employed. And there are hundreds of committees."* (SME consultant, April 2010)

The IMC procedures appear to be more transparent and less complicated and time-consuming than elsewhere:

> *"For us it has taken just 45 days until our application was approved - that is nothing in Egypt."* (Ahmed Abd-el-Fattah, Contistahl, 29 April 2010)

One reason for targeting inefficiencies is the EIDS' overemphasis on financial assistance. Export subsidies equal 15 per cent of the value of the goods, while subsidies for modernisation efforts amount to as much as 95 per cent of the costs. Even worse, none of the subsidies is conditional on any change in behaviour or performance by the beneficiary.

Another reason for targeting inefficiencies is the rampant fraud in most IMC programmes. Beneficiaries and service providers agree on the cost of an arbitrage transaction. Then the service providers issue invoices for prices far above what was actually paid by the clients, who submit the manipulated invoices to the IMC. The IMC refunds up to 95 per cent of the falsified price, which results in a net gain for the beneficiary that will be shared with the service providers. Some observers even report invoices being submitted to the IMC for services that were never provided.

> *"There is so much room for arbitrage in the whole procedure and many consultants just like enterprises make a big amount of money with this*." (Egyptian entrepreneur, April 2010)

Such 'generosity' also produces substantial deadweight effects: Many companies receive financial support although they do not need it.

> *"Of course, some companies get funding although they do not really need it. But why should we not give them the same? There is no need to curtail, as long as we have enough money. For example, there is only one big producer of locks in Egypt. It is a world player. Why should we exempt him from our support? Also there is only one big glass producer, Crystal Asfour. It is the Number 1 worldwide in the production of crystal with 30,000 employees in Egypt. It exports 98 per cent of its products. Why should*

56 Interviews with Ashraf Dowidar, IDA, 21 June 2009; Nihal El-Megharbel, economist, 15 June 2009; Reem Elsaady, GAFI, 5 May 2010; and Ali Kamel, USAID, 17 June 2009.

> *we exempt him? Our goals are: job creation, export promotion, FDI attraction and GDP growth. And the two companies contribute to all of these goals."* (Hesham Dayem, IMC, 27 April 2010)
>
> *"If an entrepreneur wants to modernise, the state pays almost everything for him. This creates perverse incentives. The money is used for just anything but in many cases nothing useful."* (consultant, June 2009)

At the same time, all these programmes lack mechanisms to transparently and independently evaluate their impact and monitor effectiveness and efficiency. The programmes must regularly report to the responsible ministry – but only on the development of inputs and outputs, not on indicators of outcome and impacts.

5.2.3 Transparency and fairness

Astonishingly, many experts[57] maintain that there has been less corruption and unfair treatment in the core programmes of Egyptian industrial policies than in most other policy fields. Most IMC funds have been allocated to large companies; it is more difficult for SMEs to get their applications approved. However, the latter are still in the running, and there is little evidence that either policy-makers or bureaucrats intentionally discriminate against medium-size companies.

For other agencies, however, the picture is a bit bleaker. The SFD, for example, has been accused of misusing its funds for political aims.

The IMC

Implicitly, the IMC's main objective is to help Egyptian companies become exporters. Accordingly, micro- and small enterprises are seldom considered for IMC support because they rarely have export potential. In principle, any company that satisfies this criterion qualifies for IMC support.

A very large share of the IMC budget is allocated to a small group of comparatively large companies – although most of them are already able to export their products.[58] Many of these firms are said to have had good connections to the Nazif government or other members of the Mubarak regime.

One explanation why so much funding went to this small group of 'big shots' is that many of the projects they implemented in cooperation with the IMC were so expensive that they used up a large chunk of the IMC budget. For example, when VW brought an Austrian consultant to help make its Egyptian suppliers understand proper costing procedures, the IMC contributed EUR 125,000 to the project.[59]

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57 For example, Angus Blair, head, Beltone Financial, 22 June 2009; Hanaa Kheir-El-Din, then-executive director, ECES, 2 May 2010; and Selçuk Tanatar, programme manager for industry development, International Finance Corporation, 21 June 2009.

58 Interview with Hany Barakat, first undersecretary, MFTI, 17 June 2009.

59 Interview with Ahmed Wahab, Engineering Export Council, 25 June 2009.

> *"Some medium-size enterprises also benefit from the IMC, but most of the IMC's money is targeted to the very large enterprises even though they could pay for a consultant themselves. Funding them is wasted money."* (Tamer El-Meehy, Entrust, 28 April 2010)

This does not mean that the IMC does not provide any support to medium-size companies. The 2012 DIE/ECES field study on SME upgrading in Egypt reported that 24 of the 102 entrepreneurs said that they had benefited from financial or technical BDSs during the previous five years – most of them provided by the IMC.[60] This included most of the very large firms in the sample but also 11 MSEs[61], while 68 respondents stated that they had not received any BDSs during the previous five years and seven did not answer (Loewe et al. 2013, Table A27).

Apparently, a distinction[62] must be made between the various IMC programmes:

- Enterprise promotion through the IMC cluster programme seems to be very transparent. All the companies in a sector or region are included – regardless of size.
- Most observers also attest to the IMC's fairness regarding the provision of support to individual companies by its standard programmes, which have very clear selection criteria and accept every eligible applicant – although not always immediately.
- The problem seems to crop up when applicants who request non-standard services such as financial support for a special consultancy or a technical solution. In these cases, standard criteria do not apply so the IMC has more flexibility to decide. Of course, some of the big and influential companies have tried to benefit from this flexibility, which means there is room for discretion in IMC decisions.

Particularly in the IMC's early years, there were cases of corruption and preferential treatment regarding requests for non-standard services. When these came to light some staff was forced to leave.[63]

> *"Even IMC is subject to the interference of big and influential companies who want to defend their market position. That is exactly why I call for an independent monitoring of the industrial policy implementation."* (Nihal El-Megharbel, economist, 15 June 2009)

But almost all observers agree that the IMC is much less corrupt than the rest of Egypt's public administration.[64] Applications from some large companies have been approved despite being outside the IMC's scope, but a valid claim from a less well-connected company has rarely been completely rejected – although it may have been considerably delayed:

60 Out these 24 companies, 8 received funding for staff training; 5 export subsidies; 4 consultancy; 4 credit; 2 financial support for travel to international fairs; 2 for the purchase of new machines; and 1 for a quality certificate (according to primary data collected for Loewe et al. 2013).

61 In 2007, before the relevant reference period, 4 of the BDS recipients were micro-enterprises, 11 were small, 7 medium-size and 2 large. At the time of the interview in 2012, 2 were micro-, 9 were small, 7 were medium-size and 6 were large (according to primary data collected for Loewe et al. 2013).

62 Interviews with Akrum Bastawi, MFTI, 21 June 2009; Frank Giesel, Chamber of Food Industries, 25 June 2009; and Natalija El-Hage, GTZ, 23 June 2009.

63 Interviews with Jennifer Bremer, American University of Cairo, 26 April 2010 and Steven Lee, consultant, 2 May 2010.

64 Interviews with Frank Giesel, Chamber of Food Industries, 25 June 2009; Natalija El-Hage, GTZ, 23 June 2009; and Ahmed Wahab, Engineering Export Council, 25 June 2009.

> *"IMC does not exclude enterprises from support as long as these fulfil the criteria. But it has long waiting lists. Entrepreneurs who are not in the focus of IMC are not refused – they get simply stuck on the waiting lists, while others are considered immediately"* (Akrum Bastawi, MFTI, 21 June 2009)

Still, many owners of SMEs complain that they do not benefit from the IMC, and in fact, they are underserved: many of them have never applied to the IMC for support.[65] The IMC[66] offers four explanations for this phenomenon:

- Some medium-size entrepreneurs mistrust government agencies like the IMC and therefore do not request its support.
- Others lack information on what the IMC offers and to whom.
- Some are unable to prepare the IMC applications for support (perhaps because they do not understand the questions) or face problems with the application procedures (they may feel they cannot afford to wait for hours in the IMC office).
- Still others feel that IMC support is not helpful because, for example, they believe that training employees is a waste of working hours.

According to experts outside the IMC, however, the SMEs' limited interest in the IMC programmes has more fundamental reasons. The services the IMC offers and the way it offers them do not correspond to the everyday reality of medium-size companies. For example, many entrepreneurs do not want the IMC on-the-job training that was designed by people from government and large, successful companies that were already exporting. These people had in mind the challenges of national champions that were almost at the stage to offer their products abroad, but they lacked the understanding of medium-size companies that have still some way to go to become exporters.[67]

Furthermore, the IMC has its own incentive to pick winners, the big companies, even if these can already – or are almost able to – conquer export markets. Because the IMC is tasked with transforming as many Egyptian companies as possible into exporters, it is normal that it should prefer to support companies that are already successful rather than medium-size companies that still have to grow a lot. The problem is that this widens the gap in Egypt between the champions and the wannabes.[68]

For a long time, the Egyptian government believed that the big companies would eventually take the small ones with them.[69] But this assumption assumes that the small enterprises are linked to the large ones within the value chain, which is not the case in Egypt. The 2012 DIE/ECES study shows that there is hardly any horizontal or vertical cooperation between Egyptian companies (Loewe et al. 2013).

65 Interviews with Hany Barakat, first undersecretary, MFTI, 17 June 2009 and Reem Elsaady, GAFI, 5 May 2010.

66 Interview with Mohammed Ismail, project manager, IMC, 3 May 2010.

67 Interviews with Khaled Attiah, former executive director, Egyptian Competitive Authority, 3 May 2010 and Natalija El-Hage, GTZ, 23 June 2009.

68 Interviews with Khaled Attiah, former executive director, Egyptian Competitive Authority, 3 May 2010 and Ahmed Abd-el-Fattah, Contistahl Group, 29 April 2010.

69 Interview with Nihal El-Megharbel, economist, 15 June 2009.

On the other hand, the IMC could not just support winners. It had too much money to spend to only consider a few big companies:

> *"You know, IMC likes to give out the money that they have: They are not supposed to keep it back."* (Mohamed Kassem, World Trading Company, 6 May 2010)

The SFD

Although the SFD has a much smaller budget than the IMC, it misuses its funds more often – perhaps because of its longer institutional history. When the World Bank established the SFD in the late 1980s, it was lauded as a model of efficiency, transparency and lean management. Today, however, the SFD suffers from the overstaffing, petty corruption and burdensome procedures common to many Egyptian government agencies.

The SFD was also misused by the Mubarak regime to legitimise the rule of those in government more than other government programmes. The SFD has always been touted as an initiative that shows how much the government cares about the very weak and vulnerable in society – although most SFD funds come from donors rather than the government.

