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Solving the Six Percent Dilemma

That’s what has to happen if the economy is to meet thepresident’s job-creation target. Here’s how RachidMohamed Rachid is looking to pull it off.

By Fatima El-Saadani

By Omar Mohsen

Minister of Trade and Industry Rachid Mohamed Rachid is confident industry can spark a level of growth that will allow the economy to create jobs for everyone entering the labor force through 2025.

It was hard not to groan when the Nazif government announced that Egypt had found the “One True Path” to sustainable economic growth. After all, the nation has been tinkering with economic theories for decades, and each and every one of them was declared the One True Path of its time.

Gamal Abdel Nasser’s nationalization campaign in the 1950s made the state the all-providing patron: from jobs to education, services to subsidies, from the cradle to the grave. While the people were largely happy to be provided for, we all know how that policy turned out. Anwar al-Sadat tried to turn things around with his 1974 Infitah, as the Open Door Policy is better known, easing government economic controls and giving the private sector a new lease on life. Would-be investors, however, quickly discovered that there’s a difference between a country saying it’s open for business and that country having the systems in place that make it possible for free enterprise to function.

Under President Hosni Mubarak’s watch, economic policies have come and gone as frequently as his governments have changed. Understandably preoccupied with national and social security in the 1980s, it wasn’t until after the Gulf War — and the debt forgiveness package he orchestrated in return for joining the coalition that ousted Iraqi troops from Kuwait — that Mubarak ordered his prime ministers to prioritize economic reform packages. Those efforts, often half-hearted on the part of policymakers whose souls were untrained, uninspired or leaning toward economic nationalism, came to a grinding halt at the turn of the last century.

Tourism would lead the economy forward, Cabinet’s Grand Wizards of Economic Progress would declare, only to decide a few quarters later that agriculture was the best route to sustainable growth. Policies prioritizing export-led growth followed, but never won complete support in the halls of power. Maybe attracting new foreign direct investment was the answer? Eventually, the government amended tax laws (without really reforming the system and certainly without cutting taxes), tinkered with the customs regime, set up industrial zones and granted ten-year tax holidays to any foreign investor willing to set up a Popsicle stand. It was all well and good, but investors need something tangible in which to invest. The suggestion that that ‘something’ was petroleum has proven apt, but oil, gas and petrochemicals alone can’t keep GDP growth above 6% — the threshold it must hit if we’re to stand a chance of creating a job for every person who enters the labor force each year.

Enter the 2005 presidential election campaign. After lengthy discussion at the highest levels of the governing National Democratic Party (NDP) — debates led largely by reformers close to Mubarak and his activist son Gamal, the head of the party’s policies committee — the president-as-candidate declared he had found a solution: industry.

Cover Story

Azza Fahmy Goes Global

How a one-time maker of “primitive hippie jewelry” has transformed herself into not just Egypt’s first designer label, but the country’s newest multinational brand, joining the ranks of Orascom Telecom and Oriental Weavers

Competition and Trends

By Mohamed Allouba

Unlike the fumbling efforts of just a few years ago, Cabinet is intent on working out functional mechanisms to deliver on Mubarak's promise of at least 6% annual growth in GDP — and both the home audience and the international community are starting to buy in.

The theory is predicated on the blunt (and unconstitutional) notion that the public sector cannot be the economy's engine of growth. Egypt has cheap, highly skilled labor, abundant raw materials, bargain-basement energy prices and a newfound awareness that quality just might matter — at least to foreign markets. Convince enough local and foreign investors to set up shop here and unemployment might just be controllable. And by churning out globally competitive low- and medium-technology goods for export, policy wonks say, industrial growth could hit 9% per year.

(And, yes, the Constitution still proclaims socialism is the basis of the economy. Would someone please slip an amendment past Parliament this fall?)

