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Introduction

With the enactment of Law No. 43 of 1974 concerning the Investment of Arab and Foreign Funds and the Free Zones,[1] Egypt embarked upon a policy of actively encouraging foreign investment as a means of stimulating economic development. This new policy, known in Arabic as *al-Infitah* or "openness," represented a marked departure from the Arab socialist economic orientation of the Nasser era when the government, with its emphasis on centralized planning and the development of public sector enterprises, had virtually closed the country to private foreign investment.

The passage of Law No. 43 of 1974 initially engendered great expectations in both potential foreign investors and the Egyptian government. Attracted by the country' large market, its sizeable pool of inexpensive labor, and its proximity to the accumulating wealth of the Arabian Peninsula, numerous foreign firms sent representatives and delegations to Egypt to explore the nature of the economic opening and the prospects for profitable investments, particularly those of the much heralded "trilateral" nature; i.e., projects which would bring together Arab capital, western technology, and Egyptian manpower and resources for productive purposes. This nearly overwhelming influx of

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[1] For a discussion of the background and provisions of Law No. 43 of 1974, *see generally* Jeswald W. Salacuse, *Egypt's New Law on Foreign Investment: The Framework for Economic Openness,* 9 THE INT'L LAW. 647-660 (1975).

visitors, in turn, gave the Egyptian government reason to believe that numerous major investment projects would be undertaken within a very short time.

These early expectations did not materialize fully. The relatively slow pace of implementation may be attributed to a number of factors, including political considerations, lack of infrastructure, insufficient incentives under Law No. 43 and administrative difficulties. As foreign firms came to understand some of the difficulties of operating in Egypt, many abandoned or postponed plans for investment projects. For its part, the Egyptian government became increasingly aware that numerous proposals resulting from such visits either were not in the interests of the country or were merely disguised attempts to sell technology. Nonetheless, certain foreign investments did take place during the first three years of the operation of Law No. 43. By June 30, 1977, a total of 161 projects valued at Ŀ.E. 262.4 million, with a foreign exchange component of Ŀ.E. 210.9 million, were in operation. An additional 158 projects, valued at Ŀ.E. 692.1 million with a foreign exchange component of Ŀ.E. 423.6 million, were then "under development."[2] The bulk of such projects, however, took the form of banks, investment companies, touristic enterprises, and real estate development schemes. Major industrial ventures of the trilateral type which the government had hoped would revitalize the economy were few and far between.

Initial expectations aside, the three years following the enactment of Law No. 43 of 1974 proved to be basically a period of adjustment for both Egypt and interested foreign firms. Indeed, such an adjustment was probably inevitable in view of the fact that the country had been closed to international private investment for two decades and that therefore Egypt and foreign businesses had much to learn about each other. Eventually, the Egyptian government gained a better understanding of the objectives and methods of multinational companies and began to search for new ways to facilitate the entry of foreign capital. Foreign investors, on the other hand, came to see that they could solve many problems initially judged to be "insuperable" and that they did have the ability to adjust to the conditions prevailing in the country.

Throughout this period, multinational companies, banks, and international organizations engaged in an intense dialogue with the Egyptian government concerning the problems impeding the effective implementation of the policy of economic openness. Much, but by no means all, of this discussion centered on Law No. 43, which had become both the symbol and the most authoritative expression of the new policy. Ultimately, the government decided to amend Law No. 43 of 1974 to take account of certain objections and criticisms raised

[2]Source: Unpublished figures supplied by the General Authority for Investment and Free Zones.

by investors and others in a host of reports,[3] recommendations, and meetings. On May 16, 1977, after careful consideration of a draft bill prepared by the government, the People's Assembly of Egypt approved Law No. 32 of 1977,[4] amending Law No. 43 of 1974.

The basic thrust of the 1977 amendments is to widen the opening created in 1974 and to remove many of the difficulties and uncertainties which foreign investors claimed were inhibiting investment in Egypt. The revision of Law No. 43 may therefore mark the beginning of a new and more dynamic phase of the policy of economic openness. In an effort to determine the prospects for such an eventuality, this article will examine the experience of the first three years under Law No. 43 of 1974 and will then analyze the amendments contained in Law No. 32 of 1977.

I. The First Three Years Under Law No. 43 of 1977

In establishing a legal framework for the policy of economic openness, Law No. 43 of 1974, as well as its implementing regulations,[5] sought basically to achieve three things: (1) to define the types of investments desired by Egypt; (2) to specify the guarantees and privileges to be accorded such investments; and (3) to provide for an institutional apparatus to administer the investment legislation. As time passed, potential investors encountered difficulties in each of these three areas and asserted that such problems, real or perceived, were significantly obstructing the entry of foreign capital. A brief examination of the nature of these problems will contribute to an understanding of the amendments that emerged in 1977.