> *"The SFD is ... heavily politicised. When the current director was appointed, he decided to establish SFD lending offices in the premises of the NDP* [the ruling party, led by Mubarak himself; author's note]. *I asked him whether he would also establish offices in the premises of other parties, and he said that of course they could apply for it."* (Consultant, April 2010)

5.2.4 Relevance

The Nazif government industrial policies principally failed because they did not tackle the five most binding constraints for investment and economic development in Egypt:

- low-quality irrelevant education and training by the Egyptian school system, which limits entrepreneurs' capabilities as well as their ability to attract and retain skilled workers
- persistent deficits in the rule of law
- widespread corruption and unfair competition
- inadequate private sector representation
- shortages of affordable land

Industrial policies in Egypt will remain irrelevant unless they address these constraints.

> *"IMC and IDA: what can they do? They do not have the mandate and the capacities and the instruments to bring about changes in the areas that are most binding for businesspeople in Egypt: education and training, bureaucracy, infrastructure and the coordination of investors and government agencies for joint sector-development efforts."* (Steven Lee, consultant, 2 May 2010)

Low-quality, irrelevant education and training

Deficits in the education and training of workers are among Egypt's core challenges:

> *"Recent growth may have brought Egypt to the point where education constraints become binding."* (Enders 2007, 24)

The 2012 DIE/ECES field study showed that the most serious challenge for SME owners in Egypt is the lack and high turnover of adequately trained workers: 35 per cent of the interviewees identified it as the single most important constraint and 45 per cent considered it to be among the top four constraints. The World Economic Forum GCR 2010/2011 ranked the 'lack of skilled labour' second among the most binding constraints to doing business in Egypt (WEF 2011), while a study commissioned by the Egyptian Ministry of Finance (MOF 2008) concluded that SMEs find it difficult to keep qualified and committed workers.

This problem is mainly due to the low quality of Egypt's educational system and the mismatch between school or university curricula and the knowledge employers need from their employees. According to the GCR 2010/2011, Egypt ranked 135th out of 142 countries regarding the 'quality of its educational system' and 131st in terms of the 'quality of staff training' (WEF 2011).

The main problem is the low quality and irrelevance of primary and secondary education:

> *"Adequate training of workers is the challenge for the Egyptian industry. We have to upgrade our human resources. Of course, that should start much earlier than at the age of training. Reforming the education system in Egypt is even more important."* (Ahmed Wahab, Engineering Export Council, 25 June 2009)

Furthermore, many graduates have skills that the private sector does not need (El-Megharbel 2008a, 6).

> *"Education is really an important issue. For example, university graduates enter the labour market and expect to find good jobs, but the market does not need engineers, it needs technically trained workers."* (Mohamed Youssef, MOF, 16 February 2012)

Higher quality more relevant education is not only important in itself but is also a prerequisite for improved training and for greater awareness of work ethics, investment, savings, health, etc. It would create more profit-oriented entrepreneurs, better qualified and engaged workers, and more investment in R&D, technology adoption and adjustment:

> *"There is a lack of creativity which is due to the education system. It does not push talents, it does not teach you how to market ideas, how to become a risk taker, how to transfer an idea to an output, how to get market information."* (Mona Garf, Cairo University, 29 February 2012)

> *"We have a problem with business skills. People lack knowledge on how it is to run a business. Entrepreneurial spirit does not exist. We do not teach entrepreneurship – not in the families, not in our schools. People do not know anything about financial statements and marketing. You have to teach people entrepreneurial skills very early."* (Khaled Sewelam, American Chamber of Commerce, 7 March 2012)

Much of the crisis in the educational system is because public spending on education has been slashed to less than 4 per cent of GDP in the last 20 years. Teachers and equipment are sorely lacking and teacher training is deplorable. Ever more children attend private lessons after school. A whole sector of tutoring schools and programmes has developed to help compensate for the weak public system, meaning that education expenditures are increasingly privatised and children's educational achievements reflect their parents' financial means. Social mobility is dwindling – perhaps because it was planned by those who formulated Egypt's policies between 2004 and 2011 in a government dominated by Egypt's top business elite. The privatisation of education helps this elite self-reproduce and prevents the advancement of competing social groups. All the members of the Gamal faction attended very expensive private schools, and most studied at private universities in the US. They are very aware the difference quality education makes for a career (Demmelhuber 2008, 208).

Most Egyptian children cannot afford to attend private schools. At best they can take some private lessons at home or at their teacher's, in mosques or at non-governmental organisations or commercial service providers (Hartmann 2008). Such education does little to improve the employment chances of workforce entrants and translates into rising unemployment rates, low productivity and a segmented labour market with marked wage differentials.

Furthermore, both the knowledge imparted by the Egyptian educational system and the methods used to teach it discourage students from becoming independent and creative. School curricula are frontally taught, and students are expected to learn by heart. Critical thinking and the ability to discuss are not valued. Instruction is authoritarian and patriarchal, with no room for questions – much less contradictions. Students are not taught or encouraged to learn to learn, to acquire knowledge independently or to develop creative, problem-oriented thinking (UNDP / AFESD 2003, 3).

According to the second Arab Human Development Report of 2003, these problems persist because during the Mubarak era, neither policy-makers nor religious scholars were interested in establishing an educational system that would have nurtured students' analytic skills, creativity and independent thinking:

> *"An alliance between some oppressive regimes and certain types of conservative religious scholars led to interpretations of Islam which serve the governments but are inimical to human development, particularly with respect to freedom of thought, the interpretation of judgments, the accountability of regimes to the people and women's participation in public life."* (UNDP / AFESD 2003, 6)

Many observers agree with this finding:

> *"The quality of education in Egypt is not conducive to innovation. On the other hand, this has not come unintentionally. Policy-makers don't want people to think freely."* (Akrum Bastawi, MFTI, 21 June 2009)

One must hope that the situation will improve under the new Muslim Brotherhood government.

Deficits in the rule of law

In addition, entrepreneurs in Egypt continue to suffer from such problems as licensing, taxation, customs clearance, inspection and public tendering – as well as competition, corruption and the protection of property rights. In addition to excessive amounts of time and money, the main challenge of interactions with the state is the impossibility of assessing the true costs and outcomes. Small entrepreneurs are very insecure because of serious deficits in the rule of law:

> *"Lack of law enforcement is a very big issue. As from a certain firm size, you have some security – at least in standard procedures. For the small and informal ones, however, there is no security at all."* (Roland Steurer, GTZ, 17 June 2009)

Smaller firms can be randomly subjected to a serious bureaucratic obstacle in the form of a restriction, prohibition, fine or fee that they had not (and could not have) anticipated:

> *"There is a very smart entrepreneur in town that has opened a couple of shops for delicatessen. They are really perfect. You believe that you come to another world when you enter them. The articles they sell are really the best that you can get. The employees are better trained than anybody else in the country. The building materials fit best for their purpose – for example, the stone floor is rounded up a little thereby allowing for easy cleaning and avoiding anybody from falling when it is wet. Then the owner had ordered some most exquisite sorts of cheese from France. But the order was blocked at the border and not let in. The argument was: The cheese smells."* (Angus Blair, head, Beltone Financial, 22 June 2009)

Especially for SMEs, the amount of quickly changing legislation creates legal obscurity, while the overlapping responsibilities and competences of various authorities create ambiguities in bureaucratic regulations and sometimes lead to unexpected decisions.

Tax officials, for example, often ask SME owners to pay a bribe to lower the tax demand:

> *"Some big companies pay the whole wage of some tax officers just to lower their tax burden. And of course, you better bribe tax officers than to pay the tax amount that they charge you! I know a pious Muslim who refused to pay any bribe. He ended up paying taxes three times a year and each time much too much, given his real income."* (Yasser Zaher, Banque du Caire, 26 April 2012)

But it is not a good idea to contest an administrative decision. Legal procedures are very lengthy and expensive for all parties, and the result is even less predictable than a decision taken by the public administration.

Corruption and unfair competition

Corruption is another cause of concern for entrepreneurs, and bribery is frequent in business relations in Egypt:

> *"In Egypt, you have to bribe for every licence. That can be expensive but big companies can afford it."* (Mohammed Abdel Hameed, Textile and Clothing Business Center, 22 February 2012)

When it comes to the big business deals, favouritism – *wasţa* – is widespread. Although it does not always have a negative connotation, it does have negative effects on the fairness of state–business relations and the competitiveness of single entrepreneurs and the economy as a whole.[70]

People with good connections often get confidential information, which helps them exploit market opportunities before others. For example, one private entrepreneur learned about the government plan to establish a new big settlement to the east of Cairo before everyone else. He bought a big plot of land there at a moderate price and then resold small subplots at much higher prices.[71]

70 For an extensive analysis of the effects of *wasţa* on state–business relations and the investment climate in Jordan cf. Loewe et al. (2007).

71 Interview with a well-informed researcher, April 2010.

Many observers agree that entrepreneurs in Egypt often need more than capital, a good business idea, a promising strategy, skills and diligence:

> *"For example, when somebody imported the first energy-saving lamps to Egypt a couple of years ago, they were not let in by the customs authority. They said that the socket had to be painted yellow, green or red – depending on the power of the bulbs. Otherwise, the bulbs would have to be sent back. Of course, this decision had been brought about by some domestic producers of conventional bulbs with good connections to the regime who were afraid of the competition with the new energy-saving bulbs."* (Donor representative, June 2009)

What makes these phenomena more serious is that because everyone knows about them, they have a dampening effect on Egyptians' interest in opening innovative businesses.[72]

Some economic sectors are explicitly protected against new market entrants. This includes the entire energy sector, landline telecommunications, railway traffic and postal services, all of which continue to be legally monopolised by the state. For some sectors, the number of production licences is limited. In the case of taxi services and Nile River boats, the argument is that space is limited, while the steel, aluminium and fertilizer branches are said to consume so much energy already that the country might be unable to provide for new companies (OECD 2007, 32).[73]

Whatever the real reason was to regulate entry into these sectors, at least until the revolution in 2011, all three were dominated by quasi-monopolies. Ezz Steel, for example, accounted for 65 per cent of Egypt's steel production in 2010. Its owner, Ahmed Ezz, used to be one of Gamal Mubarak's closest friends and a member of parliament, until he was arrested in 2011 – right after the revolution – and accused of corruption (El Amrani 2011). Ezz had greatly benefited from his market dominance and the availability of cheap energy in Egypt. Although additional licences for steel production were issued in 2009, the market share of Ezz Steel did not significantly decrease before the revolution. This suggests that either the licences were very small or Ezz himself had bought up some of them under another company name. The Haltementi company controlled 50 to 60 per cent of the Egyptian cement market in 2010, and two other companies controlled 90 per cent of the fertiliser market. The situation was similar in the metallurgy sector:

> *"There is a lot of corruption within the cement and metallurgical industries. Corruption can reach such levels that the government itself cannot keep it quiet any more.* […] *The greatest monopoly of the metallurgical industry is held by the Z, one of the closest allies of our king, the President. We are told that this sector is not being privatised because specialised knowledge is needed in this field. You don't know anything about it, you are ignorant! But no, we know plenty!"* (Consultant quoted in Yousfi / Humphrey 2008, 13)

72 Interviews with Nihal El-Megharbel, economist, 15 June 2009 and Eberhard Kienle, Ford Foundation, 12 June 2009.

73 Several sectors (shipping, foreign trading, insurance brokerage, legal consultancy and representation, accounting, architecture and engineering services) remain closed to foreign investors. In the aviation and construction sectors, foreigners may only hold minority shares. Foreign insurance companies may only operate in the free zones. Cf. Egypt (2010, 3); OECD (2007, 31).