Rather than the scattershot approach of yesteryear, all of this is coming amid an industrial development strategy (dubbed "The IDS" by insiders) that Minister of Trade and Industry Rachid Mohamed Rachid and his staff are working overtime to implement. Among the IDS' lynchpins are industrial parks organized under the cluster principle. Not the non-industry-specific 'industrial zones' of Sixth of October or Tenth of Ramadan, which churn out everything from dairy products to household goods, but privately developed clusters specific to the industries that policymakers believe can spark sustainable economic growth.

Among them: car parts, textiles, furniture and leather goods, though officials say they'll authorize the creation of as many zones — in as many industries — as there are private investors willing to run them.

"We've set a 25-year industrial strategy, which was finalized almost 18 months ago, and it made clear that one of the critical areas where we need to do more is the area of industrial zones in Egypt," Rachid said in an exclusive interview with bt last month.

It is, the minister says, all about improving the wheel instead of reinventing it: "We want to establish well-run, modern industrial zones based on clustering bringing many activities of the same type together — an industrial zone where technology and training centers and all the logistical requirements for any specific industry will be made available and managed by specialized private-sector companies."

Gone are blanket tax holidays. Instead, Rachid is handing free land to some investors, even paying startup subsidies to others, all with a view to creating specific geographic zones that group together critical masses of foreign investors, major local companies and the small- to medium-sized Egyptian firms that supply them.

In charge of day-to-day operations is Amr Assal, chairman of the seven-month-old Industrial Development Authority (IDA).

"[The IDA] is setting administrative regulations [for industrial zones] and developing existing industrial zones that have problems with their infrastructure and facilities and need to be developed to attract more investments," explains Assal, who entered government service after founding Assal Engineering. As a member of the board of Al-Farama (as the East Port Said Industrial Zone Development Company is better known), he was also involved in the redevelopment of East Port Said's port into a new industrial estate based on Dubai's Jebel Ali.

The integrated industrial zones are only one part of the IDS, which aims to deliver on President Mubarak's campaign promise to create 4 million jobs and build 1,000 factories by 2012. During the

By Khaled Habib
Industrial Development Authority Chairman Amr Assal says he's going to fix the old industrial zoneswhile at the same time helping create new privately developed industrial clusters. First up: Car parts.

By Courtesy of SETCORE
SETCORE is hoping local suppliers and foreign clients will join them in a new, private-sector-developed textiles cluster in Borg El-Arab Free Zone

By Mohamed Allouba
will other domestic textile makers hop on board?

By Omar Mohsen
Is a white-goods cluster next?

campaign, pundits were raising their eyebrows and wondering how the presidential candidate expected to keep his promise.

“We already have a clear plan to 2012 the 1,000-factories project, each of which will have investments worth more than LE 15 million and employ more than 50 workers,” says Assal, who adds that the strategy envisions 5,000 more factories following in the 19 years afterward.

How realistic is that? Quite, it seems: At a minimum investment of LE 15 million per factory multiplied by a target of 1,000 factories, that’s a net inflow of LE 15 billion in just about six years. Etisalat paid LE 16.7 billion for the right to operate the nation’s third mobile telephone network — that’s about 10 times what its two competitors agreed to pay just a few years before.

Target #1: Integrated Industrial Zones

The IDA has at least three core tasks, and the first one is simple: To get out of the industrial park business.

“For the last 30 years, the government has been responsible for everything,” Assal says. “It would plan, license and market industrial zones. The government is not the best marketing or licensing agency, and that’s part of the reason why there are problems in the existing zones.”

The template Assal plans to follow — a template that has proven successful in Eastern Europe — sees industrial parks as privately run “ecosystems” developed to promote “localized concentrations of industrial specializations” in the words of the IDS — or “industrial clusters” as Rachid and Assal call them.

The logic is simple: When you buy a home, proximity to services — a supermarket, hospital, bank, good schools — is a key factor in your decision. Similar calculations factor into where you build a factory. Companies in existing industrial or free zones may have benefited from custom-free inputs (free zones) and tax breaks (industrial zones), among other perks, but they lacked vertical and horizontal integration with industrial activities.