A. THE NATURE OF DESIRED INVESTMENTS

Law No. 43 established a system requiring approval by the Egyptian government of any investment proposal prior to its actual implementation; however, neither the Law nor the regulations specified the precise nature of desired projects or set down detailed objective criteria to be applied in appraising investment proposals. They merely stated that investments might be undertaken in such areas as "industry, mining, energy, tourism, transportation and other

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[3]*See, e.g.*, REPORT ON FOREIGN INVESTMENT (1976), prepared by the EGYPT-U.S. BUSINESS COUNCIL.

[4]Published officially in issue no. 23 (bis) of June 9, 1977, of the Garida Rasmia, Egypt's Arabic-language official gazette. The amendments became effective on June 9, 1977.

[5]Decision No. 91 of 1975 by the Prime Minister, Promulgating the Executive Regulations of Law No. 43 for the Year 1974; published in the issue of January 30, 1975, of the Garida Rasmia, the official gazette. Revised Executive Regulations implementing Law No. 43 as amended by Law No. 32 were not, at the date this article was written, available in an official English version and are accordingly not included in the present analysis.

fields" but without indicating government priorities with respect to the various sectors open to foreign capital. While the Law did direct the General Authority for Arab and Foreign Investment—the agency charged with administering the investment legislation—to prepare lists designating the specific types of projects desired, such lists also proved fairly general in nature. Contrary to the expectations of certain foreign firms, the General Authority never developed a roster of specific project proposals to present to potential investors seeking business opportunities.

The lack of specificity disturbed certain foreigners, who felt it demonstrated that Egypt had not really delineated the precise role it wished foreign capital to play in its economy. For them, Law No. 43 was, in the words of one American lawyer, "merely an invitation to come in and negotiate a deal." Without more precise guidance than that afforded by the Law and regulations, several foreign companies claimed an unwillingness to spend funds on feasibility studies for projects that in the end might not receive approval from the General Authority.

It is difficult to determine the exact extent to which this alleged lack of governmental specificity operated as a substantive obstacle to foreign investment. Demands for greater precision in the early stages of the policy may have merely been a reflection of the foreign firms' lack of knowledge about the Egyptian economy, a problem which eased with time as potential investors accumulated the necessary data and project ideas.[6] In any event, by June 30, 1977, investors felt sufficiently confident of their role in the economy to have incurred the expense of preparing and obtaining approval of some 641 projects which contemplated a total investment of Ŀ.E. 3,123.3 million.[7]

The dominant economic position of Egyptian public enterprises was another factor which created an attitude of uncertainty among some foreign firms and prompted a demand for a more specific delineation of the place granted foreign private investment. Fearful of entering into a losing competition with public corporations enjoying special advantages and subsidies, most investors would have preferred Law No. 43 to designate certain sectors as the exclusive domain of private enterprise or joint ventures. The Egyptian government chose not to adopt such a solution, not only because the public sector would have strongly opposed it, but also because it raised the specter of a return to an economy dominated by foreign interests. In the end, investors had to make their decisions empirically and on an *ad hoc* basis with respect to the nature of

[6]For example, in 1976, the Egypt-U.S. Business Council prepared abstracts of 35 feasible projects in which it then attempted to interest American investors.

[7]*See supra,* note 2. The fact that an investment proposal has received an approval does not necessarily mean the investor will proceed to implement the proposed project.

their projects and the choice of their partners.[8]

In many ways, Law No. 43 concerned itself more with the nature of the capital invested in a project than with the activities of the project itself. Indeed, for this reason it was probably as much a foreign exchange law as it was an investment promotion statute. Faced with the country's desperate shortage of foreign currency, the government viewed the policy of openness as a means to obtain the foreign exchange necessary for development. As a result, Law No. 43 went to great lengths to assure that an investment made under its provisions represented a net inflow of foreign resources and that the potential demands of a project on Egypt's foreign exchange reserves would be minimal. Thus, for example, regardless of the nationality of the owner, only free foreign currency or assets imported from abroad could qualify as "invested capital" under the Law.[9] In addition, the effect of the provisions regarding transfer of profits and capital was to encourage investments that would generate foreign exchange through export earnings.

Indeed, for all practical purposes, export-oriented projects were the *only* ones the Law contemplated. For not only did it reserve its most favorable treatment for investments in the free zones, but it also specifically provided that a project could repatriate earnings only to the extent that it earned sufficient foreign exchange to do so. Moreover, no project was assured of foreign exchange to cover debt servicing and expenditures abroad unless it had adequate foreign revenues or financing. While it is true that Article 22(ii) of Law No. 43 permitted "basic projects with major significance for the national economy where no exports are contemplated" to transfer net profits in full, neither the Law nor the regulations ever defined a "basic project" and in fact until 1977 the general Authority never designated a project as such.

In general, potential investors were less certain than the government of Egypt's comparative advantage as a site for exporting manufactured goods to the world market. For them, the country's principal attraction was its population of nearly 40 million people, constituting the largest market in the Middle East. Most firms believed that the profitable investment opportunities in Egypt lay in serving the domestic market and they therefore urged the government to approve projects aimed at import substitution.

