

V.6 GOVERNMENT IMPACT ON SMALL-SCALE INDUSTRY

Progress Report

March 15, 1977 - September 1, 1977

This report covers activities carried out in the period of March 15 - September 1st, 1977 under the project on the impact of governmental policy on small-scale industrial development in Egypt. The principal objective of this study is to analyze the ways that government encourages or discourages innovation and expansion in small industrial firms by examining the impact of governmental policies, bureaucratic practices, and organizational structures on the behavior of small entrepreneurs. On the basis of this analysis, recommendations can be developed for policy and organizational changes to increase incentives for expansion in the small-scale industrial sector. Project activities fall into three categories: (1) Data collection and analysis of small-scale industry; (2) Data collection on governmental activities in the small-scale sector and analysis of the interactions between small firms and government; and (3) Recommendations. Because the project is to be completed in a short period (March 15, 1977 - December 15, 1977), we chose to study one industry in depth: shoemaking. This industry was selected because of its export potential, its high labor-capital ratios, and its weight within the private sector.

1. Data collection and analysis of small-scale industry

In this study, small-scale industry has been defined as firms employing under 100 workers. Data on such firms is scattered throughout government ministries; and little of it is current: the last comprehensive census of industrial production was taken in 1966.

The major data bases available for the project are the 1977 GOFI study of the private sector, a 1974 census of firms employing 1-9 workers and a 1972 survey of shoemaking firms. Project activities in the period March - June focused on the discovery, collection, and translation of these sources and on planning the collection of two new sets of data: the first, data on shoemaking firms that have applied for loans from the Development Industrial Bank; and the second, survey data on a stratified sample of 200 shoemaking firms in the Cairo governorate. With the assistance of the Development Industrial Bank, data was collected from the dossiers of shoe

firms that applied for loans on firm characteristics (assets, number of workers, indebtedness, investment projects) and on success in loan repayment. The survey of 200 shoemaking firms is presently underway under the supervision of Dr. Mustapha Kamel El-Said Ibrahim and will be completed by October, 1977. The sample has been stratified by firm assets; this information has been provided by the tax inspectorate for annual wealth. We seek information on firm characteristics (ownership, assets, number of workers, equipment), firm histories, and the contacts between various governmental agents (tax inspectors, social security inspectors, cooperative officials, and so forth) and small firms. We also seek to understand the entrepreneurs' perceptions of their chances for growth and to determine under what circumstances (lower interest rates? no interest-profit-sharing? more flexibility in firing and hiring? increased demand? more secure demand?) small industrialists might decide to invest and expand.

2. Data collection on governmental activities in the small-scale sector and analysis of industry-government interactions

Responsibility for the small-scale private industrial sector is divided between the Ministry for Local Governments and the Ministry of Industry. The former deals with firms employing 1-9 workers; under its aegis is organized the Handicrafts Industries and Productive Cooperative Organization whose member organizations provide some of the raw materials for artisanal producers, market some of their production, provide some social services, and in a few cases, organize joint production. The Ministry of Industry deals with firms employing over 9 and is responsible for licensing the expansion or creation of new productive facilities and for controlling the quality of production. In addition to these two ministries with direct responsibility for the private small-scale sector, other government agencies take decisions with significant impact on small firms. For example, the tax reform currently proposed by the Ministry of Finance, which would lower taxes for all firms in the small-size category that agreed to keep books, would clearly alter the structure of incentives for small entrepreneurs. Regulations on hiring, firing, wages, apprenticeships and social benefits payments are determined by the Ministries of Labor and Social Welfare. The policies and procedures of the Development Industrial Bank and the Naar Social Bank affect the likelihood of investment by small entrepreneurs.

The principal sources of data on the activities of government in small-scale sector and on the impact of various policies and procedures on expansion in the sector are extended interviews in the ministries and agencies, on the one hand, and interviews with industrialists, on the other. The work in the ministries was begun in a pre-study visit to Cairo in January, 1977, continued during a two-week stay in June, and will be completed in a two-week period in the winter of 1977-8. Site visits to about twenty small firms and cooperatives provided the opportunity for preliminary discussions of the impact of governmental policies and procedures. On the basis of these open-ended discussions, questions were designed for the shoe industry survey described above that will systematically explore the industrialists' perceptions of governmental impact.

