Investment Climate: Lessons and Challenges

Nicholas Stern

Distinguished Lecture Series 19

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Foreword

Not many people dispute the notion that investment is crucial to economic growth and prosperity, and that a favorable investment climate is essential for the promotion of entrepreneurial dynamism. There is no consensus, however, about what constitutes an investment climate and the best way to convince policymakers of taking the necessary measures to improve it. In this distinguished lecture, Mr. Nicholas Stern provides a convincing answer to both questions.

Stern starts his analysis with a broad framework for development, which places equal emphasis on investment and the empowerment of the poor. His discussion of the investment climate – under macroeconomic stability, infrastructure, and governance/institutions – is founded on hard evidence drawn from firm-level surveys conducted in developing countries. The emphasis on hard evidence is not accidental. Rather, it reflects the view that the collection and dissemination of such evidence is a powerful tool for bringing about improvements in the investment climate.

Stern's presentation, which was organized by ECES and the American Chamber of Commerce in Egypt, stimulated a lively discussion. While most participants agreed with his broad conclusions, they raised several concerns. For example, some participants questioned the value of focusing on SMEs, noting that SMEs cannot serve as an engine of growth. Others wondered whether political and economic reforms need to be undertaken in tandem. Yet others sought explanations about how to introduce certain reforms, most notably in the area of civil service. I have no doubt that the reader will find both the paper and subsequent discussion most informative, especially in terms of identifying the measures needed to improve the investment climate in Egypt.

Ahmed Galal
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March 2003

ABOUT THE SPEAKER

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Chief Economist and Senior Vice President, Development Economics, the World Bank

Nicholas Stern has been the World Bank Chief Economist and Senior Vice President, Development Economics since July 2000. From 1994 to late 1999, he was Chief Economist and Special Counselor to the President at the European Bank for Reconstruction and Development

While having extensively served as an economic advisor to businesses, governments and international institutions, Dr. Stern has also held a number of positions in academia, including visiting scholar or professor at the Massachusetts Institute of Technology, the Ecole Polytechnique in Paris, the Indian Statistical Institute in Bangalore and Delhi, and the People's University of China in Beijing, where he is an Honorary Professor.

Dr. Stern earned his BA from Cambridge University and his doctorate from Oxford. In 1987 he was selected Chairman of the Suntory-Toyota Centre for Economics and Related Disciplines at the London School of Economics (LSE), and was appointed the Sir John Hicks Professor of Economics at LSE, where he returned as School Professor of Economics at the beginning of 2000.

Dr. Stern's research achievements have earned him the highest academic honors. He was elected to a Fellowship of the Econometric Society in 1978 (and is currently a Member of Council), to a Fellowship of the British Academy in July 1993, and to a Foreign Honorary Membership of the American Academy of Arts and Sciences in 1998.

PART I

INVESTMENT CLIMATE: LESSONS AND CHALLENGES*

1. The Challenges and the Opportunities

Evidence suggests that improving the investment climate is key to accelerating growth of income and employment in Egypt. Building a better climate for firms to invest, generate jobs and grow is one of the two main pillars of a strategy for development. Before outlining that strategy and discussing why improvements in the investment climate matter and how they can be promoted, the lessons of development experience on which this strategy is based must be examined.

We have lived through a remarkable 25 years. At the end of the 1970s, China emerged from the turmoil of the Cultural Revolution and embarked on the reforms initiated by Deng Xiaoping. As a result, more than a billion people, one-fifth of the population of this planet, have seen a sustained period of growth and poverty reduction that has been unique in human history. At the end of the 1980s, four hundred million people of Central Europe and the former Soviet Union also set off on a remarkable transition from a command economy to a market economy. There have been both achievements and trauma, but the changes are irreversible and many countries are now being welcomed into the European Union. More quietly in the early 1990s, India initiated a process of economic change and is now seeing growth and poverty reduction which few would have thought possible 20 years ago.

Remarkable too has been the overall improvement in living standards in the last few decades. In the past 40 years, life expectancy in developing countries has increased from the mid-40s to

* This paper is based on earlier lectures (Stern 2002a,b) and has drawn on various World Bank reports on Egypt and World Bank investment climate assessments. The author would like to thank Caralee McLiesh for her contribution to the development and preparation of this speech, and Shahrokh Fardoust, Mahmood Ayub, Mustapha Nabli, Arup Banerji, Ahmed Galal, Michael Klein, Genevieve Boyreau-Debray, Jean-Jacques Dethier, Timothy Irwin, Joyce Msuya, Priya Mathur, Richard Newfarmer, Shaha Riza, and Warrick Smith for their inputs, comments and contributions to the development of this paper.

the mid-60s. In the developing world, the share of people who are illiterate has declined in the past 30 years from around one-half to around one-quarter, with particularly strong progress for females. In the last 20 years, the absolute number of people living less than $1 a day has decreased by around 200 million people, the first sustained decrease since the early 19th century. This decrease has occurred at a time when the population of the developing world rose by 1.5 billion.

However, this progress has not been shared universally. While child mortality for children under the age of 5 in developed countries is 7 deaths per 1,000 children per year, the average in developing countries is 84 deaths per 1000, and in sub-Saharan Africa it is a shocking 162 deaths per 1000. Half of all women over the age of 15 in both South Asia and sub-Saharan Africa are illiterate. Over one billion people in low and middle-income countries lack access to safe drinking water.

Reaching those left behind presents many challenges, including overcoming disillusionment in many countries where growth has failed despite undertaking difficult reforms. Although average tariffs have been cut by half in developing countries over the last decade, and inflation has been largely brought under control with average rates now in single figures, many countries in Latin America and sub-Saharan Africa have not seen the results in terms of growth and poverty reduction.

There is also the real possibility of a retreat into protectionism in developed countries. When the challenge should be to dismantle obstacles to developing-country trade, rich countries are subsidizing their agriculture with over $300 billion per year: a figure that is 6 times the total amount of development assistance from OECD countries. These subsidies, along with protectionist anti-dumping actions and bureaucratic applications of safety and sanitation standards, block developing-country agricultural exports at an enormous cost to farm incomes in poor countries. This protectionism goes far beyond agriculture, with deeply damaging effects, especially in textiles. While preaching trade, the rich countries have erected obstacles precisely in those areas where poor countries have a comparative advantage.

While we should not be under any illusions about the magnitude of the challenge, I believe, however, that we now face a special opportunity. Building on the optimism and good intentions of a new millennium, an extraordinary international commitment to promoting development and fighting poverty has been created. This has been crystallized in the Millennium Development Goals (MDGs) adopted at the UN at the end of 1999. These goals represent specific targets for improvements in income poverty, health, education, the status of women and girls, the environment, and international development cooperation for the period from 1990–2015. In *Doha* in November of 2001 the international community committed to a new round of WTO trade negotiations, and for the first time placed the interests of developing countries at the top of the agenda. In *Monterrey* in 2002, the international community reaffirmed its commitment to the MDGs. Developing countries committed to making improvements in governance, institutions, and policies, and rich countries committed to increasing aid, opening to trade, and supporting capacity building. The *Johannesburg* meetings in August of 2002 looked further ahead to address the challenges of achieving sustainable development and protecting the environment. Taken together with past achievements, and what we have learned about development policy, these commitments put us in a uniquely strong position to take action to achieve the Millennium Development Goals. But with this comes a deep risk of failure that could cause lasting, and possibly irrevocable damage.

These global challenges and opportunities are felt strongly in the Middle East and North Africa (MENA) region and in Egypt. The current challenges and opportunities include:[1]

- Rapid *demographic change*, driven by past high fertility rates, has created a need for over 600,000 new jobs annually as young people enter the workforce. Between 1997-99, even with the rapid economic growth, only about 500,000 jobs were created annually. With existing structures it is estimated that growth would need to rise to 7 percent to generate the required employment opportunities for new entrants; yet, current forecasts are for 5

[1] These challenges and opportunities are presented in further detail in the World Bank (2001a,b) and World Bank and Government of Egypt (2002).

percent and could be considerably lower in case of new exogenous shocks, such as possible military action on Iraq.

- *Bridging the gender gap,* an important component in the current Five-Year Plan, continues to remain a challenge. Female illiteracy rates (56 percent) are significantly higher than for men (33 percent), and female unemployment is 2–3 times that for men. Agriculture and the public sector are important sources of employment for women, so integrating gender considerations into any reforms of these sectors is important.

- A fragile *environment,* with acute water scarcity and declining water quality, increasing pollution and land degradation. Development is inextricably linked to the Nile River, where industry and the population are concentrated. Protecting the Nile and Egypt's other natural resources from the burden of social and economic development is vital for sustainable growth.

- *Growth* throughout the 1990s averaged 4.9 percent between 1991–2000, which is well above the MENA and lower-middle income country average. Growth was spurred by structural reforms and facilitated by macroeconomic stability – in particular, the successful reduction of inflation. However, it is uncertain whether the momentum of growth can be sustained, since it was driven by domestic rather than foreign demand and by accumulation of labor and capital rather than by productivity growth. Performance on merchandise exports has declined, and FDI is low at around 1 percent of GDP; indeed, Egypt's share of FDI has fallen at a time when overall FDI flows have increased dramatically.[2]

- *A transition* is needed toward a more market-based economy with an increasing role for the private sector. In the mid-1990s, over $4 billion worth of public enterprises were

[2] Countries in North Africa received an average of 2.6 percent GDP in FDI flows. World Bank (2001b).

privatized. The public sector now accounts for 25–30 percent of GDP, still on the high side but down from around 40 percent in the early 1990s, although the state still plays a dominant role in some sectors such as banking.

- *Declining poverty rates*[3] for the first time since the 1980s, to less than 17 percent of the population (10.7 million people) by the year 2000, as well as progress in non-income dimensions of poverty offer hope. But the progress was not shared equally across regions – with poverty in the metropolitan and Lower Egypt falling to low levels, while poverty in Upper Egypt remained high and increased. Moreover, part of the reason for the fall in poverty in the 1990s was the creation of jobs from the growth in construction and import-substituting industries, which has now slowed down.

