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Gregory Bishop

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Closing the Open Door: A Reappraisal of Foreign Investment in Egypt*

In 1973 the Egyptian government began encouraging foreign investment to strengthen its struggling economy.[1] Egypt hoped that a healthy injection of foreign capital and technology would stimulate economic growth. To increase foreign interest in Egypt, the government completely revised its foreign investment laws. The government's purpose was to decrease perceived risks associated with Egyptian investment and to increase projected returns of potential investors. The vehicle for doing so was Law No. 43 of 1974,[2] commonly known as the Open Door Policy.[3]

Law 43 provided foreigners with investment incentives such as guarantees against nationalization, limited allowances for tax-free profits, and provisions for tax-free return of invested capital. Since the Open Door Policy was announced in 1974, the Egyptian government has continued to rely on Law 43 as the principal means of encouraging foreign investment in Egypt.

This comment reviews the history and purpose of Law 43 and evaluates the law's impact on foreign investment decisions. It then identifies four problems that must be addressed if future investment levels are to exceed the disappointing results of the past decade.

I. History of the Open Door Policy

In 1952 Gamal Abdel-Nasser and other leaders of the Revolutionary Council led a successful military coup against the

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*The author gratefully acknowledges the assistance of Dr. Delwin A. Roy and Dean Jeswald W. Salacuse, both of whom provided direction and helpful critique in the preparation of this article. The conclusions reached, of course, are the author's own.

1. Economic reform was not the sole motivation for Egypt's change of position on the role of foreign investment. As one expert pointed out, the change in policy "was first and foremost a political doctrine, a fundamental part of [Egypt's] dramatic turn to the West in seeking resolution of the conflict with Israel." D. Roy, Impact Analysis of Economic Liberalization in Egypt: An Assessment of Selected Socio-Economic Groups 3 (March 15, 1982) (unpublished memorandum).

2. Law No. 43 of 1974, Concerning the Investment of Arab and Foreign Funds and the Free Zones, as amended by Law No. 32 of 1977 [hereinafter cited as Law No. 43], *reprinted in* D. Carr, Foreign Investment and Development in Egypt 123 (1979).

3. *See* McLaughlin, *Infitah in Egypt: An Appraisal of Egypt's Open-Door Policy for Foreign Investment*, 46 Fordham L. Rev. 885, 892 (1978). The Open Door Policy figuratively refers to the government's open attitude toward foreign investment.

reigning monarch, King Farouk.[4] The Revolutionary Council, although not motivated by any particular economic ideology, was interested in eliminating the special privileges of the wealthy. Accordingly, some of Nasser's subsequent reforms set maximum limits on individual land ownership, with the excess expropriated by the government.[5] By 1956 Egypt had completely nationalized the foreign private sector. Four years later, Nasser began nationalizing the Egyptian private sector as well. These actions led to the flight of foreign and Egyptian capital and the emigration of many entrepreneurs and managers.[6]

From 1956 to 1971 the government attempted to stimulate economic growth by subsidizing major industrial concerns such as utilities, transportation, and food production.[7] These subsidies to the public sector produced temporary economic benefits; however, the economy slowed significantly by the end of the Nasser era in 1970.[8]

Nasser's successor, Anwar al-Sadat, reexamined Egypt's foreign investment policies and questioned the government's ability to stimulate the economy effectively.[9] Sadat's reexamination led to adoption of Law 65 of 1971.[10] Law 65 created the General Authority for Investment of Arab Funds and the Free Zones and empowered it to regulate certain aspects of foreign investment. Law 65 also created investment incentives such as provisions for tax-free return of invested capital, guarantees against nationalization without compensation, and limited allowances for tax-free return of profits.[11] Despite these efforts to improve the investment environment, foreign investment in Egypt remained stagnant.[12]

By 1973 "Sadat crystallized his perception of . . . [Egypt's] economic future" in what has since been called the October Pa-

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4. D. CARR, *supra* note 2, at 23; *see also* U.S. DEP'T OF COMMERCE, INVESTMENT CLIMATE STATEMENT: EGYPT 3 (Oct. 16, 1984) [hereinafter cited as INVESTMENT CLIMATE STATEMENT].

5. D. CARR, *supra* note 2, at 23.

6. Roy, *Economic Liberalization and the Private Industry Sector in Egypt*, 1 MIDDLE E. MGMT. REV., Dec. 1977, at 4, 5.

7. INVESTMENT CLIMATE STATEMENT, *supra* note 4, at 3.

8. D. CARR, *supra* note 2, at 23.

9. Roy, *supra* note 6, at 5.

10. The full text of law 65 is not readily available. However, it is discussed in D. CARR, *supra* note 2, at 41-42.

11. *Id.* at 42.

12. Note, *The Development of Foreign Investment Law in Egypt and Its Effect on Private Foreign Investment*, 10 GA. J. INT'L & COMP. L. 301, 303 (1980).

per. In the October Paper, Sadat announced the concept of "infitah" or "openness."[13] Approval of the October Paper in a national referendum in May 1974[14] marked the end of the anti-private investment sentiment of the Nasser period[15] and opened the way for passage of Law 43 the following month.[16]

As originally enacted, Law 43 had four principal provisions. First, it was designed to promote specific kinds of investment projects,[17] with each project requiring prior government approval.[18] Second, it required each project to include some financial participation by Egyptian investors.[19] Third, it permitted

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13. Roy, *supra* note 6, at 4, 5.

