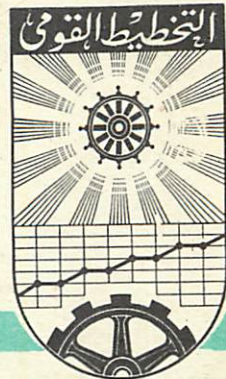


# ARAB REPUBLIC OF EGYPT

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Industrialization Strategy in Egypt  
and the  
New International Economic Order

By

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I. Introduction

1. The international division of labor as it exists today is the result of a long historical development that goes back to the beginning of the 17<sup>th</sup> century, when national states started to rise in Western Europe and to compete among themselves to conquer new territories and establish new empires. This political subordination, in addition to the growth of modern industry and technology as a result of the Industrial Revolution in Western Europe have together shaped the existing international division of labor between developed and less developed countries.

Modern industry and technology, as well as production and income, are concentrated in the developed countries (DC) of the North while the less developed countries (LDC) of the South have specialized mainly in agriculture and extractive industries.

2. In so far as the LDC are concerned, this pattern of division of labor has led to increasing dependency on the DC, structural disequilibrium among available factors of production, secular deterioration of their terms of

trade vis-a-vis the DC, and an income elasticity of demand for imports which is greater than one. These developments, in addition to political independence of the LDC and the advance in the means of communication have shown the inappropriateness of the existing system to the long term interests of the LDC, and the need for a new international economic order (NIEO). The struggle for the NIEO took, however, a definite shape with the UN announcement of the 1960s as the first development decade, with the creation in 1964 of the UNCTAD Secretariat which specialized in the international political and economic affairs and their impact upon the LDC, and with the appearance of energy crises in the early, 1970s and the new power given to OPEC in defending the interests of petroleum exporting countries with the industrialized countries.

3. The essence of the NIEO is the call for the restructuring of the international division of labor, stabilization of prices of primary commodities and increasing their exports, an increase in the flow of foreign aid, and an increase in the emphasis given to employment, income distribution, and the renewal of social and economic structures of the LDC. It appears, thus, that the NIEO is not mainly concerned with specific decision, but it re-

presents the efforts of the international community to change the pattern of relations between the LDC and the DC. This process is of a long term nature, and the success of the LDC in achieving their goals requires endured struggle on their part as well as the seriousness in planning their economies, and the competence of coordination among their national plans.

4. It was within this context that the second conference of the UNIDO in March 1975, issued the Lima Declaration which calls for a package of measures on the national, regional, and international levels to increase the rates of industrial growth in LDC in such a way that the share of these countries in total world industrial production will reach a minimum of 25 per cent in the year 2000. The declaration calls also upon the LDC to achieve effective control over their natural resources, to diversify their economies and to conserve their nonrenewable resources, and to take into consideration that the market mechanism is not effective in increasing the rates of industrial growth. The declaration, finally, calls for the intensification of industrial relations among the LDC in such a way as to increase their rates of industrial growth and to explore new avenues for the LDC to participate

effectively in the international industrial production.

5. For the call for a NIEO to be effective and for the fulfillment of the objectives of Lima declaration, there are certain measures that have to be taken by the governments of LDC. The most important measure of these is that the industrialization strategy must address itself to the elimination of the major causes of underdevelopment, permit the rational choice of new industries that will raise the rate of growth of the industrial sector, and achieve high rates of development at the national levels through the integration of the industrial sector with the national economy. Greater cooperation and coordination of industrial plans among LDC are required, too.

6. This paper attempts to review and appraise the industrial strategy in Egypt from 1952 up to the present time. The main elements of an alternative strategy that fits better with the main objectives of the NIEO, and which at the same time deals with the constraints on industrial development will be specified.

## II. The Development of Industrial Structure in Egypt:

7. The Egyptian efforts in developing the industrial sector since 1952 have led to some observable changes in the structure of GDP, which involved an increase in the share of industry at the expense of that of agriculture. The sector observed a period of sustained growth at a fairly high rate stretching between 1952 and 1964. The data further reveal a downturn in performance after 1964, where the rates of growth of industrial output started to decline, reaching negative values in 1967/68. There was a short recovery between 1968/69 and 1970/71, followed again by stagnation until 1974. The national accounts suggest a high rate of increase in industrial output in 1975.