Between 2004 and 2011, these same entrepreneurial families came to dominate the government. Several ministers were related or good friends.

> *"Egypt is controlled by a government consisting of billionaires who lead their respective ministry like their own company and ask mainly how they can maximise their private gains. And if there is no other way they even make the laws themselves as they need them for their private businesses."* (Analyst, June 2009)

> *"A particularly instructive case is the story of the fertiliser factory that they wanted to build in Damietta. Everything was planned and licensed. However, overnight a group of so-called NGO activists showed up and demonstrated against the factory. They were quickly supported by some parliamentarians, and after some time, the project was given up until only a few months later, an almost identical project was successfully implemented by a different company."* (Donor representative, June 2009)

Before the revolution, only a few economic sectors, such as the cement and steel industries, were protected by formal market-entry barriers. But in many others, competition was also distorted – though in a more supple manner. The causes of such distortions could be termed 'market-entry obstacles' meaning that access was possible but difficult – at least until the 2011 revolution – because the established producers benefited from advantages such as preferential access to land or tax reductions:

> *"Two weeks ago, a decision was taken to earmark a larger tract of land for wind energy plants. It was divided into small plots of the same size. In principle, there would have been enough plots for all bidders but even before the call for bids was published, it turned out that some plots had already been promised to some interested parties. Very early, these had got the information that the wind conditions on the individual plots were quite different – with the effect that more energy can be produced on some of them than on the rest."* (Ibid.)

The Egypt Competition Authority supervises markets and controls concentrations of market power. But it is not authorised to take any legal action against such trends – even if it detects a veritable monopoly. Only the prime minister can start a formal prosecution (Demmelhuber / Roll 2007, 12).

Subsidies were another instrument that the Nazif government used to generate competitive advantages for individual firms. The MOF has provided general subsidies on specific commodities such as energy and food (see Section 5.1), and used a variety of arguments and logics to grant transfers to single firms. In 2005/2006, for example, it transferred large sums of money to several Egyptian banks to settle their debts. The MOF also transferred funds for other ministries to subsidise public, private and foreign companies, and the recipient ministries did not have to explain to either the public or the MOF why they had been granted the subsidy (Egypt 2010, 3). Unfortunately, we do not know what the situation is today.

Hardly any observer of Egypt's economic development reports on any cases of unfair competition with firms belonging to the army, which is surprising because the army is not only politically but also economically by far the most important player in the country. One explanation is that the army avoids direct competition with private or government-owned enterprises. Another explanation would be that nobody has yet dared to say anything negative about the army.

The tourism sector is an exception, which may be due to the fact that the army is a particularly big player in it. It benefits from the fact that it owns broad strips of Egypt's coastline where recreational tourism boomed in the 1980s. The army handsomely profited from selling land to tourism development projects and also started its own. Several hotel complexes in resorts like Sharm el-Sheikh are run by army-owned companies.[74] In addition, in some regions (e.g. along the coasts), the army must consent to any large construction project even if it does not own the land. Many private construction companies may well choose to cooperate with army companies to avoid any trouble during licensing procedures (Clover / Khalaf 2011).

Inadequate private-sector representation

Under Mubarak, the Egyptian state was organised like a pyramid, with the president at the top, playing competing branches against each other so that he always dominated the political scene. One influential person (for example, a line minister) headed each branch and manipulated the smaller branches beneath him the way the president played the larger branches against each other. And so on. In this way, the political system was comparatively stable. Branch and sub-branch heads behaved like little presidents, claiming full authority for their tasks and not coordinating with any other branches.

Usually decisions were taken at the top of each segment, sector and branch – without any formal negotiations. Sometimes the interests of various shareholder groups were taken into consideration but very often they were not. In any case, there was no transparent bargaining between the stakeholder groups before a decision was taken. At most, the decision-maker consulted a small group of people he knew personally. Citizens and entrepreneurs were not regarded as customers of public services who should be consulted in the interest of making public services more customer-friendly. Instead, the public administration behaved as if citizens and entrepreneurs *"receive state support by the grace of the government and should therefore take what they get"* (donor representative, June 2009).

In recent years, many scholars have discussed how important trustful state-business relations are for investment and economic growth. On one hand, they help overcome market failures such as those related to information-related market coordination and problems of collective action. On the other hand, they can also help solve government failure. If they are well institutionalised, they lead to a credible commitment of the government to continue some policy for a certain time. Thereby, they reduce entrepreneurs' uncertainties about the direction of government policies and encourage them to make longer-term investments. Trustful state–business relations also create an environment where the state is more prone to provide the infrastructure that businesspeople need, create an effective public administration, secure investors' property rights, and negotiate with businesspeople about tax and customs tariffs and public spending priorities (Sen / te Velde 2009).

Chekir and Diwan (2013) confirm that

> "*there is nothing intrinsically bad about close state business relations. [...] To the extent that they have the right incentives to perform, close state-business relations can form the basis for dynamic capitalism and an effective state. But they can also be-*

74 A well-informed researcher, April 2010.

come sources of influence, corruption and other forms of rent-seeking that distorts economic and political incentives." (Chekir and Diwan 2013, 2)

The question is what the characteristics of effective state-business relations are, i.e. what is needed to generate the positive effects mentioned above. Sen and te Velde (2009) name five attributes: (i) transparency of information, (ii) reciprocity of actions, (iii) credibility in statements, (iv) mutual trust, and (v) the absence of collusive behaviour between individual businesses and the state. Perhaps the most essential prerequisite for these attributes is adequate private sector representation (e.g. in the form of chambers of commerce or business associations) meaning that it is transparent, independent and equally represents all its members.

Abdel-Latif and Schmitz (2009) argue that less transparent and less formalised state–business relationships can have the same positive effects as those with the five attributes mentioned above. They use evidence from Egypt to support their thesis, describing four economic sectors where negotiations between businesspeople and public officials have taken place, created mutual trust and led to a significant increase in investment in the sector. In all four cases, however, the state negotiated with individual entrepreneurs rather than all of the sector's entrepreneurs or formal representatives; the results of the negotiations were not made public (at least not to the other players in the sector); collusion between the state and individual entrepreneurs was initiated rather than prevented; and trust was created between the state and some, but not all, market players.

Investments did increase in all four sectors but it was the entrepreneurs who had been on the deal who did most of the new investing. In fact, many entrepreneurs were alienated from the state and discouraged from making longer-term economic commitments in Egypt because they recognised that some of their competitors had preferential access to the government.

How do we know that the rise in investments was due to the negotiations conducted between the state and some entrepreneurs and the trust created between them? Abdel-Latif and Schmitz (2009) fail to present a counterfactual to support their thesis. It may quite be true that the increase in investment in the four sectors after 2004 was due to the special relations between businesspeople and the state. At that year, red-tape bureaucracy and political risk kept investors away from Egypt. Their deal with the government gave the businesspeople the protection they needed to overcome their fears. It may thus have well been the oil that an economy needs to take off. However, two of the four sectors portrayed by Abdel-Latif and Schmitz (2009) were mobile telecommunications and information technology, both of which had previously been closed to private investors. Therefore much of the rise in investment is probably just because these sectors were finally opened. In this situation, the deal with the government was a partial opening of the sectors for selected businesspeople that was clearly excluding competitors and hence not oil but sand for the economy and "*a story of corruption*" as Chekri and Diwan (2013, 11) write.

Is it possible that even more investment would have been attracted to the mobile telecommunications sector if the government had awarded more than three licenses?[75] The tele-

75 One licence was given to Mobinil, which is owned by Orascom – the Sawiris Family company – and France Télécom. The second went to a joint venture of state-owned Egypt Telecom and Vodafone. And

communications sector has never been subjected to supervision by the Egypt Competition Authority.[76]

The exclusive extension of licenses to well-connected businesspeople in several sectors meant that these could secure their respective market shares as well as access to credit irrespective of their competitiveness. They could make profit even if they were badly managed, had high production costs and charged high prices to their customers. Capital and labour may thus flow to inefficient companies and sectors rather than more competitive ones. In addition, this unfair competition sent out a signal to the whole economy that competitiveness would not pay off and that business people should better spend their energy on rent-seeking rather than innovation (see Loewe/ Blume/ Speer on this issue with reference to the case of favouritism in Jordan).

Chekir and Diwan (2013, 13) provide evidence that well connected Egyptian companies grew faster on average than others between 2004 and 2010 but started to plummet two months before the break-out of the revolution on 25 January 2011. And they invested significantly more than other firms even though the return on assets and equity was below average. As a result, there was no incentive to invest into these companies other than their good government relations, which provided investors at least security against political risks. This does not mean that other firms (without good government relations but possibly a more competitive cost structure) would not have benefitted from higher returns from investments in the same sectors if the government had granted them access as well.

But the government had done all it could for the trustfully linked entrepreneurs – but not for others. Abdel-Latif and Schmitz conclude themselves: *"The deal violated all the rules but was forgotten over time, as Mobinil proved to be a worthy competitor to Vodafone…"* (Abdel-Latif / Schmitz 2009, 65)

The deals would have been much less difficult if the Egyptian government had negotiated them with private sector representation that fulfilled the three criteria mentioned above – transparency, independency and equal representation of all members.