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[8]With respect to the rules governing joint ventures, it should be noted that in 1975 the General Authority issued "Model Articles of Incorporation for Joint Ventures Established in Accordance with the Provisions of Law No. 43 for the Year 1974 in the form of Joint Stock Companies." The General Authority required joint ventures to follow these model articles; however, Article 6 of Law No. 32 of 1977 makes it clear that projects are not obliged to follow such model articles insofar as its provisions do not relate to Egyptian public policy.

[9]However, reinvested profits could, under certain circumstances, qualify as invested capital, but only upon the approval of the Board of Directors of the General Authority.

Although Law No. 43 did not specifically forbid import-substitution enterprises, its restrictions on the availability of foreign exchange for the repatriation of profits and the payment of expenditures abroad effectively precluded them from consideration by investors in the absence of a special exception granted by the government. Such an exception, however, if applied on a broad basis, would have amounted to a significant alteration of the policy of economic openness as orignally conceived. In addition, various officials believed that requiring projects to export at least a portion of their production would ensure that their technology and product quality met international standards. As a result, the Egyptian government generally adhered to its export-oriented policy throughout the first three years and also refused to consider alloting to import-substitution projects a portion of the foreign exchange which their activities might save the country.

Preoccupations with questions of foreign exchange led to another, even more serious problem: the appropriate exchange rate to be applied to the entry of foreign capital, as well as to the repatriation of capital and profits. The origins of this problem resided in the fact that Egypt had two basic exchange rates for its currency: an "official rate" of approximately \$2.50 to the pound and a "parallel rate"[10] of approximately \$1.44 to the pound. Different rates applied to different transactions and Law No. 43 specifically provided that all foreign currency invested in approved projects was to be converted at the official rate.

Potential investors judged the official rate to be artificially high and believed that its application would result in an unduly low evaluation of their investment in the project. They considered it particularly unfair in the case of joint ventures with Egyptian partners since it distorted the relationship in the real value of the assets contributed by the two parties to the enterprise. Denied the benefits of the parallel market rate, investors sought to minimize the adverse effects of the official rate by reducing cash contributions to a minimum, by overvaluing foreign investments in kind, undervaluing the contribution of local partners, and by capitalizing technology.

The problem of exchange rates was even more complex with respect to repatriation of capital and profits. While Law No. 43 specifically stated that invested currency was to be converted at the official rate, it also provided that capital was to be repatriated at the "prevailing rate." Neither the Law nor the

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[10]In 1973, Egypt created the parallel market primarily to attract the savings of Egyptian residents abroad by offering an incentive rate 50% above the official rate. In addition, foreign revenues from tourism and certain designated exports could also be exchanged on the parallel market. Egyptian firms, including those owned by foreigners, could purchase foreign exchange on the market to finance the importation of specified items. In the following years, the Egyptian government steadily expanded both the permissible sources of foreign exchange for the parallel market as well as the list of imports it might finance.

regulations indicated whether this expression referred to the prevailing *official* rate or the prevailing *parallel* rate. The issue held more than academic interest for many investors since the application of the parallel rate to the repatriation of capital originally transferred at the official rate could, all other things being equal,[11] result in a loss of nearly 50 percent on the value of the investment.

To complicate matters even further, the Law's provisions on the repatriation of profits gave no indication at all as to the appropriate rate to be used, even omitting any reference to a "prevailing rate." Here, too, the application of the parallel rate might have had disastrous results, for its effect, absent careful planning in the joint venture documents, could have been to halve the rate of return on an investment originally made at the official rate.

While the General Authority might have attempted to clarify the foreign exchange question through the issuance of a regulation, it never chose to do so. On the other hand, in view of the importance of the question, many investors felt that only an amendment of the Law itself would afford them the necessary certainty. Eventually government officials did acknowledge the existence of a problem in this area and promised a forthcoming legislative revision; however, such statements merely persuaded many investors to await the amendment before seriously considering an investment.

B. INCENTIVES, PRIVILEGES AND EXEMPTIONS

Law No. 43, like most investment promotion acts, offered foreign capital a variety of incentives, privileges, and exemptions as inducements to enter the country. Indeed, it actually created two systems of privileges: one for "inland projects" and a second, consisting of additional special privileges, for projects located in free zones.

1. FISCAL INCENTIVES

The basic fiscal incentive for inland projects was an exemption from taxes on industrial and commercial profits for a period of from five to eight years beginning with the commencement of production. Believing such exemption to be of minimal benefit to enterprises requiring as lengthy period of development before becoming profitable, certain investors urged that its duration be extended or that it be made to run from the first year in which the project actually showed a profit.

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[11]This was not a necessary result, however, as original Article 21 spoke in terms of repatriating the "registered" invested capital. Since Article 26 provided that invested capital, if in cash, was "registered" in terms of the original currency units, a fluctuation of the rate for the Egyptian pound would not have affected the amount that was permitted to be repatriated. For example, a $1 million investment, valued at the official rate of £.E. 400,000, if sold later for £.E. 700,000, could have resulted in a permissible repatriation of £.E. 700,000 which at the parallel rate would equal the $1 million of invested capital as originally registered.