14. D. CARR, *supra* note 2, at 43.

15. D. Roy, *supra* note 1, at 4.

16. D. CARR, *supra* note 2, at 43.

17. Law 43 originally provided for foreign investment projects to be established in geographical areas known as free zones. "The concept of the free zone is intended to capitalize on Egypt's central geographical location in the Middle East and to encourage the use of the country as an export platform to the area around it as well as to Europe." CHASE TRADE INFORMATION ASSOCIATION & CHASE NATIONAL BANK (EGYPT) S.A.E., GUIDE TO DOING BUSINESS IN EGYPT 45 (1983) [hereinafter cited as GUIDE TO DOING BUSINESS]. Although the Egyptian government continues to encourage investment in free zones, by the end of 1984 only 8.9% of total capital invested under Law 43 was invested in free zones. Table One, *infra* p. 452. In summarizing the early history of Law 43, one expert noted:

> A problem that was proving particularly critical was the decision of the government to stimulate the economy through an appeal to the private sector to establish investments in free zones rather than permitting access to domestic markets. This approach was taken to avoid confrontation with the public sector, to minimize the visibility of a foreign presence on Egyptian soil, and to mitigate the need to undertake constitutional reform occasioned by substantive alteration of matters such as the rights of the workers . . . . [However, the] private sector simply was not interested in free zones.

D. Roy, *supra* note 1, at 37-38. Law 43 now permits foreigners to invest in free zones or inland projects, which were created to allow foreign investors access to domestic markets. *See generally* Note, *supra* note 12.

18. Article 3 of Law 43 provides:

> The investment of Arab and Foreign capital in the Arab Republic of Egypt shall be for the purpose of realising objectives of economic and social development within the framework of the State's general policy and national plan, provided that the investment is made in projects in need of international expertise in the spheres of modern development or in projects requiring foreign capital.

Law No. 43, art. 3, reprinted in D. CARR, *supra* note 2, at 125. Article 3 goes on to specify the types of projects the Investment Authority will consider, but adds that "[s]pecial priority shall be given to those projects which are designed to generate exports, encourage tourism, or reduce the need to import basic commodities as well as projects which require advanced technical expertise or which make use of patents or trade marks of world wide reputation." *Id.* at 126.

19. Article 4 [of Law 43] stipulates that capital invested under the provisions of this law shall take the form of participation with public or private Egyptian

foreign investors to repatriate their capital.[20] Fourth, it offered foreigners other investment incentives such as provisions for tax-free return of profits and guarantees against nationalization.[21] Much like Law 65, Law 43's intent was to increase economic activity by encouraging an infusion of foreign capital and technology.[22]

Notwithstanding the improved incentives of Law 43, initial investor response was lower than anticipated. Slow investment was attributed to several factors including political considerations, insufficient incentives, administrative difficulties, and underdeveloped sources of communication, transportation, and energy.[23] After three years of experience with Law 43, the Egyptian government received a report highlighting critical problem areas and giving specific recommendations for reform.[24] Based on this report, Law 43 was amended by Law 32 of 1977.[25] The purpose of Law 32 was to enhance the objectives of Law 43 and to remove the difficulties and uncertainties inhibiting foreign investment.[26] The underlying purpose of Law 43 remained unchanged:

> capital. Foreign investment in banks engaging in local currency transactions can not exceed 49 percent of the total equity. The 1974 law does not stipulate a strict minimum percentage of local equity in other fields. Some local participation is required in branches of foreign investment banks and merchant banks, and the basic spirit of the law strongly suggests the desirability of some local participation elsewhere.

D. CARR, *supra* note 2, at 44.

20.
> The repatriation of capital is allowed after five years in five equal annual installments at the rate of exchange prevailing at the time of transfer. Article 21 of the law goes on to state that the value of the capital allowed to be repatriated shall be the original registered value plus a percentage to be fixed by the [Investment] Authority to match any appreciation which may have occurred in the value of such capital.

Id.

21. *See generally id.*

22.
> [The Open Door Policy] was to esteblish a framework within which modern, i.e., Western industrial technology could be transferred to Egypt by coupling this with Arab capital and Egyptian manpower and resources. . . . [Sadat] acknowledged that such a transfer of technology should have positive effects on the economic operation of the public sector companies and that it should result in a substantial reduction of the degree to which the bureaucracy controls the operation of the economy . . . .

Roy, *supra* note 6, at 6-7.

23. *See* Salacuse & Parnall, *Foreign Investment and Economic Openness in Egypt: Legal Problems and Legislative Adjustments of the First Three Years*, 12 INT'L LAW. 759, 760 (1978).

24. D. CARR, *supra* note 2, at 46.

25. The full text of Law 43 as amended by Law 32 is reprinted in D. CARR, *supra* note 2, at 123.

26. Salacuse & Parnall, *supra* note 23, at 761.

Egypt wanted to dramatically increase the level of foreign investment and to accelerate the process of technology transfer. As President Hosni Mubarak recently emphasized:

> "We want to increase production and productivity. We want to create more jobs for our working force. We want to absorb the latest technology.
>
> "To achieve all that, we must raise the level of investment and accelerate the process of technology transfer.
>
> "Hence, comes the role of the private sector and foreign investment. We are determined to stimulate capital investment in every possible way. The Open-Door Policy must be reinforced in all areas of production."[27]

Shortly after the 1977 amendment was adopted, initial expectations were that most of the problems had been resolved and that the incentives provided by amended Law 43 had won acceptance from foreign investors.[28] In fact, significant problems still prevent foreign investment in Egypt from reaching a meaningful level.

II. Actual Investment Since Passage of Law 43

Since enactment of Law 43 in 1974, the Egyptian Investment Authority has published cumulative investment statistics for each fiscal quarter.[29] Statistics for December 31, 1984, are reproduced in Table One. As illustrated, the Investment Authority reports investment projects by three categories: (1) approved projects, (2) projects in operation, and (3) projects under implementation.

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27. Ministry of Investment and International Cooperation, Investment and Free Zones Authority, Egypt: The Right Orientation for Your Investment 4 (1984) [hereinafter cited as Egypt: The Right Orientation].

