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EGYPT'S POLICY TOWARDS FOREIGN INVESTMENT

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I. Background

Long before President Nasser took over in 1952, Egypt was considered a very attractive location for foreign investment, particularly from Europe. A large number of Italian, French, and British firms established their own subsidiaries and joint ventures to produce a variety of consumer products to meet domestic demand. Banking, tourism, and petroleum exploration and production were also among the favored sectors. Under the rule of President Nasser, however, foreign investors grew skeptical about Egypt's official policy of welcome. Their doubts were partially confirmed in 1956 when Nasser nationalized the Suez Canal. Their apprehensions were fully realized in 1961, when all foreign and Arab investment in Egypt was nationalized.

From 1956 until his death in 1970, President Nasser directed his attention to the East and adopted the socialist system. He was convinced that this was the only system that would permit Egypt and its people to fulfill the objectives of accelerated social and economic development. Unfortunately, these objectives remained unfulfilled. During this period debate of Government policies in the press was prohibited. The Arab Socialist Union, the nation's sole political organization, established in 1962, reflected only one political opinion. Formal censorship of international communication was instituted. Tight security at home coupled with censorship of the press was common practice following the nationalization of Arab and foreign investment in the early 1960s. Property of nationals was confiscated without due process of law. These measures and others isolated Egypt from other Arab countries and encouraged Egyptian professionals to leave the country. In addition, the increase in armaments expenditure and the neglect of infrastructure maintenance weakened the Egyptian economy.

Since President Sadat took over in 1970, the political and economic climate has improved tremendously. The Government has allowed open debate of its policies by a free press. The Arab Social-

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ist Union has been liberalized to reflect right, left, and middle course opinions. Censorship of international communications has been abolished. Due process of law has been established in the Government's dealing with its citizens and a new law was passed restoring sequestrated property to its owners. In 1972 President Sadat asked the Soviet advisers to leave Egypt. After the Soviet Union failed to resupply Egypt with arms following the 1973 October War, the Soviet-Egyptian friendship pact of 1971 was abrogated.

Turning to President Sadat's economic policy, we find that in 1971 Law No. 65 on Arab Capital Investment and Free Zones was approved. This law carried the seeds of the open door policy because it contained the first invitation to Arab and foreign investors to do business in and with Egypt. Due to some shortcomings of the law, however, the response was rather limited. In 1974 the Egyptian Parliament approved Law No. 43, which repealed Law No. 65 of 1971 and officially endorsed the open door policy. The open door policy led to significant changes in agriculture, industry, and mining. In agriculture, the country is opening wide tracts of land for reclamation and cultivation by Western companies.[1] A number of United States firms are already actively involved with other European firms in the development of dairy, citrus, poultry, and other agro-industries. In industry,[2] the Government's present policy seeks to revive the activities of the private sector in Egypt and to dismantle a multitude of regulations and restrictions that governed economic activity there. During 1975 private sector investments jumped 500 per cent over the previous year. Private firms

1. Egypt remains a basically agricultural economy with a dominant public sector. Agriculture accounts for nearly one-third of the gross domestic product, over 60% of exports, and nearly one-half of the labor force. Despite its agricultural base and about 6 million farm acres, Egypt, with 38 million people and a population increase of over 1 million persons a year, cannot feed itself. The reason is the territorial constraint on the growth potential of the farm sector, where the cultivable land is a mere 3% of the country's total land area. Prior to the new legislation, land reform resulted in fragmenting the planting area with the inefficiency inherent in small farms. Speech delivered by His Excellency Osman Ahmad Osman, Minister of Construction and Chairman of Higher Agriculture Committee, at U.S.-Arab Association for Commerce and Industry, June 9, 1976.

2. *Id.* Industry and mining contribute just over one-fifth of the GNP and employ only 13% of the labor force. As a result of the government policy of keeping the country on a war footing, foreign exchange needed for building productive capacity and buying raw material and spare parts for the country's industrial plants was unavailable and led to large idle capacity. Industrial growth fell to 6% in 1971/1972 and to 3% in 1973.

now have freer access to hard currency for the imported raw material they need, though at the more costly exchange rate on the parallel market.[3] In an effort to unencumber industrial managers in the public sector industries, the Government abolished most of the general industrial organizations that had interfered with the management of the individual plants and replaced them with "supreme sectoral councils," which exert less control and provide judgment only on the broad outlines of budget and investment programs of public companies.