The first industrial cluster is already materializing in Borg El-Arab Free Zone, an industrial zone west of Alexandria. Cotton yarn exporter SETCORE started its 65,000-square-meter factory there three years ago. Today, it is working with the government to set up an industrial cluster that it plans to market as an investment destination for foreign investors.

“Our customers — who are mainly in Europe — started coming to Egypt to visit our factories, and they liked the quality and standards of what they saw and wanted to invest in setting up their own factories here,” says Tamer Nassar, SETCORE executive vice chairman. “An industrial cluster is a group of businesses that are interrelated somehow through the supply chain to help support each other and produce a product at the end that uses different inputs.”

Nassar says it would be ideal to have his cotton yarn consumers weaving cloth in factories across the street in Borg El-Arab rather than across the Mediterranean in Italy. The chain could go on, he says, to include the cloth weavers dyeing their output in a Borg El-Arab dyeing house, then selling it to garments manufacturers operating in the zone — effectively walking up the value chain until, eventually, the entire garment is produced in Egypt.

The SECTORE executive says Rachid’s ministry has proven exceptionally supportive as they’ve worked together to get the cluster off the ground.

“Because textile factories need huge amounts of space, land has been dedicated for [textile producers], which allows us to set up private free-zone companies within the public free zone,” he says. “The Borg El-Arab municipality provides us with the basic services, and we get the benefit of being a free-zone company that doesn’t pay customs, for example, and we’re on our own property.”

For the first time, according to Nassar, the government is working with investors to both formulate the best strategies and offer concrete assistance. It’s a fresh new attitude compared with the top-down, directive strategies of another era. Among the areas in which the state is most prepared to help is workforce training, where Nassar says he expects the Ministry of Trade and Industry will help establish a training facility to ensure workers in the cluster are fully up-to-date with modern technologies and techniques.

Target #2: Job Creation

When Nasser embarked on his nationalization project, the government became the sole employer in a country with a population of 20 million. By Sadat's time, the crippled private sector was suddenly expected to help create enough jobs to support a population of 34 million people. Mubarak's family-planning campaigns have curbed population growth in recent years, but there are now an estimated 78.9 million Egyptians (as of July 2006), 62.9% falling squarely in the 15–64 (ie employment) age range.

Is it any wonder that unemployment now stands at over 10%?

Today, Egypt's workforce is approximately 20 million strong, with half of them working in services, 32% in agriculture and only 17% in industry. Mubarak has pledged to expand the workforce to 40 million over the next 20 years by creating 1 million new jobs per annum.

"[Egypt's] capacity to create jobs right now is at 350,000 to 400,000 jobs per year, of which 150,000 are in the public sector and 200,000 are in the private sector," says Helmy Abouleish, executive director of the Ministry of Trade and Industry's Industrial Modernization Center (IMC) and one of the masterminds of the IDS.

That means policymakers have to find a way of creating another 600,000 to 650,000 jobs each year, and the burden will fall squarely on the private sector.

"What in the private sector will be able to sustain a 5-6% growth of the job market for the next 20 years, keeping in mind that no country in the world in the last 200 years — basically since the industrial revolution — has done this? It hasn't been achieved, and that's what makes this a huge challenge," Abouleish explains. "We need to clearly define what is going to be the engine of growth."

Two years ago, when the Nazif government's economic gurus started putting their heads together to answer that question, they drew on models in Malaysia, the Czech Republic, Slovenia and Poland — nations in which 30-40% of the labor force works in industry.

The engine of growth, they decided, was industry.

Target #3: GDP Growth

Policymakers have tried tapping everything from agriculture and construction to tourism and petroleum in bids to push the economy past the (official) 3% growth rate at which it had been stuck for years. While those remain important sectors, each lacks the potential to help the economy hit growth rates of 6% or more.

"Eastern European countries turned themselves into the continent's factory 15 years ago when they abandoned their communist ideology and opted for capitalism," says Abouleish, pointing to examples in the Czech Republic and Poland. "Now they are benefiting from a strong economy."