28. Salacuse & Parnall, *supra* note 23, at 776.

29. The statistics are published annually in Investments and Free Zones Authority, Facts and Figures. A copy of these statistics may be obtained by contacting the Investment and Free Zones Authority:

8 Adly St., Cairo, Egypt
P.O. Box 1007
Cable Address: INVESTAZON
Telex: 92235 INVST UN
Telephone: 906804 / 906796

TABLE ONE—Projects Approved Under Law 43 as of Dec. 31, 1984

(Value in L.E. Million)

Sectors	APPROVED PROJECTS					PROJECTS IN OPERATION					PROJECTS UNDER IMPLEMENTATION				
	No.	Capital Local	Capital Foreign	Capital Total	Total Invest. Costs	No.	Capital Local	Capital Foreign	Capital Total	Total Invest. Costs	No.	Capital Local	Capital Foreign	Capital Total	Total Invest. Costs
A- Inland :															
Industrial Projects	547	910.4	1087.6	1998.0	5366.8	274	323.3	361.1	684.4	1856.9	114	141.0	150.5	291.5	663.0
Financial Projects	264	853.8	975.1	1828.9	1988.4	217	663.1	833.7	1496.8	1626.3	12	26.2	28.2	54.4	54.4
Agricultural Projects	99	144.4	152.3	296.7	651.3	37	81.1	58.0	139.1	308.2	22	31.1	26.4	57.5	138.0
Construction Projects	197	318.0	225.4	543.4	1197.4	99	46.2	64.5	110.7	306.9	42	50.8	79.3	130.1	332.4
Services Projects	219	338.3	695.4	1033.7	2082.6	133	135.5	237.4	372.9	759.7	39	80.1	180.8	260.9	663.6
Total	1326	2564.9	3135.8	5700.7	11286.5	760	1249.2	1554.7	2803.9	4858.0	229	329.2	465.2	794.4	1851.4
B- Free Zones															
Cairo	60	2.5	313.2	315.7	353.0	46	2.2	155.9	158.1	182.3	6	—	18.5	18.5	19.4
Alexandria	126	0.4	334.9	335.3	526.6	102	0.4	288.3	288.7	461.0	15	—	11.4	11.4	18.7
Suez	40	0.4	78.2	78.6	129.2	27	0.4	40.1	40.5	42.7	9	—	13.2	13.2	17.5
Port-Said	85	1.9	84.4	86.3	97.0	83	1.9	82.4	84.3	95.0	2	—	2.0	2.0	2.0
Total	311	5.2	810.7	815.9	1105.8	258	4.9	566.7	571.6	781.0	32	—	45.1	45.1	57.6
Grand Total	1637	2570.1	3946.5	6516.6	12392.3	1018	1254.1	2121.4	3375.5	5639.0	261	329.2	510.3	839.5	1909.0

The first category, approved projects, refers to the number of projects the Investment Authority has approved since Law 43 was adopted in 1974. The Investment Authority does not publish information regarding the number of applications submitted each year, nor the number of projects accepted as a percentage of applications submitted. Therefore, investors cannot easily estimate the probability of receiving government approval. The second category, projects in operation, refers to the number of approved projects that are now functioning. The final category, projects under implementation, refers to approved projects that have taken steps toward starting operations, but that are not yet operating. Statistics are further broken down into two specific types of investments: investments in inland projects and investments in free zones.[30] The following discussion is limited to investments in inland projects.

The statistical format used by the Investment Authority provides potential investors with little useful information regarding past investment trends. For example, Table One shows that as of December 31, 1984, the government had approved a total of 1,326 inland projects. However, without the benefit of past statistical data, a potential investor does not know how many of those projects were approved during the current year, and how many were approved in each of the preceding years. The statistical format obscures investment trends. Such information could be valuable in making an investment decision because it illustrates past investment opportunities as perceived by previous investors.

Information provided by the Investment Authority can be restructured, however, to provide potential investors with more useful data. By comparing cumulative statistics of one year with cumulative statistics of each succeeding year, a potential investor can estimate investment trends. Graph One provides this type of analysis for the three major investment categories.