- Egypt also has *great strengths* that are a foundation for spurring further growth and reducing poverty. It has a large domestic market with rising purchasing power, has one of the fastest growing information technology markets in the world (at 35 percent annually), a relatively low-cost labor force, and proven natural gas reserves of over double domestic consumption. Its geographical position offers proximity to large markets in the EU and MENA region and it owns a controls a key transport facility – the Suez Canal. And its exceptional *cultural* heritage provide incomparable attractions for visitors.

How can these opportunities be seized and challenges met? This paper presents a strategy for development based development experience. The strategy is founded on two pillars: creating a good investment climate for dynamic growth to take place; and empowering and investing in poor people to participate in the growth process. The first pillar - investment climate - is a central issue in Egypt today. To meet the challenges of sustaining growth and generating employment

[3] Poverty rates were constructed on a cost-of-basic-needs method (absolute poverty line) resulting in a household-specific poverty line based on food and non-food consumption. Using the internationally comparable $2 per day line, poverty rates were 19.4 percent, which is relatively low by international standards – e.g. Ecuador 52 percent; Thailand 28 percent; Turkey 18 percent; Jordan 7 percent. See World Bank and Government of Egypt (2002) for details.

opportunities, the substantial progress made in macroeconomic and structural reforms would need to be accompanied by corresponding progress in deeper institutional and governance reforms that encourage entrepreneurs to invest, grow and create jobs. Therefore, this paper focuses on what we have learned from our work on the investment climate and offers some of our ideas, building on broad lessons of development experience, as well as more detailed evidence from developing countries. Also, an attempt has been made to relate these ideas to the challenges that lie ahead for Egypt.

2. Lessons from Development Experience

My focus on the two pillars of investment climate and empowerment is based on my reading of development experience over the past 50 years. Development is about fundamental change in economic structures, the movement of resources out of agriculture to services and industry, about migration to cities and peri-urban areas, and about transformations in trade and technology. Changes to social life – in health and life expectancy, in education and literacy, in population size and structure, in gender relations, and in social relations – are at the heart of the story. The challenge to policy is to help release and guide these forces of change. In characterizing what we have learned from development experience, seven key lessons are outlined in a way that can help to inform effective development strategy.

The first lesson concerns the *role of the state*. The state is not a substitute for the market, but a critical complement. We have learned that markets need government and government needs markets; and that government action is crucial to the ability of people to participate effectively in economic opportunity. These lessons point to an active state that fosters an environment where markets can function, contracts are enforced, basic infrastructure works, and there is provision for adequate health, education and social protection.

The second lesson is that the most powerful force for the reduction of income poverty is *economic growth*. Countries that have reduced income poverty the most effectively are those that

have grown the fastest, and poverty has expanded most in countries that have stagnated or declined economically.

Third, notwithstanding the importance of an active state, the most powerful force for sustained economic growth is the *private sector*. Within the private sector, small and medium-sized enterprises (SMEs) play a particularly important role in generating employment opportunities for poor people.

The fourth lesson is that *trade* has been a crucial engine of growth. Trade patterns have changed dramatically since the 1970s, when trade with developing countries was still dominated by commodity exports. The shift away from import substituting strategies in many countries, which was particularly strong in China's opening to the world, has led to a surge in labor-intensive manufactures, which now dominate aggregate trade flows for the more rapidly growing developing countries.

Fifth, we have learned that changing *institutions and governance* is at the heart of these processes that generate growth. Weak institutions and poor governance can cause market reforms to go badly awry, with great costs, particularly for the poor. Aid is most effective in countries where institutions support market development and governance is strong.

A sixth and highly important lesson is that development activities function much more effectively if poor people are *empowered*. We can define an individual as being empowered if she or he has the ability to shape the basic elements of her or his own life. This requires that both women and men be educated and healthy, in other words they need what economists call human capital. But empowerment goes beyond human capital. It also means effective participation, which depends in turn on information, accountability, and the quality of local organizations. We have seen this in examples across the developing world, from communities running schools in El Salvador with the EDUCO program, to community driven resource management and irrigation investment in Egypt. Through such activities we have also learned that the involvement of

women is particularly important for the functioning of virtually every sector of activity, from agricultural production, to education, to credit, to fighting corruption.[4]

The seventh and final lesson is that reform programs imposed from outside, without local commitment, are likely to fail. *Ownership* of the development agenda by a country and society is a vital ingredient for its effective implementation.

3. A Development Strategy

A strategy for development that emerges from examining these lessons of experience is that development is about fundamental processes of change. The strategy that I propose is in essence a strategy for 'pro-poor growth', for lack of a better term. It is based on two pillars, both of which embody the idea of an active state complementary to markets.

- The first pillar is to *create a good investment climate*—one that encourages firms, both small and large, to invest, create jobs, and increase productivity. A good investment climate has three broad components: a stable macroeconomic environment; adequate infrastructure; and good governance and institutions. The foundations for this pillar emerge from the lessons I mentioned earlier on the role of growth, of the private sector, of trade and of institutions.

I would like to emphasize at the outset that in speaking of the investment climate I am thinking first of small and medium size enterprises (SMEs). And the most important small enterprise in most developing countries is the farm. SMEs suffer most from a weak investment climate and they are the main source of employment for poor people. Measures to improve the investment climate for SMEs are also likely to improve the investment climate for bigger and foreign firms which also, of course, have an important role to play in growth and employment opportunities.

[4] See World Bank (2001c) for evidence on women and development.

- The second pillar is to *empower and invest in poor people* – by enabling their access to health, education, and social protection, and by fostering mechanisms for participating in the decisions that affect their lives. This is based on the lessons on the relationship between development effectiveness and social inclusion and ownership of reform

These underlying processes are intertwined and mutually reinforcing. Growth generated by improvements in the investment climate is empowering: and if poor people are empowered, they contribute strongly to the process of growth.

Although my focus is primarily on the investment climate, empowerment is of equal and complementary importance. The MENA region as a whole has not done especially well in empowerment. The 2002 Arab Human Development Report describes three 'deficits' in the MENA region that are core to the empowerment agenda: the freedom deficit; the human capabilities/knowledge deficit; and the women's empowerment deficit. Measures of participation of people in the decisions and processes that shape their lives are low in the MENA region relative to other parts of the developing world. And despite relatively high levels of investment in human capital for some parts of the population, health and in particular education outcomes for the population as a whole are low relative to other regional benchmarks, taking into account income (Table 1).[5]

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[5] Galal (2002) writes that in Egypt "big spending on education is often associated with small returns," and points to a skills mismatch in labor supply and demand.

Table 1: Education Indicators: Egypt and Regional Comparisons

Country/Region	GNI per capita	Male Illiteracy	Female Illiteracy	Enrollment ratio (tertiary)
Egypt	1490	33	56	39
East Asia & Pacific	1060	8	21	8.8
Europe & Central Asia	2010	2	5	45.4
Latin America and Caribbean	3670	11	13	22.1
Middle East and North Africa	2090	25	46	22
South Asia	440	34	57	6.5
Sub-Saharan Africa	470	30	47	3.6

Source: World Bank (2003) *World Development Indicators*.

Gender disparities are of particular concern. A lack of opportunity incurs great costs not only for the lives and livelihoods of individual women, but also hurts economic opportunity for everyone. According to one study, annual per capita income growth rates in South Asia, sub-Saharan Africa and MENA would have been 0.5 percent to 0.9 percent higher between 1960 and 1962, had these regions followed the same trend in gender gaps in education as in East Asia.[6] We have seen countless examples of women's entrepreneurial activities being a source of creativity, productivity improvement and new job generation for people across the world. In Egypt, successful micro finance programs for women and innovative programs such as ensuring women have identity cards and citizenship have helped them to participate in the workforce and create new opportunities for others. These efforts deepen our understanding of gender and empowerment and in themselves will have a profound effect on growth.

4. The Central Importance of the Investment Climate for Growth and Employment Opportunities

The strategy proposed here is centered on the investment climate and empowerment. We define "investment climate" as the policy, institutional, and behavioral environment, both present and expected, that influences how entrepreneurs perceive returns and risks associated with

[6] Klasen (1999).

investment. This includes not only the quantity of investment but also of the productivity of investment and economic activity.

Entrepreneurship

In stressing the investment climate, my focus is on the obstacles to entrepreneurship, particularly those obstacles associated with governance and institutions. Too often, we see societies that have stagnated in low-level equilibria because of a lack of opportunities or incentives for investment. The government may protect the interests of those with accumulated wealth of the past - large landed property or established large businesses, for example. In some countries, it has acted as the "employer of last resort." We have seen this in MENA, particularly for college graduates. But unless the government takes steps to encourage entrepreneurial investment in the private sector, or at a minimum to avoid stifling such investment, strong growth and poverty reduction are unlikely to ensue.

Consider the example of countries in MENA region, which suffered the paradox of high investment in physical capital juxtaposed with stagnation in the 1980s and 1990s. With the exception of Egypt, countries in the MENA region witnessed a 0.8 percent annual decline in their GDP per capita in the 1980s, which increased by only 1.1 percent per year in the 1990s. Yet rates of investment in physical capital in the area have been impressively high. One of the primary reasons that such high rates of investment generated so little additional output is that the institutional structure of the labor market has systematically misallocated labor. High government wages attracted the most qualified personnel to the public sector. And measures designed to protect existing employment have made it difficult for entrepreneurs to start and sustain dynamic businesses. Egypt has been somewhat more successful – achieving macroeconomic stability and making gradual progress in privatization and structural reform. It has seen the benefits in terms of better growth performance, although many constraints still restrict entrepreneurial activity. Privatization is focused on the transformation of the old. The investment climate is focused on conditions for birth and growth of new initiatives.