That's right, folks, it's time to bring in the smokestacks: According to figures outlined in the IDS, industrial output currently accounts for less than 17% of Egypt's gross domestic product, while exports of manufactured goods comprise 3% of GDP and 11% of total current account receipts. That's far below the sector's potential — and even further below Eastern European benchmarks.

The IDS is aiming to push industrial production from LE 92 billion in 2005 to LE 728 billion by 2025, thereby increasing industry's share of the GDP to 22.6% from today's 17.1%. To do so, Egypt will have to lure billions in new investment every year — LE 229 billion by 2025 compared with just LE 12 billion last year, to be precise. That means more than doubling industry's share of total investment to 33.8% in two decades' time from 14% in 2005.

"The strategy basically says that if Egypt wants to be a globally competitive player and to export its products to compete with the best companies and countries in the world — whether they're from China or India — it has to change," says Abouleish. "It has to grow and become more dynamic and more competitive."

Industrial production needs to grow at an average of 9% per year to become the driving force behind the economy, which the latest government figures show is growing at 6%. "For that, we need short-, medium- and long-term action to start today," says Abouleish.

In a country where more than 20% of the population lives below the poverty line, as Minister of Investment Mahmoud Mohieldin told bt in June, the local market cannot be expected to create demand sufficient to send industrialists running to their factories to ramp up production. Instead, Egypt will have to penetrate new markets in Europe, Asia and the Americas — and attract industrialists from those areas to Egypt's shores with new value propositions.

Among the country's selling points: a location that grants cheap and easy access to key markets including Europe, the Middle East, Africa and Central Asia; vast and relatively cheap sources of energy and raw materials; a cheap, potentially world-class labor force; low taxes and an investment-friendly environment.

"If we compare the costs of raw material, labor and energy between China and Egypt, we'll find that raw materials are an international commodity with one market price, energy costs are the same — if not lower — in Egypt as they are in China, and labor in Egypt is cheaper than China," says Abouleish. "So theoretically, Egypt is more competitive than China."

Two things Egypt lacks, however: efficiency and productivity.

"China is three or four times more productive than Egypt," he says. Enhancing productivity and efficiency will be rough in many areas of a largely complacent labor force.

"Increasing efficiency is always linked to reducing manpower," says Abouleish. Introducing new technologies will eventually make some labor redundant, but the key is doing it in a manner that will ultimately create jobs.

"Either our markets grow 10% and our efficiency 5% so we can still create jobs, or our 'efficiency' will mean laying off people. If we are able to transform from export-led growth to efficiency-led growth, we will still achieve economic growth."

Then comes the really hard part: Nurturing innovation and creativity, which Abouleish says will be backed by a long-term strategy based on cooperation between industry, universities and research centers to develop curricula and harmonize the needs of industry and research.

A One-Stop Shop

Egypt naturally has plenty of raw materials, labor and energy to offer investors, but it also has an abundance of red tape in which to trap them. The Cabinet — like its predecessors — claims that it understands the problem and is taking steps to streamline the paperwork. This time around, investors say change is actually starting to happen.

Assal admits that Nasser's 1954 industry law doesn't serve the purposes of a country aiming for unprecedented growth, but says there are no plans to change it just yet.

"A significant amount of the processes can be changed by decrees issued by the IDA or the Cabinet," Assal says. "Right now, we are trying to work out the obstacles in the regulations and paperwork until the law is changed. The feedback for the amendment of the industrial law will definitely come from the IDA and other authorities involved in Egypt's industrial policy."

Ultimately, Assal says he would like to be able to offer each investor exactly what he or she wants: a fast and easy way to complete the paperwork necessary to start a business in Egypt — a One-Stop Shop, which the IDA chief is looking to station out in the governorates. But eliminating almost 170 signatures needed for a license is no simple task.