However, at that time there were no independent business organisations in Egypt that represented the interests of all the relevant companies in one sector. All enterprises had to belong to one of the country's 16 chambers of commerce or industry – which were not independent: two-thirds of their board members were elected by the entrepreneur-members, one-third was appointed by the government.[77]

Although this changed after the revolution, the chambers continue to be dominated by a few businesspeople – usually the owners of the largest firms in each sector. Of course, their interests differ from those of medium-size and small entrepreneurs, which means that the chambers' policies often conflict with the interests of most of their members.[78]

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the third one was granted a bit later to a consortium that is led by the Abu Dhabi-based Etisalat company with a minority share being owned by the son of former president Sadat.

76 Demmelhuber / Roll (2007, 12) and interview with Francesco Sciacchitano, resident twinning advisor, Egyptian Telecommunications Regulatory Authority, 24 June 2009.

77 Interview with Hani Hafez, executive director, Federation of Egyptian Industries, 25 June 2009.

78 Interviews with Hassan Omar, MFTI, 17 June 2009; Yousri Tinawy, general manager, Chamber of Food Industries, 25 June 2009; and Mohamed Youssef, Ministry of Finance, 16 February 2012.

Shortages of affordable land

A fifth challenge for entrepreneurs – especially smaller ones – is getting affordable land with reliable infrastructure for their production facilities. Egypt's surface area is large and the government has generally earmarked enough land for productive and commercial activities. But this land is not where workers live or where entrepreneurs would like it. For example, only 17 per cent of all land with infrastructure services in Upper Egypt has been allocated to enterprises, with 65 per cent for Lower Egypt and an even higher ratio for the metropolitan areas (Benhassine et al. 2009, 132).

It has become very difficult to find appropriate plots in Greater Cairo and Alexandria. In some industrial zones there are only very small, unattractive plots or plots for the wrong economic branches (see Section 4.2.1). In other zones, the prices are too high or there are no infrastructure or services such as reliable utilities, rapid access to highways or railway lines to transport heavy products, adequate industrial zone management and maintenance, etc. (El-Megharbel 2008b, 6).

The IDA is also reported to have considerable discretionary power in allocating available land to competing bidders.[79] Sometimes the IDA gives a plot of land to an entrepreneur and soon thereafter, another person shows up with evidence of legal claims to the same plot – from the time when other public agencies were responsible for land distribution:

> *"In these cases we never know how things end up at courts. We can only act according to our information and guidelines. Of course, these cases frustrate investors."* (Ashraf Dowidar, IDA, 21 June 2009)

This is particularly problematic for SMEs. While larger companies can buy their own industrial zones (and perhaps resell or let parts to other companies), SMEs depend on land allocation by the IDA or SFD.[80]

This is why some investors have bought state-owned enterprises – just to get the land – and then tried to let the workers go and close the old enterprise as quickly as possible.[81]

The army benefits from rising land prices because it owns so much of it, including a broad strip of land around Cairo with barracks and military defence posts that were erected after the war in 1973 when, for a couple of hours, Israeli tanks were just 120 kilometres from Cairo. Since then, whenever city development reached that strip, the army simply sold it at reasonable prices to private investors for housing and industrial development projects – and was granted a free new strip from the government further outside town (that was even larger because in the meantime, Cairo had grown) (Ginsburg 2011).

5.3 Explanation for the strengths and weaknesses

The strengths and weaknesses of the industrial policies implemented by the Nazif government, which we identified in the previous sections, are no surprise. All the relevant ministers were businesspeople who were familiar with the problems and needs of the pri-

79 Interview with Nihal El-Megharbel, economist, 15 June 2009.

80 Ibid.

81 A well-informed researcher, April 2010.

vate sector. They understood economic policy, and had a vision and a feeling for the needs of other entrepreneurs:

> *"Now things have changed, there is a plan and a long term strategy…. We can feel it in the way that problems are resolved, the conversations have changed, the government is conscious of changing things... to take the interests of investors into account. This has happened thanks to the new ministers, who were businessmen before."* (Executive of a French company quoted in Yousfi / Humphrey 2008, 25)

These businesspeople took up their appointments with great ambition. Possibly, they wanted to do right as government leaders: ease the conditions of doing business in Egypt for foreign and private investors, support firms of all sizes, improve the rules and eliminate market distortions.

Unfortunately, however, the ministers continued to view reality through the lenses of large-scale, successful entrepreneurs. This means, *first*, that they lacked understanding for SMEs. Most probably, they did not want to discriminate against SMEs, but they were unaware of how much SMEs need different support than medium-size and large companies.

Second, these businessmen-ministers, of course, also continued to feel responsible for their own enterprises and those of their friends and partners. Although they did not necessarily try to create individual advantages for their own companies, most ministers did want to provide benefits to companies like their own (and even to their competitors). This is why the IMC had such a large budget and offered such generous support for export promotion.

In addition, the ministers tended to only support economic reforms, such as the streamlining of administrative procedures and financial sector liberalisation, if these benefited their own companies and others like them – and they blocked reforms that might have negatively impacted on the development of their own company or the companies of friends, relatives and partners. Between 2004 and 2011 nothing was done to fight corruption (especially favouritism) or competition distortions on any market where one of their companies or friends enjoyed a quasi-monopolistic position (Roll 2010, 4).

And some ministers even used their positions to increase their wealth by creating competitive advantages for their companies, buying stakes of privatised state companies at cut-rate prices, and so on (Demmelhuber / Roll 2007).

Third, the ministers focused on the sectors where they had stakes. Abdel-Latif and Schmitz (2009) explain that "*there were a number of selective interventions focused on specific sectors. They are less well known because neither government nor business- people like to talk about them – because of the risk of accusations of favouritism and corruption"* (Abdellatif / Schmitz 2009, 40). They applaud these interventions, arguing that they significantly improved some sectors' business potential, forgetting that such preferential treatment could lead to intra-sectoral distortion based on individual preferences and discriminatory treatment of sectors in which no government member has a personal stake.

Fourth, some sectors seem to have received support, not because they are the most promising ones, but because they are some of the older ones that suffer most from government liberalisation. The automobile and textiles industries benefit from generous export subsidies although many observers believe that they have little natural competitive advantage on world markets. At the same time, some of the most promising sectors, such as the outsourcing-services industry, receive hardly any government support.[82]

Fifth, the businessmen-ministers focused on micro-level reforms (company modernisation, on-the-job workers' training, travel to international fairs, etc.) and overlooked the key problems of most Egyptian entrepreneurs that are of a more structural nature and located at a much higher aggregate level. This may be because big entrepreneurs in Egypt suffer much less than SMEs from the lack of skilled workers (they can offer higher wages or train workers themselves), persistent deficits in the rule of law, widespread corruption and unfair competition, inadequate private sector representation and access to attractive land. But the phenomenon may also reflect the Nazif government's reluctance to address more fundamental – political – issues.

At the same time, the businessmen-ministers also looked at industrial policies through the lenses of free-market economists, focusing on micro-level measures and neglecting more structural reforms. This perspective explains why the Nazif cabinet refrained from taking the more interventionist approach to industrial policy that is needed to overcome coordination failure within economic sectors or shift investment into new sectors. This predilection for a non-interventionist industrial policy is probably due to two factors: first, the business ministers did not want to repeat the mistakes of previous governments and second, most of them had studied at American or British universities during the heyday of the free-market school of economics.

5.4 Who benefited and who did not

The policy reforms implemented by the Nazif government generally benefited both segments of the private sector: entrepreneurs and consumers. Everyone gained from the liberalisation of the financial sector, the reorganisation of the customs clearance system and the streamlining of administrative procedures. In addition, the Egyptian economy as a whole also profited – at least indirectly – from the increased foreign investment, exports and GDP.

However, these gains were unevenly distributed across households and enterprises. In Chapter 3, we showed that Egypt's growth between 2004 and 2011 did not favour poorer households: it did not reduce either poverty or unemployment rates. Many observers[83] maintain that members of the business elite were the main beneficiaries of Nazif government policies. The policies affected business groups in different ways: while they did not harm any specific groups, some benefited much more than others. We cannot quantify these differences, nor do we have much empirical evidence for them.

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82 Interviews with Akrum Bastawi, MFTI, 21 June 2009; Frank Giesel, Chamber of Food Industries, 25 June 2009; Natalija El-Hage, GTZ, 23 June 2009; and Wolfgang Klos, National Automotive Co., 15 June 2009.

83 Including Jennifer Bremer, American University of Cairo, 26 April 2010 and Andreas Jacobs, Konrad Adenauer Foundation, 22 June 2009.

Military enterprises still form Egypt's largest business block. But because they mostly produce for the domestic market (much of their production is sold to the army) the policy changes between 2004 and 2011 probably did not benefit them much. They were ineligible for many enterprise development programmes.

The remaining government-owned enterprises used to benefit from protectionism. While some are still protected by state monopolies (as in the energy sector), most are in the red and would not survive without government subsidies. Government-owned enterprises may be the only real victims of Nazif government economic policies that deregulated markets, opened Egypt to foreign investors and imports, and privatised a great number of companies.

The traditional medium-size enterprises in small trade survived the nationalisation and central-planning phases of Egyptian industrial policies. Most are rather conservative and tend to support the Muslim Brothers. They mainly produce for the domestic market and have generally adapted well to new industrial policies. Between 2004 and 2011, however, these enterprises may also have been victims of policies that led to a steep rise in cheap imports from Asia and increased competition for domestic producers.

Manufacturing MSEs did not benefit much from the Nazif government's general economic reforms – but they did not suffer from them, either. This group of companies tends to produce for niches in the domestic market, where competition with foreign exports is less intense (perhaps because Chinese and other foreign producers concentrate on mass production). Yet MSEs have benefited from some changes in legislation: for example, since 2004,10 per cent of all government bids must go to SMEs (Section 4.2.2). Also, the SFD now provides BDSs to MSEs.

Medium-size to large manufacturing companies that produce for the domestic market have expanded under Sadat's unique offer of market protection, tax holidays and preferential access to relevant market information. Since then, most of them have learnt to withstand the competition of imports on the domestic market. Nevertheless, many of these companies complain that they benefited much less from the Nazif government industrial policies than exporters.

Enterprises that aspired to become exporters are a small group but the main winners of Egypt's recent industrial policies. They have received generous technical and financial support to help them sell their products abroad.

Enterprises that already were exporters when the Nazif government was appointed form an even smaller group of rather large companies that also benefited from substantial financial support that they did not need. Along with the aspiring exporters, they were the main constituency of the business ministers and Gamal Mubarak's wing in the NDP and Parliament.