American investors, in particular, feared that the entire tax exemption might be illusory with respect to their projects because of the nature of U.S. tax law and the language of a condition attached to Article 16 of Law No. 43 granting the exemption:

> These exemptions shall remain applicable only so long as the profits of the project are not, as a consequence, subject to taxation in the foreign investor's home country or in any other country.

The intent of this provision was to ensure that any revenue loss to the Egyptian treasury because of the exemption would benefit the investor rather than the treasury of another country. Under American law, however, a U.S. corporation would be subject to taxation on profits earned on a direct Egyptian investment in the year made and on the dividends from an Egyptian subsidiary in the year of distribution to the parent. The Egyptian tax exemption would, of course, result in increased profits on a direct investment and eventually in larger dividends on an investment in a subsidiary, both of which would in turn lead to an increased tax liability for an American investor under U.S. law. In such event, could it be said that the profits of the project were *as a consequence of the exemption* subject to taxation in the United States, thereby disqualifying it completely from the benefits of the exemption? Neither the General Authority nor any other Egyptian agency gave a definitive answer to this question, and it therefore remained the subject of controversy and uncertainty for American firms throughout the first three years following the enactment of Law No. 43.

The above-mentioned problem did not arise in the case of Free Zone projects because the Law gave them a general income tax exemption without imposing conditions or time limits;[12] however, they did face a vexing issue in the form of the annual duty imposed on their operations. In order to support the administrative and infrastructural costs of the free zones, the Law levied an annual duty of 1 percent of the value of goods entering and leaving the free zone for the account of the project. In practice, since the duty was based on the total value of goods entering or leaving the zone, rather than on the profits of the project, it proved to be a rather onerous burden on enterprises with a low profit margin and a high turnover. In certain cases, it significantly reduced the attractiveness of situating projects in a free zone.

Regardless of exemptions, it was generally agreed that the Egyptian tax law on incomes and profits was in need of a thorough revision to make it accord with the spirit and aims of the policy of openness. Its exceptionally high personal income tax rates, which reached a maximum of 95 percent on incomes

[12]The provisions of the Law were, however, somewhat ambiguous as to whether dividends and distributed profits of free zone projects were also exempt from taxation.

about Ł.E. 10,000 proved to be a significant obstacle in recruiting foreign staff for "inland projects."[13] To obviate the hardships of the Egyptian tax law, many enterprises paid their managers and technicians additional sums to compensate for the tax loss or engaged in various strategems to reduce the apparent amount of income paid in Egypt.

2. FOREIGN EXCHANGE PRIVILEGES

As indicated above, a project without sufficient foreign earnings or financing had no assurance of being able to obtain foreign exchange to meet its needs. This uncertainty proved to be a major obstacle in planning and developing an enterprise. Before making a financial commitment, investors naturally wanted some assurance that they would be able, at a very minimum, to obtain foreign exchange for necessary imported raw materials and spare parts. In view of the country's exceptionally acute balance of payments problems, the Egyptian government was exceedingly reluctant to make any such guarantee. In time, however, beginning with the expansion of the parallel market in 1974, the establishment of foreign banks, and the creation of the "own exchange market" in 1976,[14] foreign exchange became increasingly available, albeit at a premium.

3. EXEMPTIONS FROM RESTRICTIVE BUSINESS AND LABOR LAWS

Law No. 43 exempted approved projects from some of the more onerous restrictive legislation enacted during the Nasser era to foster the socialist objectives of the day. As a result, approved investment projects, unlike ordinary Egyptian companies, were not required to have worker representation on the board of directors or to pay a fixed percentage of profits to employees. Despite these exemptions, investors soon found that the business and labor laws of Egypt contained a multitude of other restrictions which rendered efficient operations and effective management difficult. For example, Law No. 113 of 1961 prevented a company from paying its chairman, board members, or managing director compensation in excess of Ł.E. 5000 a year. Law No. 26 of 1954 prohibited the negotiability of shares for two years following the incorporation of a company, and it also forbade the members of the board of a joint stock company from working for another company without the express authorization of the President of the Republic. And Law No. 91 of 1959 required employers to hire workers in accordance with the chronological order of their registration at the Labor Office. It soon became clear that the entire

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[13]The foreign personnel of free zone projects were completely exempt from Egyptian income taxation.

[14]The "own exchange" system allows Egyptians owning foreign currency to buy specified imports without converting their currency through the Egyptian banking system.

body of Egyptian business law was in need of a thorough revision to bring it into accord with the spirit of the new policy. In the meantime, investors sought to obtain additional exemptions from unduly restricted provisions.

C. THE INSTITUTIONAL APPARATUS

The creation of an appropriate institutional apparatus to encourage foreign investment in the midst of a massive bureaucracy and a public sector devoted to Arab socialism proved to be an almost herculean task. Nonetheless, despite numerous investor complaints about "bureaucratic problems," the first three years of the new policy did witness significant progress in this area.

Law No. 43 entrusted the General Authority for Arab and Foreign Investment and the Free Zones with direct responsibility for administering its provisions, including the approval of investment proposals, the supervision of free zones, and the general encouragement of foreign investment in Egypt. Originally subject to the Organization for Arab and International Cooperation, the General Authority in July, 1975, was transferred to the supervision of the Minister of Economy and Economic Cooperation, who was also made the Chairman of the General Authority's Board of Directors. This organizational change did much to strengthen the position of the General Authority within the Egyptian government.