In taking this view on the importance of entrepreneurship for growth, I have been influenced strongly by my work in developing and transition countries. Of particular importance in shaping my outlook have been China and India – two countries with which I have been most involved personally in my research and policy work as a development economist. In both countries the release of constraints on entrepreneurship has produced a powerful response in terms of growth and poverty reduction. Since China launched its reforms 25 years ago, it has lived through the single most important episode of poverty reduction in history. My work in India, including the close study of one Indian village over several decades, with Christopher Bliss, Jean Dreze, Peter Lanjouw and others, has made me well aware of India's long-standing barriers to entrepreneurship.[7] Yet India's reforms, particularly since 1991, have begun to dismantle what has been called the Permit Raj, and have thereby engendered a strong growth response.

During my 6 years at the European Bank for Reconstruction and Development (EBRD) in the 1990s, I saw entrepreneurship stir in the former Soviet Union after seven decades of suppression – and then saw failings in governance divert much of that entrepreneurial energy in destructive directions. In my first applied project in Africa in the 1960s, which focused on tea farming, I witnessed the powerful entrepreneurship of smallholders (most of them women) in the highlands of Kenya, who were supported by public-sector investments in infrastructure and agricultural extension.

There is also a growing body of evidence that states that entrepreneurial activity plays a direct and important role poverty reduction. Studies of household data in several countries have shown that private entrepreneurial activity is a primary determinant of upward income mobility of poor people.[8] In Vietnam, for example, households that operated enterprises were more likely to make advances in living standards.[9] Empirical studies in the US also show that small scale

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[7] Lanjouw and Stern (1998).

[8] Fields and others (forthcoming).

[9] Vijverberg and Haughton (2002).

entrepreneurial activities are a path out of poverty, a finding confirmed by poor people across developing countries who participated in the World Bank's *Voices of the Poor* study.[10]

These experiences, and the emerging evidence, have convinced me that entrepreneurship is, or can be, the central creative economic force in all countries. Sometimes that force is expressed positively, sometimes it is latent, and sometimes it is misdirected into rent-seeking and crime. Our goal should be to support policy change that creates conditions where entrepreneurship is constructive and dynamic.

Firms

To focus on entrepreneurship is to focus on private firms. Private enterprise is not only the main engine of aggregate growth, but is also the main provider of economic opportunity and activity for poor people. Of the 1.2 billion people in the world who live on less than $1 a day, only a small fraction work in the public sector. In Egypt, fewer than one-in-eight poor people have income from public employment, whereas one-in-four non-poor have work in the public sector (Table 2). Private-sector growth is vital to the reduction of poverty.

Table 2: Sector of Employment of Individuals by Poverty Status

Sector	Non-poor	Poor
Government	25.16	12.01
Private	69.44	85.93
Formal	35.98	17.44
Informal	64.02	82.56
Agriculture	36.02	56.56
Manufacturing	11.09	7.58

Source: World Bank/Government of Egypt (2002)

As previously noted, in focusing on the investment climate and the private sector, we think first of the climate for SMEs, which are both an important source of employment for poor people and a source of creativity and innovation. Larger firms might result from successful innovation and growth in the past, but then the tendency is to "rest on one's laurels" and to only seek innovations that will sustain one's position. Smaller firms in a more competitive environment

[10] Holtz-Eakin, Rosen and Weathers (2000); Narayan, (2000).

have less to lose by pursuing real innovation that might disrupt the old ways of doing things. Moreover, their innovative ideas tend to be more "out in the open" supplying a positive externality to competing firms. Small firms also give a breadth and depth to public voice, which is very important for the development of democratic processes and governance. SMEs can thus be dynamic agents of change in the economy, exerting pressure on larger firms and governments alike for change. SMEs are the foundation of the private sector in Egypt as well – enterprises with less than 10 workers are estimated to contribute 80 percent of private sector value added and account for 75 percent of employment.

For very many, SMEs provide the first route out of poverty. In rural areas, off-farm SME employment can play a vital role in income growth and stability.[11] In China, for example, the development of township and village enterprises fuelled remarkable poverty reduction as more rural labor shifted toward the non-farm economy. In India, although off-farm employment has played a smaller role in poverty reduction, our survey research shows that about one-third of rural households' income comes from non-farm sources, much of it from micro, small, or medium-sized firms. These incomes come from a variety of sectors, including commerce, manufacturing and services, and they stem from regular and part-time wage employment, as well as self-employment.

Village studies reveal that rural households highly value such non-farm incomes, not only because they contribute significantly to overall income levels, but also because by spreading risk across different activities they can reduce the exposure of households to potentially devastating income fluctuations associated with bad harvests. A strong investment climate, then, is central to encouraging off-farm SME employment that can lead to higher incomes for poor people as well as diversification of economic risks.

Off-farm rural employment in SMEs is also a crucial issue in Egypt. In Upper Egypt, the region with the highest poverty rates, the share of employment in non-agricultural rural activities is 37 percent, significantly lower than the rate in wealthier Lower Egypt (47 percent).

[11] See Lanjouw and Lanjouw (2001).

Employment growth in the manufacturing sector seemed confined to Lower Egypt, and this growth was almost entirely due to accelerating manufacturing employment in rural areas. Given the higher levels of productivity in manufacturing, it is very likely that this off-farm rural employment growth contributed significantly to the sharp fall in poverty rates among these workers.[12] While there are no regional studies yet for Egypt, the contribution of off-farm activities to income of poor people may be very significant: One study for Egypt in the late 1990s showed that the poorest 20 percent of the population received 60 percent of their income from non-farm sources.[13]

Although they are crucial to development, in many developing and transition countries, the SME sector has languished. A weak investment climate hits SMEs harder then other firms, reducing the dynamism of this sector and obscuring its potentially powerful role.[14] This effect is particularly large in poorer countries – possibly a result of greater government harassment, and less political organization of small businesses.[15] And let me stress again, an improvement in the climate for SMEs will usually bring such an improvement for large and foreign firms, and they too have a major role to play in development.

In emphasizing the role of SMEs in development the aim is not to target some idealized notion of an optimal size small firm. Applied indiscriminately, pro-SME policies can have the unintended consequence of encouraging small firms to remain small and large firms to fragment. In many developing countries we see a “missing middle” in firms – with a proliferation of very small, unproductive firms that do not grow, and larger (sometimes state-owned or controlled) enterprises, but very few middle-sized firms.[16] Often this is a symptom of barriers to growth; an investment climate in which it is more efficient for firms to remain very small and informal and escape bureaucratic harassment. Evidence of this phenomenon comes from firm-level surveys in

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[12] World Bank and Government of Egypt (2002).

[13] Adams, Jr. R. (2001).

[14] Schiffer and Weder (2001); Beck, Demirgüç-Kunt and Vojislav Maksimovic (2002).

[15] Brunetti, Kisunko and Weder, (1999).

[16] See, for example Tybout, (2000).

Russia,[17] and Hernando de Soto has argued eloquently that this is a characteristic of many developing economies.[18] Studies by the Institute for Liberty and Democracy (ILD) directed by de Soto together with the ECES indicate how aspects of the legal and institutional environment here in Egypt discourage small informal business from joining the formal sector and growing.[19] In transition countries, the missing middle is also a result of the dominant role of large state-owned enterprises. By encouraging SMEs, I mean creating a climate that encourages informal firms to become formal, new SMEs to enter the market and place competitive pressure on incumbents, and existing SMEs to become more productive, create more jobs and grow into larger firms.

The dynamics of the birth, growth and death of firms, in which SMEs are central, depends heavily on an investment climate that encourages competition and innovation among enterprises.[20] In his grand vision of market-driven development, Joseph Schumpeter used the phrase “creative destruction” to emphasize that birth and death are equal parts of economic life. The creative institutional solution at one stage may become an impediment that needs to be transformed in order to move onto the next stage. This applies at the level of society as a whole as well as the micro level of firms. Encouraging vibrant competition among enterprises by making entry, growth and exit of firms easier is a crucial part of a sound investment climate.

There is growing evidence that shows the large gains from improvements in the investment climate. In India, the states with better investment climates grew over twice as fast as states with poor investment climates; and there is a threefold difference in investment rates between the best and worst state.[21] In China, our research shows that improving regionally weak investment climates to the level of the best regions would increase firm productivity by around 30 percent

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[17] See, for example Broadman, Dutz and Vagliasindi (2002); McMillan and Woodruff (2002).

[18] De Soto (1989).

[19] Egyptian Center for Economic Studies and Institute for Liberty and Democracy (forthcoming).

[20] Klein (2003).

[21] Investment rate is calculated from firm-level data on the growth of fixed assets, controlling for firms’ sector, age and size of initial fixed assets.

and investment rates from 14 percent to 19 percent.[22] Improvements in the investment climate are dynamic processes that generate accelerating and self-reinforcing change; they not only bring static gains but strong and sustained increases in growth rates. As the investment climate improves, the frontier of opportunity expands: existing investment becomes more productive; the incentives for productive behavior (as opposed to predatory or defensive behavior) rise; the "animal spirits" of entrepreneurs are invigorated; the case of those arguing for improvements in the investment climate is strengthened; the effects on investment climate and investment reinforce each other; and the economy generates more and more productive investment. The success of entrepreneurship and investment show other investors what is possible, broadening the constituency for further improvements in the investment climate, and sustained growth. Such a "virtuous circle" can be a powerful force for accelerating growth and job creation.

5. Building the Investment Climate: Lessons and Experience

Having argued the importance of improving the investment climate in order to accelerate growth and reduce poverty, we must now ask how can we improve it? Let me elaborate on some of the lessons from empirical investigations and country experience under each of the three broad headings of investment climate: (i) macroeconomic, trade, and economy-wide policies, (ii) infrastructure, and (iii) governance and institutions.

Macroeconomic Environment

Stable macroeconomic conditions – fiscal stability and transparency, low inflation, sound monetary and exchange rate policies – as well as political stability, all support the private sector by promoting clarity, reducing risk and providing sound economic signals. Openness to trade and foreign investment promote competition and incentives for innovation and entrepreneurship.