6 After Mubarak … a new beginning

The January 25th revolution of 2011 opened the way to a new beginning in Egypt – not least in the field of industrial policies. Egypt now has a new constitution, president and government, and eventually will hold its second post-revolution parliamentary elections. But the new order will only be stable if political decision-makers manage to revamp economic growth, reduce unemployment and fight poverty. In the long term, this will take renewed efforts to promote structural change.

In order to succeed at this task, the new government should learn from the past: The challenge will be to save the good elements of the 'incomplete reforms' implemented by the Nazif government in the field of economic policy in general and industrial policy in particular while overcoming its weaknesses.

Section 6.1 reviews the most important political and economic developments since the revolution. Section 6.2 sums up the main lessons to be learnt from the Nazif government industrial policy strategy and Section 6.3 formulates recommendations for Egypt's future government.

6.1 Political and economic developments since the revolution in 2011

The revolution that erupted on 25 January 2011 did away with President Mubarak and his regime. Although first Mubarak dismissed the Nazif government on 29 January 2011 to appease demonstrators, he finally also had to resign on 11 February 2011 and hand power to the Supreme Council of the Armed Forces (SCAF). The SCAF chairman, Mohamed Husein Tantawi, became the effective head of state. He suspended the constitution, banned the NDP, dissolved both houses of parliament and appointed an interim government (Mattes 2013).

One year later, Mubarak and his two sons were sentenced to prison for not stopping the murder of peaceful demonstrators during the revolution. But they were not found guilty of having ordered the killing and most of the other accusations, including corruption and economic fraud, were dismissed. Ahmed Nazif is being held in prison for embezzlement and corruption; his trial is pending. The former Minister of Finance, Youssef Boutros-Ghali and the former Minister for Trade and Industry, Rashid Mohamed Rashid, were sentenced *in absentia* (both escaped from Egypt during the revolution and are now living abroad) to prison terms of 30 and five years, respectively, for embezzlement and squandering public funds. Many elite businesspeople, such as Ahmed Ezz, were also arrested. He was sentenced to 17 years in prison for corruption and money laundering. Yet many who were directly responsible for human rights violations before and during the revolution were acquitted or released on bail (Brakel 2011).

Between November 2011 and January 2012, a new parliament was elected in three rounds. The Muslim Brotherhood's 'Freedom and Justice' party won almost half of the seats and the Salafi 'An-Nour' Party got another 21 per cent, while liberals and social democrats won only 10, and the old nationalist Wafd Party 7, per cent (Carnegie Endowment 2012).

Presidential elections held in June 2012 resulted in another victory for the Muslim Brotherhood: one of their leaders, Mohammed Mursi, became president. He formed a new government of Islamists and members of the old Mubarak regime and dismissed Mohamed Husein Tantawi from his functions as Minister of Defence and head of the SCAF, along with Sami Annan, who as Army Chief of Staff was probably responsible for most of the decisions taken by the post-revolution military regime (Mattes 2013). Apparently, the Muslim Brothers and the army have made a deal; the army will not interfere into politics as long as the government leaves the privileges of the army untouched and there is no threat for Egypt's national unity.

In any case, the new government (or the winner of the next parliamentary elections) will have to take some very important decisions regarding the Egyptian economy. During the revolution, the economy collapsed because many workers were on strike or unable to reach their workplaces as a result of the dramatic security situation. Tourists cancelled their plans to travel to Egypt and foreign investment came to a standstill. Egyptian investors and consumers also felt insecure and domestic demand for high-end products imploded. In 2012, the growth rate fell to 1.6 %, which is not even enough to compensate for the increase of the population. Some companies went bankrupt, while many others laid off workers, further slackening domestic consumption and causing tax income to decline. Prices of imported goods continued to rise with the increase in global energy prices after the 2008–2009 world financial and economic crisis. The government strained the budget by continuing to stabilise prices for energy, water and basic food items through consumer and producer subsidies with the effect that the deficit was equal to about 12 per cent of GDP in Fiscal Year 2012–13 and inflation rose to more than 12 per cent. Even though Qatar and some other countries granted some very generous credits to Egypt, the country's foreign exchange reserves plummeted from USD 36 billion in 2010 to USD 14 billion in May 2013, when Standard and Poor's lowered Egypt's sovereign credit rating to 'CCC+'. Finally, the government is now considering reducing energy subsidies and increasing income taxes. But it also should reflect on how it can boost economic growth and exports to broaden the tax base (Bergmann 2012; Ginsburg 2012).

So far, we have few signs of Egypt's future economic policy course. The Muslim Brotherhood government has not clearly expressed its vision and in fact, it has given contradictory messages. Presumably this is because only a few Muslim Brothers are familiar with economics and there are competing views of the future within the movement. Most of its economic policy ideas fit into a 'social-market economy'. However, it includes models that come close to German 'ordoliberalism' as well as models that would be called 'social democratic' if they were propagated by secular parties (El Shorbagi 2013; Habibi 2012).

All the Muslim Brotherhood models rely on market forces, competition and free trade to provide for the efficient allocation of goods and production factors. But they are also all based on the notion that all citizens should participate in the country's economic development and that the government may have to intervene in order to assure that nobody is left out. Almost all their economic development models emphasise the need to reform institutions, fight corruption, eliminate monopolies and more effectively control competition. Many of them include provisions to protect foreign and domestic investments, increase spending on education, create more efficient and fairer social-protection schemes and reduce the budget deficit. Finally, many models express the need to foster economic diversification and structural change and strengthen export orientation – without elaborating how these goals can be achieved (Habibi 2012).

However, we do not even know if the Muslim Brothers will win the next elections again. Their popularity has fallen sharply since the parliamentary elections in December 2011 and January 2012 because the government has been unable to stimulate the economy or effectively combat unemployment and poverty. Today, it seems likely that the Muslim Brothers will have to form a broad coalition with other religious or secular parties – or that Salafi parties will make the race (El Shorbagi 2013).

6.2 Lessons learnt

The main lesson to be drawn from the economic development strategies implemented by the Nazif government is that industrial policies must involve much more than private enterprise development. The businessmen-ministers who held power between 2004 and 2011 seem to have believed that any broad provision of generous BDSs would do to foster structural change. The results indicate that they were mistaken. At best, their strategic approach can be described as an incomplete reform:

First, support for the private sector will only have limited effects as long as significant deficits persist in the broader business environment – especially in the quality of education and vocational training, but also in the transparency of the political system, the public administration and the judicial system, in the rule of law, in market competition, in government–private sector dialogue and the availability of land.

Second, industrial policies risk being ineffective if they address just some of the market failures that inhibit structural change. The Nazif government strategy, for example, addressed the lack of public goods such as R&D and workers' training, but it did not overcome coordination failure within sectors. This deficit may have resulted from policymakers' reluctance to be overly interventionist, which is understandable considering Egypt's experience with industrial policies under Nasser and Sadat. It may have been wise for the government to not focus its support too much on selected economic sectors that are considered to have high potential. But it should have been more interventionist within sectors, encouraging companies to try new forms of cooperation and industrial organisation.

Third, industrial policies must focus in particular on technology transfer. Economic development is increasingly linked to the ability of countries to acquire and build know-how. Comparative advantages come less from resources and abundant labour – as it may have been the case in the past – but more from the successful application of knowledge.

Fourth, innovation requires more than technology transfer: the transferred technology must be adopted and used. In this regard, Egypt's main constraint is entrepreneurs' lack of awareness regarding the need to constantly innovate.

Fifth, in order to be socially inclusive and economically sustainable, industrial policies also should be more supportive of SMEs. They should not focus on single SMEs but rather create an entrepreneurial ecosystem that is equally supportive of SMEs and larger companies, and helps both groups cooperate and integrate. In particular, SMEs should be supported in their efforts to upgrade (i.e. to grow through innovation) – either through well-tailored individual support or through cluster or value-chain programmes.

Sixth, industrial policies should not rely too heavily on financial instruments because too generous financial support reduces the incentive for government agencies to use their funds sensibly and companies' incentive to become more competitive by themselves. Any major financial support should be conditioned on proof of how it helped the recipient – for example, by significantly increasing exports.

Seventh, industrial policies should be formulated with well-informed and well-organised private sector representation in a transparent and participatory dialogue. Without such dialogue, the government risks providing support that fails to address the main concerns of private enterprises.

6.3 Recommendations for the new government

The Nazif government showed that Egypt is capable of designing a rational industrial policy strategy that includes reasonable goals with measurable progress indicators and identifies appropriate instruments.

In addition, the IMC has demonstrated that it is possible to set up agencies in Egypt that deliver government services by following the rules in a relatively efficient, transparent and fair fashion. However, we have seen that the efficiency and transparency of these agencies may fade away over time: once one of the leanest, most transparent agencies in Egypt, the SFD is now plagued by high overheads, favouritism and the misuse of funds for political ends.

The main problem of the industrial policies between 2004 and 2011 was the Egyptian government's reluctance to implement more comprehensive reforms. It did not overhaul the public education system, formulate clear and transparent rules for decision-making in the public sector, respect the rule of law, establish fair, market-based competition or permit democratic private sector representation.

As long as these fundamental deficits persist, no industrial policy strategy can easily achieve its goals. Therefore, the first step that Egypt's new government should do is to care about the fundamentals. A second step should be to reorganise how industrial policy is drafted and managed. And the actual redesign of industrial policies should only be the third step.

6.3.1 Reforming the framework of industrial policies

Egypt is unlikely to remain (or become more) competitive unless the government manages to improve the quality and relevance of education and training, restore the rule of law, combat corruption and unfair competition, encourage the establishment of democratic private sector representation and allocate enough suitable land for productive purposes.

Quality and relevance of education and training

Probably the most urgent reform is that of education and training. Experts opine that the entire public education and training sector must be overhauled so as to promote not just students' knowledge and skills, but also their powers of analysis, creativity and imagination, and the basic competencies needed for entrepreneurship. Public schools should also encourage teamwork.

The Egyptian government would be wise to help its next generation of entrepreneurs acquire the skills needed to run a business. Basic economic and business know-how should be part of the secondary school curriculum. Professional business schools should be opened; university-level economics and business administration courses should be more practical and relevant. The government could organise business-plan competitions like the Junior Business Association of Jordan has done for more than five years.

The government might also consider providing more support to help young Egyptians get international exposure – by promoting international student exchanges, helping students intern in foreign companies and funding attendance at international fairs and business conferences. These activities can help inspire future entrepreneurs to innovate, think business and build international networks.

Finally, a comprehensive vocational training system should be developed. The Mubarak-Kohl Initiative has taken important steps towards this goal. However, this initiative has shown that it will take a very long time to train a significant share of future workers. The government could also consider expanding the outreach of short-term training courses that truly respond to the demands of employers and employees. Curricula should be developed in close cooperation with private sector representatives like trade unions, chambers of commerce and industry as well as general business, small enterprise and employers' associations.