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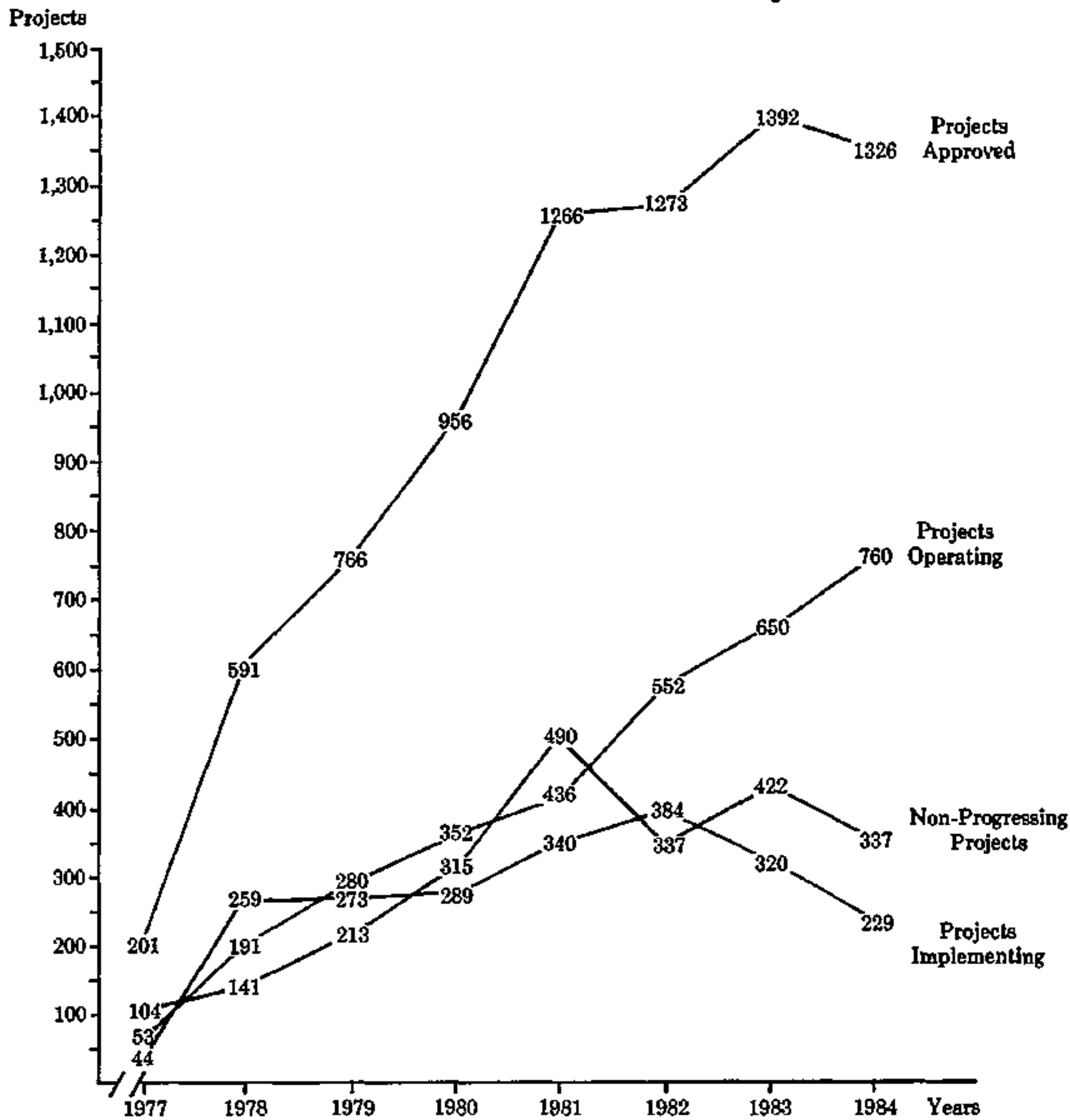
30. For a discussion of the differences between inland projects and free zones projects, see *supra* note 17.

GRAPH ONE

Cumulative Investments in Inland Projects*



*Data taken from "Facts & Figures," published by the Investment and Free Zones Authority. All data for 1977 represents the cumulative total from passage of Law 43 in 1974 through year end 1977.

Graph One also shows annual changes in the number of "nonprogressing projects." Nonprogressing projects may be defined as projects approved by the Investment Authority that are not yet included in the subcategories of projects in operation or projects under implementation. As of 1984, for example, 1,326 projects had received approval to invest in Egypt, of which 760 had commenced operations and 229 had taken steps toward starting operations. The remaining 337 projects had not taken any steps toward beginning operations and therefore could be classified as nonprogressing projects.

By computing annual changes in the cumulative totals, a potential investor can estimate investment statistics for any given year.[31]

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31. Statistics generated in this manner will not be completely accurate because the Investment Authority may revoke previous project approvals. For each approval revoked, the number of cumulative approvals decreases correspondingly. For example, although the Investment Authority may have approved 100 new projects in a given year, only 75 of them would be added to the cumulative statistics if 25 project approvals were also revoked during the same year. "If the investor fails to take 'serious steps' to carry out the project within six months of approval, the approval will lapse." Sidley & Austin & Naguib, *Doing Business in Egypt: Legal Planning Considerations* (pt. 1), MIDDLE E. EXECUTIVE REP., Dec. 1983, at 9, 10.

TABLE TWO — Annual Investment Statistics*

	Total number of projects approved	Total number of projects in operation	Total number of projects imple-menting	Total number of projects not progressing
1977	201	53	44	104
1978	390	138	215	37
1979	175	89	14	72
1980	190	72	16	102
1981	310	84	51	175
1982	7	116	44	**
1983	119	98	−64	**
1984	−66	110	−91	**

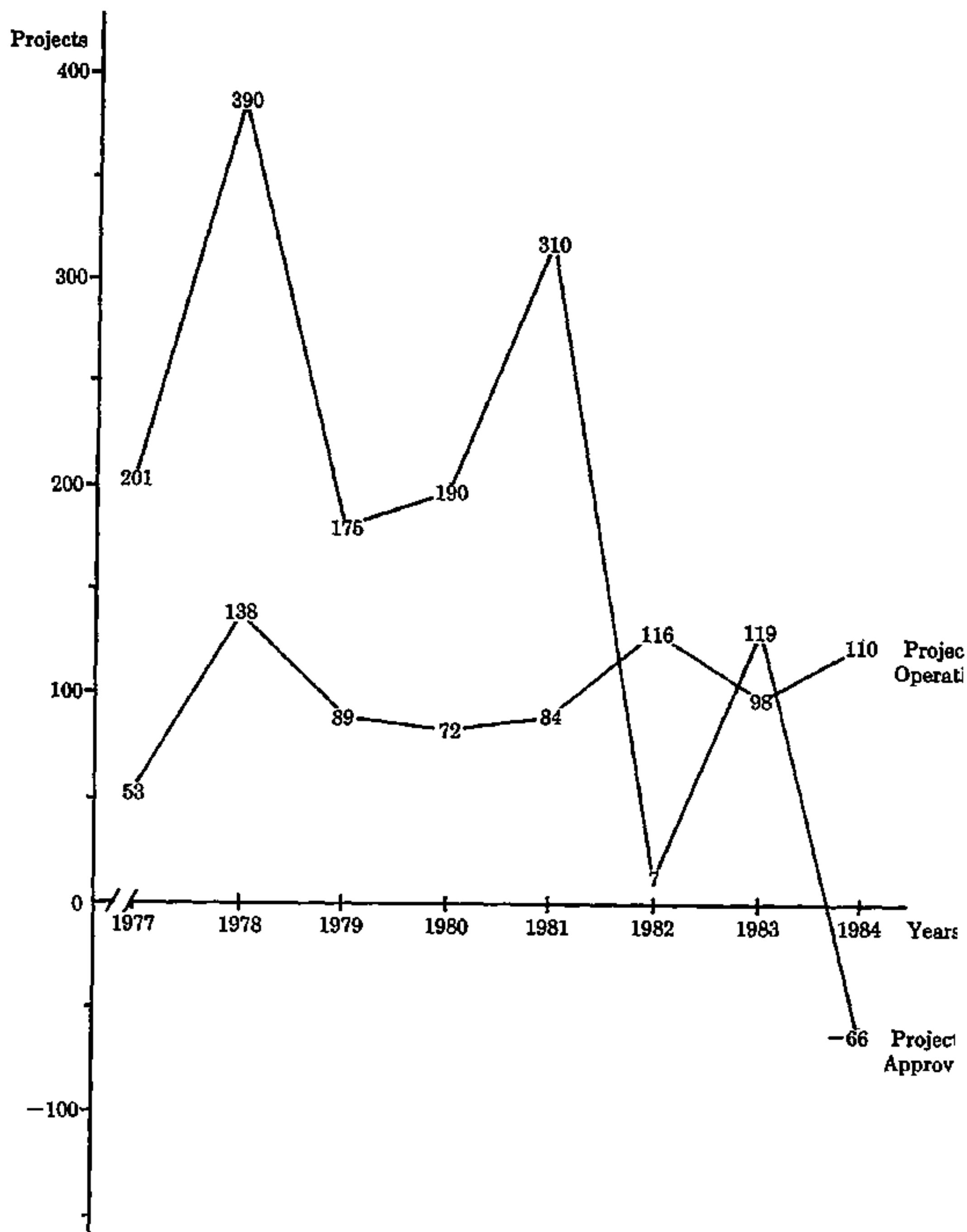
*Data taken from "Facts & Figures," published by the Investment and Free Zones Authority. All data from 1977 represents the cumulative total from passage of Law 43 in 1974 through 1977. Negative numbers result from project approvals being revoked by the Investment Authority.