These macro aspects of the investment climate have been well understood for some time. A large empirical literature shows that good macro conditions accelerate growth, in particular there is strong evidence about the importance of low inflation, low government consumption, and

[22] World Bank (forthcoming[b])

openness to trade and direct foreign investment.[23] And it is well accepted that the slowdown of growth in developing countries after the 1960s and early 1970s stemmed in part from macroeconomic instability, which reduced confidence in government and in its ability to maintain a stable climate for private firms.

Comprehensive macroeconomic reforms and stabilization programs have been pursued in many countries in recent decades including, with considerable success, in Egypt. External and internal balances in Egypt were stable through the late 1990s, and inflation checked to low levels – policies that had a substantial impact in encouraging private investment. Between 1991–2000, the budget deficit fell from 15.2 percent of GDP to 2.6 percent, inflation was reduced from 15 percent to 3 percent and the average current account balance was 1.7 percent of GDP.

Yet macroeconomic issues remain important for Egypt, with some recent pressures emerging on the balance of payments and resulting loss of reserves and currency uncertainties. Among the most difficult macroeconomic challenges of the last few years has been exchange rate policy. Although Egypt's fixed exchange rate was fundamental to the stabilization program through the 1990s, it also led to an appreciation of the real exchange rate by over 50 percent, higher interest rates, loss of reserves, and forced devaluation. Continuation of a more flexible approach to exchange rate management according to market forces, and increased emphasis on sound monetary policy with inflation targets are a central part of a sound macroeconomic framework.[24] Egypt could also improve the predictability of the macroeconomic environment by quickly moving to enhance fiscal transparency. For example, by making government budgets publicly available, entrepreneurs would find it easier to make decisions on investment and production; fiscal transparency would also reduce the possibility of unexpected shocks because of better public monitoring and enhanced accountability.

Many countries in the developing world have also made great progress in increasing openness over the past two decades. Most economies are more open: average tariff levels have

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[23] For example, Fischer (1993), Frankel and Romer (1999) and Dollar and Kraay (2001).

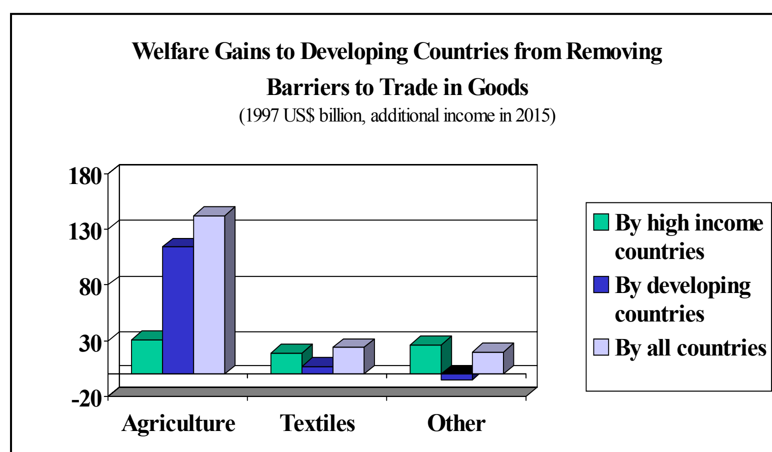
[24] Panizza (2001).

declined sharply in all developing regions since the first half of the 1980s, and the dispersion of tariffs has also narrowed in many countries. The benefits from integration have been very large. Growth rates for recent globalizing countries have generally accelerated rapidly in the 1990s, including in India, Mexico, Uganda and Vietnam. Even in historically closed economies such as China, high growth stemmed in part from increased access to international capital and goods although, I should emphasize *increased* access because overall access remained relatively low. Economic integration has been favorable not only for growth, but also for reducing poverty by creating jobs and reducing consumer prices. Protectionism often leads to missed opportunities for job creation in potentially high productivity activities and results in higher consumer prices in closed economies, which hit poor people particularly hard.

In this post-Doha period, development is at the top of the trade agenda. In order for developing countries to fully benefit from global integration, they have to be able to export. Subsidies levied by developed countries are enormously damaging, particularly in the agricultural sector. The average European cow receives $2.50 per day in government subsidies and the average Japanese cow receives $7.50 in subsidies, while 75 percent of people in Africa live on less than $2 per day. Removing these subsidies will greatly benefit the developing world. They will also save resources and environmental damage in developed countries.

But developing countries are also likely to greatly impact growth by reforming their own trade policies. Although imperfect, the best global trade models we have suggest that developing countries would gain around $75 billion annually from liberalization of merchandise trade by OECD countries, and almost $120 billion from liberalizing their own trade systems. These estimates do not even take into account the dynamic gains from trade, trade in services, and non-tariff barriers to merchandise trade. In comparison, the total sum of official development assistance is far less, at around $60 billion annually over the last 10 years.

Figure 1: Welfare Gains from Trade



Source: World Bank (2002), *Global Economic Prospects*.

The role that integration into global markets plays in fuelling growth is well acknowledged within Egypt and is clearly expressed in its 20-year strategy: the "2017 Vision". Egypt's geographic location, with its proximity to large markets, offers inherent trade advantages; as does its abundant natural resources and labor, especially low-skilled labor. However there remains room for improvement in Egypt's openness to international markets. I have mentioned that Egypt's strong growth was spurred by domestic demand – as indicators of this both exports and FDI are low and falling relative to GDP and as a relative share of world markets.[25] Openness declined from 13.7 percent to 9.6 percent between 1990–2000; by comparison openness rose in both Morocco and Tunisia.[26] Egypt's high fiscal barriers to imports protect domestic producers; and tariffs are not only relatively high but also dispersed both across and within various sectors of the economy. Although liberalization in the early 1990s cut tariffs by over 50 percent, in 1999 nominal tariffs were 28 percent compared with 18 percent for low-

[25] Export share of GDP declined from 27 percent to 16 percent between 1990–2000. Net FDI inflows averaged 1.3 percent of GDP over the last decade. By contrast, average FDI flows for North Africa was 2.6 percent.

[26] Openness is measured as the percent of trade turnover divided by two multiplied by GDP. World Bank (2001b).

income countries and 14 percent for middle-income countries. Cumbersome customs procedures and quality standards further impede trade.[27]

Egypt's approach to liberalization has been largely one of regional integration, through free trade agreements with the EU and Arab nations, as well as various bilateral agreements, including with the US. While the regional approach is inferior to more comprehensive global integration, it is nonetheless a positive step, and evidence suggests the both the EU and US agreements will enhance growth and opportunity.[28] The challenge for sustaining economic performance is to reduce remaining obstacles to engaging further with the international economy and shift toward more export-led growth.

Where local conditions for entrepreneurship and growth are good, exposure to international competition increases the productivity of domestic firms and lowers input costs for downstream users, while FDI brings with it new production and process technologies, organizational capacity and marketing networks. Consider, for example, the case of the Indian machine tool industry.[29] When protection was reduced in the early 1990s, Taiwanese firms entered and claimed around one-third of the market. But after nearly a decade of more open policies, several Indian producers adapted; they dramatically increased productivity, introduced new products, reclaimed much of the market, and started to export. Higher productivity and better quality products are among the sources of gains from openness. The response of the private sector to trade reform will be greatly enhanced by improvements in the business environment.

Also, as with all change, greater openness to trade may incur dislocation adjustment costs, which must be recognized and managed. Seizing the opportunities of global integration means moving resources and changing ways of doing things. This can place serious pressure on national systems of social assistance, environmental protection, national values and local communities. Because gains are unlikely to be distributed equally, and those who benefit most from reform are

[27] It is reported that clearance, licensing and inspection processes take 11 days and add the equivalent of 15 percent tariff although this may have fallen following efforts to streamline the inspections process. World Bank (2001b).
[28] Galal and Hoekman (1997).
[29] Sutton (2000).

dispersed, change is likely to face resistance and may invite protection of special interests. Adjustment programs are needed to help assure the political viability of liberalization and to ensure that the most vulnerable are not negatively affected.

Macro factors – fiscal stability, inflation, and openness – are therefore central to the investment climate and to growth. But they do not tell the whole story. For example, although on average the rapidly globalizing developing countries have grown much faster (5 percent) than less integrated economies (1.1 percent), there is considerable variation among the globalizers – from 0.4 percent in the Philippines to almost 8 percent in China. The investment climate involves micro issues of infrastructure and institutions as well. We have also seen from country experience that growth generated by macroeconomic reforms is likely to falter unless accompanied by institutional, regulatory and infrastructure reforms. After a wave of stabilization programs in the 1990s, many governments are looking beyond macro policies to what are sometimes called "second-generation reforms" in order to maintain growth performance. Understanding the micro aspects of the investment climate is key.

Toward a Better Empirical Understanding of the Micro Aspects of the Investment Climate

The micro and structural issues of the investment climate, including infrastructure and governance are not as well understood as the macro factors. A part of the reason is the limitation on data. To understand these issues it is essential to go beyond inputs and outputs and ask how processes actually work and how people are involved. In particular, we need to gather two types of micro data to provide details on the quality of the investment climate: firm-level data from surveys of firms; and country-level data on the institutions that affect firms.

Firm-level surveys: One of our recent and continuing initiatives at the World Bank has been to help developing countries carry out large, systematic surveys of firms in order to better understand the infrastructure and governance problems that stand in the way of more productive investment and job creation.

Systematic investigation of the investment climate using firm-level surveys started at the World Bank and the EBRD during the 1990s, and has gathered pace in the last year or two. The surveys cover large random samples of firms (some 1,200 firms in India and 1,500 in China, are two examples). The surveys collect the usual firm information on sales, outputs, inputs, and costs, but they also include specific quantitative questions about the infrastructure and governance aspects of the investment climate. Examples include: "How often are you visited by the authorities, and how much management time is spent with them?" and, "How many days did your firm experience power outages?" Our objective is to link these investment climate indicators to outcomes such as firm productivity, investment and growth. Comparable surveys are completed, under way, or planned for 30 countries.