Given the uneven quality of the economic data we have and can hope to obtain, it is illusory to expect any rigorous measures of the impact of policy on production and investment decisions. And yet, even from the "soft" data obtained in the preliminary round of interviews, certain trends emerged which are illuminating clues to government-industry relationships. For example, we learned from government officials about new efforts to develop the marketing services of the cooperatives; also, that when cooperatives sell the merchandise of a member, they subtract a sum to be applied at the end of each year against the member's taxes. We learned from the tax inspectors of the extremely high rates of tax evasion among the very firms that are the target group of the cooperatives: typically, these small firms are inspected every four to six years. Virtually no penalties are ever levied against them. We learned from industrialists about their distrust of the apparently arbitrary and erratic interventions of the tax authorities. It comes as no surprise, then, to learn that even in a period of surplus shoe production, members are reluctant to let the cooperatives market their goods, for fear of enmeshing themselves in negotiations with tax inspectors whose notice they might otherwise hope to escape, if not indefinitely, at least for four or five years. In brief, two bureaucracies -- the tax authorities and the cooperatives -- are working at cross purposes. Using the cooperatives as tax collectors is weakening the cooperatives without producing substantial improvement in the collection of taxes. On the basis of data from our

interviews and from the survey we hope to build on cases like the example just cited to develop a fuller picture of the way the policies and procedures of various government agencies work either to provide incentives for industrial growth or, conversely, as in the example, to persuade the industrialist that the prudent course is remaining within old routines and avoiding risks.

3. Recommendations

Although it will be impossible to spell-out recommendations before the study described above is completed, several tentative conclusions are already emerging. First, with respect to measures that the Egyptian government might take within existing budgetary constraints to promote development of small-scale industry, our observations of the interactions between government and business suggest that policies which require considerable bureaucratic intervention and expertise are less likely to be successful than policies that provide across-the-board incentives to which any industrialist might respond. An example of the first kind of policies are technical assistance programs, which presuppose that managers and workers are so deficient in necessary skill that no significant advance is possible without remedying these deficiencies and that this is best accomplished by using experts, administrative agencies (whether Egyptian governmental or international), and a structured program of government interventions to provide training. The World Bank Mission that studied small-scale industry in Egypt (report of June, 1977) has proposed such an approach. An example of the second kind of approach would be reform of the tax system in order to eliminate those features that discourage expansion. Such a reform might be implemented without the creation of new bureaucracies; its success would be far less dependent on administrative competence and far more dependent on appropriate structuring of tax incentives. To achieve this, the Egyptian government would need much better information on the sectors it is trying to tax, regulate, and stimulate than it currently possesses. Though the two approaches are not mutually exclusive, choices must be made; and in our final recommendations we foresee suggesting steps that might be taken to implement reforms of the second type.

Secondly, with respect to measures that foreign funding agencies might take to promote the development of small-scale industry in Egypt, we hope to be able to propose criteria and procedures for financing that would substitute for those currently applied in evaluating loans to large enterprises.

Mustapha Kamal El-Said Ibrahim (Cairo University) has primary responsibility for the completion of part (1); Suzanne Berger (M.I.T.) has primary responsibility for (2); they will jointly prepare part (3). John Potter (M.I.T.) and Judith Chubb (M.I.T.) are associated with the research.

Attachment A: Government Impact on Small-Scale Industry

QUESTIONNAIRE

Introduction: Interviewer explains: In our country in the past we have been interested in big firms and public sector firms. Now we realize that we need to know about small firms, for they are important to the country. We are from Cairo University and we are doing research on this question. After the open door policies, it is clear that this is very important, and we ask your help. What we need is to understand how your business works and what its problems are. Everything you say to me is confidential. We do not record your name. We do not give information on particular individuals to government or to anyone. We are interviewing 200 people and in our report, all the comments and figures from all 200 firms will be combined, so it will be impossible to identify your particular firm.