8. The industrial structure of Egypt as well as the structural changes that took place over time may be depicted with the aid of value added data by groups of industries, for selected years.

Table 1:

Composition of Gross Value Added in Percentage  
by Categories of Industries (Selected Years)

Group	1947	1966/67	1969/70	1975
A: Basic Consumer goods	79.8	55.0	51.6	49.7
B: Intermediate Industries	19.7	38.2	40.6	40.6
C: Consumer Durables/ Equipment.	0.5	6.8	7.4	9.3

Source: IBRD, ARE: Economic Management in a Period  
of Transition, Vol. III. P. 71, 1978.

Group A: This includes, food beverages, tobacco, textiles,  
and wearing apparel. Two industries dominated this group  
the first in textile industry which retained its first

place in the ranking of gross value added by branch of  
activity, even though its share in this group declined

over time. The dominant place of textile is the consequen-

ce of import substituting policies rather than the mani-  
fistation of natural advantage, due to the inherent dis-  
advantage of using a high quality input (Egyptian long  
staple cotton) for the manufacture of coarse products.

Such inputs can be used to produce a high quality output,  
which commands a high international price.



The second industry is food, even though its share in value added is declining. The major reason is the inadequate quantitative growth of inputs. There is, thus, little opportunity for a rapid expansion of canning and dairy industries, even though an export-oriented strategy may want to encourage such expansion.

Group B: This includes chemicals (whose share in value added is increasing to take the place of food), wood, paper, printing, leather, rubber, coal, petroleum products, non-metallic, basic metals, and metallic products. The gross value added share of this category is increasing, even though it was not continuous.

Group C: This includes non-electric machinery, electric machinery, and transport equipment. It is misleading to treat industries in this group as representing the capital goods sector, as most of the output is transport equipment, car repairs, and consumer durables.

9. Small scale industries include establishments employing 10-50 workers. After the Nationalization Acts of the early 1960s, only relatively small manufacturing establishments remained under private ownership while the private sector has been excluded from the intermediate and

capital goods sectors, its share tends to be larger in consumer goods and generally in industries where scale economics are not very important. Small scale industries have managed, however, to hold their position, and they account now for about one third of total value added generated in industry and 54 percent of total industrial employment.

### III. Industrialization Strategy in Egypt:

10. The dominant feature of industrialization in Egypt has been import substitution, despite various changes in economic systems, under free private enterprise before 1952, under the mixed system of the 1950s and under the planned socialist economy of the 1960s and early 1970s. It is too soon to judge whether the open market policy of 1973 will succeed in changing the industrial pattern from import-substitution to export-orientation because the transition between these patterns is likely to take some time.

11. The dominant place of basic consumer goods, especially textiles, in the industrial structure of Egypt is the consequence of import substituting policies. This is a typical pattern of such policies due to the inherent dis-

crimination against the capital and intermediate goods sectors emanating partly from the cascading structure of tariff protection. This type of tariff structure implies negative effective rates of protection for the intermediate and capital goods sectors.

12. A balanced appraisal of industrialization strategy in Egypt must allow for the external circumstances - economic sanctions after the nationalization of the Suez Canal in 1956 which have been responsible for the call for self sufficiency and the defense burden which led to some deterioration in performance. Aside from these external circumstances, the appraisal must involve various effects of industrialization strategy on the balance of payment, efficiency in the use of resources, contribution to employment, consumption patterns, and the composition of establishment by size<sup>3</sup>.

A. Effect on the Balance of payment The period under consideration has witnessed a deterioration in the Egyptian balance of current account. Aside from the inadequate growth of agriculture to meet the demands of the increasing population, the policies undertaken during the period have led to such deterioration. Commercial policy in the form of the cascaded system of tariffs has led to the

encouragement of the final stages of consumer goods industries, which led to an increase in the demand for imported intermediate inputs and capital goods and the unprofitability of producing these goods domestically.