In its early days, insufficiency of staff plagued the General Authority and prevented it from executing its statutory duties efficiently. Foreign investors found, for example, that they often had to wait for as much as twelve months to secure a decision from the Authority on an investment proposal. Over time, the General Authority gradually increased and improved its staff, introduced new procedures, determined the precise nature of the information required of investors, and clarified various aspects of the policy of openness, thereby reducing delays to the point where a decision on an adequately documented proposal might be received within two to three months of its submission. In addition, it made efforts to improve coordination with other government departments, although much remained to be done in this area even after the passage of three years.

II. The Revision of Law No. 43 of 1974

In response to the concerns expressed by investors, the Egyptian government decided, by mid-December 1976, to amend Law No. 43.[15] While it is generally acknowledged that many, if not all, of the legal problems encountered during the first three years might have been resolved by either (i) administrative

[15] The decision was made by the recently appointed group of Ministers under the direction of the Deputy Prime Minister for Economic and Financial Affairs.

regulation at the ministerial level[16] or (ii) modification of ancillary legislation,[17] the decision to revise Law No. 43 itself seems to have been based on three grounds. First, it was Law No. 43 that had been the principal focus of comment and criticism by the investing community. Second, a legislative amendment would provide more authoritative guidance than would a regulation to persons charged with implementing the law and would in addition demonstrate that the country's elected representatives continued to support strongly the government's policy of economic openness. Finally, a revision of Law No. 43 could be accomplished more quickly than a modification of the various ancillary laws affecting foreign investment.[18] In the interests of developing a stable legal environment for foreign investment, the government chose to maintain the basic framework of Law No. 43 rather than to adopt an entirely new act on the subject.

A. THE PROCESS OF REVISION

The process of revision, which included close communication between the government and the private sector, and the speed (five and one-half months) with which it was accomplished, clearly demonstrate Egypt's strong determination to pursue the openness policy and create a more favorable climate for foreign investment.

The international investing community was first made aware of the specific areas that the revision would cover by the General Authority's issuance, in late December 1976, of a brief outline of the changes in the Law being considered. While the outline produced further comments and was generally favorably received by the investors, the need for a more detailed itemization of proposed amendments was recognized by late January 1977. Accordingly, the General Authority decided it would be appropriate, *prior* to amending the Law, to establish further dialogue between the persons who would be affected by the amendments and the officials responsible for preparing the draft legislation. The goal of this dialogue was to avoid potential confusion arising from the adoption of amendments presented to the investor as a *fait accompli;* the officials would instead explain what the proposed amendments entailed and would solicit comments with a view toward their possible incorporation in the draft to be submitted to the People's Assembly.

To provide a forum for the dialogue, the General Authority organized a series of seminars and a public workshop on the proposed amendments to Law

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[16]For example, administrative regulations could have clarified the exchange rate issue as well as provided guidelines for the "basic projects" exception of Article 22(2). *See* text *supra* at p. 763.

[17]For example, onerous provisions of the Companies Law could have been corrected by amendment of that law.

[18]The draft legislation for a revision of Egypt's tax laws has been under consideration for at least two years.

No. 43. During the seminars, government officials and private sector representatives discussed proposed changes, considered earlier written comments on the Law, and produced specific recommended changes which were to serve as the focus of the workshop. On February 26, 1977, the public workshop was attended by approximately 100 local and foreign businessmen, lawyers and government officials met to exchange views on the proposed changes. No recommendations, as such, were solicited, but comments concerning the problems of Law No. 43 specifically, and improving the investment climate generally, were encouraged.

Following the workshop, the participants in the working session met to draft the text of the proposed amendments. This draft incorporated several of the concepts discussed by workshop participants. After additional discussions with business leaders and international financing organizations, it was submitted to the Cabinet several days following the workshop.

After a review by the Cabinet, the Council of State and legislative leaders, the draft was submitted to the People's Assembly in early May. Following a lengthy article-by-article debate,[19] the revision was completed by the adoption of Law No. 32 of 1977, which became effective on June 9, 1977.

B. THE SUBSTANCE OF THE AMENDMENTS

As indicated above, the experience in implementing Law No. 43 of 1974 during the first three years revealed several significant problems, including—

(1) the nature of permissible projects, particularly in the area of import substitution;
(2) the application of the appropriate exchange rate;
(3) the repatriation of capital and profits;
(4) the interpretation and application of the fiscal exemptions; and
(5) the restrictions persisting in the company and labor legislation.

Law No. 32 of 1977 sought to resolve each of these difficulties.

