# State-business relations and investment in Egypt[1]

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The relative roles of governments and markets have always been an area of fundamental importance in economic theory and policy. For too long, economists were trapped in the false dichotomy that opposed the market and its "invisible hand" to the state and its planning and implementation capabilities. From Adam Smith's laissez-faire to Keynesian interventionism, from the old structuralist school to neoclassical economics, the pendulum has swung from one extreme to another, generating many policy failures across the developing world, disappointment, and intellectual controversies.

Can state-business relations (SBRs) influence private investment at the sectoral level? Are all informal SBRs bad and corruptive, or can they also have potential for positive enhancement of growth in a developing country? These and other related questions have been addressed by research on the case of Egypt. In what follows, we briefly present the private investment trend and evolution of SBRs that triggered the research, followed by a brief overview of the research methodology, analysis, main conclusions and policy implications.

Industrial investment as a percentage of total investment in Egypt has been declining since the late 1960s, from 30% to only 10% in 2005. The private sector has shown decreasing interest in industrial investment: its share of total private investment decreased from 26% in 1992-1997 to 11% in 2000-2003. Serious private divestiture was also observed in 2002 and 2003. The year 2004 saw a sudden change of trend: industrial investment increased, first making up for lost investments in the previous couple of years, then achieving positive rates of growth.

What is most interesting is that this positive change in the private investment pattern coincided with a major cabinet change in 2004, involving the appointment of members of the business community to ministerial positions for the first time in Egypt since 1952. The change brought about a change in perceptions and attitudes, creating a 'friendly and useful' atmosphere for SBRs that created the potential for cooperation between the state and the private sector. This is opposed to the 'hostile' relations of the 1960s – when the public sector dominated the scene – and the 'friendly yet useless' setting that governed relations from the resurge of the private sector with the open door policy in 1973 until 2003. In the friendly yet useless phase, the state and the business community accepted each other's existence and often interacted, but no real cooperation ever took place.

Even though the cabinet changes were followed by the swift introduction of a number of regulatory changes improving the business climate, this still could not fully explain the new investment trend, especially the substantial inter-sectoral and intemporal differences in investment. It also could not explain why investment was increasing even though investors continued to suffer from other serious constraints in the business climate.[2] Also, why witness an increase in 2004 specifically, when policy changes to enhance investment have been initiated since the mid-1970s with little response by investment?

The situation called for deeper exploration of the reasons behind the recent increases in private investment, particularly inter-sectoral differences, and the potential role played by SBRs, if any. Using quantitative and qualitative techniques, the research explored the cases of four sectors: two traditional sectors (food and furniture) and two modern ones (communication and information technology – CIT). The analysis revealed the existence of active SBRs, particularly informal SBRs, at the sectoral level, with very high intensity in sectors witnessing unusual increases in investment. The empirical research collected detailed evidence on informal SBRs' contribution to overcoming impediments to growth and investment in these sectors.

For example, informal SBRs contributed significantly to the removal of initial barriers to entry in the CIT sectors, and thus the establishment of a new industry virtually from scratch. It also contributed to the resolution of the long pending problems of introducing a unified food law and harmonisation of standards, in the case of food industries. Informal SBRs also backed up the introduction of permanent formal institutions, such as product export councils in food and furniture and semi-formal arrangements such as ad hoc working groups in the case of communication. Both arrangements created forums for active technical cooperation between the state and the private sector to the benefit of the sector and its business community. One major observation is that more inclusive benefits from SBRs, formal and informal, exist the better organised the sectoral business community. In such cases, the naturally exclusive SBRs between specific players in each of the two groups benefit a whole sector and promote its growth.

The research on Egypt clearly shows that SBRs played a critical role in raising levels of investment and fostering economic growth in specific sectors, not as a direct cause but rather through improving policy formulation and overcoming supply constraints and impediments to policy implementation that impede the wheel of growth, thus unleashing the full potential of the sector. This positive role of SBRs, however, is possible only when interactions between the state and business reach the stage of mutual understanding of, and mutual interest in, the sector. We call this the stage of active cooperation (AC). Comparative observations showed that common social roots and professional backgrounds facilitate the emergence of an effective public-private growth alliance, but the only necessary conditions remain common interest and common understanding of the problems to be solved.

Quantitative examination of whether SBRs, featuring AC, had an enduring investment-enhancing effect was inconclusive. There is no doubt, however, that this was an effective transitional arrangement. It helped investors to overcome barriers to economic growth, it helped policymakers to overcome deficiencies in their own government agencies and it helped both sides to work together in establishing new sector-specific rules and improving the general regulatory framework. The main general policy implication of this research is that such transitional arrangements deserve more attention, both to gain a better understanding of the political economy of investment and growth and to make research more relevant for policy. More specific implications are: 1) informal SBRs are not necessarily all bad and can be strong growth enhancers – but a setting must be created that avoids corruption and maximises inclusiveness through an organised private sector, strong monitoring agencies and free media; 2) there is a need for change of public and private mentalities towards seeing working together as the only way forward; and 3) the focus of industrial policy needs to be more on how to implement the policies than on what policies to adopt. On the how side, SBRs featuring AC can be very effective.

***Endnotes:***

*1. This paper draws on Abdel-Latif and Schmitz (2009) and work in progress.*

*2. For example, inconsistent legislation and weak contract enforcement, not to mention poor understanding and implementation of new legislation, such as in the case of the new competition law.*

***References:***

*Abdel-Latif, A. and Schmitz, H. (2009) 'State-Business Relations and Investment in Egypt.' Research Report 61. Brighton: IDS.*