In 1973 the Government invited international oil companies to Egypt under a production-sharing formula which allowed foreign firms to recover their investment costs and then share production. Among the 23 companies now exploring for or producing oil, there are seventeen United States firms with total investments of approximately $1 billion. Israel's return of the Abu Rudeis Field contributed handsomely to Egypt's foreign exchange earnings.[4] By 1980 Egypt expects to be producing over one million barrels a day. Her share in the Sumed pipeline, which connects the ports of Suez and Alexandria, will amount to $120 million a year.

II. Investing in Egypt Under Law No. 43

Egypt's new Foreign Investment Law permits foreign investments in industry, mining, energy, tourism, transportation, animal and land development, and "other fields."[5] The Law also pro-

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3. Law No. 97 of 1976, issued August 14, 1976, which organizes dealings in foreign exchange.

4. The Israeli occupation of the Sinai oil fields at Abu Rudeis had deprived Egypt of 90,000 barrels per day of oil or 8% of its total output in 1967. Statement of His Excellency, Minister of Petroleum, to Industry and Petroleum Committee, Egyptian Parliament, January 1977.

5. Law No. 43 of 1974 Concerning the Investment of Arab and Foreign Funds and the Free Zones (1974), Decree of the President of the Arab Republic of Egypt, published in the Official Gazette [hereinafter cited as Investment Law]. The Investment Law has been published in English in 13 INT'L LEGAL MATERIALS 1500 (1974).

Revisions in the Investment Law have recently been submitted to Parliament for approval. Some of the highlights are:

(1) Transfer of funds connected with approved projects to and from Egypt shall be at the highest rate prevailing and declared for foreign currency by the competent official authorities thereby cancelling the requirement that funds should be transferred at the official rate.

(2) All wages, salaries and bonuses or other similar payments subject to the Employment Earnings Tax and made to foreign employees or experts on projects established according to the provisions of Law No. 43 shall be

vides for the establishment of banking institutions—including investment companies, merchant banks, and reinsurance companies—dealing in foreign currency transactions.[6] Leading institutions such as Citibank, American Express, Bank of America, and Manufacturers Hanover have already taken advantage of the Law by commencing operations in Egypt. In March 1977, Goodyear, Ford Motor Company, Union Carbide, Colgate-Palmolive, and Xerox received approval to start projects in Egypt. Any foreign investment in Egypt must take the form of a joint venture with the public or private sector,[7] but no strict percentage requirements for local participation are imposed except where the investment is in banking[8] or where the project is established in the Free Zone, which will be discussed later.[9] Since banks dealing in local currency can have only 49 per cent foreign ownership, Chase Manhattan Bank and American Express began joint operations with Egyptian banks dealing in local currency.

A. *Incentives*

A five-year exemption from taxes on company profits, proportional stamp duties on shares, and taxes on revenue from movable capital, *e.g.*, stocks and bonds, is provided for approved projects.[10]

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exempt from the General Income Tax.

(3) The period of tax exemption shall be eight years instead of 5 - 8 years under Law 43. Exemption for projects involving reconstruction, establishment of new cities outside the agricultural area and the perimeters of existing cities, and land reclamation shall be for a ten year period that may be extended to fifteen years.

(4) The profits distributed by a project under Law No. 43 shall be exempted from the General Income Tax up to a maximum of 10% of taxpayer's share in the invested capital. Under the present law it was only 5%.

(5) Customs duties and taxes shall be payable in respect of goods withdrawn from the free zone for local consumption, as though such were imported from abroad and in accordance with their condition after manufacturing, with due regard to rules and procedures governing imports. Such customs duties and taxes shall be payable on goods containing local materials, in proportion to the *ad valorem* value of foreign materials contained in the manufactured products. Notwithstanding any of the foregoing, in the event that local components constitute 40% or more of the manufactured product, such dues as shall be payable in accordance with the provisions of this Article shall be reduced by 50%.