1. THE SCOPE OF PERMISSIBLE PROJECTS EXPANDED

a. Export Projects vs. Import-Substitution Projects

Under the original provisions of Law No. 43, export oriented projects were favored in at least two significant ways: (i) Article 22, dealing with the repatriation of profits, conferred a general right to repatriate earnings only in

[19]The government's draft bill was considerably altered by the People's Assembly. It is interesting to note that while relatively few changes were made with respect to the original bill's treatment of *foreign* investment, there was a significant reduction of the incentives for the purely domestic private sector.

the event that a project was self-sufficient in its foreign currency needs. Because the original text of Article 14, dealing with a project's foreign exchange account, required foreign currency deposits to have their source from outside the country, the two original provisions had the effect of requiring projects to produce primarily for export in order to be entitled to transfer profits abroad.[20] The exemption to this general rule, provided in the original text of Article 22(2), dealing with "basic projects" which would be entitled to transfer their profits in full regardless of their foreign current earnings, was never implemented. Failure to implement Article 22(2), which would have met the needs of import-substitution projects, could be attributed to the open-ended nature of the exemption: if an import-substitution project was deemed "basic," it would have the right to transfer 100 percent of its profits regardless of the country's current foreign currency position.

Both Articles 14 and 22 have been revised so that import substitution projects may now be encouraged to come to Egypt. Under the new provisions, profits generated in the local market in Egyptian currency are transferable as follows:

1) Revised Article 22(2) eliminates the requirement that an import-substitution project be "basic" and, within limits negotiated with the Authority at the time of approval (and within the foreign currency regulations), permits repatriation of all or part of the profits generated in the local market; and
2) Revised Article 14 permits a project to obtain foreign exchange locally by *e.g.*, selling local currency to banks and by making local sales in exchange for foreign currency. It may also be possible for a project to acquire foreign currency in the newly created "own" exchange market.

Thus the *right* to transfer profits abroad is given by revised Article 22(2) and the *availability* of foreign exchange to fund that right is dealt with in revised Article 14.

b. Projects Financed Exclusively in Local Currency

As originally enacted, Law No. 43 of 1974 did not apply to investments made entirely in Egyptian currency and local resources by Egyptian nationals. The 1977 revision has expanded the scope of the Law in a second respect by granting such projects many of the same benefits accorded to foreign investors[21] and by giving the General Authority similar responsibilities with

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[20] *See* text, *supra*, pp. 763-764

[21] Law No. 86 of 1974 provided similar tax incentives to projects financed exclusively with local currency as were available to Law No. 43 projects. However, no mechanism was established to administer the former law and its impact on the local private sector was negligible. Revised Article 6

respect to the approval and supervision of such local projects as it has had over foreign investments and joint ventures.[22]

c. Other Permissible Activities

The 1977 amendments further broaden the scope of permissible projects by defining several new fields of activity in which they might engage. To stimulate construction within the country, as well as to encourage the introduction of needed technology, the Law now allows approved projects in the following newly designated fields:

- construction activities in regions outside the agricultural areas and the perimeters of existing cities;
- construction contracting activities carried out by joint venture stock companies in which Egyptian participation constitutes not less than 50 percent of the capital; and
- technical consulting activities in the form of joint stock companies and in participation with foreign international consulting firms where such activities are related to and required by a project approved under Law No. 43.

2. CLARIFYING THE EXCHANGE RATE

To end the confusion caused by the existence of multiple exchange rates for the Egyptian pound, Law No. 32 introduces a new Article 2 (bis) which provides that the transfer of invested capital, as well as the repatriation of capital and the transfer of profits, is to be effected at a single rate of exchange, which is "the highest rate prevailing and declared applicable for free foreign currency by the competent Egyptian authorities." Announced periodically by the Central Bank of Egypt, this "highest rate" applies to all the foreign currency transactions of projects approved under revised Law No. 43, including funds transferred to Egypt for the purchase of land and other real property constituting an integral part of the capital assets of the project.[23]

With respect to projects that had transferred their capital to Egypt prior to the revision, Law No. 32 is less clear and has been the subject of some controversy. Capital previously transferred at the official rate may be revalued in

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of Law No. 43 extends the privileges and exemptions of Articles 9, 14, 15, 16, 17 and 18 to projects financed entirely in local currency. Significantly, exemptions from restrictions on the transfer of profits and capital, as well as from certain provisions of local Labor and Companies Law, are thus not available to such projects.

[22]An Egyptian national making an investment at least partially in foreign currency remains entitled to the full benefits of Law No. 43 of 1974, as has been the case since its enactment.

[23]The intent of this provision appears to be that land and real property purchased for speculative purposes and not constituting an integral part of the capital assets of an approved project insofar as such property is not directly necessary for the project's operation must be paid for in foreign currency converted at the official rate.

accordance with the "highest rate" upon the approval of the partners representing three-quarters of the capital of the project or by a resolution of an extraordinary general meeting of the shareholders.[24] Such revaluation may be accomplished, with no imposition of a tax, either by increasing the value of the shares or by issuing non-voting bonus shares equivalent to the difference resulting from the revaluation.

In the event that no voluntary revaluation takes place pursuant to the rules described above, Law No. 32 provides that all participations shall continue to be valued at the official rate at which they were transferred and that the right to share in profits shall continue as originally provided when the project was approved. Thus, if there was an existing controversy arising from the ambiguity of Law No. 43's original treatment of the exchange rate issue, Law No. 32 standing alone does not appear to resolve it.