Rule of law

The Egyptian government can take the following steps to enhance the rule of law:

Provide incentives for government officials to comply with laws and regulations – for example, by creating monthly awards for the officials who best meet clients' demands.

Establish an efficient government-employee impeachment procedure.

Reform the judiciary and make it independent of the executive branch.

Make public officials more accountable through improved monitoring mechanisms. The government could publish laws and guidelines helping public administration customers compare the theory and practice of administrative procedures. It could also introduce more elements of e-government throughout the public administration and extend ICT solutions to all public services. E-procurement and e-tendering are especially effective for reducing corruption. Moreover, independent bodies could be used to assess the performance of all government departments and evaluate the transparency of their decision-making. Finally, whistle blowing could be encouraged to help identify individuals in the public administration who are corrupt or break the rules.

Combat corruption and unfair competition

While most measures that help establish the rule of law also combat corruption and unfair competition, the government of Egypt could achieve more by also strengthening the Egyptian Competition Authority and providing it with an effective sanctioning mechanism. In addition, it could pass an anti-trust law and set up an independent anti-trust commission.

Democratic private sector representation

Another challenge is to encourage the private sector to establish free and democratic representation to speak on behalf of all companies in Egypt and take part in constructive dialogue with the government. The Federation of Egyptian Industries, the umbrella organisation of all chambers of industry and commerce, would be most suitable for this task. Enterprises are already obliged to belong to one of the two chambers. To make chamber membership attractive even for informal companies, membership fees should be as low as possible – at least for MSEs. Board members should be elected to represent all enterprises. Quotas for representatives of large, medium-size, small and micro-enterprises would help assure equality of representation.

Workers should also be encouraged to join trade unions. It is in the government's interest to have elected trade union representatives who can speak on behalf of all Egyptian workers.

Finally, enterprises could be encouraged to establish business associations alongside the chambers of commerce. These could facilitate mutual exchange, joint action and the airing of concerns of particular sub-groups of entrepreneurs. But the government must remember that associations with voluntary membership normally represent only a fraction of businesspeople, whose interests and opinions may not be in line with other – sometimes, most of the other – entrepreneurs:

> *"What is really needed is an organisation representing SMEs, which can sit down with the government to inform it about the real needs of SMEs."* (Mona Garf, Cairo University, 19 February 2012)

Land for productive purposes

Supporting small and medium-size companies in Egypt also calls for the allocation of more land at attractive locations for industrial use. Obviously the government of Egypt cannot offer all companies land next to Alexandria and Cairo. But it can offer companies more choice with regard to land, and it must expand the areas reserved for MSEs that cannot get plots in some of the most attractive industrial zones.

The infrastructure in industrial zones and traditional industrial production areas needs to be improved. Transportation, in particular, has become a problem for many enterprises.

6.3.2 Reorganising the making and management of industrial policies

Reforms are also overdue in the fields of industrial policy-making and implementation. Both should be comprehensive in terms of (i) the actors involved, (ii) policy fields considered and (iii) instruments employed.

Multi-stakeholder process

In order to make future industrial policies more responsive to the needs of the private sector, the government of Egypt should involve not only all relevant line ministries and implementing government agencies, but also representatives from all sub-groups of entrepreneurs and workers, in drafting a new strategy. It might also be good to involve non-governmental organisations such as groups that lobby for environmental concerns.

In addition, it would be wise to also establish an independent supervisory board composed of representatives from the government and public administration, entrepreneurs, workers and civil society to monitor the implementation of industrial policy. The effects of industrial policies should be reviewed in regular public–private consultations.

Broad perspective

The government and the private sector should work together to identify the most binding constraints to growth and structural change to be addressed by the industrial policy strategy. These constraints could be entrepreneur or enterprise characteristics, industrial organisation or the business environment. The industrial policy strategy must not be restricted to specific policy fields such as BDSs: reforms may actually be more pressing in education, public sector organisation, trade policies or infrastructure. Industrial policy planning must therefore adopt a very broad perspective.

Integrated set of many different instruments

Egypt's future industrial policy strategy should consist of a large variety of instruments that address the country's various constraints to growth and structural change. In no case should it be limited to a specific set of tools.

At the same time, however, the possibly heterogeneous tools should be conceptually consistent. Programmes implemented by the different line ministries should be harmonised and coordinated so that their responsibilities do not overlap or leave gaps:

> *"SME promotion has to be much better coordinated than it is today. We have so many different programmes and they are not harmonised at all. We need one specialised entity for SME promotion and a comprehensive strategy for the whole country. This strategy has to include all different pillars of SME promotion, namely finance, clustering, export promotion, etc."* (Mona Garf, Cairo University, 19 February 2012)

6.3.3 Redesigning industrial policies

Ideally, reforms in the design of industrial policies would emerge from the reorganisation of the drafting process. Also, it is not necessary to start from scratch: Egypt's new government can build on the programmes it has inherited. They are not all bad; some just need to have their implementation processes overhauled, and some existing programmes may need more vigorous state interventions.

Better coordination of the IMC, GAFI and SFD

The IMC services – now only provided to medium-size and large manufacturing firms – should be extended to companies of all sizes and from all sectors. It might make sense to let the SFD continue to focus on MSEs for a while so that the IMC can get adjusted to working with MSE customers. In the long run, however, companies of all sizes ought to be able to access the same services. Programme officers would then be able to accompany and support the entire growth process of their customer firms and understand the type of support that each company needs in each development phase.

The IMC should also extend its services to offer consultancy services, such as those provided by GAFI to help customers locate and access finance (credit, equity, insurance, etc.), and non-financial BDSs from other providers. After a period of transition, GAFI's entire *Bedaya* programme could be merged with the IMC.

In the long run, the SFD should focus on providing MSEs with micro-finance, including credit, private equity, micro-leasing and micro-insurance.

In order to offer all these services, the IMC might need a larger budget. To ensure effective, efficient, transparent and fair use of this funding, an independent supervisory board made up of government, private sector and NGO representatives should be established with authority to review every IMC document and impeach any IMC employees suspected of embezzlement or corruption.

More holistic approach to human resource development

The IMC should in particular continue to support enterprises that train their workers. However, the content of IMC co-funded training programmes should be redesigned with private sector representatives to make sure that the content and modalities of training conform as much as possible with the needs of different kinds of enterprises and groups of workers. This consultative process should also include people who understand the specific problems of smaller and informal firms.

However, the IMC might also have to take action to stimulate demand for its training programmes. It should run campaigns to raise awareness of the importance of workers' training for their productivity, motivation and loyalty. The IMC could cooperate in this regard with the chambers of commerce and industry, and get business associations to publicise the training programmes.

The IMC could offer to support its customers in their human resources development efforts. Its awareness campaigns should emphasise that human resources development helps workers feel good about the firm, creates incentives for the more skilled and motivated workers to stay and helps integrate them into major decision-making processes at the firm.

At the same time, the IMC could consider raising the co-payments of beneficiaries of its training programmes. Programmes that are more responsive to the demands of employees and employers will help reduce misuse (take-home effects) and lower costs.

More emphasis on technology transfer

Egypt's new government should place more emphasis on technology transfer. This requires both improvements in the availability of technologies for Egyptian enterprises and in their absorptive capacities.

To facilitate technology transfer, the IMC should spend a larger share of its budget on the ETTICs, which need to be completely overhauled. The food technology centre's transformation into a service agency could serve as an example. Representatives of the private sector should have a major say on how to improve the demand orientation of the ETTICs. The ETTICs should also raise their researchers' salaries to provide an incentive for academics to conduct application-oriented research instead of collecting credits for academic careers.

Interaction between enterprises and Egyptian universities should be intensified. Private sector representatives should participate in academic planning and course design, and university professors should be encouraged to work part-time in industry-initiated research projects and professional development activities. Job assessments could be amended to invite participation in applied research and consultancy, and university professors abetted to seek third-party funding through paid assignments by private companies that need support for technical problems. Conversely, industry staff could be prompted to second to universities.

Rationalisation of subsidies

Egypt's new government must reduce subsidies both to reduce its budget deficit and to lessen their negative incentives for entrepreneurs. The government should raise electricity and petrol prices that are incentives to waste energy and encourage investments in sectors that are energy- instead of employment-intensive. Egyptian enterprises must become competitive without energy subsidies– for social, ecological and economic reasons. Egypt's energy subsidy is unsustainable.

The government should also rationalise its export subsidies. Sooner or later, some competitor country will sue Egypt at the WTO because its export subsidies violate the General Agreement on Tariffs and Trade. Subsidies also reduce Egyptian producers' incentive to become competitive on world markets. Following the logic of the 'infant industry' theory, export subsidies could be granted for a limited number of years to help exporters become competitive as the subsidy is gradually reduced to zero. But even in this case, the government should reconsider its subsidy focus, which now includes old industries (textiles and food production), and add industries with potential.

Finally, while tax holidays for firms in the free zones could be continued, they should be conditioned on some performance indicator.

Coordination

The most important action for the Egyptian government is to crowd investments into target sectors that have been neglected by private entrepreneurs because of coordination failures. For example, foreign investors may want to invest in renewable energy but lack local cooperation partners (Vidican 2012). The state can solve this problem by (i) providing complementary investments to investors, (ii) encouraging private domestic investors to invest (for example, by assuming some of the investment risk), or (iii) helping foreign investors create local value chains.

The IMC already tried the last option by helping foreign automobile companies improve their local supplier networks, which at first was very successful. (Unfortunately, the programme was not introduced in any other sectors.) The idea is to create value chains in a promising sector through partnering with a leading private firm that understands markets, technologies and entrepreneurial requirements better than the state. Such a firm might be interested in cooperating with local suppliers but not want to assume the risks associated with local supplier development. The firm could be allowed to select the suppliers to be developed with IMC help on the condition that it guarantees to purchase a minimum amount of products from these firms in subsequent years.

The government should generally support the extension of Egyptian value chains as a means of increasing the local content of exported or domestically sold products:

> *"It is all about the supply chain. Many Egyptian firms import large shares of their inputs. But they do not have to. Rather, the country should rely on its own wealth. In addition, Egypt should also move up the value chain. It could start from its marble, vegetables, and cotton – and step by step move up."* (Steven Lee, consultant, 17 February 2012)

For this, the government can provide financial incentives:

> *"The initiative to foster the linkages between SMEs and large firms is the responsibility of the government as it cannot be expected that large firms will take the lead. The government could offer tax holidays for large companies that integrate SMEs into their value chain. Moreover, such companies could be favoured in government tenders."* (Nihal El-Megharbel, economist, 15 June 2009)

It is however even more important to create confidence between cooperating companies. The main reason for the limited number of vertical linkages between Egyptian firms is mistrust, which comes from problems in enforcing contracts, that is, in the rule of law. The state could effectively moderate between partners and arbitrate if needed.