6. *Id.* art. 3, §§ 4 & 5.
7. *Id.* art. 4.
8. *Id.* art. 4(b).
9. *See* text at subhead C *infra*.
10. Investment Law, art. 16, *but see* art. 17 (profits distributed by each pro-

This exemption is applicable provided the exempted profits are not, as a consequence, subject to taxation in the foreign investor's home country or any other country. The five-year tax exemption may be extended for another three years provided the project's location, size, and contribution to the economic development of the country warrant such extension.[11] The tax system of Egypt provides a three-year carry-over of losses which applies to companies established under Law 43. Interest payments made by approved projects on foreign loans are also exempt from taxation.[12]

B. *Protection*

As protection against noncommercial risks is very important to the foreign investor, the Law specifies that projects approved under its terms may not be nationalized or confiscated.[13] Assets of projects may not be seized, blocked, confiscated, or sequestrated except by judicial procedures. Investment disputes may be settled in several ways: (1) in a manner to be agreed upon with the investor; (2) within the framework of bilateral agreements entered into between the Arab Republic of Egypt and the investor's home country; (3) within the framework of the Convention for Settlement of Investment Disputes administered by the International Bank for Reconstruction and Development (to which Egypt is a signatory); or (4) by a three member arbitration board appointed by the parties.[14] The Law also allows the full transfer of investment profits.[15] Projects realizing self-sufficiency in their foreign exchange needs can transfer their annual net profits to the extent of the proceeds of the project's exports. Basic projects with major significance to the national economy irrespective of exports, however, are permitted to transfer the net profits from the investment in full from the Government's foreign exchange resources. The Law further allows the withdrawal of invested capital after five years from the date it was first transferred into Egypt.[16] Withdrawal before five years may, however, take place upon a showing that the project cannot be implemented or continued for reasons beyond the control of the

ject shall be exempted from general tax on income. This exemption applies only to profits up to a maximum of 5% of the taxpayer's share on the invested capital.)

11. *Id.* art. 16.
12. *Id.* art. 18.
13. *Id.* art. 7.
14. *Id.* art. 8.
15. *Id.* art. 22.
16. *Id.* art. 21.

investor.[17] In addition, immediate repatriation of capital is possible if the investor disposes of his interest in convertible currency transferred into Egypt.

C. *Free Zones*

To capitalize on Egypt's strategic location, the Law provides generous incentives for investors interested in establishing projects under the free zones status.[18] The Law mentions public and private free zones. To accommodate the need of foreign investors whose operation requirements must, for various reasons, be separate from other projects, the Law grants such investors the status of a private free zone for their projects.[19] Thus the project enjoys all the rights and bears all the responsibilities of a project in the public free zone parks. Because it takes some time to develop the infrastructure for the public free zone parks, an attempt has been made to expedite the implementation of projects with free zone status by allowing the owners of these projects to locate in any convenient place in Egypt and start operations with a free zone status without waiting for the completion of the public free zone parks. As soon as the public parks are completed, however, permission will be given to operate only in the public free zone parks that are being established in Cairo, Alexandria, Suez, and Port Said unless the requirement of the project necessitates a private free zone status. This will reduce the administrative and management responsibilities of the free zones.

The Law exempts projects established under the free zone status from exchange control regulations and from all Egyptian taxation for an unlimited period.[20] In lieu of Egyptian taxes, however, those projects dealing with mixing, blending, packaging, and storing of products will be subject to an annual duty of one percent[21] of the value of the product entering the free zone. Projects dealing with assembling and manufacturing will be subject to a duty of one per cent of the value of the products leaving the free zone. On projects that do not require the ingress or egress of commodities, the Board of Directors of the Investment and Free Zone Authority will fix an annual duty not to exceed three per cent of the annual value added by the projects.

17. *Id.* art. 21(1).
18. *Id.* arts. 30 & 31.
19. *Id.* art. 30.
20. *Id.* art. 46.
21. *Id.*

Another free zone incentive is that goods, equipment, machinery, and other items entering or leaving the zones are exempted from the usual customs procedures, taxes, and duties.[22] Local goods entering free zones are, however, subject to export or other taxes unless permitted temporary entry for repair or complimentary operations, in which case a customs tax will be paid in respect of repair or other operation. All goods withdrawn from the free zones for local consumption except those containing local material are treated as imported goods from the market abroad. In addition, all compensations and other payments to expatriate employees of free zone projects are exempt from income tax.

