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Report on the Implementation of the Investment Policy Review

Egypt

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Report on the Implementation of the Investment Policy Review of Egypt

1. Introduction

The Investment Policy Review (IPR) of Egypt was published in 1999. It was one of the earliest IPRs to be conducted and made recommendations to improve the investment framework, the investment promotion effort and strategy to attract and benefit from foreign direct investment (FDI) in selected business activities.

The Government of Egypt invited UNCTAD to assess the extent to which it has implemented the recommendations of the IPR. A mission to Egypt was conducted in February 2005 and its findings are contained in this Implementation Report. This report was prepared by Rory Allan and Fiorina Mugione under the direction of Taffere Tesfachew and Khalil Hamdani. A preliminary version of this report was discussed at the Commission on Investment, Technology and Related Financial Issues on March 2005.

2. Summary of Findings

The IPR reported on conditions in 1998 and this has been taken as the base year from which to assess the extent of changes. In summary, the key findings are:

- On the **investment framework**, the majority of the policy recommendations have been implemented, mostly in the last two years. In some cases, reforms have surpassed expectations. Changes in administrative procedures and machinery have begun, but only recently. Thus it is still an open question as to whether they will be fully implemented and sustained and, crucially, whether improved governance can be inculcated throughout the large government bureaucracy, including in the regions.

- On **investment promotion**, the recommendation has been adopted to transform GAFI, the investment agency from a regulator to an investment promoter and facilitator. The initial effort has been a pragmatic and sensible focus on improving investment facilitation and after care. Development of investment attraction strategy and capacity has begun and will prime focus of the 2005 agenda.

- **FDI performance** has been weak over the period even taking into account external factors such as the Asian financial crisis and the recent slowdown in global FDI inflows. Egypt's FDI data is unreliable and may understate FDI inflows. Efforts are under way to improve FDI statistics and reliable figures should be available before the end of 2005. The Central Bank of Egypt has adopted the international guidelines for FDI data collection and it is revising the balance of payments statistics series. According to the World Investment Report, FDI in Egypt totalled in 2004 a record $1.2 billion.[1] Currently, interest

[1] UNCTAD (2005). *World Investment Report. Transnational Corporations and the Internationalization of R&D*. United Nations publications Sales. No.E.05.II.D.10.

by new investors is picking up and some investors established before 1998 have dramatically increased capacity.

The new Government, appointed in mid-2004, is spearheading an accelerated pace of reforms of the investment framework. A Ministry of Investment was created within the new Government and this is injecting additional dynamism into investment-related policies and institutions. A progressive new management team has been appointed to the General Authority for Investment and Free Zones (GAFI).

A checklist of initiatives shows a strong implementation record. Also the tone has changed since 1998. The current Government is listening more to investor concerns and acting more quickly on them. Moreover, a vision may be taking hold among legislators and policy makers that entails a groundbreaking change in the relationship between the public and private sectors - one that its architects are confident will enable private investment to flourish and to benefit Egypt. In short, therefore, an impressive agenda and leadership is now at work to improve investor conditions and to enhance the flow and benefits of FDI.

Of course many of the regulatory and institutional reforms only enable Egypt to catch up with good practice elsewhere. Alternative locations for FDI have not stood still since 1998. Egypt has slipped in the World Competitiveness Report rankings from 40th in 1998 to 62nd in 2004. However, it ranked 53rd in 2005. Some established and new investors have found Egypt sufficiently competitive to substantially increase their manufacturing export capacity.

3. Implementation of recommendations on the investment framework

FDI entry

Some formal restrictions on **FDI entry** have been eased since 1998. The 49% ceiling on foreign ownership in commercial banking and insurance has been abolished. Major international banks such as CCF, HSBC, Crédit Agricole and Barclays have increased their presence in banking. Allianz among others has entered the insurance market. Some professional services are a closed shop and foreign investment is restricted in import agencies and distributorships. Restrictions noted in the IPR on foreign ownership of agricultural land have been abolished in 2005.

Apart from those exceptions, almost all Egyptian commercial activities that are open for private investment are also open to FDI. State enterprise is still quite pervasive but in most sectors does not operate to the exclusion of private, including foreign, investment. In the absence of an FDI law there appears to be no single statement as to which activities are restricted to foreign investors, perhaps because such restrictions are so few. A forthcoming FDI policy statement should assist.

There is no explicit screening of foreign investment by GAFI as part of its company establishment procedure. (See below.)