Country-level indicators of regulatory institutions: In addition to firm-level surveys, we have also been accumulating data on several important areas of business regulation in over 100 countries. Examples include the procedures, time and cost to register a new business, enforce a contract, or go through bankruptcy proceedings. With these data we can benchmark country performance and analyze what drives cross-country differences in investment climate outcomes. Because the data measure the details of regulations, they complement firm surveys by identifying some specific sources of regulatory constraints on firms. For example, firm surveys can tell us the time required for business registration. Regulatory indicators can tell us what specific procedures cause the delays and therefore indicate what might need to be changed in order to reduce the time it takes for an entrepreneur to register a firm. The regulatory data will be updated annually, so over time we will be able to learn more about what drives changes in regulations and institutions in the investment climate.

Although these two areas of data collection have been expanded only in the last year or two, they are already a rich source of information on the micro aspects of the investment climate. Other examples of what we are learning from these data deal with the two other components of the investment climate: infrastructure, and governance and institutions.

Infrastructure

Firms are dependent on adequate quality and quantity of infrastructure - power, communications, water, transport, and financial infrastructure, as well as skills and technology. Poor infrastructure services require firms to spend more effort in acquiring information, acquiring inputs, and getting their products to market. These additional costs can easily eliminate apparent comparative advantages of firms, and if they are high enough they may deter firms from investing or entering at all.

The investment climate surveys often highlight infrastructure issues such as power reliability, transport time and cost, and access to communications technologies as key determinants of firm competitiveness and profitability. They also provide interesting insights into a country's strengths in providing infrastructure services to entrepreneurs, as well as useful guidance about challenges ahead. For example, the survey in China showed that infrastructure services compare quite favorably to many other locations in the developing world. Firms in China report losing an average of 2 percent of sales to power outages, compared to 6 percent in our Pakistan survey. Many firms surveyed were importing materials or machinery, and the typical Chinese firm was able to get its most recent shipment through customs in 8 days, which is comparable to more developed countries such as Korea or Thailand. In India, by contrast, the figure was 11 days; in Pakistan it was 18 days. The two extremes in clearing customs both come from the MENA region: it takes a remarkably high 24 days in Algeria, and is most efficient in Morocco at 3 days. We also find that in the poorest investment climates, many of the firms tend to have their own power generator. In this case, China performs closer to other countries as 27 percent of firms in China reported having their own generator compared with Algeria (25 percent), Morocco (17 percent), India (69 percent).

The surveys also show that poor infrastructure is often particularly harmful for small firms (Table 3). In the countries in which we conducted an investment climate survey, small firms are much more likely to experience days without electricity and water services. The difference between small and large firms is especially great in Algeria, where small firms are 50 percent

more likely to experience power disruptions (totaling 18 days), and almost 3 times as likely to experience disruptions for water services (totaling 54 days). Moreover, small firms are less likely than large firms to have mechanisms to cope with inefficient infrastructure, such as their own generator. In India, energy costs are a severe problem for SMEs – unlike in other countries, the typical SME has its own generator, which ties up one-sixth of its capital. Poor infrastructure also has an indirect cost for SMEs – when basic infrastructure is poor, foreign investment is suppressed. This means less opportunities for SMEs to develop local supply relationships with multinational investors, which can be a great stimulus to the SME sector.

Table 3: International Comparisons of Infrastructure Indicators

Country	Firm Size	Percent with own generator	Days without electricity	Days without water	Percent with own water well
Algeria	Small	16	18	54	27
	Large	53	13	17	43
Morocco	Small	14	16	3	28
	Large	25	16	3	32
China	Small	16	5		
	Large	39	4		
India	Small	61			43
	Large	84			65

Source: World Bank, *Investment Climate Surveys*.

Infrastructure services have a direct effect on firm performance. In India, we can now compare the investment climates at the state level with the firm survey data. Twice as many firms (proportionally) in the state of Uttar Pradesh (U.P.) have their own generators, reflecting the lower reliability of electrical power in U.P., and firms in U.P. also report twice as many visits from officials as firms in the state of Maharashtra. The result is that U.P., the largest and one of the poorest states in India, has both a higher capital intensity and a lower growth rate than Maharashtra. Poor infrastructure also helps to explain productivity gaps across Indian states. Average productivity per worker in states with a poor investment climate is 6 percent lower than

in the best climate states because of the higher cost of electricity. These findings are strong and easily communicated, and they can make a powerful impact on policymakers.

We do not have comparable firm-level data on Egypt, but available evidence indicates that while there may be room for improvement, infrastructure services are not a barrier for firms to the same extent as in many other developing countries. Over the past two decades, substantial investment in upgrades seem to have resulted in generally good quality and quantity infrastructure services. The challenge now is to maintain services in the face of declining public investment, and continue improvements in quality and access.

What can governments do to improve infrastructure services for entrepreneurs? A primary reason for poor performance of infrastructure services is that they are often provided by inefficient government monopolies, which usually suffer from serious under-investment in maintenance and capacity. Expanding private participation in the provision of infrastructure services, and importantly, accompanied by a sound regulatory framework, has helped to enhance efficiency, increase investment and expand access. Examples of successful reforms include:

- *Privatization:* for example, impressive gains were achieved in the privatization of water services in Cartagena, Colombia. Continuity of service jumped from 7 to 24 hours per day; connections in poor areas went from 0 to 98 percent; and connections overall increased by 40 percent.
- *Liberalizing entry for private providers*: for example, small scale private firms and individuals provide water services in Mexico and Paraguay; and small enterprises supply electricity in Yemen.[30]

The form of private sector participation is also an important consideration. It is generally more successful when accompanied by sector-wide regulatory reform that aligns incentives of private infrastructure service providers with the needs of consumers, encourages competition,

[30] World Bank (2001d).

provides for an independent regulatory body on, among other things, quality, price, coverage of service and involves commitments to cost reduction and service quality by providers.[31]

While acknowledging the important role of private sector participation, we also have to recognize that the bulk of infrastructure is likely to remain in the public sector. Privatization should not be regarded as a universal solution. One of the key challenges of the investment climate will be to increase the quality of public infrastructure services

Governance and Regulatory Institutions

Although our understanding of the importance of governance and institutions has grown tremendously, building stronger governance and institutions is no simple matter. Elements of this component of the investment climate are the institutions shaping:

–Competitive markets: e.g., entry, exit, government ownership, and subsidies

–Resource allocation: e.g., taxation, labor, capital (including strong financial institutions)

–Property rights and enforcement: e.g., rule of law, courts

–Public interest concerns: e.g., environment, health, safety

A central concern in all these areas is the relationship between government and private individuals and firms, including the levels of corruption, arbitrary behavior and harassment of entrepreneurs.

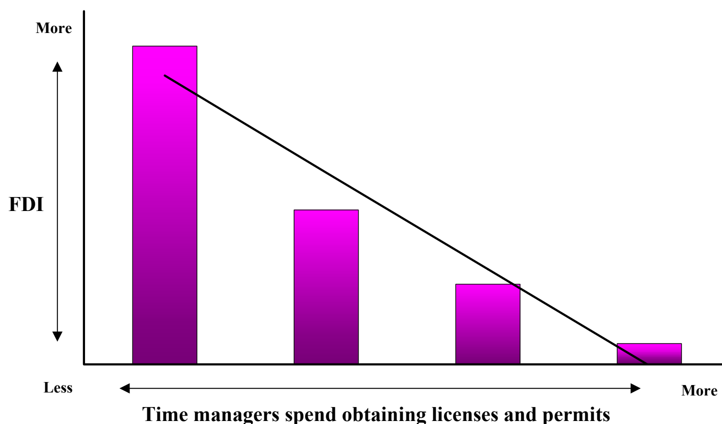
There is a risk of confusing the need to avoid bureaucratic harassment with a need to avoid regulation altogether. The question is not whether to regulate, but what to regulate and how to do it. Regulations can facilitate efficient outcomes and serve public interests. This is a very important topic but not my main concern in this assessment. The way regulatory systems operate can be a source of bureaucratic nuisance and corruption. Harassment and poor governance is profoundly damaging to the investment climate, imposing barriers to entry, adding to operating costs, and creating uncertainty once the firm is established. Cross-country studies have shown

[31] See, for example, Galal (2001); World Bank (2001d).

that indicators of governance and institutions are strongly linked with development outcomes.[32] This applies to both large and small firms, but it is especially important for SMEs, with their weaker capacity to finance start-up costs to deal with regulation and to use "political contacts" and other means to resist harassment.

In our investment climate surveys we are trying to find some creative ways to get at analysis and quantification of these difficult issues. For example, we ask firms to estimate how much time they spend dealing with the government bureaucracy and how much they pay in informal payments to get things done. The results can be striking. In Pakistan, entrepreneurs report that they spend around 36 days per year dealing with inspections from government officials, compared with 16 days in Bangladesh and 10 days in India. In China, firms in cities characterized by a high level of corruption and greater loss from theft had lower performances. And across 69 countries, the time that managers report they spend dealing with government bureaucracy to obtain licenses and permits is associated with significantly lower levels of FDI, controlling for market size, human capital and macroeconomic stability (Figure 2). [33]

Figure 2: Time Spent Dealing with Bureaucracy and FDI



Source: World Bank (2003) Global Economic Prospects.

[32] For example, Kaufman and others (1999, 2002).
[33] World Bank (2003).

The surveys can also expose the degree of competition in markets. One of the most revealing indicators of how vibrant competition is in markets is the productivity dispersion of firms within an industry. When the less efficient producers are not being forced to improve their productivity or exit the market, productivity dispersion is high. As competition intensifies, firms are pressured to innovate, improve efficiency, adopt better technologies or exit, and as a result productivity dispersion should shrink. The high performers in the Indian electronics industry are five times more productive than the lower performers. Compare this with Korea, where the difference in productivity is only twofold. Studies show that productivity is closely related to barriers to entry and exit. Countries with greater barriers to entry tend to have more dispersion between the best and worst performers.[34]

Aside from reducing direct regulatory barriers to entry and exit, *privatization* can largely impact the facilitation of more vibrant competition, encouraging new entrants and productivity gains. Many studies as well as country experiences – in particular from transition economies – show that privatization can yield substantial gains.[35] But it is not a panacea. Privatization requires a strong institutional environment to succeed and delivers the greatest gains when combined with competition. There is a big difference between privatization in public services such as infrastructure, and privatization in ordinary competitive sectors of production, where it has been shown to bring the greatest benefits. Research shows that government ownership of banks tends to reduce competition, limit access to credit, and may heighten the risk of crisis.[36] This is potentially of great relevance to Egypt, where the state owns a large share of financial institutions.