**Cannot be calculated accurately.

Table Two estimates the number of investments for each year from 1977 to 1984. Like Graph One, Table Two also includes a category for nonprogressing projects. Some data contained in Table Two is also illustrated in Graph Two.

GRAPH TWO

Annual Investments in Inland Projects*



*Data taken from "Facts & Figures," published by the Investment and Free Zones Authority. All data from 1977 represents the cumulative total from passage of Law 43 in 1974 through year end 1977. The negative number in 1984 results from project approvals being revoked by the Investment Authority.

Finally, Table Three divides inland projects into three categories: (1) percentage of approved projects operating, (2) percentage of approved projects implementing, and (3) percentage of approved projects not progressing. Graph Three presents this same information in graph form.

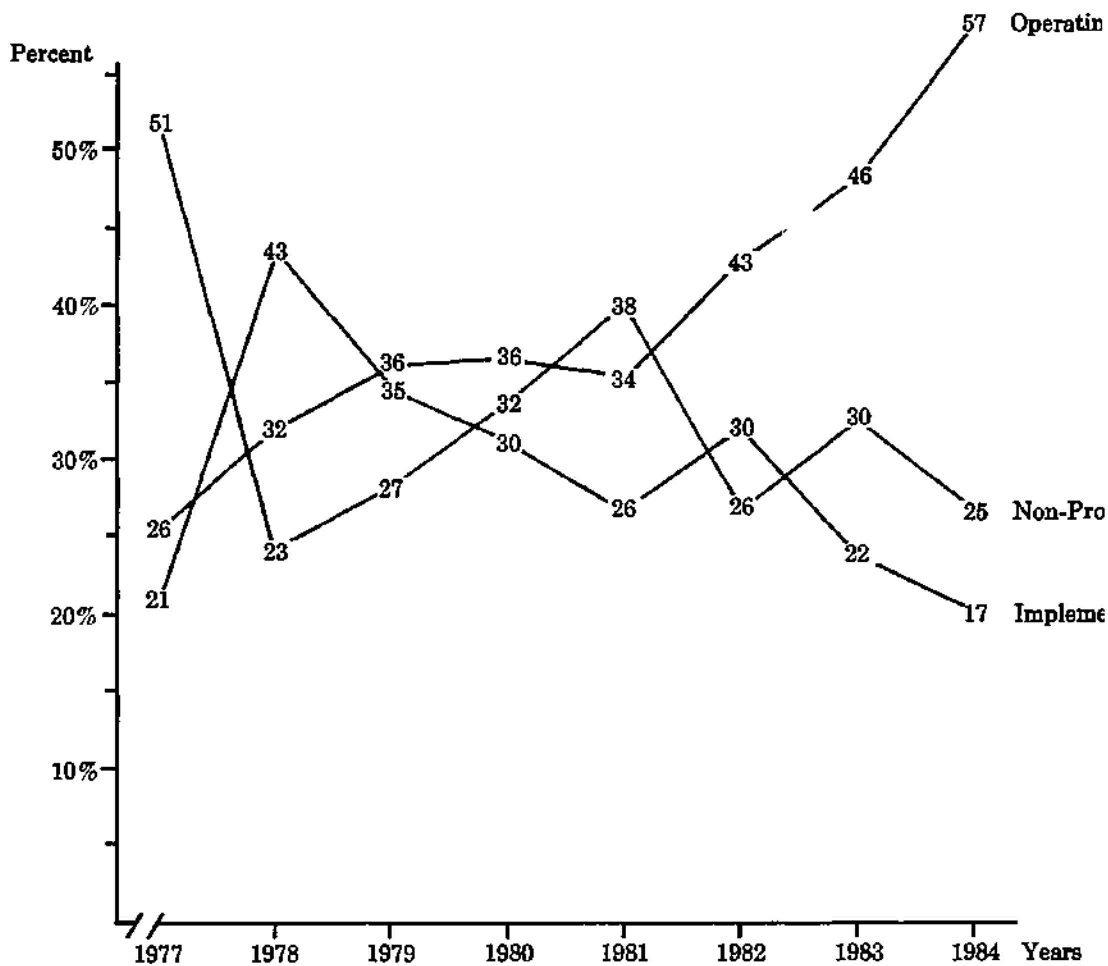
TABLE THREE — Percentage Breakdown of Annual Statistics*