3. REPATRIATION OF CAPITAL

In addition to removing the problem of multiple exchange rates, the amended Law establishes somewhat more flexible rules concerning the repatriation of capital. Originally, Law No. 43 limited the amount of repatriated capital to the value of invested capital plus a rate to be fixed by the General Authority to meet any rise in the value of the investment. The 1977 revision has deleted this limitation; consequently, an investor may repatriate the full amount realized through sale or liquidation. In addition, whereas repatriation of capital must normally take place in five equal annual installments, it may now be effected immediately and in full, subject only to notification of the General Authority, if an investor has disposed of his investment for foreign currency or if the credit balance in the foreign exchange account is sufficient to cover the transfer. Shares offered in free foreign currency may in all cases be sold through an Egyptian Stock Exchange in which event the proceeds are immediately transferable to the seller's account abroad.

If an investor sells his interest for local currency, the purchaser is entitled to enjoy all the benefits of Law No. 43, except the right to transfer funds abroad. Previously, the Law denied such a purchaser any of its privileges.

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[24]Article 5, Law No. 32 of 1977. Note that this Article is not a part of Law No. 43 as amended and is found exclusively in Law No. 32. In the case of joint ventures between Egyptian and foreign partners, revaluation may, of course, have the effect of altering the relationship between the parties, with respect to such matters as sharing in profits and capital, to the benefit of the foreigner and to the detriment of the Egyptian insofar as the latter has not contributed capital in the form of foreign currency or assets imported from abroad. As a result, one can expect Egyptian partners to resist attempts at revaluation, particularly in joint ventures where the shares are fairly evenly divided between the two parties. In such cases, it will be difficult for the foreign partner to muster the required three-quarters majority or to pass a resolution at an extraordinary general meeting of shareholders, which, according to the Model Articles for Joint Ventures, requires a quorum representing two-thirds of the capital of the company.

4. THE FISCAL INCENTIVES

a. The Tax Holiday

New article 16, relating to the tax holiday, enumerates the specific taxes from which projects are exempt and now makes it clear that both projects and persons receiving distributions therefrom are exempt from the General Tax on Income. Moreover an extended tax holiday of from ten to fifteen years has been added to the Law for projects involving reconstruction, land reclamation, and the establishment of new cities.

The 1977 amendment also significantly alters the troublesome second paragraph of Article 16, discussed above, which attached a confusing condition to the tax holiday. As a practical matter, it would have been difficult, as the article originally required, to determine with any degree of accuracy whether, *as a consequence of the Egyptian tax exemption,* the profits generated by a project were taxed in a foreign country.[25] Under the revised article, projects will be entitled to the exemptions set forth therein regardless of the tax policy of the investor's home country, and foreign firms may seek maximum utilization of the tax holiday in accordance with their overall strategy; however, the exemption from the General Tax on Income "is conditioned upon such income not being subject to similar taxation in the investor's home country or in the country to which income is transferred, as the case may be." Unfortunately, the wording of this provision is likely to raise questions in the minds of investors, not the least of which are (a) the meaning of "similar taxation," and (b) the extent to which the exemption would be lost.[26]

The original text of Law No. 43 was not clear as to whether distributed profits, as well as the earnings of the project itself, would enjoy a tax holiday, or whether such distributions are exempt only to the extent of 5 percent of the investor's capital. It is now clear, as a result of the revision, that the 5 percent exemption from the General Tax on Income provided for in Article 17 comes into operation at the end of the tax holiday and does not affect the complete exemption from such tax of both profits and distributions for the initial tax holiday period.

b. A New Exemption for Foreign Employees

It should be noted that revised Article 20 exempts all wages, salaries, or similar payments made to an approved project's foreign employees from the

[25] *See* text, *supra,* pp. 765-766.

[26] For example, a reasonable interpretation of the provision might be that if Country *X* imposed what was deemed a "similar" tax on a Law No. 43 project, but at a lower rate than that exacted under Egypt's General Tax on Income, the exemption would be lost, not *in toto,* but only to the extent of the tax paid to Country *X*.

General Tax on Income, thus granting them tax treatment which previously only foreign employees in the free zones had enjoyed.

c. Alteration of the Free Zone Duty

As indicated above, the 1 percent duty charged to Free Zone projects was considered to be high for enterprises with a low profit margin. Under revised Article 46 of the Law, the one percent rate is now established as a *maximum* duty; however, projects may be subjected to a lesser duty where warranted by their profit margin and other circumstances. Projects whose principal activities do not involve the entry and exit of commodities from the free zone continue to be subject to an annual duty not exceeding 3 percent of the value added. Revised Article 37 offers an additional fiscal incentive to free zone manufacturing projects as it reduces customs duties by 50 percent on free zone products imported into Egypt where 40 percent of the components of such products are of local origin.

d. Reductions of Miscellaneous Fees

Revised Article 23 reduces, and in some cases, eliminates entirely several of the incidental fees and stamp duties originally required of Law No. 43 projects. The frequently onerous Endorsement Fee imposed on companies formed in Egypt[27] is now limited to ¼ of 1 percent of the project's capital to a maximum of 1,000 Ŀ.E. Moreover, the contracts establishing the project, as well as all contracts relating to a project including loan agreements, mortgages, construction contracts, and contracts for the purchase of real estate and machinery are exempt from stamp duties, registration and publication fees for a period of one year following commencement of a project's operations.