Exchange rate policies, through the overvaluation of the Egyptian currency, worked also as a mechanism to redistribute income from the traditional export sector to new industries, and to discriminate against the exports of these new industries. Furthermore, export policies were not very effective despite the recourse to subsidies for the promotion of exports of selected manufactured goods, because the range of these measures has always been extremely limited.

B. Employment Policies. The commercial and exchange rate policies determined in the framework of import substitution strategy have led to the choice of capital intensive techniques in the new industries, and thus, the industrial sector was unable to expand productive employment effectively. On the other hand the industrial sector suffered from the employment policy pursued since 1962, which has resulted in large scale overmanning of public sector enterprises.

C. Capacity Utilization. The shortages of foreign exchange referred to above, in addition to inventory mismanagement have led to the existence of capacity underutilization. The performance of industry has, thus, been made extremely sensitive to the administrative of the foreign exchange budget and hence import quotas and controls. Between 1961 and 1973 the foreign trade regime was most illiberal and extensively centralized and there was no convincing procedure for appraising the relative needs of various sectors and individual enterprises of foreign exchange. This means that capacity underutilization was not only the result of the binding limitation of the foreign exchange availabilities, but it was also due to considerable misallocation of foreign exchange to imports.

D. Consumption Patterns. The introduction of new industries under the import substitution strategy has led to a continuous increase in the propensity to consume. Two reasons have been behind this development; the first is the overvaluation of the Egyptian currency which has led to the minimization of the foreign exchange component of total cost and thus led to an increase in consumption and a change in consumption patterns. The second reason is the attempt by

the authorities to encourage the purchase of the newly produced commodities through extension of consumer credit. This last measure has been required to overcome the limited size of the market and thus to permit the economic utilization of capacity of the newly erected industries.

E. Small Scale Industry. The emphasis given to the establishment of modern large scale industries through the activities of the public sector, has led to some major problems adverse, affecting productivity, quality of output of services, and, by extension, constraining the growth of small scale industries. These major problems include out-of-date machinery; deficient production and management (product design and development, production planning and work methods, material selection, quality control, preventive maintenance, etc.); poor working condition and house-keeping, and marketing problems. Their relative importance varies with the particular industrial activity and the size of establishment. To correct the situation, and to permit this type of industry to play its role in the development of the industrial sector in Egypt, extensive technical and financial assistance are necessary.

#### IV Some Recent Developments

13. The draft of the new five year plan(1978-82) tried to take a moderate view with respect to industrialization strategy, by emphasizing the need for economic accounting of costs and benefits in the selection of new industries, whether it is for import substitution or export promotion. Export promotion is given, however, special attention in the plan due to the effects of such policy on widening of the size of the market and the resultant reduction in per unit cost. Another factor is the improvement of production techniques as a result of competition in the world market. A third factor is the net effect of exports on foreign exchange, which is required to pay for the imports of consumer, capital, and other goods required for national development.

This policy orientation is coupled with the recent emphasis put by the government on manufactured exports, and especially private sector exports. The foreign investment law, law no 43, 1974, can be seen in this context as an export promotion measure. The law provides Foreign investment in Free Trade Zones with various incentives: complete exemption from all taxes and tariff duties for an indefinite period, no restriction on repatriation of

earnings and capital, and, further, an implicit subsidy on the infrastructure provided to foreign investors in the free Zones because public utility services are at present grossly underpriced. The idea behind these incentives is that all the output of such areas will be exported. The private sector is also encouraged to export through a set of various incentives including the right to retain a portion of their foreign exchange earnings for own imports, and a rebate on duties and certain taxes paid on inputs for the production of exported goods.