	Percentage of approved projects operating	Percentage of approved projects implementing	Percentage of approved projects not progressing
1977	26.37	21.89	51.74
1978	32.32	43.82	23.86
1979	36.55	35.64	27.81
1980	36.82	30.23	32.94
1981	34.44	26.86	38.70
1982	43.36	30.16	26.47
1983	46.70	22.99	30.32
1984	57.31	17.26	25.41

*Data taken from "Facts & Figures," published by the Investment and Free Zones Authority. All data from 1977 represents cumulative total from passage of Law 43 in 1974 through year end 1977. All percentages have been rounded to two decimal places.

GRAPH THREE

Percentage Breakdown of Approved Inland Investments*



*Data taken from "Facts & Figures," published by the Investment and Free Zones Authority. All data for 1977 represents the cumulative total from passage of Law 43 of 1974 through year end 1977.

With statistical information in these restructured formats, several observations are possible. First, if investor interest in Egypt can be accurately measured by the number of project approvals, then investor response was greater in the early years of Law 43 than it has been in more recent years, as illustrated in Table Two and Graph Two.

Second, many approved projects are either slow to invest or fail to become actual investments. Statistics illustrate that many investors complete the application process and receive permission to invest, but fail to actually invest. Table Three indicates that the percentage of these nonprogressing projects has ranged from 23% to 51% of the total number of approved projects. A final observation gleaned from Table Three is that only 57% of approved projects have actually started operations.

In addition to these statistical trends, the sources of investment capital provide other insight for potential investors. For example, even though Law 43 was designed to attract Western investors (who presumably could transfer advanced technology), only 15% of investment in Egypt has come from Western sources. American participation accounts for only 26.6% of that amount. In other words, American participation accounts for only 4% of total foreign investment in Egypt. Nearly 65% of investment under Law 43 has come from Egyptian investors, with the remaining 20% coming from other Arab investors.[32]

A review of historical trends in Egyptian foreign investment leaves potential investors with several unanswered questions. Why has the rate of investment decreased in recent years? Why is there such a high percentage of nonprogressing projects? Why are so few approved projects in operation? And why has Western, and particularly American, response to Law 43 been so poor? To answer these questions, potential investors should examine the problems being encountered by current foreign investors.

III. Disincentives for Foreign Investment

Although investors contribute investment capital for many different reasons, most investment decisions are based on the

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32. Investment and Free Zones Authority, Facts & Figures XIV, Dec. 1984. The 15% from Western sources is broken down as follows: U.S.A. (4%); European Economic Communities (6%); and Others, which may or may not include Western investors, (5%). *Id.*

expected rate of return on the investment. The expected return may be defined as the investor's share of projected net profits expressed as a percentage of the amount invested. For example, if the investor's share of the projected profit on a $100,000 investment is $20,000, then the expected return is 20%.

An investor must estimate several variables when calculating expected return. These variables include projected revenues, projected costs, and projected risks. The general effect of increased costs or increased risks on expected return is shown in Table Four, which illustrates that expected return decreases as projected costs or projected risks increase. Because the converse is also true, a government may increase expected returns by decreasing the costs or risks associated with an investment. This is exactly what the Open Door Policy was designed to accomplish for Egypt.

TABLE FOUR—Expected Return on a $100,000 Investment*

Scenario	Gross Profit	Costs of Goods**	Risk Factor***	Net Profit	Expected Return
1-Normal	$100,000	$80,000	1.0	$20,000	20%
2-Increased Risks	$100,000	$80,000	.8	$16,000	16%
3-Increased Costs	$100,000	$90,000	1.0	$10,000	10%
4-Increased Risks & Costs	$100,000	$90,000	.8	$ 8,000	8%

* The expected return on a $100,000 investment is calculated according to the following formula:

$$\text{Gross Profit} - \text{Cost of Goods} \times \text{Risk Factor} = \frac{\text{Net Profit}}{\text{\$100,000 investment}} = \text{Expected Return}$$

** "Cost of Goods" includes all expenses that arise in generating the gross profit (i.e., raw materials, overhead, labor, etc.).

*** Investment risk may be defined as the probability of arriving at the expected return. A risk factor of 1.0 represents a 100% chance of achieving the expected return; a risk factor of .8 represents an 80% chance.

In addition to the favorable investment climate created by the Open Door Policy, Egypt offers other investment incentives.

Egypt enjoys the largest consumer market in the Middle East[33] (approximately forty-seven million people),[34] the "[l]argest pool of trained labour in the Arab World," the "[b]roadest agricultural and industrial base in the Arab World,"[35] and a stable and popular government.[36]

Nevertheless, several problems create disincentives that are preventing investment in Egypt from reaching a meaningful level. These disincentives create investment costs and risks that in turn decrease the expected return on investments. The four principal disincentives for Egyptian investment are bureaucratic obstacles, shortages of foreign exchange, public sector problems, and poor infrastructure.

A. *Bureaucratic Obstacles*

One investment risk facing investors considering Egypt as a possible investment location is the effect of the Egyptian bureaucracy. In 1983, a private consultant reporting on American business experiences in Egypt concluded tbat "[t]he major obstacles encountered by U.S. firms tend to revolve around the bureaucracy."[37] A recent report by the U.S. Department of Commerce confirms that conclusion. The report noted that while "[t]he very term [bureaucracy] evokes distasteful imagery in any country[,] . . . in Egypt 'bureaucracy' takes on new meanings of despair."[38] The report continued:

> Several potential investment projects have heen known to collapse owing to haste and the dashed expectation by the investor that the process of application would follow American norms. Unclear and overlapping lines of authority are manifested particularly in the area of customs clearance and duty payment. Company representatives have also complained of last-minute import restrictions which have slowed production to a halt.[39]

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33. EGYPT: THE RIGHT ORIENTATION, *supra* note 27, at 6.