5. NEW EXEMPTIONS FROM THE COMPANIES LAW AND LABOR LEGISLATION

In an effort to facilitate the operation of foreign investments, amended Articles 11 and 12 grant approved projects additional exemptions from certain restrictive provisions of the companies and labor laws. Thus, for example, projects need no longer advertise vacant posts publicly prior to hiring, nor must they hire workers in accordance with their date of registration at the Labor Office. Moreover, the management of joint stock companies will be considerably eased with the lifting of various restrictions on the maximum salaries of directors, interlocking directorates, dividend policies and the negotiability of shares.

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[27]This fee was sometimes avoided by forming the company through an Egyptian consular office outside Egypt.

6. INSTITUTIONAL ADJUSTMENTS

Law No. 32's only direct impact on the administrative organization charged with implementing Law No. 43 was to broaden its jurisdiction to encompass investments of the purely local private sector in addition to those of a foreign or joint venture nature. To reflect this broadened jurisdiction, the organization's name was shortened from the "General Authority for Arab and Foreign Investment and Free Zones" to the "General Authority for Investment and Free Zones." The name change may also be attributable in part to a desire to deemphasize the distinction between Arab and non-Arab investments.

The indirect impact of both the government-private sector dialogue that took place throughout the amendment process, as well as the preceding three years' experience, have been greater in terms of shifting the General Authority's emphasis from screening and control to promotion. Public statements by the Deputy Prime Minister for Economic Affairs and by General Authority spokesmen indicate that there is at present a greater stress being placed on services to the investor and facilitating the implementation of projects. Moreover, while the General Authority has not yet become a "one-stop" center for investors, the government has made significant progress in coordinating the activities of the various ministries affecting foreign investment projects. The General Authority's staff and physical facilities have been upgraded to reflect its new direction, and both the Board of Directors of the General Authority and the newly created Supreme Council for Investment (chaired by the Prime Minister) are taking steps to reduce interministerial conflicts and delays.

Under current procedures, an investor is likely to receive a decision within as few as three months if he submits an adequately prepared proposal and feasibility study to the Department of Project Appraisal of the General Authority. The Department then makes an economic analysis of the proposal while requesting the competent Ministry, such as the Ministry of Industry or Tourism, to give a technical opinion. On the basis of these studies, the staff of the General Authority prepares a recommendation for its Board of Directors which meets monthly. Thereafter, the Authority informs the investor of the decision of the Board by letter, attaching thereto a copy of the Board resolution which, under Egytian law, has the effect of an administrative decision. The investor then has six months within which to begin implementing his project, subject to extension by decision of the Board.

Conclusion

The 1977 amendments to Egypt's foreign investment law have resolved most of the legal problems revealed during the first three years of the policy of economic openness. The provisions on foreign exchange rates, tax holidays,

and access to foreign currency are clear and, for the most part, seem to have won the acceptance of foreign investors. Moreover, the revision has greatly expanded the scope of the economic opening by specifically allowing import-substitution projects to serve the Egyptian market. Throughout this period of adjustment, the Egyptian government itself showed great openness to the opinions and criticisms of investors, involving them closely in the process of revision and in the end incorporating many of their suggestions into the revised law.

A previous article in this journal[28] suggested that the adoption of Law No. 43 of 1974 would lead to the revision of a major portion of Egyptian legislation, at least as it related to business and commerce. Despite early declarations to this effect, the government has thus far refrained from broad-scale law reform but has instead chosen merely to exempt foreign investment from the more onerous legislative provisions. This practice, which may be a satisfactory expedient in the short term, cannot create in the long run an adequate legal environment for the modern operation of foreign investment and a resurgence of the Egytian private sector. Ultimately, Egypt will have to revise its business laws to bring them into conformity with the spirit of economic openness and to modernize the underlying commercial legislation which for the most part is based on pre-World War II laws from France.

Law, of course, is merely one element in the creation of a favorable investment climate. Egypt's antiquated infrastructure, its chronic balance of payments deficits, and its massive and sometimes unresponsive bureaucracy are among the remaining major obstacles to the successful implementation of the foreign investment policy. In each of these areas, as well as many others, the government is making a major effort to improve the situation, but progress will no doubt be slow in view of the enormity of the task. Above all else, however, the primary constraint on the economic development of Egypt and the creation of an optimum climate for investment remains the unsettled political situation in the Middle East. Should current peace initiatives achieve fruition, it is not unreasonable to expect that Egypt will experience the kind of massive infusion of western technology and Arab capital which the architects of the openness policy from the very start had hoped would transform the country.

[28] *See supra,* note 1.