D. *Administration*

The Law is administered by the General Authority for Arab and Foreign Investment.[23] The authority is chaired by the Minister of Economy and Economic Co-operation. The Egyptian President names the Board of Directors as well as the general manager, who has the title of Deputy Chairman. In addition to the Chairman and Deputy Chairman, the Board is composed of six other members. They are the Undersecretaries of State for Tourism, Industry, Housing and Reconstruction, Electricity, Petroleum, and Planning. One of the responsibilities of the Authority is to "take the hand" of foreign investors and contact on their behalf all relevant Government departments to expedite a response to their needs. It takes approximately two months to process an application if all papers are in order and include a pre-feasibility or a feasibility study. Once submitted, the application will be referred to the substantive Government departments concerned for their comments. The company's bylaws and statutes should be submitted within six months of approval.[24]

III. EVALUATION

The reaction of potential foreign investors to some of the features of Law No. 43 has been mixed. Foreign investors state that Egypt

22. *Id.* arts. 37 & 38.
23. *Id.* arts. 25 & 26.
24. The implementing rules for Law No. 43 have been published in English and are available to interested parties. The Authority has published "A Guide for Investment in Egypt," and in an attempt to reach North American investors the Egyptian Government has established an office in New York. The office is to act as a catalyst between the American business community and Egypt. Other offices are planned for Europe.

provides them with several inducements that make it profitable to do business there. Some of these factors are as follows:

1. A relatively large domestic market coupled with proximity to the Arab, European, and African markets;
2. The availability of a relatively large, adaptable, and inexpensive labor pool;
3. Continued political stability within Egypt;
4. A high probability of significant increases in hard currency earnings from the Suez Canal, tourism, crude oil, and remittances from Egyptians working in neighboring countries;
5. The availability of a double taxation treaty with the United States and European countries;
6. The existence of the Overseas Private Investment Corporation, which guarantees insurance for United States direct investment in Egypt.

Foreign investors also noted factors which they consider to be obstacles to the development of their investment plans. One deterrent, they claim, is the exchange rate structure. According to Law No. 43, capital investments of foreign currencies are to be made at the official rate and the repatriation of capital is to be made at the "prevailing rate," which is usually much higher (approximately 50 per cent) than the official rate.[25] Critics argue that the official rate for bringing capital into the country specified by present laws is artifically inflated. Therefore, when foreign currency is translated into Egyptian pounds at the official rate, the foreign investor is automatically subjected to a major loss. If the capital should be required to be repatriated at the "prevailing rate," rather than the official rate, the loss of original investment could be substantial. While no rate is specified in Law No. 43, article 40 of the Executive Regulations[26] states that the transfer shall be made at the current rate of exchange. At present, the Egyptian Government is seriously examining this problem. The Government is aware that in some proposed investments the ambiguity of the exchange rate provisions of the Law has tended to minimize the foreign capital supplied to capitalize technology and inflate the value placed upon machinery supplied from abroad. It is hoped that within a few months this problem will be resolved.

25. "Prevailing rate" is the market rate at the time repatriation of capital takes place.

26. Prime Minister's Decision No. 91/1975. Copies of the Decision may be obtained from the Egyptian Economic Mission, 529 Fifth Avenue, New York, New York 10017.

Another problem cited by potential investors as a hindrance to the smooth flow of foreign investment into Egypt is the shortage of foreign exchange. To attract foreign investors, a country must assure that within the foreseeable future adequate quantities of foreign exchange will be available to enable foreign investors to purchase raw or semi-finished materials from abroad, to service external debt, and to repatriate dividends and, perhaps, capital. Undoubtedly, Egypt is suffering from a large and persistent foreign exchange gap. This is partially due to the wars in which Egypt has been involved since 1948 and the consequent channeling of foreign exchange towards war materials. Contributing factors have been Egypt's lack of natural resources, the pressure of increasing population, and the need for increased imports of food-stuffs. To alleviate this shortage, it has been recommended that a fund be established through Arab financing, bilateral assistance programs, and the Government's own resources.[27] This fund would guarantee the availability of the foreign exchange necessary for importing goods needed in an approved investment considered valuable to the Egyptian economy. If the investment is unable to generate or obtain the foreign currencies needed to meet its demand, the fund would supply the investor with the required foreign exchange in return for Egyptian pounds.