Our cross-country indicators of regulatory institutions also allow us to make some interesting comparisons of how countries differ in their approach to regulating firms. Moreover, they can provide insight on the impact of different regulatory approaches on entrepreneurial activity; for instance, showing how certain types of regulations can either increase the costs of doing business

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[34] World Bank (forthcoming[a]).

[35] See, for example Galal and others (1994); World Bank (2002a); World Bank (forthcoming[a]).

[36] World Bank (2001e); La Porta and others (2000).

or provide incentives for firms to join the formal sector, invest, and grow. As I have mentioned, these are important issues in Egypt that are being investigated by the ECES. Some of the findings from our surveys in relation to comparative data for Egypt are outlined below (Table 4):

Table 4: Regulatory Indicators

Indicator	Egypt	MENA Average	OECD Average	Best
# Procedures to register a business	13	11	7	2
Days to register a business	52	60	33	2
Cost to register a business (% GNP per capita)	61.0	62.4	10.9	-
Days to enforce contracts	202	302	205	7
Cost to enforce contracts (% GNP per capita)	17	23	16	10
Index of bureaucratic complexity in courts	3.79	4.11	3.08	0.73
Index of rigidity of employment law	1.81	1.45	1.35	0.77
Index of rigidity of industrial relations law	1.74	1.10	1.24	0.25
Share of unofficial economy (% GNP)	35.10	27.48	17.40	8.80

Source: World Bank (forthcoming[a]).

- *Entry regulations*: In January 2002, it took 13 procedures, 52 days and cost 61 percent of per capita income to register a new business in Egypt. These figures are significantly worse than good practice – for example, in Canada it takes 2 procedures, 2 days and is entirely electronic. In Denmark registration is free. Bureaucratic entry procedures are usually associated with higher levels of corruption and a larger informal sector.
- *Contract enforcement*: The number of procedures (17) and days (202) to enforce a contract is better than the MENA average and closer to OECD levels, however the bureaucratic complexity[37] of the procedures is higher. Across countries, higher levels of bureaucratic complexity are associated with less access to justice, lower enforceability of contracts and more corruption in the courts. The most efficient dispute resolution system

[37] Bureaucratic complexity is measured as an index of the statutory intervention in judicial dispute resolution, including variables such as the extent of legal justification required, whether submissions must be written, requirements for legal professionals (as opposed to adjudicators or lay people), and the extent of statutory regulation of procedures relating to evidence in a case. World Bank (forthcoming[a]).

in the survey is in Tunisia, where a special proceedings in general jurisdiction courts take only 7 days and 10 procedures.

- *Labor regulation*s: Egypt labor market regulations are significantly more rigid than those in MENA and OECD countries. Greater rigidity in labor regulations is associated with larger unofficial economies.
- *Unofficial economy*: Estimates indicate Egypt has a higher share of the unofficial economy to GDP (35 percent) than MENA and OECD countries (averaging 28 percent and 17 percent respectively).

Further reforms of these regulatory aspects of the investment climate offer significant potential for accelerating growth.

6. Rising to the Challenge

A review of 50 years of development and the key lessons learned has placed investment climate as one of two central pillars of development strategy. In Egypt, the challenge of building an environment that encourages entrepreneurs to create jobs, improve productivity and grow their firms is fundamental for development.

The Urgency of the Challenge in Egypt

Sustaining the robust growth rates that Egypt experienced in recent years will require a more competitive private sector that is further integrated in the global economy. Absorbing the large numbers of new entrants to the workforce requires that private firms be able to generate employment opportunities at a much faster rate. As mentioned, Egypt already offers several advantages for both foreign and domestic investors, but without further improvements in the investment climate, the required productivity improvements, job creation, and trade flows are unlikely to be achieved.

Rising to this challenge will require continued and deeper reforms. The lessons on the investment climate from other countries, as well as the following brief overview of some of the

issues facing Egypt, would seem to indicate that continued reforms are needed in six areas. Indeed, these are reform areas where the government is actively engaged at present.[38]

- *Increasing openness* is an important avenue for accelerating growth and poverty reduction. Opportunities for increasing trade include reducing the level and dispersion of import tariffs, unification, continuing a more flexible and market oriented management of the exchange rate (accompanied by sound monetary policy), and streamlining customs procedures and other significant non-tariff barriers, such as many of the licensing requirements.

- *Strengthening the institutional framework for competition*, through continued but selected privatization, reducing state intervention and streamlining registration and bankruptcy procedures is an important step. Promoting greater competition in the financial sector is of particular importance. Such reforms can do much to encourage the dynamism of private firms and in particular SMEs.

- *Improving contract enforcement*, through judicial reform to improve the efficiency and capacity of commercial courts, would help entrepreneurs overcome a major cost of doing business, and encourage transactions beyond established business contacts and insiders.

- *Reforming tax systems* can help reduce tax evasion and opportunities for excessive bureaucratic discretion, as well as improve predictability and reduce costs for firms, particularly for SMEs. The income tax reform just completed in Egypt, and the sales tax reforms underway, may be promising in this regard. Continuing to pursue reforms that simplify the tax system, improve transparency, and enhance the effectiveness of tax collection will be of great importance.

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[38] These are priorities relevant to the investment climate described in the World Bank's *Country Assistance Strategy* and *Social and Structural Policy Review*. World Bank (2000a,b).

- *Increasing the flexibility of labor regulations* is important for reducing incentives for firms to operate in the informal sector, as well as to ensure that firms are not deterred from creating jobs or that they distort their investment decisions toward capital-intensive technologies.

- *Infrastructure services,* which have improved greatly in the past two decades, require continued investment, maintenance and improvements in organization and productivity. Further opportunities for more private participation in infrastructure are important for expanding access to infrastructure.

Driving Change

We now understand that changing institutions and governance is the key to moving toward a positive investment climate. But we are only beginning to understand *how* they can be changed. The following six ideas outline how to promote change in institutions and in the investment climate and give examples successes in other countries. It is important to note that the impetus for change can be top-down, bottom-up, or both. We also know that these changes are most likely to succeed when they are driven locally and tailored to local conditions and history.

First, I believe strongly in the power of *evidence*, information, and analysis as a catalyst for change. In Peru, for example, Hernando de Soto documented that it took 728 bureaucratic steps for a person to convert their informal right to housing to a formal legal title.[39] Sharing this evidence throughout the country created overwhelming public support for simplifying property titling, and eventually led to the Peruvian Congress unanimously passing legislation to formalize titles - improving property rights and investment opportunities for slum dwellers.

The firm-level surveys and cross-country benchmarking of regulatory institutions that I previously mentioned have also proven a powerful tool for understanding which approaches to the investment climate could work in a given situation. At times, the negative information in these data is also a powerful tool for embarrassment. Good evidence triggers innovation and

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[39] De Soto (1989).

learning, and it bolsters and arms the constituencies for change. In Egypt, further surveys of firms will help provide better understanding of the barriers they face and determine which obstacles have the greatest impact on productivity, thereby helping to prioritize reforms.

Second, certain *policy choices* can encourage or impede movement toward the right kind of change. As has long been pointed out by economists, quotas and licensing requirements breed corruption and arbitrary use of discretion by government officials. This diverts entrepreneurial energy from the innovation needed to create new products and institutions. In this case, removing bad policies can promote much-needed institutional change, and as I pointed out earlier, dismantling what is called the Permit Raj in India has indeed delivered more rapid growth. In Korea, a comprehensive regulatory review program succeeded in eliminating 5,430 unnecessary regulations – a 50 percent reduction – in less than a year, which not only reduced the opportunities for discretionary behavior, but also proved the government's commitment to providing better governance for firms. Countries in Central Asia are also successfully lowering bureaucratic harassment by restricting the number of inspections that may be conducted legally, as well as providing entrepreneurs with official "inspections books" that an inspector must sign before investigating a business, and implementing complaints policies for entrepreneurs who have faced harassment and corrupt officials.

Third, change can be generated by *competition*. In particular, competition among *jurisdictions* for investment has pressured many governments to reform the investment climate. For example, studies have shown that competitive pressures drove the evolution of corporate law in Japan, Chile, and the US.[40] Competitive pressure from other firms and foreign entrants may encourage firms to lobby for better institutions, as in the case of Mexican banks pressuring for better prudential regulations after the North American Free Trade Agreement paved the way for foreign competition. Competition for resources also promotes change. In the late 19th century in Thailand, for example, increasing openness to trade led to a rice export boom. Intense competition for land for rice paddies created the demand for clear and enforceable property

[40] Pistor and others (2000).

rights. Beginning in 1892, the government introduced an innovative land titling system that balances local tradition with formal legal requirements. These types of competitive forces are likely to increase as the pace of globalization accelerates.[41]

Fourth, *entrepreneurial leadership* can promote change. Like markets for private goods, markets for policy and institutional innovation are not characterized by spontaneous combination of inputs. It takes an entrepreneur to recognize an opportunity and exploit it – someone like Muhammad Yunis of the Grameen Bank for micro credit in Bangladesh, or Ela Bhatt of India's Self-Employed Women's Association (SEWA) who showed how practical action at the local level – providing business advice and financing – can encourage the entrepreneurial activity of women.