Establishment and operation

Business start-up has improved since 1998 in ways recommended by the IPR. The fundamentals have not changed but it has been speeded up. GAFI now performs the registration procedure for both Law 159 (non-incentive) and Law 8 (incentive) companies, as recommended. In January 2005, GAFI opened a full fledge **one-stop shop** to facilitate establishment procedures as recommended in the IPR. As of July 2005, GAFI has also opened other branches for its one-stop shop in Alexandria and three more are soon to open. The number of procedural steps has been reduced, the system is computerised and in some instances regulation has eased to enable a company to begin operating pending security clearance. Average time taken to register a company over the last 4 weeks was reported to be 3 days. In 1998 the procedure could take from 1-6 months. This is impressive, given that the Law 8 company registrations also entail screening of eligibility for fiscal incentives.

GAFI's one-stop shop includes representation from many government agencies that issue regulatory permits and approvals. In other cases GAFI acts as a window to receive applications. GAFI has encouraged these agencies to set up units within the one-stop shop that as far as possible are fully empowered to grant approvals. Of course, there are some permits in complex matters where the processing must be done in the parent ministry. The table in the Annex shows the representation in GAFI and whether approvals can be given in-house.

The changes are quite recent but should in short order dramatically reduce business start up time. Given the current rate of progress there is reason to expect that there will be further streamlining of procedures, including of those directly controlled by GAFI.

The one-stop shop has only just been established and GAFI officials indicated that the set up would be complete by the end of 2005. There is still much to do including:

- Replicating the one-stop approach in GAFI offices outside Cairo,
- Developing an outreach programme in the key regulatory ministries and regions not touched by the one-stop shop. These include land acquisition and property development, which entail major registration and permitting delays.

Privatisation had been slower than expected until 2003 and the Government had not entirely withdrawn from investing in new businesses. Privatisation transactions were 16% fewer in 1999-2003 than in the previous six years and the value of sales proceeds fell by nearly 30%. However, since 2003, transactions involving sales to strategic investors have accelerated and include a number of acquisitions by foreign investors, notably in the cement industry. Total proceeds tripled in 2004-2005 and totalled 9.8 billion Egyptian pounds.

Yet many companies remain in state ownership. These include important services such as fixed line telecommunications, electricity, gas distribution in which state ownership has precluded direct private investment. Many reasons have been put forward for the slow pace including the prospect of large job losses, the daunting reinvestment requirements for modernisation, the setting of unrealistic reserve prices, the wish to retain control over "strategic" industries, and, in some cases, the need for prior regulatory reform. Undoubtedly, there are complex issues and deep adjustment

problems have been generated by decades of widespread state domination of large sections of industry and services.

Privatisation is now the responsibility of the new Ministry of Investment and is being vigorously re-launched with more flexible procedures and a "no sacred cows" approach. A total of 175 companies have been designated for privatisation (54 in 2005) and, where suitable, will entail sale to strategic investors. No restrictions will be placed on FDI in these transactions. More flexible and market oriented valuation procedures will be applied. The Government will absorb more restructuring costs and fiscal incentives will apply. The Government has announced (3 March 2005) that it will divest of its stakes in all joint venture companies and joint venture banks as well as its ownership of a public petroleum company and an insurance company (privatization of Bank of Alexandria and Telecom Egypt has been announced). By the end of 2005, the privatisation record will have markedly improved. In one instance, the petrochemical industry, the Government continues to invest in purely commercial activities. It has been made clear to private investors that state minority participation will be mandatory before access to feedstock will be possible. This activity may undercut the ultimate objective of the privatisation programme.

Protection and treatment of FDI

The IPR reported no contentious issues in the **protection and treatment of foreign investors.** By 1998, 62 bilateral investment treaties had been signed and another 22 have been added since. However, it appears that only 18 have entered into force (one since 1998). No explanation has been given for this. . There have been no expropriations of foreign investment since 1998. Some investor-state disputes have resulted in international arbitration cases. One interviewee operating in a regulated sector reported that the Government had fully honoured its market-related undertakings.

On a more general note, the ministerial level **investor complaints** committee mooted in 1998 has indeed been activated and has met 25 times. This committee was given legislative backing in 2004 and its decisions made binding on government agencies. GAFI was also given the legal authority in 2004 to form an investor conciliation body, headed by a judge. Apart from these formal mechanisms, as noted above, a striking feature of the present Government is its accessibility and its willingness to listen to and act upon concerns raised by investors.

General measures

In **taxation,** several extensions have been made to the direct and indirect tax incentives introduced in Law 8 of 1997:

- The list of eligible activities was extended in 2000.
- The incentives were extended in 2003 to include acquisition of existing businesses through privatisation in return for the new investor undertaking training and R&D.