34. American Embassy, Cairo, Egypt, Economic Trends Report: Egypt 7 (Oct. 21, 1984) (unpublished memorandum) [hereinafter cited as Economic Trends Report].

35. EGYPT: THE RIGHT ORIENTATION, *supra* note 27, at 6.

36. Interview with Cynthia Anthony, Egyptian Desk Officer, Dep't of Commerce, in Washington, D.C. (Dec. 22, 1984) [hereinafter cited as Anthony Interview].

37. Reckford Int'l, Inc., U.S. Business Experience in Egypt 4 (Mar. 8, 1983) (unpublished memorandum) [hereinafter cited as Reckford Report].

38. INVESTMENT CLIMATE STATEMENT, *supra* note 4, at 5.

39. *Id.*

The report concluded that "[t]he [Egyptian] government continues to take steps to rationalize the foreign investment mechanism, but American investors should be prepared for a formidable obstacle course."[40]

Two bureaucratic problems are typical and deserve special mention. First, many firms encounter difficulties in importing raw materials. Problems arise from a variety of government entities, both national and local, as well as from customs officials who hold up goods that have already been approved by the appropriate government agencies.[41] A delay in delivery of raw materials can increase production costs or temporarily shut down operations. Investors relying on imports for their production process are therefore exposed to a higher degree of risk in Egypt than they might face elsewhere.

A second bureaucratic problem is government reluctance to meet investor needs after an investment decision has been made. Some investors have complained that they are baffled by the government's disappointing follow-through on specific commitments, and others have noted the sometimes divergent treatment given private and public sector companies.[42] Several investors have "pointed out that the Egyptian government seems to be much more interested in attracting new investments than in helping earlier investors to be successful."[43] As with other factors, risks associated with unpredictable government behavior will be considered in an investment decision.

B. Shortage of Foreign Exchange

The Open Door Policy attempted to decrease foreign investment costs by decreasing taxes that investors might otherwise pay on their investments. Law 43 provides that investors are not required to pay taxes during applicable "tax holidays." Such holidays generally last for five years from the date operations begin, but they can extend as long as fifteen years.[44] Law 43 also provides investors with the right to a pro rata, tax-free withdrawal of invested capital (repatriation) five years from the time the capital is transferred into Egypt.[45]

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40. *Id.*
41. Anthony Interview, *supra* note 36.
42. Economic Trends Report, *supra* note 34, at 9.
43. Reckford Report, *supra* note 37, at 7.
44. *See* EGYPT: THE RIGHT ORIENTATION, *supra* note 27, at 8.
45. *See* Law No. 43, art. 21, reprinted in D. CARR, *supra* note 2, at 132-33.

To illustrate, a company bringing a $1,000,000 computer system into Egypt can withdraw, tax-free, one-fifth of that amount ($200,000) after five years. The remaining $800,000 can be repatriated in equal amounts over the next four years. In exceptional circumstances, capital may be repatriated without regard to the five-year time period.[46] Similar provisions exist for repatriation of tax-free or after-tax profits.

Article 26 of Law 43 outlines specific procedures for repatriation of both capital and profits. First, an application for transfer of funds is presented to the Investment Authority. The application must be "accompanied by a certified copy of the project's balance sheet and profit and loss statement . . . [plus] an accountant's certificate attesting that the company has fulfilled its tax obligations and other obligations to [Egypt]."[47] The Investment Authority then reviews the application to determine if the amounts have been calculated properly. If the application is in order, the Investment Authority permits the investor to transfer the equivalent value of the capital or profits abroad.[48]

Article 22(i) of Law 43 provides that Egyptian currency is to be exchanged for foreign currency according to the "highest rate prevailing." The term "highest rate prevailing" is presently interpreted to mean the official government exchange rate.[49] Hence, an American company with permission to repatriate 1,000,000 Egyptian pounds must first translate that amount into American dollars according to the official government exchange rate.

Once a company has received permission to repatriate, the challenge is finding the desired currency. Currency acquisition is extremely difficult because a shortage of foreign funds[50] has made it impossible for companies to obtain currency at the official exchange rate prices. In the past, the Egyptian government has allowed and even encouraged foreign investors to purchase foreign currency at a premium through the "Own Exchange Market,"[51] commonly known as the free market exchange.[52]

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46. EGYPT: THE RIGHT ORIENTATION, *supra* note 27, at 9.

47. Sidley & Austin & Naguib, *Doing Business in Egypt: Legal Planning Considerations* (pt. 4), MIDDLE E. EXECUTIVE REP., July 1984, at 13, 14.

48. *Id.*

49. *Id.* at 15.

50. *Id.*

51. GUIDE TO DOING BUSINESS, *supra* note 17, at 45.

52. INVESTMENT CLIMATE STATEMENT, *supra* note 4, at 10.

The free market exchange operates similarly to a black market exchange; that is, currency is sold for a cost greater than its face value. In early 1984, the free market exchange operated at about 40% above the official government rate.[53] To repatriate the equivalent of $100, therefore, an investor would have to spend approximately $40. Hence, although Law 43 provides that a company can repatriate 100% of its capital, tax holiday profits, and after-tax profits, the foreign exchange laws impose a transactions cost of approximately 40%. Like any other cost, this transactions cost decreases the expected return on the investment.