Fifth, the press and *media* can pressure policymakers to change. In particular, the media can improve governance by increasing the risk of exposure of corruption, as well as the penalties for corrupt activity. In one example, a television station in Peru broadcasted a video of an opposition legislator being bribed by the national security chief. The story was picked up by other publications, and the resulting public furor led to the fall of President Fujimori's government. The 2002 World Development Report on *Building Institutions for Markets*, and a recent volume on the role of the media[42] include a host of other examples of the media's developmental role as a catalyst for change in governance and institutions.

Sixth, the momentum for change can be built through promoting *effective partnerships* to sustain reform and the creation of *constituencies for reform*. This is often difficult since different interest groups may not recognize the gains possible from working together. But there are strong examples of success in promoting partnerships for reform of the investment climate. In Russia, a group of foreign investors proposed an international conference in 1994 to forge an alliance between government, business leaders, and international experts on the investment climate. The forum, evolved into what is now known as the Foreign Investment Advisory Council (FIAC),

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[41] World Bank (2001d).

[42] World Bank (2001d, 2002b).

meets once or twice a year to identify ways in which Russia can become a preferred alternative for foreign investors. FIAC dialogue has initiated several improvements in the investment climate, including in tax policy, corporate governance, and legal protection for foreign investors.

In other cases, enhancing the voice and representation of constituencies with an interest in reform may strengthen the prospects for change. Russia also offers a good lesson on the importance of constituencies for change. In the former Soviet Union, potentially beneficial reforms were derailed or hijacked in the first decade of transition by elites that quickly became entrenched. Russia's loans-for-shares deal and other schemes allowed well-connected oligarchs to capture and entrench monopoly positions at very low cost and, in so doing, undermined attempts to move to a vibrant and competitive private sector. Equally important, these developments further raised the barriers to reform of the investment climate. With greater economic power, the oligarchs now had greater political power to block reforms, so that the state was in effect captured and used for private interests. One could not expect those benefiting from the institutional defects of the existing system, at least in the short run, to campaign for institutional and governance improvements that would limit their activities. In this light, expanding opportunities for SMEs is also important for creating a constituency for reform of the investment climate. The growth of the SME sector increases the number of firms and households with a clear interest in the investment climate and thereby can strengthen the forces for improving it. There are of course many more examples of how one can trigger institutional change. We are beginning to shift from an understanding of the importance of institutions to an analysis of how to change them. But we have a long way to go.

7. Conclusion

I have tried to draw key lessons from analysis and experience in promoting growth and reducing poverty, which can be seen broadly in terms of two pillars: the investment climate, and empowering and investing in people. My emphasis on the investment climate does not diminish the importance of empowerment. There is an equally important agenda in improving the health,

education and participation of people in economic decision-making; this agenda deserves to be addressed on its own.[43] The empowerment agenda will also have greater impact if it is pursued in collaboration with changes in the investment climate using the kind of reforms I have discussed.

Each of the three broad areas of the investment climate – macro factors, infrastructure and governance and institutions – can exert a powerful influence on growth. In this context I have tried to relate some features of Egypt's investment climate with evidence and experience from other countries. From these comparisons, a number of opportunities for improving the investment climate appear to emerge, the key elements of which include: further integration of Egypt into the global economy; encouraging more vibrant competition through privatization, particularly of banks; and further strengthening governance and institutions – including more efficient contract enforcement, tax systems and more flexible labor regulations.

Egypt's past success in macro stabilization and other reforms make me confident that it is possible to take these steps. It has great strengths to build upon and talented entrepreneurs who are complemented by an active state to do it. With its rapidly increasing workforce and signs of falling growth Egypt cannot afford to miss the opportunities it faces. Deepening reforms in the investment climate would encourage entrepreneurs to innovate, invest, generate jobs and grow their businesses, with a tremendous impact on growth and poverty reduction.

[43] See Stern (2002a).

PART II: DISCUSSION

INVESTMENT CLIMATE: LESSONS AND CHALLENGES

Participants in the discussion following Nicholas Stern's presentation included Mahmoud El Mohieldin, Head of the Economic Committee of Egypt's National Democratic Party. Faika El Rafaie, member of the People's Assembly; Ahmed Galal, Executive Director of the Egyptian Center for Economic Studies; Anissa Hassouna, Assistant General Manager of Research, Translation and Library at Misr Iran Development Bank; Mona El Baradei, Faculty of Economics and Political Science at Cairo University; Abdel Aziz El Aguizy, Chairman of El Aguizy International Co. for Economic Development; and Hassan El Hayawan, Faculty of Commerce at Ain Shams University and Chairman of Integrated Financial Services (Integra). The following is a summary of the discussion.

Moderator: Thank you Dr. Stern for a very comprehensive presentation. I think we all agree that improving the business climate is very important for growth and development. Egypt has made significant progress but improving the business climate is a continuous process to cope with new developments, whether internally or externally, and sometimes we lag behind. We do well for a couple of years and then we lose the ball.

Looking at the world around us, as Dr. Stern very clearly explained, there is no doubt that countries like China and India have a bigger population problem than we do. We think Egypt has a population problem with 68-70 million people, but India has over 1 billion people today and China has even more. Yet both India and China have been able to consistently achieve high economic growth, with China reaching close to 10 percent. India was also able to deal with poverty. That is really incredible. That's the competition we're facing today and that is the reason why consistent policy reforms are very important.

Participant: I've been to a number of conferences over the years where we discussed reforms that needed to be undertaken and what we could do to affect change in Egypt. The actual change has been modest. Sure, there has been some improvement but not as much as is needed and recommended in these conferences. My question is why, in your opinion, has progress been so slow?

Speaker: When we recently met with the prime minister, foreign trade minister, finance minister and other members of the cabinet we put the kind of arguments that I presented here to them and witnessed great receptivity. I know that receptivity and action are not the same thing, but these arguments seemed to be well registered. At the World Bank we're optimistic that changes will be forthcoming, but a follow-up visit in 2 or 3 years will reveal if they have indeed occurred.

Participant: I want to discuss the set of priorities you outlined to improve the investment climate in Egypt, which includes increased openness, institutional framework for competition, contract enforcement, tax and customs administrations, flexibility of labor regulations, and infrastructure. I want to point out that all of the laws that we are drafting in Egypt now are consistent with this set of priorities. Our problem lies in implementation.

We need to address the quality of government and the quality of economic agents beyond the government itself. These reforms are more important now than ever before. During the 1980s Egypt and very few countries were attractive to investors. Now everybody's reforming. We have to do the same at the right time without delay. We tried 5 or 6 years ago to seek the help of the World Bank in civil service reform. But the World Bank was reluctant, perhaps because it is too complicated. Is now the time to get such support?

On another point, we in Egypt know how to attract FDI. During the 1980s Egypt managed to get a reasonable share of the FDI going to the developing world. Now, as you rightly pointed out, our share of FDI relative to GDP is less than 0.5 percent. How do we turn these figures around, taking into account that we're not interested in investment per se. Rather, we're interested in the work opportunities investment produces. I think improvements in the investment climate should also take into account the link between growth, investment, employment opportunities, and reduction of poverty.

Speaker: I strongly agree with your emphasis on implementation. My view is that it's not only the rules themselves that matter, but it's how the organizations that implement the rules actually function. That is absolutely critical. Take, for example, a rule that states that a customs officer is obliged to look for drugs. In practice he could interpret this by looking inside every bottle of

olive oil and every shoe that comes into the country. I think there is considerable experience now where one can get help with the distortions in how rules are applied. I do not know the history of the World Bank and civil service reform in Egypt, but perhaps after a few more questions, Dr. Mahmood Ayub, the World Bank country director, could address some of the experiences. We are here to be chastised as well as to offer advice. It's a two way street.

Participant: I would like you to comment on two topics. First, in your opinion, what is the likely impact of a war in Iraq on investment and economic growth both regionally and in Egypt?

Second, over the past 2 years the government has been talking a lot about SMEs, which comprise 80 percent of industries in Egypt. But if we concentrate on SMEs, I believe that we'll have a lot of baby industries that lack specialization. I don't think that these industries will be able to compete and make exports an engine of growth.

Speaker: The first observation which I agree very strongly with is that conflicts of any kind, certainly international conflicts, are very bad for the investment climate. The main reason that Africa has done so poorly over the last 30 years or so has been because of conflict. So from the perspective of both economic growth and the investment climate, and of course for humanitarian reasons, we share your anxiety about the potential for war in the region. I think that to bring peace to this part of the world, though it's not a simple matter, would be an enormous contribution. If only that one source of uncertainty could be removed it would be great, but I don't pretend that it's easy or that I have a solution. I do know that tourism in Egypt will suffer as a result of this kind of uncertainty and that will be a cost that poor people in Egypt will bear.

On SMEs, I think that to encourage SMEs is not to encourage baby industries. It's to encourage firms within an industry by creating better conditions within that industry. In northern Italy for example, a lot of small firms in the textile business are doing quite well and the conditions for that kind of industry are quite good from various perspectives. But that doesn't mean that it's a baby industry, it just means that they're small firms. Of course, if small firms get bigger that's great. No one wants small firms to stay small, that's not the point. The point is to create conditions where firms can grow.

Participant: You will not find many people in this room who disagree about the importance of investment for growth, job creation and poverty reduction. Nor will people disagree that Egypt needs to make additional efforts to improve the business environment. Rather than dwell on areas of agreement, I want to ask you specific debatable questions. The first one is how do you relax a particular constraint? For example, if I can not undertake civil service reform, do I create a parallel system? More broadly, should I reform the entire country or create special economic zones where I have labor rules straightened out, bureaucratic intervention reduced and taxes lowered among other things? The choice is important in Egypt because we seem to be relying heavily on the parallel track approach. So whether these tracks can actually take us forward or backward is one question.

Secondly, everyone agrees that opening up is good for the business environment. The debatable issue is whether it should be done multilaterally, regionally or bilaterally. And what will happen when you have a proliferation of agreements at all levels at the same time? Are those arrangements building blocks or stumbling blocks? This is a real story for us in Egypt.