A more fundamental and important reform has been introduced that introduces a sharp reduction in tax holidays in activities and areas previously exempted by law no. 8 and

a simultaneous lowering of uncompetitive general rates of corporate taxation. This applies to companies established after the enactment of the new tax law. The standard corporate tax rate is likely to be reduced from 42% to 20%. This is a welcome development. It will enable all investors to operate in a competitive fiscal regime. Detailed tax policy changes were not addressed in the IPR but it is appropriate to note here this proposal.

This change in business tax policy is a landmark in the reform programme. It offers competitive arrangements to all investors and reduces the scope for unnecessary and discretionary exemptions and intrusive compliance procedures. It seems likely that an exception will be made for the free zones. They will continue to offer lifetime tax holidays to new investors. If this exception leads to others, it may in due course undermine the landmark nature of this reform.

The IPR reported problems with **customs administration** and singled out the poor implementation of customs duty drawback for export investors. The operation of the drawback scheme was improved in 2002 by centralising funding and administrative control in a single agency, the Export and Import Control authority. More generally, important reforms have begun. Tariff rates have been reduced from a weighted average 14% to 9% and the plethora of tariffs bands reduced to six, which will simplify customs' assessments. Reforms in customs' procedures themselves have been implemented by administrative authority, aided by strong ministerial oversight in the current Government. A new law will be issued shortly to institutionalise these. Based on the detail provided, it is clear that these are closely addressed to removing unnecessary red tape. Work will now begin on all-important management and organisational reforms in the customs' administration.

Most investors interviewed report already a noticeable improvement in customs' clearance times. One investor reported the improvement as a "miracle" and another is planning to reduce its customs clearing staff from 20 to 3-4. However, the change is less noticeable for smaller investors who have less administrative resources and clout with government. Thus, the improvements are not yet systemic.

The IPR did not identify **corporate tax administration** as a serious issue although at the time around 200,000 disputed tax cases were before the courts. These disputes often arose from what all investors interviewed described as highly arbitrary tax assessments. The problem appears to have worsened, as there may now be over 300,000 disputed tax cases in court. Details were provided of comprehensive reforms in compliance procedures that have been enacted as law by the Parliament in 2005. The new law will enable the tax authorities to take a more focussed and less arbitrary approach, will introduce an independent appeals system and appoint a watchdog to safeguard taxpayers' rights. An amnesty is planned to clear the backlog of pending cases.

Foreign exchange arrangements have surpassed expectations in the IPR. The requirement for exporters to surrender 75% of foreign currency proceeds was lifted in December 2004 and, in January 2005, Egypt accepted the IMF Article VIII obligation to maintain current account convertibility. This sets the seal on a series of sustained reforms to move to a market oriented approach to exchange rate setting and stable macroeconomic policy to underpin currency convertibility.

Labour regulation was overhauled through the introduction of a unified Labour Law in 2003. Historically, government permission has been required for companies to lay off workers. Although eased and not notably burdensome in practice, this inflexibility in termination procedures remains. This is separate from the issue of handling cases of unfair dismissal, for which governments must provide appropriate grievance procedures.

Work and residence permits for non-citizen employment has improved. Previously, rules were liberal but approvals could be slow. GAFI's one-stop shop incorporates representatives of the relevant authorities and they claim that issuing delays have been reduced. For example, new work permits can be issued in 48 hours and renewals in 24 hours. Provided that foreign workers do not account for more than 10% of total employment the principal check is on the credentials of the employee. At GAFI the entry visa can be issued on the spot once the work permit is approved.

A **competition law** was being prepared in 1998. A new law, including merger provisions, was passed by Parliament in January 2004 and entered into force on 16 June 2005 and the competition authority has been established. Key implementation regulations are not in place. The law was not evaluated in detail for this report.

A new **intellectual property protection** law was issued in 2002 (82 of 2002), somewhat later than the forecast date of 2000. The new law is designed to be TRIPS compliant and gained a positive peer review at the WTO. Furthermore, Egypt's conclusion of **trade agreements** has surpassed the expectations of the IPR.

Longstanding negotiations of a partnership agreement with the European Union were concluded in 2004, enabling Egypt to secure a free trade agreement with its most important export market.

The 1997 Greater Arab Free Trade Agreement (GAFTA) free trade agreement between 17 Middle Eastern states to eliminate progressively tariff and non-tariff barriers has been implemented ahead of time (2005 instead of 2007), at least in respect of tariff barriers. Attention will now focus on reducing barriers to trade in services. Some academic research suggests that the gains to Egypt from domestic services liberalisation arising from GAFTA would exceed those from goods and that FDI would be particularly beneficial in such a liberalisation. The ultimate goal is

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