First, some facts we need to know about your firm:

1. How old is it? _____
2. Is there one owner or more? (Specify) _____
- 2A. How many workshops? _____
3. To understand how your firm works, could you answer (here insert Arak questionnaire, p. 22-23)
4. This place of work -- do you own it or rent it? _____
Estimated size _____
5. What are the places you buy raw materials? (Interviewer: take each place and ask for each the following questions:)
 - a/ Is it a cooperative or what? _____
 - b/ How often do you go there? _____
 - c/ Do you pay cash everytime? _____
 - d/ If not, what are the conditions of purchase? _____
 - e/ Do they always have what you need? _____

QUESTIONNAIRE - Page 2

6. How many regular workers do you have here? (exclude trainees and boys) _____
7. How long have they been here? (Interviewer: In small firms go through individual cases; in firms over ten, get average time in firm and range of time in firm.) _____
8. How old were the workers when they came to the firm? _____
9. How many trainees and boys help here? _____
10. Did you have more workers or fewer workers three years ago? _____
11. How many hour per day do workers work this month on average? _____
How many did they work three years ago? _____
12. What is the total number of pairs of shoes you made this month?
_____ How many did you make in a month three years ago? _____
13. If you had the opportunity to sell more shoes that you are making now, what would you do? _____
- (If he says, 'hire more workers,' ask:
What do you have to offer a worker to get him to come? _____
How do you get rid of the worker when you don't need him any more? _____)
- (If he says 'buy more machines,' ask:
What type of machines? _____
Where, how, did you learn aboutt the machines? _____)
- (If he says subcontract, ask:
Will he subcontract all or part of the shoes needed? _____
How will he divide profits with the subcontractor? _____)
14. If you need to borrow money to operate or expand, how do you get it? (List all sources) If he says family and friends, ask if they earned it by work abroad)

QUESTIONNAIRE - Page 3

15. If you had the opportunity to borrow money at 2-3% interest to buy machines, would you? _____

(If he says no, ask: Would you consider a new machine if offered, like the Nasr bank offers taxis, with monthly repayment? _____)

If no, Or would you agree to get money be a profit-sharing arrangement? _____)

(If he answers yes to Question 15, ask:

What kind of machines would you buy? _____

What kind of guarantee could you offer to the bank? _____

16. Do you produce only when you have orders? _____

(If yes, ask: How do you get orders? _____)

(If no, ask: How do you decide how much to produce? _____)

and then ask:

17. How do you sell what you produce? (Interviewer asks: local market? _____ Export market? _____)

18. Sometimes opportunities exist to expand a business, either with more machines or more workers. But owners hesitate. Have you ever been in this situation? _____

(If yes, ask:) Why did you hesitate? _____)

(If he mentions hisgher taxes, follow up with questions. If not, ask directly, Would you hesitate because tax inspectors would look at new machines and more benches and increase your taxes too much? _____ (Explore)

(If he mentions social insurance, follow up with questions.

If not ask directly, If you hired new workers, might you have troubles with social insurance? _____ (Explore)

QUESTIONNAIRE - 4

- 18A. How often do you change your models? _____
Where do you get the new ideas? _____
19. Some people say that government interferes too much; others say that government does not do enough. We would like to know your experiences.
- a/ Have you ever gone to the local government? For What?
What happened?
- b/ Have you ever gone to the government to get raw materials?
What happened?
- c/ What government officials have come to see you in your shop?
What happened? Determine department.
20. What about the cooperatives? What is your experience with them?
21. Many things changed after the October war in 1973. Are things better for you now, worse, or the same? _____
(Explore)
22. When you think about the future, do you think in 2 or 3 years your situation will be better or worse? or same? Do you think your firm will be bigger?
23. Finally, would you like your son to follow you in your business?
(If not, why not)