14. These developments, which is the result of the open door policy pronounced in 1973 and thereafter, point to the same direction of the industrialization pattern applied in some latin American Countries such as Mexico, Argentina, and Brazil. This pattern of industrialization, commonly referred to as the Brazilian model, is based upon several factors<sup>5</sup>, the first of which is giving absolute primacy to industrialization, which after some time will be able to pull other sectors. Next, industrialization is based upon using available natural resources and cheap labor to produce essentially for exports. Furthermore, industrialization efforts depend on foreign capital with some encouragement to domestic private sector, while the state tries to provide



adequate infrastructure facilities. - Also, there is complete dependence on imported technology from advanced countries, which is a direct corollary of producing for export. Last of all, such model gives no emphasis to the issue of social justice-on the assumption that the trickling down effect resulting from the increase in the demand for labor and the improvements in social services as a result of the increase in tax revenues collected by the government, will ultimately improve the position of the poor.

15. The application of the previous model since the 1950, has led to a) an increase in the economic and technological dependency of these countries on the DC. b) In ~~1950~~ addition, due to high capital intensity and the high cost of imported technology the return on investment is usually inadequate relative to the burden of investment on the economy. c) A third result of this type of industrialization is the resultant economic dualism, not only among sectors of production, but also with regard to people working in these sectors. d) Furthermore, this model has led to the marginalization of the majority of the population which manifests itself in greater disparity in income distribution. This disparity is accentuated by the

neglect of traditional industries and agriculture, the lack of protection of small scale industries, the acceleration of inflationary tendencies etc. e) This type is also going to lead after a while to a decrease in the rate of growth as a result of the restrictions put by the multi national corporation(MNC)on export expansion and the limited size of the domestic market emanating from the type and price of various products. f) Finally, the impact of increasing income disparities is most likely going to increase social tensions and political unrest. This has led to the spread of gurrilla warfare in some of the latin American countries.

16. Some of the abovementioned shortcomings have started to show up in Egypt recently. The first of these is the increase in dependency on the outside world. The open door policy has led up to now to an increase in the imports of manufactured goods which compete with domestic production. This has been leading to the divergence of investment resources from productive sectors to trade and commerce, which in turn has been leading to an increase both in the deficit of current account and Egyptian indebtedness. The government hopes to eliminate this deficit in the early 1980s through expected growth in Sue Canal

dues, tourism revenues, Egyptian workers remittances from abroad, expected increase in petroleum exports, and the inflow of foreign investments. These measures will, however, lead to an increase in the dependency of the economy on exporting raw materials instead of industrial and agricultural products, and on foreign capital instead of domestic savings.<sup>6</sup>

Another development is related to the recent developments in income distribution. The period since 1973 has shown that the high rates of economic growth was accompanied by an increase in income disparities, due to emphasis given to the roles of private sector and foreign investments. This is quite different from developments that occurred from the late 1950s up to the early 1960s where high rates of economic growth was accompanied by a decrease in income disparities. Thus, the recent developments in economic policy in Egypt in addition to the high rates of inflation in Egypt since 1973 have been responsible for the recent increase in income disparities, and may lead to social unrest.<sup>8</sup>

## V. Towards an Alternative Strategy

17. In this section, the main elements of a proposed alternative strategy that fits better with the goals of the NIEO, will be sketched:

A. Industrialization for the Satisfaction of Basic Human Needs. The difficulties encountered with the application of the export promotion type referred to above, in addition to the fallacy of generalizing from the special case of few countries such as Taiwan, or South Korea to the LDC in general, point to an inward looking strategy. This is not to propose import substitution once more, because this type of production is constrained by the limited size of the market. It does mean, however, that we must begin by identifying basic human needs which include food, shelter, transport and communication, education and culture, health care, and amusements, guiding the industrialization strategy by the goal of satisfying the needs of the poor will lead to a different composition of output (and thus a different distribution of income), and reduce the demand for skilled labor. Similarly, it will reduce the pressure to leave the country side and thus reduce the demand for urban services. It will also lead to a reorientation towards more trade between developing countries.<sup>9</sup>

The success of this strategy requires partly, the planned convergence of consumption patterns with needs. This will be required to bridge the gap between the pattern of consumption and needs,<sup>10</sup> a gap which is responsible for the diversion of a tangible share of income from productive investment to satisfy the desires of the privileged minority to acquire the consumption patterns of DC.

