

TAPR 99-027

MEMORANDUM

**DATE:** December 1999

**TO:** Ingi Lotfi, COTR, USAID/SP

**FROM:** James T. Riordan, Chief of party

**REF:** (A) Technical Assistance to Support the Reform Activities of the Government of Egypt and Provide Management Activities (TAPR), Contract Number 263-Q-00-97-00104-00.  
B) Task Order No. 5, Task Three, Investment Incentive More Cost Effective.

**SUBJECT:** Completion Report, Task Order Five (TO #5), Task Three (3), Investment Incentive More Cost Effective.

In accordance with the reporting requirements set forth in TAPR's contract, Section F.7

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*“Completion reports: The Contractor shall prepare a completion report which summarizes the accomplishments of the assignment, methods of work used, and recommendations regarding unfinished work and/or program continuation. The completion report shall also contain an index of all reports and information products produced by the contract.*”

**This completion report is organized in 5 sections:**

- I. Task Objectives
- II. Summary of Accomplishments of the Assignment
- III. Methods of Work Used
- IV. Recommendations Regarding Unfinished and /or Program Continuation.
- V. Summary Contents of the Deliverable Documents.

## **I. Task Objectives**

The objective of Task Order 5, Task No. 3 is to assist the Government of Egypt (GOE) monitor Sector Policy Reform Program (SPR) progress, and achieve the specific SPR objective of making investment incentives more cost effective. Specifically, this study will ascertain whether recent changes in investment incentives legislation are more cost effective.

The study was conducted by a three-person team.

Siegfried Marks, Senior Macro-Economist/Team Leader  
Pierre Gianni, Senior Attorney and Tax Specialist.  
Taha M. Khaled, Managing Partner, Zarrouk, Khaled & Co., an Egyptian public accounting firm.

The project started October 20, 1998 and was completed December 18, 1998 in Egypt.

## **II. Summary of Accomplishments of the Assignment**

The study accomplished the following tasks:

- Examined investment incentives from both the legal and the economic standpoints.
- Examined investment incentives offered by the GOE currently under Law 8 and 159 and under previous legislation.
- Compared and assessed the cost effectiveness of Egypt's investment incentives program under Law 8 and previous legislation.
- Identified qualitative improvements of Law 8 when compared with previous legislation.
- Identified less favorable results of Law 8.

The authors conclude that Law 8 is more cost effective than previous legislation. The authors identified the following qualitative improvements:

- 1 . More efficient, automatic, speeded-up approval process.
- 2 Statistical analysis revealed positive results in terms of more companies established and investments made.
3. More jobs and more exports generated and/or planned under Law 8 than for a comparable period under previous legislation

Less favorable results identified were:

1. Little foreign investment has been attracted by investment incentives and its share in the total has declined somewhat under Law 8.

2. **The generous incentives available to investors in the Free Zones have not led to dynamic export development. Instead, permanent tax exemption has encouraged the growth of simple import operations from the free zones into Egypt. The GOE is now aware of this problem and has issued a new decree to contain further development of this practice.**

**Overall, though Law 8 is more cost effective than previous legislation offering a tax holiday indiscriminately to all companies large and small in all industries, as does Egypt, is not cost effective. Investment tax credits and accelerated depreciation and other tax incentives that reward investments rather than profitability are generally more cost effective forms of investment incentives than tax holidays. These alternative forms offer governments some tax revenue already in the first year of profitable operation and the revenue collected is related to profitability. Many countries employ investment incentives as a strategy tied closely to national economic objectives. Investment incentives are reserved for companies that develop non-traditional exports, infrastructure, large-scale employment opportunities, or set up operations in remote areas. Egypt has only partly followed this targeted approach.**

### **III. Methods of Work Used**

- **Reviewed Law 8 of Investment Guarantees and Incentives and its Executive Regulations as well as all other current and recent past laws relating directly or indirectly to investment incentives.**
- **Reviewed literature and data pertinent to Egypt's investment incentives, impediments to investments, the Egyptian economy, shortcomings of Egyptian economic statistics, other countries' investment incentive laws and regulations, and statistical information about the private sector response to Egypt's investment incentives.**
- **Gathered and analyzed data from The General Authority for Investment and Free Zones (GAFI). GAFI is the main source of data used in this study. Information from the USAID library, the International Monetary Fund, the International Finance Corporation of the World Bank, and other sources was also used.**
- **Held extensive interviews and telephone discussions with GOE officials, international financial institutions, think tanks, private sector organizations, and private companies. Written requests for specific data and information were sent to public entities and prompt responses were received.**

### **IV. Recommendations Regarding Unfinished and/or Program Continuation**

- **Further study is recommended for a more comprehensive assessment of cost**

effectiveness of investment incentives. This recommendation is made for two reasons. First, the period elapsed since the enactment of Law 8 is too short to draw conclusive judgments in areas where results depend on the completion of investments and the start of production. Second, the main source of data, GAFI publishes data only of planned rather than actual investments and employment generated by the investment incentive program more conclusive analysis was not realizable. Also, GAFI makes no information available on exports or foregone government revenue from tax exempt companies. There is no data available to measure the multiplier effects of the investments stimulated by incentives, such as the additional sales, production, services, jobs, income, and tax revenue generated among suppliers, contractors, infrastructure and service providers to the tax-exempt companies. Also, lack of data precluded a more thorough analysis of revenue lost due to the tax holiday and tax revenue gained as a result of the multiplier effects of investments stimulated by investment incentives.

- **It is recommended that to increase foreign investment a pro-active foreign investment promotion campaign be developed. Use of diverse means of communication in foreign investors' own countries to acquaint them with Egypt's attractive investment incentive program, new investment opportunities, economic reform progress, continued removal of impediments to private investment, financial and political stability and security is a strategy recommended by the authors..**
- **Recommend a comprehensive review of the government's Free Zone policy, legislation, and administration. Panama, a country with a major canal like Egypt has taken full advantage of its situation by offering international private companies attractive opportunities to centralize manufacturing, assembly, mixing, warehousing, and distribution in its free zone adjacent to the canal for transshipment to the Central and South American markets. At the same time Panama pursues an international trade policy that combines the existence of the Canal with the Panama Free Zone and two adjacent major modern transshipment facilities built and operated by experienced private international shipping and stevedoring companies. Egypt should investigate whether it can replicate Panama's successful example.**
- **Though significant progress in legislation has been made to facilitate private investment development there is still room for substantial improvement. Continued unification of legislation is an example. Steps are being taken by the GOE in this area and several major comprehensive projects are under way.**
- **Regarding the cost-effectiveness of tax incentives, other factors usually outweigh tax considerations. While tax incentives have a cost, facilitating laws, updated legislation, and flexible administrative procedures do not result in foregone revenues. Recent changes of attitude by various countries regarding tax sparing should also be taken into consideration by the GOE in its efforts to rationalize tax incentives.**

V. **Summary Contents of the Deliverable Documents**