

# AN EXAMINATION OF LEGAL INSTRUMENTALISM IN PUBLIC ENTERPRISE DEVELOPMENT IN THE MIDDLE EAST

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## I. INTRODUCTION

Within a relatively short time, the concept of law in many developing countries has begun to evolve from that of a reflection of the customs, beliefs and ethics of a people toward that of an instrument at the service of the state. Increasingly, law has become associated with development, modernization, social change and, on occasion, revolution. Disaffection with the slow pace of change mounted, beginning in the 1960's, as governments recognized that the strategies of development espoused by the economic purist—of capitalist or socialist persuasion—did not, in the final analysis, incorporate sufficient reference to the complexities involved in social and economic change. Consequently, the relation between law and development has gained currency and has become a more sharply defined, respectable and legitimate concern, as have the relations between development and other disciplinary perspectives.<sup>1</sup>

Many developing countries have attempted to promote industrial growth through the use of the discretionary powers of the state as exercised through laws. Anxious to stimulate economic growth and social modernization through industrialization, this new use of law was seen as a means of achieving developmental goals while imposing what were thought to be appropriate norms and procedures. This process of grafting a new legal order onto the traditional society is perhaps nowhere more pronounced than in the case of the creation, evolution and regulation of public

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<sup>1</sup> Within the social sciences it has long been felt that the economics discipline has overshadowed all others in the effort to bring about modernization and change in the traditional societies. It is now recognized that the other disciplines may bring useful perspectives to the various issues involved in development. However, there remains a strong tendency to segment development issues along disciplinary lines rather than seek a multi- or interdisciplinary perspective.

enterprises in the developing countries. Often relying heavily on imported legal concepts, the developing countries have sought to stimulate growth through the formation of public enterprise sectors that—besides their economic function—also incorporate social goals such as the redistribution of wealth, employment generation and the provision of vital goods and services to society. Thus, public enterprises frequently have been created to promote those objectives believed to be consistent with the maximization of social benefit but inconsistent with private profitability.

It is precisely because of the social as well as the economic character of public enterprises that a basic problem arises. The pursuit of social goals has often led developing countries to undertake highly unprofitable projects. While social benefit may, indeed, derive from such projects, it is more likely that the state and the society will incur net welfare losses.<sup>2</sup> A public enterprise, as an economic unit required to perform its economic function efficiently, is nevertheless also accountable to the state—a state that often may pursue vague and unclear social objectives and feel compelled to direct the firm's operations. The task facing the public enterprise is, therefore, a complex one. The concomitant legal problem is also complex, since the law must seek to define both the task of the enterprise and its requisite performance. A proper balance must be found between the various competing objectives expected of the public enterprise; further, this balance must find adequate expression in legal instruments to ensure achievement of these objectives.

It is not surprising that law has been used extensively in the creation of public enterprises and in seeking to define, in precise legal terms, their roles, objectives and operations in sufficiently detailed terms to mitigate any economic and social ambiguities as to purpose and goal.<sup>3</sup> Law has both posed and attempted to answer the basic question, i.e., whether the legal form of public enterprise organization can be so constructed as to produce the requisite managerial and employee behavior so that both the social and economic ends are met.

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<sup>2</sup> For a recent study on the performance experience of public enterprise sectors in a number of developing countries, see Choksi, *State Intervention in the Industrialization of Developing Countries: Selected Issues*, WORLD BANK STAFF WORKING PAPER NO. 41 (1979).

<sup>3</sup> The effort to legally define the social and economic purposes of public enterprises can often prove quite extensive, particularly in the socialist economies. See GOVERNMENT OF YUGOSLAVIA, SECRETARIAT OF INFORMATION, *THE ASSOCIATED LABOUR ACT, THE S.F.R. OF YUGOSLAVIA ASSEMBLY SERIES* (1977).

There is mounting evidence in the developing world that law has largely failed to produce that framework in which the performance of public enterprises corresponds in sufficient measure to their social and economic objectives. Increasingly, meeting social objectives results in excessive and continuing economic costs that, in the final analysis, only serve to weaken the economy to such an extent that the social objectives are themselves undermined. The continuous subsidization of unprofitable firms, in the long run, leads to a serious misallocation of resources brought about by the diversion of national savings. Even if the financial performance of an enterprise may improve over time, the net welfare loss, evaluated over the total years of operation of the firm, is still likely to be quite large. As a result, many countries have found it necessary to review carefully the present condition of their public enterprise sectors. Where redress is sought, it is not unusual to find that reformulation of policies, operating styles and goals is once again viewed mainly as a legal exercise.