My final question has to do with FDI. I think most FDI goes to two sectors: natural-resource based and infrastructure. Of course there is also FDI in other industries, but the bulk of FDI that is going to countries like Chile, Mexico or Argentina is for infrastructure activities. The question is how do we attract FDI in infrastructure? In Egypt, so far, we're relying on BOT arrangements. What do you think about that? Should we seek FDI under common rules of the game or under discreet contracts that are related to particular transactions?

Speaker: I agree that the people in this room will not disagree about the importance of the business climate, but nonetheless it's very important to bring hard evidence to the table. We can get specific about what's going wrong by using the firm-level surveys I was arguing for. It's through that type of empirical evidence that you define your priorities because firms determine what their problems actually are. I tried to make a specific point about the investment climate by going into the details of the regulations: quality, time spent with authorities, length of procedures, function of the infrastructure, and so on. What I wanted to do is emphasize that you

really can get those details. I would have loved to have reported the results of an investment climate survey on Egypt and I'm sure over time this kind of evidence will appear.

So what about parallel tracks and special economic zones? I think a lot depends on how they function and what you do with them. I'm certainly cautious about the whole tax holiday/special privilege issue. I think that if you get the investment climate right then the firms will come and they will pay their taxes. What they don't want to face is being hassled every time they try to get goods through customs or having the tax authorities persecute them rather than simply cutting taxes. I wouldn't emphasize the tax holiday side of special economic zones, but I would emphasize the importance of one-stop shops for licensing and rapid hook-ups to infrastructure. If the zones act as models for the rest of the country then I think they can be very productive. If not, then I think they contribute less. Shenzhen, which was started more than 20 years ago in southern China, was not just a little island. It was an island with good ideas that got carried forward across the country. So if special economic zones become an incubator for ideas that lead to the implementation of reforms across the country then that's great. If they remain a small area of special privilege, then it actually can be an example of "cronie capitalism" that can do damage. Some good examples exist of how it's been done well.

Whether to open up trade multilaterally, bilaterally or regionally does not have a single answer. The most important thing I'd emphasize is to get on with the job and there are a lot of things you can do unilaterally. If you look at India in the last 10 years, the fraction of exports to GDP has risen from 7 percent to 14 percent. It's quite extraordinary that India, the great inward-looking closed economy, was producing cars and shutting out all the competition using a second-hand production line taken from the central part of England 40 years ago. India now has all sorts of different cars being driven around, most of them made in India in collaboration with one of the giant producers. India did that by itself as part of a bilateral agreement. China's advances in world economic integration are such that 15 years from now it will be the biggest trader in the world in terms of the dollar value of exports. To a large extent China did that by itself, though it very recently joined the WTO.

I would emphasize the one thing you didn't mention which is to take a unilateral track and focus on the variety of things that you can do yourself. After that I would emphasize a multilateral track. Now the problem with the multilateral option, and particularly with the WTO, is that it can be an extraordinarily long, drawn out process. So if along the way regional and bilateral agreements come along then that's fine. But it's important that those agreements do not shut out others. For example, if you reduce your tariffs in a region and between neighbors that's absolutely fine, but it should not shut out others or raise tariffs or slow down the reduction of tariffs against other groups. If you're going to go with regional trade, World Bank research suggests that the most beneficial agreements are those between developed and developing countries. Trade agreements between countries that are different usually yield more than trade arrangements between countries that are similar.

Regarding FDI, it's actually quite interesting how the structure is changing. There is not much FDI in the natural resource or infrastructure sectors in China relative to manufacturing. Of course, there is FDI in these sectors but most of it is going to manufacturing of various kinds. A lot of firms got their fingers burned in infrastructure, so now you're finding a reluctance for firms to invest in that sector. I hope that will turn around but it is clearly not the flavor of the month as it was 5 or 6 years ago. FDI in natural resources can be extremely important but it can bring its own problems. Much of the conflict in sub-Saharan Africa has been funded by back-handed investments in natural resources. So the way in which it operates is extremely important as well.

The final question was what kind of models are best for private infrastructure investment. I don't think there is a single formula, but BOT has been found to work reasonably well in some countries. However, there are several different models and I would look at the specifics of the industry, the country and of the possible partner. Look at the details of the financing arrangements and of the regulations and so on. You have to see the whole picture.

Participant: You talked about the importance of governance which is an umbrella concept that covers accountability and transparency among other things. It seems to me that this would require political reform at least to allow for more participation in decision making and for

rallying support for reform programs. Do you think, based on experience elsewhere, that political reform is a prerequisite for economic reform in developing countries?

Speaker: There is a lot you can do within most systems. There are many governments, authoritarian or otherwise, that actually want to improve living standards. If you can show that involving farmers in a water usage association is going to improve the functioning of irrigation, improve the happiness of farmers, and get more votes from them then I think you can convince the government it's a good idea. It doesn't necessarily involve turning the whole political system upside down.

In other words, I wouldn't start by thinking that there is no room to maneuver. I would start by testing the boundaries of the room to maneuver and I think you will be surprised at just how well you can do things. At the same time, if politicians can claim credit for improvements then they're obviously happy to do so.

Participant: I want to get your opinion on a number of constraints in the business environment in Egypt that you did not emphasize in your presentation. Two of them are the lack of e-commerce and lack of human skills. Another is the affordability of and accessibility to technology, in a country where the majority of companies are SMEs. The final constraint is lack of innovation, even among Egypt's FDI companies. I believe that these are important constraints that should be addressed along with the priorities you emphasized.

Speaker: You've raised a lot of points for discussion. I think e-commerce, or more generally linking up to the world wide web, is one area in which developing countries can move pretty rapidly. They're gaining enormous investment in this area in China right now, which really underlines the importance of a well-functioning telecommunications system because internet access largely depends on the whole structure of the telecommunications industry. We recently heard from a Korean representative at the conference of the Global Development Network who said that 75 percent of Korean households now have broadband internet access. And the growth in China in internet access right now is quite phenomenal. This is something that should

increasingly be seen as a conscious part of the expansion of the infrastructure that can be affected by government policy.

On the topic of human skills, the prime minister told us that education reform is a priority. Again, awareness and action are not the same thing but clearly awareness is there. For example, there is concern about the kinds of skills people have when they leave higher education. I think innovation is something that can happen under almost any circumstance without necessarily a lot of research and development. Innovation goes on in small firms and on farms all the time. Agricultural extension is one example of innovation on the farm. I think access to the internet and to finance are key parts of that story. I also think the expansion of the banking system, micro-credit schemes and so on, in Egypt and other countries could be extremely important in encouraging innovation.

Participant: I'd like to address a subject that was not presented in your lecture. How do you bridge the gap between the culture of the business community and that of the civil sector? In Egypt there are 6.5 million people working in the government with no standard of proficiency, while in contrast, the business sector operates with objectives, efficiency, profitability, and so on. A farmer running a farm knows exactly what he is doing, he has an objective, and he produces a result. But the civil servant waiting for his salary at the end of the month comes from a completely different culture. After 27 years of openness in Egypt, we're still talking about bureaucracy and regulation. How can we educate civil servants about productivity and efficiency?

Speaker: This is an enormously important and obviously very difficult question. I do think there is something one can do. If it's recognized that the private sector is going to be driving growth in Egypt and that young people can not expect to find another half million public sector jobs each year – and I think it's pretty clear to people that this couldn't happen – then the extra employment and activity is going to come from the private sector. I think that if the daughters and sons of the civil servants recognize that then it is a major step forward.

I think groups like the one gathered here today, which bring strong evidence to the table, can help politicians push for the right kind of civil service reform. Bringing reform experiences to bear is also useful. Some of my colleagues here today have been involved in reform in different states in India and a lot has changed. I think you'll see that civil service employees will start being measured by how long it takes to get a driving license or passport, for example. There are various parts of civil service jobs that can be measured with targets. I won't pretend that all can or could be measured this way, nor will I pretend that it should all be run as a business. There are many of parts of civil service that act for the good of the general public in ways that don't always lend themselves to measurable targets. But an awful lot of what they do can be set in terms of management and targets, which could and should be part of the path to reform.

Also, evidence and accountability are making a big difference in a number of countries. For example, in Bangalore, India and the Philippines they've developed good score card systems for evaluating infrastructure. Now, people in an area can evaluate the electricity supply and water supply in terms of specific variable things such as how long it takes to get things fixed, how often the water goes off and so on. You get specific measurable criteria and publish that in the newspapers. I believe in the power of embarrassment that comes from information. Also important is awareness of the kind of politics we're doing here in a sense; the structure of the administration, the measurement of things that can be measured, and the collection of information. I don't want to pretend it's easy, but I do think there is a lot more one can do to take on the issue of civil service reform.

Participant: The point has been made that bureaucracy is a big cost of doing business in Egypt and we all pay the price. We pay the price in time, which is reflected in the price of goods. I think, however, that the media has a real role to play in changing the public's mindset on reform issues.

Speaker: I strongly agree that the media has a big part to play in reform efforts and more openness and opportunity for them is a big part of the story. The media plays a big part in exposing corruption, as was the case in Peru and India. If the media publishes the surveys from

the type of scorecard system I mentioned earlier, it could be very important. Also, they could pick up stories about bureaucratic inefficiencies and make that into news. The World Bank published a book called "The Right to Tell" that is full of examples of how the media can make a big difference. The same is true for community leaders. Both groups are part of the same thing – information and accountability; they must have access to the information and they've got to hold someone accountable. It's not just in the hands of the government. You need constituencies for reform to happen. Egypt's numerous SMEs must be a powerful constituency for reform, if only they can mobilize. I think once you look for information, accountability, and constituencies for reform then a lot of good community action can occur.

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Hisham Younes
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Hussein Lotfy
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Soheir Saad
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Spencer King
Int'l Executive Services Corp.
Steven Lee
Industrial Moderization Center
Taher Helmy
Helmy & Hamza (Baker & McKenzie)
Tarek Mansour
PWC
Tarek Selim
CDM Int'l
Thomas Foley
Golden Pyramids Plaza
Thomas Thomason
Intergen
Wafaa El Dars
American Express Bank
Wafaa Youssef
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