Unfortunately, recent action by the Egyptian government has further restricted foreign investors' ability to obtain foreign currency. In late 1984, the Egyptian government took steps to unify the official government exchange rate to make more foreign currency available for government use. This new policy formally discriminates against private sector investors who want to purchase foreign currency.[54]

The discriminatory nature of the new currency regulations was one of the major topics discussed in 1984 by the Egypt-U.S. Business Council. The council noted that "[w]hereas adequate (although expensive) supplies of foreign exchange had been available through the free market over most of the 1979-1984 period, recent government measures designed to divert more hard currency to the public sector have made for[eign] exchange *unavailable to the private sector at any price.*"[55] Investor inability to obtain foreign currency renders meaningless Law 43's provisions relative to repatriation of profits or capital. Not surprisingly, the council concluded that "these conditions will effectively halt further private sector development."[56]

C. *Public Sector Problems*

Although Egypt has actively encouraged private sector investment since 1974, it has also been very concerned about strengthening the public sector, which accounted for approxi-

53. Sidley & Austin & Naguib, *supra* note 47, at 14.

54. Economic Trends Report, *supra* note 34, at 9.

55. Joint Communique of the Annual Meeting of the Egypt-U.S. Business Council 7 (Oct. 29-30, 1984) (emphasis added) (copies may be obtained from the United States Department of Commerce).

56. *Id.*

mately 70% of Egypt's total industrial output in 1984.[57] The government's commitment to public sector development can produce other costs and risks for the foreign investor. Specifically, additional costs and risks occur because the government subsidizes public sector companies and regulates employment.

The Egyptian government began subsidizing many industrial activities in the early part of the Nasser era. [58] Energy prices, for example, are heavily subsidized.[59] Public sector companies can buy their energy at subsidized prices. Private sector companies, however, have to pay a higher, world market price, which increases production costs.[60] Because private and public sector companies may compete in the same industries, private sector investors are often at a competitive disadvantage.

These investors have complained that government subsidies have allowed public sector companies to "sell products at a price lower than the cost of the raw materials."[61] The foreign investor's problem is that investment risks increase because government subsidies decrease investor revenues. This occurs because a private sector investor must keep its prices relatively higher in order to cover its increased costs. At a higher price, fewer products will be sold and less revenue will be generated. Like increased costs, lower revenues will negatively affect the expected return on investment.

Government employment regulations also produce additional costs for foreign investors. Under Egyptian law, some companies are required to maintain a certain percentage of local employees.[62] Private sector companies may be subject to these requirements.[63] Those private sector companies that must com-

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57. *Id.* at 3.

58. INVESTMENT CLIMATE STATEMENT, *supra* note 4, at 3.

59. Economic Trends Report, *supra* note 34, at 9.

60. INVESTMENT CLIMATE STATEMENT, *supra* note 4, at 3.

61. Reckford Report, *supra* note 37, at 5.

62. Law 159 of 1981 "sets minimum percentages for Egyptian employment and compensation packages vis-a-vis expatriates and contains control mechanisms to ascertain compliance with those percentages." EGYPT: THE RIGHT ORIENTATION, *supra* note 27, at 11.

63. Law 159 [which sets minimum Egyptian employment requirements] is applicable to companies incorporated under Law 43 unless the company was incorporated before the effective date of Law 159, and either: the statutes of the company contain provisions contrary to those contained in Law 159; or Law 159 removes a benefit to, or imposes an obligation on, the company.

> The above polic[y is] . . . subject to change.

Sidley & Austin & Naguib, *supra* note 31, at 11.

ply with the employment requirements are often forced to hire more employees than they would otherwise.[64] Foreign investors complain that these requirements increase basic labor costs and create "make work and inefficiency."[65] Thus, labor costs increase both because there are more employees and because extra employees create inefficiencies.

D. Poor Infrastructure

Potential investors must also account for investment costs and risks arising from Egypt's developing system of communication, transportation, and energy sources—collectively termed infrastructure. Although infrastructure improvements have increased in recent years, foreign investors still complain of "frequent electric, water and sewerage [sic] failures."[66] Investors are also annoyed by the lack of working telephone and telex lines, and perhaps more so by the government's inability to resolve the matter.[67] Unreliable transportation into and around Egypt is another source of investor frustration. Despite Egyptian efforts to expand and overhaul the country's entire transportation system, "it requires an act of considerable faith to envisage a future in which travel to, from and within Egypt will be anything less than a struggle, no matter how successful the work now in progress."[68] Finally, consumer demand for electricity has been increasing by more than 10% per year. Although new power stations are in the planning stages, "unless the pace of consumption slows, Egypt could face power shortages in the late 1980s."[69]

Given time and continued attention, the Egyptian government can remedy problems associated with Egypt's developing infrastructure. These problems, however, have influenced and continue to influence investment decisions of many foreigners because the prudent investor quantifies the negative effects Egypt's infrastructure has on the expected return of its invest-

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64. Anthony Interview, *supra* note 36.

65. *Id.*

66. Economic Trends Report, *supra* note 34, at 7.

67. Anthony Interview, *supra* note 36.

68. *Transport Work Gathers Pace Country Wide,* MIDDLE E. ECON. DIG. SPECIAL REP., Aug. 1984, at 19, 19.

69. *Soaring Demand Threatens Power Crisis,* MIDDLE E. ECON. DIG. SPECIAL REP., Aug. 1984, at 28, 28.

ment. Until costs and risks associated with these problems decrease, many foreigners will continue to invest elsewhere.

IV. Conclusion

Foreign response to Law 43 has been much lower than anticipated. The poor response can be primarily attributed to bureaucratic obstacles, shortages of foreign exchange, additional costs from the public sector, and poor infrastructure. These factors act as disincentives to foreign investment because they increase investment costs and risks, which in turn decrease expected returns.

The Egyptian government has acknowledged these problem areas and has taken some steps toward resolving them. Unfortunately, many investors view the solutions as temporary and cosmetic. Until investors see a noticeable decline in these perceived costs and risks, they will continue to invest capital in other, more profitable areas.

J. Gregory Bishop