"We are trying to cut the number of authorities that an investor has to deal with and trying to unify the licensing process across the country instead of having different regulations for each governorate," Assal says. "It will also be time-saving for us and the investors to delegate licensing authorities to each governorate."

Rachid clearly approves of the model, which his ministry is implementing in concert with the General Authority for Investment and Free Zones, which opened last year a general services One-Stop Shop (it's literally called that) on Heliopolis' Salah Salem Street. Rachid's One-Stop Shop is being designed with the unique needs of industrial investors in mind.

"The IDA is working to create the One-Stop Shop, which will dramatically reduce the time it takes to establish a company and acquire land," the minister says. "We also issued legislation last year to simplify all the procedures involved in import and export, and now — less than nine months after the first set of legislation was passed — we are reviewing another set of simplifications to these procedures."

"We are aware that we have an ongoing struggle against bureaucracy," the minister notes, "but we will win it."

Driving in cars with investors

Policymakers admit that Egypt will ultimately prove only as competitive as its labor force is skilled — a significant hurdle to overcome when you consider that a majority of the nation's laborers lack the skills demanded by local and foreign investors alike, particularly in medium- and high-technology industries.

With that in mind, Abouleish says, the ministry is prepared to support an independent, private-sector-driven Industrial Training Council (ITC) to support businesses with outsourced training programs that meet the needs of individual industries — and even specific companies.

In the short term, the program's goal is to "directly upgrade the skills of the current and immediate entrants to the industrial labor force through targeted training activities" when asked to do so by businesses.

In the medium term, the ITC will shift the country's overall skill structure towards medium- and high-skilled labor by engaging in new industrial niches. Its long-term goal: innovation, which will demand tight integration between the economy's needs and the fundamentals of Egypt's education system.

"Europe and the US are competitive not because of their cheap manpower or energy," says Abouleish. "Their value added comes from innovation, creativity and the introduction of new products and services."

When Rachid first came into office in 2004, he gave his staff the assignment of identifying new industries the country should develop. While Egypt was doing well in textiles and food processing, it was time to think outside the box, he said.

After examining success stories from Malaysia and China, his top policy wonks identified the automotive parts industry as a solid prospect.

Ahmed Abdel Wahab, chairman of Traxx, an auto-parts manufacturer that is now helping lay the groundwork for an automotive parts industrial park, notes that the sector demands labor with low-, medium- and high-tech skills, meaning you can start at one end of the value chain and work your way up.

"We don't have to target [the high-tech] end of the industry. We can work on the medium-technology end and we can perform very well," he says. "Management is key: If you manage [your] workforce well, then you can get what you want from them."

Egypt has recently become an attractive location for carmakers including Nissan, which has begun manufacturing here and which already hosts several car-parts producers that are targeting export markets with the bulk of their output.

Among them: Abdel Wahab's Traxx, which sells two-thirds of all the brake pads it makes to Europe and other export markets.

"The location of the park has not been specified yet," Abdel Wahab says, "but we've presented the idea to some investors who have shown interest in coming to invest in Egypt."

The park will officially launch in November with the target of attracting 20 investors within the first year.

The next best thing

The strategy has been set and the promotional efforts have begun, but there's no way to predict how successful it will prove until the new investors that Rachid and company are setting out to net actually start producing.

From government officials to industry boosters, everyone admits that investors want something more tangible than incentives.

"Investors would really like to come to a country that has a clear vision of what it wants to do with an industry, because incentives are not good enough on their own," says Abdel Wahab.

What is significant, he says, is that this is the first time in recent memory — probably since Nasser — that an Egyptian government is laying out a clear, long-term vision of the direction in which it wants the economy to move.

Another concern international investors have voiced to Abdel Wahab — besides the bureaucracy — is conflict resolution. “Most investors are using arbitration for conflict resolution — they’re going outside the Egyptian legal system,” the Traxx chairman explains. “But there really needs to be a long-term solution for conflict resolution.”

(Only time will tell whether the long-awaited commercial courts will provide that solution — see related story starting on page 46.)