But it may be mentioned that opting for such a style is not an easy matter, because of the existence of vested interests that may resist such change, the required changes in research & development, and the required changes in administration, trade, and investment policies.

**B. Self Reliance.** An inward looking strategy will by itself reduce dependency on DC, because of the lower capital intensity, and the simple and easy to acquire technology for such projects.

A strategy of self reliance requires the planned convergence of domestic resource use with domestic demand.<sup>11</sup> To achieve this the first point of investigation must be to establish what constitutes the major resource content of demand, and what scope there is for regulating this demand to a country's resource configuration. Despite the multiplicity of final products in the industrialized countries,

the raw-material content of these products depends on a narrow range of basic materials such as iron/steel, textiles (natural and synthetic), paper, plastics, rubber, glass, leather, cement, aluminum, wood, fuel and industrial chemical (primarily the alkalis, chlorine, and sulphuric acid). The bulk of value added in industry is derived from this range of industries, which constitute, as a result, the empirically verifiable range of strategic linkage and form the cornerstone of an industrialization program.<sup>12</sup>

It is important to note that if these goods are not produced locally, then the organic linkages between domestic demand and output lie abroad in the countries from which these imports are derived. The growth of domestic demand transfers the bulk of value added abroad. An effective industrialization strategy must therefore seek the vertical integration of the demand structure with domestic resource use. The unavailability of some inputs can be handled by substituting another input to produce the some product. Two other factors adding to flexibility are that the raw material inputs required in the production of basic materials have some degree of flexibility, and that technological developments abroad often can be exploited to make up for deficient resources at home.

The importance of this point should be emphasized from the Egyptian experience, where the production of sophisticated durable goods (based on imported inputs) was started, while the country is still importing basic commodities such as cement, where it has natural advantage.

Self reliance does not mean autarky, but because of the fact that trade itself is a manifestation of, and a factor reinforcing the structural disequilibrium in the LDC, the problem must be solved at the structural level by disengagement from the present international division of labor wherever possible. This means that industrialization is necessary to create a domestic capacity to convert domestic savings into investment goods and to allow for the potential development of an export capacity in industrial goods.

Similarly, self reliance does not mean the avoidance of imported technology or the attempts to adapt it, or improve its terms to LDC.<sup>13</sup> But it does mean, however, that the development of national technological capacity is essential. This is due to the fact that it is impossible to choose imported technology wisely, to bargain effectively with machine salesmen, multinational corporations and other carriers of technology, to unravel technology from investment packages, to judge proposals, to adapt imported

technology to the concrete needs of a country unless national technological capacities exist. National technological capacity is thus, as necessary for the appropriate use of imported technology and for the development of an efficient and appropriate technology.

C. Industrialization in a Unified and Independent Development Strategy. Industrialization is only a part of this unified development strategy, but it has a special role, because output and consumption per head can rise only with the help of mechanical aid, and the high growth potential of manufacturing.

An independent development strategy does not necessarily mean the avoidance of foreign investment through the MNC. The important point is that economic independence means that the government has complete freedom to structure the national economy without being subject to any economic or political threats. If the government acquires this economic independence, then the task of its dealings with the MNC should be to define their positive contribution, and the social cost involved. The government should then try to maximize the former and minimize the latter, and to provide for a gradual and agreed upon transfer to national or regional ownership and management.



D. Small Scale Industries. Such industries appear most promising in Egypt in terms of potential growth, and they include engineering, food processing, ready made garments, footwear and leather products, woodworking and furmiturs, printing and chemicals. Aside from growing demand and export potential, factors reinforcing the potential growth and viability of these industries include relatively insignificant scale economies; complementarity with larger industry - involving manufacturing operations in which the processes are readily seperable, craft or precision hand-work, simple operations of assembly, mixing or finishing, provision of services and repairs to other industries; and production of differentiated products for specialized market. These industries belong to the so-called modern small scale industry sector but have a relatively low capital intensity, and their expansion should inter alia enlarge employment for the urban poor.