The state could even go one step further and create vertical and horizontal forms of cooperation – provided it has the vision of a sector's entire cooperation network. Egypt has already been fairly successful with this approach in the marble and granite sector. In the future, though, sector deficit and development plans should be worked out with private sector representations.

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Annex

Table A1: Selected governance indicators related to industrial policy (2008)

Indicator	*What it measures*	*Range of scores*	Egypt	Ethiopia	Mozam-bique	Namibia	Syria	Tunisia	Vietnam
Government effectiveness (WGI)	*Quality of public services; quality of civil service and its degree of independence from political pressure; quality of policy formulation and implementation; credibility of government commitment to such policies*	*-2.5 (low) to 2.5 (high)*	-0.44	-0.45	-0.06	0.17	-0.88	0.46	-0.41
Voice and accountability (WGI)	*How much citizens can participate in selecting their government; freedom of expression; freedom of association; free media*		-1.24	-1.19	-0.06	0.58	-1.77	-1.22	-1.61
Steering Capability (BTI)	*How far political leadership sets and maintains strategic priorities; its effectiveness in implementing reform programmes, and flexibility and innovativeness in light of past experience*	*1 (low) to 10 (high)*	4.00	4.67	5.00	6.33	3.00	4.67	5.00
Consensus building (BTI)	*Ability of political leadership to build a broad consensus for reform with other societal actors without sacrificing its goals*		4.50	4.60	4.4	6.40	2.00	4.00	3.80
Fundamentals of market-based competition (BTI)	*Freedom to set prices; currency convertibility; freedom to participate in the market and start a business; free use and transfer of profits; non-discrimination among various forms of companies and sizes of businesses*		5	4	5	7	2	8	4
Safeguards against monopolies and cartels (BTI)	*Extent of safeguards to prevent the development of economic monopolies and cartels*		5	2	2	6	1	6	6
Rule of law (BTI)	*How much state powers check and balance each other and guarantee civil rights (separation of powers, independence of judiciary and penalties for officeholders who abuse their powers)*		4.3	3.5	4.8	7.5	1.5	3.5	2.0
Corruption Perception Index (CPI)	*Overall extent of corruption (frequency and/or size of bribes) in the public and political sectors*	*1 (high) to 10 (low)*	2.8	2.6	2.6	4.5	2.1	4.4	2.7

Table A1 cont'd: Selected governance indicators related to industrial policy (2008)

Indicator	*What it measures*	*Range of scores*	Egypt	Ethiopia	Mozambique	Namibia	Syria	Tunisia	Vietnam
Favouritism in decisions of government officials (GCR)	*Extent to which government officials ensure that well-connected firms and individuals are not favoured in policies and contracts*	*1 (low) to 7 (high)*	3.2	3.1	3.0	3.3	3.1	4.9	3.1
Transparency of government policy-making (GCR)	*Extent to which firms are informed by government of changes in policies and regulations that affect their industry*		4.1	3.8	3.8	4.3	3.5	5.2	4.2
Judicial independence (GCR)	*Extent to which judiciary is independent of political interference from members of government, citizens or firms*		5.0	3.2	3.1	5.5	3.6	5.0	3.7
Wastefulness of government spending (GCR)	*How efficiently public spending provides necessary goods and services not provided by the market*		3.2	3.7	3.3	3.5	3.4	5.5	3.2
Legal enforcement of contracts (DBI)	*Procedures, time and costs needed to resolve a commercial dispute*	*1 (high) to 181 (low)*	151	78	124	36	174	72	42

Source: BTI (Bertelsmann Transformation Index): Bertelsmann Stiftung (2008)
CPI (Corruption Perception Index of Transparency International): TI (2008)
DBI (Doing Business Index): World Bank (2007a)
GCR (Global Competitiveness Report): WEF (2008)
WGI (World Bank Governance Indicators): World Bank (2009d)

Table A2: Quality of Egypt's business climate – according to World Bank Doing Business Reports

	Egypt						MENA average	Jordan	Lebanon	Morocco	Tunisia	Syria	Algeria
	2006	**2007**	**2008**	**2009**	**2010**	**2011**							
Overall rank						**94**		**136**	**111**	**114**	**144**	**55**	**65**
Starting a business													
Rank	**n/a**	**126**	**55**	**41**	**24**	**18**		**150**	**127**	**82**	**134**	**48**	**63**
Procedures (number)	10	10	7	6	6	6	8	14	8	6	7	10	6
Duration (days)	22	19	9	7	7	7	20	24	13	12	13	11	6
Cost (% of GNI per capita)	105	69	29	18	16	6	38	13	45	16	38	5	17
Minimum paid in capital (% of GNI per capita)	740	695	13	2	0	0	104	34	18	11	355	0	10
Dealing with construction permits													
Rank	**n/a**	**165**	**163**	**165**	**156**	**154**		**113**	**92**	**98**	**134**	**106**	**137**
Procedures (number)	28	28	28	28	25	25	19	22	19	19	26	20	25
Duration (days)	249	249	249	249	22	22	152	240	87	163	128	97	188
Cost (% of per-capita income)	1169	983	475	377	332	294	410	44	634	252	568	859	231
Employing workers													
Rank	**n/a**	**106**	**108**	**107**	**120**	**n/a**		**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Difficulty of hiring index	n/a	n/a	n/a	n/a	0	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Rigidity of hours index	n/a	n/a	n/a	n/a	20	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Difficulty of redundancy index	n/a	n/a	n/a	n/a	60	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Rigidity of employment index	27	27	27	27	27	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Redundancy costs (weeks of salary)	n/a	n/a	n/a	n/a	132	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Table A2 cont'd: Egypt's business climate – according to World Bank Doing Business Reports

	Egypt						MENA average	Jordan	Lebanon	Morocco	Tunisia	Syria	Algeria
	2006	**2007**	**2008**	**2009**	**2010**	**2011**							
Registering property													
Rank	**n/a**	**147**	**101**	**85**	**87**	**93**		**165**	**106**	**124**	**80**	**64**	**38**
Procedures (number)	7	7	7	7	7	7	6	11	7	8	4	4	6
Duration (days)	193	193	193	72	72	72	33	47	21	47	19	39	6
Cost (% of property value)	6.8	6.4	1.0	0.9	0.9	0.8	5.7	7.1	7.5	4.9	27.9	6.1	3
Getting credit													
Rank	**n/a**	**n/a**	**102**	**84**	**71**	**72**		**138**	**128**	**89**	**168**	**89**	**72**
Legal rights index	n/a	3	3	3	3	3	3	3	4	3	1	3	4
Credit information index	n/a	2	4	5	6	6	3	2	2	5	2	5	5
Public registry coverage (% of adults)	1.2	1.5	1.7	2.2	2.5	2.9	5.3	0.2	1.5	0.0	2.2	22.9	18.3
Private bureau coverage (% of adults)	0.0	0.0	n/a	4.7	8.2	10.3	7.0	0.0	0.0	9.9	0.0	0.0	42.2
Protecting investors													
Rank	**n/a**	**105**	**84**	**70**	**73**	**74**		**74**	**120**	**154**	**109**	**74**	**59**
Extent of disclosure index	n/a	n/a	n/a	n/a	8	8	6	6	5	7	7	5	9
Extent of director liability index	n/a	n/a	n/a	n/a	3	3	5	6	4	2	5	5	4
Ease of shareholders' suits index	n/a	n/a	n/a	n/a	5	5	3	4	4	1	2	6	4
Investor protection index	4.3	5.0	5.0	5.3	5.3	5.3	4.8	5.3	4.3	3.3	4.7	5.3	5.7
Paying taxes													
Rank	**n/a**	**152**	**151**	**144**	**140**	**136**		**168**	**29**	**124**	**110**	**58**	**75**
Payments (number)	41	41	36	29	29	29	22	34	26	28	20	8	15
Time (hours)	536	536	711	711	480	433	194	451	101	358	336	144	223
Total tax rate (% of profit)	49.1	49.1	47.9	46.1	43.0	42.6	32.8	72	31.2	41.7	42.9	62.8	44.5

Table A2 cont'd: Egypt's business climate – according to World Bank Doing Business Reports

	Egypt						MENA average	Jordan	Lebanon	Morocco	Tunisia	Syria	Algeria
	2006	2007	2008	2009	2010	2011							
Trading across borders													
Rank	**n/a**	**86**	**21**	**24**	**29**	**21**		**124**	**77**	**80**	**120**	**30**	**76**
Documents for export (number)	8	8	6	6	6	6	6	8	7	7	8	4	7
Time for export (days)	27	20	15	14	14	12	20	17	14	14	15	13	14
Cost to export (USD per container)	1014	1014	714	737	737	613	1049	1248	825	700	1190	773	990
Documents for imports (number)	9	7	6	6	6	6	8	9	7	10	9	7	8
Time for import (days)	29	25	18	15	15	12	24	23	18	17	21	17	15
Cost to import (USD per container)	1049	1049	729	823	823	698	1229	1428	1335	1000	1625	858	1063
Enforcing contracts													
Rank	**n/a**	**153**	**152**	**151**	**148**	**143**		**127**	**129**	**106**	**176**	**78**	**26**
Procedures (number)	42	42	42	42	41	41	44	46	38	40	55	39	35
Duration (days)	1010	1010	1010	1010	1010	1010	664	630	689	615	872	565	420
Cost (% of claims)	26.2	26.2	26.2	26.2	26.2	26.2	23.6	21.9	31.2	25.2	29.3	21.8	18.8
Closing a business													
Rank	**n/a**	**127**	**128**	**128**	**132**	**131**		**51**	**98**	**59**	**95**	**37**	**115**
Procedures (number)	4.2	4.2	4.2	4.2	4.2	17.4	33.0	41.7	26.9	38.4	27.4	51.7	21.1
Duration (days)	22	22	22	22	22	4.2	3.4	2.5	4.3	1.8	4.1	1.3	3.3
Cost (% of claims)	17	17	17	17	17	22	14	7	9	18	9	7	15

Source: World Bank (2007a); World Bank (2008); World Bank (2009c); World Bank (2010).