According to potential foreign investors, a third problem area is the requirement that any foreign investment—other than one for "basic industries"—must cover its own foreign currency costs. This requirement tends to exclude those industries that do not export. For most companies, the greatest incentive to investment in Egypt appears to be the potential market of Egypt itself, *i.e.*, its population of 38 million. Some potential investors feel that the laws place undue burdens on them. Of course, nothing would have pleased the Government more than inviting foreign investors to Egypt to participate with Egyptians in joint ventures to manufacture all kinds of products. Where there is enough foreign exchange to meet the demand of all foreign investors, as in Saudi Arabia and other Arab oil-producing countries, such an invitation is possible. The lack of foreign exchange resources pressured the Egyptian Government to resort to such requirements.

Yet another problem concerns personal taxes. The rate applied to expatriates is considered unduly high. Foreign firms have said

27. "Report on Foreign Investment in Egypt" prepared by Egypt-U.S. Business Council, U.S. Chamber of Commerce, Washington, D.C., at 17.

that the tax situation deters them from sending technicians to Egypt because the tax rate reaches 95 per cent in the highest bracket under the present Egyptian general income tax law. These rates are much higher than those in the United States. The Egyptian Government has already taken steps to alleviate this problem and has submitted to Parliament a law revising the existing income tax rates to correspond with rates in Western countries including the United States.[28]

IV. Conclusion

Egypt's Foreign Investment Law No. 43 is just over two years old. Considering the fact that the open door policy comes after almost two decades of a closed door policy, an attempt to determine the full effect of the law would be premature. In addition, Mr. Kissinger's failure in February 1975 to reach an agreement on Sinai definitely affected the flow of foreign investment. After his success in September 1975, however, foreign investors began to seriously consider Egypt as a profitable place to locate. Thus far, most of the companies that have responded to Law No. 43 have been in the banking, tourism, real estate, and oil industries. Undoubtedly Egypt's economic problems, like those of many other developing countries, center around the lack of badly needed foreign exchange. In an attempt to support Egypt in this regard, the Arab oil-producing countries of Saudi Arabia, Kuwait, and the United Arab Emirates established a $2 billion fund—the Gulf Fund for the Economic Development of Egypt—to cover some of Egypt's needs for the next five years.[29] The Fund has recently guaranteed a $250 million seven-year loan from United States and European banks. Bilateral aid from the United States has also been very helpful.[30]

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28. Law revising tax rates has been submitted to Parliament, but is not finalized.

29. The agreement establishing the Gulf Fund for the Economic Development of Egypt was signed in Cairo, August 1976, by Saudi Arabia, Kuwait, Qatar, and U.A.E.

In 1974, Egypt was the recipient of over $2 billion of Arab funds which were provided as a contribution to compensate Egypt for its financial losses due to the 1973 October war.

30. Because of the change in Egyptian political and economic policies, the United States Aid Program resumed in 1974. The United States undertook to assist Egypt in reopening the Suez Canal. The Egyptian Desk, U.S. Agency for International Development, Department of State.

Although Egypt faces problems related to infrastructure, foreign exchange availability, and adjustment to the new open door approach, it offers tax and other incentives, as well as equity control. The latter is not available in some of the neighboring Arab countries. Egypt has a more educated citizenry, graduating about 60,000 a year. That far exceeds what all the other Arab countries combined can offer. Further, Egypt's population of 38 million provides a potential domestic market. All of these factors will give Egypt a tremendous push when the Suez Canal revenues[31] and income from tourism and oil begin to provide the needed financial relief.

31. The reopening of the Canal gave the Egyptian economy a major boost. Revenue from the tolls was expected to reach $400 million in 1976 and, due to the widening taking place now, revenue is expected to reach $770 million by 1980. In fiscal year 1976, total United States aid to Egypt was expected to reach $1 billion, while aid from the Arabs is budgeted on the basis of at least $500 million a year for the next five years.