Small scale industries should be encouraged through

- a) the provision of credit and technical assistance;
- b) elimination of the existing biases against small scale industry with respect to incentives, procurement, and taxation;
- c) the revision of the existing incentives scheme to ascertain its effectiveness to redirect exports;
- d) elimination of controls on prices and profit margins;
- and e) the encouragement of subcontracting arrangements.

E. Capital Goods Industries. Our emphasis on the development of small scale industries does not necessarily mean the negligence of other industries and specially the capital goods industries. The capacity of these latter industries is determined by the surplus of wage goods (i.e., surplus generated in the agricultural sector), and by the production capacity of the capital goods sector (specially the sub-sector producing machines that are used to produce the machines directly used in the production of final goods). The domestic availability of capital goods produced by this sector will put the decision to determine the extent of the investment program under the national control. In addition, the creation of productive capacity in this sector will have negative effects on the balance of payments only during the initial period during which the build up of production capacity is taking place. It can be seen, thus, that what we are suggesting is a policy of "walking on many legs" - the rural and the urban, the small scale and the large scale, labor intensive and capital intensive, technically sophisticated and unsophisticated.

F. Regional Cooperation and Integration. The success of the proposed strategy will depend upon the success in creating various forms of cooperation and integration. These forms of cooperation may be essential since most of the countries in the Arab world, or LDC in general are small or medium size national units as a result of colonial balkanization. The framework of self reliance will become in such circumstances collective self reliance.

The success of the suggested strategy of emphasizing the satisfaction of basic human needs in the framework of a collectively self reliant and independent development will depend on the degree of cooperation among these countries. This cooperation is essential since industrial development in most of these countries may suffer from the limited size of local markets for some industries, or the lack of some basic inputs required for production. Cooperation in such circumstances will lead to an increase in growth potential, and at the same time may help in avoiding economic hardships that may result from following such an independent strategy. It must finally be stressed, however, that the various forms of cooperation require partners who are following similar course.

Foot Notes

1. For a detailed and up to date review of the industrialization of Egypt, see: R.Mahro & S. Radwan, The Industrialization of Egypt, 1939-1973, Clarendon Press, Oxford, 1976; and IBRD, ARE: Economic Management in a Period of transition, Vol. III, 1978 PP. 62-97.
2. Ibid, P. 77.
3. For an appraisal of the industrialization strategy in Egypt, see: Amr Mohei-El-Din, "An Appraisal of Industrialization strategy in Egypt, and possible Substituts in the Future", in the Proceedings of the Second Annual Conference of Egyptian Economists, Cairo 24-26 March, 1977, PP. 177-207.
4. Ministry of planning, Draft of the Five Year Plan, 1978-82, Vol. VI, General Industrialization Strategy, Aug. 1977, PP. 37-50.
5. Ismail Sabry Abd-Alla, Industrialization Strategy in the Arab Countries and the International Division of Labor, Oil and Arab Cooperation, OAPEC, Vol. 2, No. 3, PP. 37-61 (in Arabic).
6. Galal Amin, "Some Issus of Open Door Policy", in the Proceedings of the Third Annual Conference of Egyptian Economists, Cairo, March 23-25, 1978, PP. 3-11(in Arabic).

7. Ibrahim El-Issawi, "Distribution, Growth, and Development", in the Proceedings of the Fourth Annual Conference of Egyptian Economists, Cairo, may 3-5, 1979, PP. 24-34(in Arabic).
8. IBRD, Vol. 1, Op. cit, P 43.
9. P, Streeten, "Industrialization in a Unified Development Strategy", World Development. (Jan. 1975), PP. 1-9.
10. C. Y. Thomas, "Industrialization and the Transformation of Africa: An Alternative Strategy to MNC Expansion", PP. 344, This law is sometimes defined as one of the two "iron laws of transformation".
11. This is the other "iron law of transformation".
12. Ibid, PP. 350-351.
13. H.W. Singer, "Appropriate Technology for a Basic Human Needs Strategy", International Development Review, No. 2, 1977, PP. 10.
14. Streeten; op. cit.