Table A3: Most problematic factors for doing business in Egypt – according to World Economic Forum Global Competitiveness Reports

Problematic factors	% of entrepreneurs interviewed considering respective factors as the most problematic one					Ranking of factor by the share of entrepreneur considering it the most problematic one						
	2006	2007	2008	2009	2010	2003	2004	2006	2007	2008	2009	2010
Corruption	9.6	7.2	7.2	9.5	19.0	7	10	4	4	8	5	1
Inflation	6.2	6.7	11.9	9.9	14.8	9	7	8	8	3	4	2
Inadequately educated workforce	11.1	12.8	14.6	10.4	10.1	8	8	3	3	1	3	3
Tax regulations	7.3	7.4	11.4	12.0	9.2	4	2	6	6	4	2	4
Access to financing	22.5	14.7	6.8	7.6	8.2	1	1	1	1	9	7	5
Inefficient government bureaucracy	15	16.9	12.1	12.3	6.1	3	4	2	2	2	1	6
Restrictive labour regulations	2.7	3.9	8.1	7.0	5.9	10	9	11	11	6	9	7
Poor work ethic in national labour force	4.6	5.7	8.6	7.8	5.6	11	11	9	9	5	6	8
Tax rates	3.4	3.1	7.4	7.3	4.5	6	3	10	10	7	8	9
Policy instability	8.2	7.7	1.4	0.7	4.5	2	5	5	5	13	15	10
Inadequate supply of infrastructure	6.5	8.3	3.2	4.8	3.8	12	12	7	7	11	10	11
Crime and theft	0	1.1	0.5	4.5	3.5	14	13	14	14	15	11	12
Poor public health	...	...	3.3	3.9	3.2	...	...	...	...	10	12	13
Foreign currency regulations	1.5	2.9	2.3	1.4	0.9	5	6	12	12	12	13	14
Government instability/coups	1.4	1.6	1.1	1.0	0.6	13	14	13	13	14	14	15

Note: The table does not display the 2011 results because they show already the effects of the revolution.

Source: Enders (2007, Table 2); WEF (2006); WEF (2007); WEF (2008); WEF (2009); WEF (2010)

Table A4: Egypt's global-competitiveness ranking – according to the World Economic Forum

	2006		2007		2008		2009		2010	
	score	rank	score	rank	score	rank	score	rank	score	rank
Global Competitiveness Report (GCR)	**4.1**	**65**	**4.0**	**77**	**4.0**	**81**	**4.0**	**70**	**4.0**	**81**
Basic requirements	**4.6**	**64**	**4.2**	**79**	**4.2**	**83**	**4.2**	**78**	**4.2**	**89**
1st pillar: Institutions	4.2	50	4.2	51	4.2	52	4.0	56	4.0	57
2nd pillar: Infrastructure	3.7	56	3.5	62	3.7	60	4.1	55	4.0	64
3rd pillar: Macro-economic stability	3.7	111	3.7	124	3.6	125	3.5	120	3.4	129
4th pillar: Health and primary education	6.5	51	5.2	83	5.2	88	5.2	84	5.4	91
Efficiency enhancers	**3.6**	**75**	**3.6**	**85**	**3.7**	**88**	**3.9**	**80**	**3.8**	**82**
5th pillar: Higher education and training	3.7	77	3.7	80	3.6	91	3.6	88	3,6	97
6th pillar: Goods market efficiency	4.1	66	4.0	76	4.0	87	4.0	87	3.9	90
7th pillar: Labour market efficiency	3.0	80	3.2	130	3.3	134	3.5	126	3.4	133
8th pillar: Financial market sophistication	...	...	3.5	113	3.7	106	4.0	84	4.0	82
9th pillar: Technological readiness	...	...	2.8	87	3.0	84	3.4	82	3.3	87
10th pillar: Market size	...	...	4.5	31	4.7	27	4.8	26	4.8	26
Innovation and sophistication factors	**3.6**	**65**	**3.6**	**63**	**3.5**	**74**	**3.5**	**71**	**3.5**	**68**
11th pillar: Business sophistication	4.2	57	4.1	67	3.9	77	4.0	72	4.0	63
12th pillar: Innovation	3.0	83	3.2	67	3.2	67	3.0	74	3.0	83
1st pillar: Institutions										
Property rights		58		51		67		67		56
Intellectual property protection		44		64		60		58		67
Diversion of public funds		...		58		85		88		83
Public trust of politicians		51		55		51		37		40
Judicial independence		40		41		42		64		64
Favouritism in decisions of gov't officials		48		50		61		81		63
Wastefulness of government spending		64		67		86		61		95
Burden of government regulation		74		57		55		70		51
Efficiency of legal framework in settling disputes		...		48		55		39		79
Efficiency of legal framework in challenging regulations		...		...		67		63		40
Transparency of government policy-making		...		92		...		57		69
Business costs of terrorism		105		106		72		106		68
Business costs of crime and violence		51		49		23		53		97
Organised crime		30		32		21		15		14
Reliability of police services		47		57		52		54		81
Ethical behaviour of firms		50		53		53		52		59
Strength of auditing and reporting standards		72		70		66		50		58
Efficacy of corporate boards		80		87		93		64		82
Protection of minority shareholders' interests		61		61		68		60		46

Table A4 cont'd: Egypt's global-competitiveness ranking – according to the World Economic Forum					
	2006	2007	2008	2009	2010
	rank	rank	rank	rank	rank
2nd pillar: Infrastructure					
Quality of overall infrastructure	57	60	57	56	68
Quality of roads	47	71	74	73	75
Quality of railroad infrastructure	47	57	54	47	46
Quality of port infrastructure	62	79	69	57	69
Quality of air transport infrastructure	57	59	52	44	39
Available seat kilometres*	...	34	32	32	33
Quality of electricity supply	54	55	53	51	53
Telephone lines*	73	75	79	73	87
3rd pillar: Macro-economic stability					
Government surplus/deficit*	127	127	126	128	107
National savings rate*	69	71	70	80	108
Inflation*	112	61	122	101	135
Interest-rate spread*	67	78	81	68	69
Government debt*	104	116	124	121	119
4th pillar: Health and primary education					
Business impact of malaria	59	60	52	1	1
Malaria incidence*	1	1	61	1	1
Business impact of tuberculosis	58	64	60	57	32
Tuberculosis incidence*	45	41	42	40	44
Business impact of HIV/AIDS	53	41	32	39	29
HIV prevalence*	1	1	1	1	1
Infant mortality*	78	81	88	89	80
Life expectancy*	82	85	89	92	94
Quality of primary education	...	126	129	124	126
Primary enrolment*	...	57	63	45	73
Education expenditure*	...	51	59	59	
5th pillar: Higher education and training					
Secondary enrolment*	61	65	65	68	90
Tertiary enrolment*	57	59	59	63	78
Quality of the educational system	106	119	126	123	131
Quality of maths and science education	96	106	128	124	125
Quality of management schools	89	100	116	114	122
Internet access in schools	...	82	99	95	96
Local availability of research and training services	80	83	92	78	64
Extent of staff training	84	81	96	106	112

Table A4 cont'd: Egypt's global-competitiveness ranking – according to the World Economic Forum					
	2006	2007	2008	2009	2010
	rank	rank	rank	rank	rank
6th pillar: Goods market efficiency					
Intensity of local competition	68	73	92	83	91
Extent of market dominance	...	55	87	102	95
Effectiveness of anti-monopoly policy	74	80	98	95	106
Extent and effect of taxation	37	33	34	52	75
Total tax rate*	...	78	80	79	78
No. of procedures required to start a business*	63	65	34	26	34
Time required to start a business*	27	29	16	15	21
Agricultural policy costs	92	75	102	99	84
Prevalence of trade barriers	107	113	118	114	114
Tariff barriers*	...	114	132	131	123
Prevalence of foreign ownership	86	93	78	66	100
Business impact of rules on FDI	...	98	83	63	75
Burden of customs procedures	...	69	77	68	50
Degree of customer orientation	...	41	27	43	63
Buyer sophistication	...	121	130	106	126
7th pillar: Labour market efficiency					
Cooperation in labour-employer relations	...	72	50	46	99
Flexibility of wage determination	...	28	62	56	60
Rigidity of employment*	...	97	40	43	67
Hiring and firing practices	...	106	92	72	76
Firing costs*	...	123	119	121	128
Pay and productivity	...	79	114	93	76
Reliance on professional management	...	94	124	106	86
Brain drain	...	115	129	123	114
Female participation in labour force*	...	129	133	127	130
8th pillar: Financial market sophistication					
Financial market sophistication	77	86	95	85	–
Financing through local equity market	55	62	49	22	29
Ease of access to loans	82	95	79	44	49
Venture capital availability	89	79	46	34	41
Restriction on capital flows	...	99	80	66	84
Strength of investor protection*	...	87	67	55	–
Soundness of banks	95	106	111	86	61
Regulation of securities exchanges	...	95	80	69	67
Legal rights index*	...	123	123	98	103

Table A4 cont'd: Egypt's global-competitiveness ranking – according to the World Economic Forum					
	2006	2007	2008	2009	2010
	rank	rank	rank	rank	rank
9th pillar: Technological readiness					
Availability of latest technologies	67	65	60	66	91
Firm-level technology absorption	60	68	63	48	58
Laws relating to ICT	81	81	64	51	–
FDI and technology transfer	51	49	55	30	53
Mobile telephone subscriptions*	94	98	106	97	102
Internet users*	85	88	92	78	90
Personal computers*	87	91	90	84	–
Broadband-Internet subscribers*	...	86	86	82	91
10th pillar: Market size					
Domestic market-size index*	...	29	25	25	27
Foreign market-size index*	...	40	39	26	27
11th pillar: Business sophistication					
Local supplier quantity	35	37	86	71	36
Local supplier quality	56	69	103	104	89
State of cluster development	...	61	46	41	66
Nature of competitive advantage	62	77	105	69	35
Value-chain breadth	44	54	73	72	67
Control of international distribution	31	28	49	66	94
Production process sophistication	74	67	61	56	46
Extent of marketing	90	89	95	85	79
Willingness to delegate authority	89	84	38	31	57
12th pillar: Innovation					
Capacity for innovation	84	78	85	96	109
Quality of scientific research institutions	96	92	96	101	110
Company spending on R&D	99	70	57	54	74
University/industry collaboration in R&D	95	85	79	96	120
Government procurement of advanced technological products	84	58	57	72	86
Availability of scientists and engineers	40	29	47	53	25
Utility patents*	72	84	70	86	84
Note: The table does not display the 2011 results because they show the effects of the revolution.					
Source: WEF (2006); WEF (2007); WEF (2008); WEF (2009); WEF (2010)					

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