Robert C. Pozen, in his recently published study on the Ghanaian experience with legal definition of the economic purpose of public enterprises, observed that "legal decisions about state-owned enterprises can be intelligently made only in reference to the developmental strategies and other aims of each country . . . lawyers have no special claim to these decisions; the selection of a developmental strategy belongs to the political leaders of each country."<sup>4</sup> Perhaps this is true, but nevertheless law is at the core of many current efforts in developing countries to once again address what David Smith (in a review of Pozen's work) calls the "political accountability-business efficiency double-decker bus."<sup>5</sup>

This article focuses on the use of legal instrumentalism as a means of inducing acceptable public enterprise performance in the Middle East, with particular reference to the Egyptian case. Under Anwar Sadat, Egypt is seeking major reforms in and improved economic performance from a public enterprise sector that in the past has not made an adequate contribution to economic development. The economy, in a precarious and seriously weakened condition, is saddled with a public enterprise sector that has incurred substantial and continuing losses for over a decade. The outcome of this "reformation" will have considerable influence on the other Arab countries, including Syria, Iraq, the Sudan and the

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<sup>4</sup> R. POZEN, *LEGAL CHOICES FOR STATE ENTERPRISES IN THE THIRD WORLD* 141 (1976).

<sup>5</sup> Smith, *Book Review*, 27 *ECONOMIC DEVELOPMENT AND CULTURAL CHANGE* 597 (1979) (R. POZEN, *LEGAL CHOICES FOR STATE ENTERPRISES IN THE THIRD WORLD*).

Gulf States, that have patterned their industrialization on the Egyptian model.<sup>6</sup>

The interplay between law and economics, the lawyer and the economist, in this process of public enterprise reform will also be examined. The Egyptian case is once again appropriate, for law and lawyers have played a predominant role in revitalizing its public enterprises. The problem of making public firms more economically efficient remains. But, in addition, they must continue to be legally responsible for maintaining past gains in social justice. The outcome will be particularly significant for other developing countries, such as India, Mexico, Turkey and Ghana, which are also increasingly aware of the high costs involved in perpetuating highly inefficient public enterprises but which must remain committed to broad social objectives.

Finally, a number of recommendations will be put forth concerning the use of law as an effective tool in the reformulation of public enterprise goals or, for that matter, broader economic development strategies and goals. There is a clear need to facilitate a common frame of reference for the lawyer and the economist as they address the basic issues involved in bringing about rapid economic and social change. The current wave of concern over public enterprise performance offers a new opportunity for creative and fresh approaches by both disciplines.

## II. PUBLIC ENTERPRISE ORGANIZATION AND ECONOMIC PERFORMANCE: AN OVERVIEW OF MIDDLE EAST EXPERIENCE

Public enterprise is a widespread and important component in the development programs of the Arab countries. Although the reasons for the adoption of public enterprises vary considerably, several factors are relatively common to all Arab nations in the Middle East. These factors include: the severe shortage of managerial and entrepreneurial talent; the existence of small private sectors relatively inexperienced in putting together large and complex industrial projects; and, in some instances (e.g., the oil rich states), the accumulation of capital surpluses too large for a private sector to absorb. Factors such as these have led govern-

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<sup>6</sup> The influence of Egypt throughout the Arab World is extensive in all matters, but especially so with respect to economic development strategy and policy. This influence, aside from any historical origins, stems from the interventionist and Pan-Arab policies pursued by Nasser and the fact that Egypt serves as a major source of professional labor for many other Arab countries. Hence, economic planning organizations, educational institutions and bureaucracies are often designed by and, on occasion, staffed with Egyptians.

ments to create public enterprises to spearhead national development.

A number of Arab countries (Egypt, Syria, Iraq and the Sudan) have, in addition to the factors noted above, felt compelled to adopt a political and economic philosophy which is consistent with widespread ownership of the means of production and with centralized direction of development. Others (Saudi Arabia, Kuwait, Bahrain and the United Arab Emirates), with a strong predilection for private enterprise, nevertheless have found that public enterprise is a more expeditious form of inducing rapid industrialization. The latter countries show no indication of a socialist policy nor have their public enterprise sectors been formed by the large-scale nationalization of pre-existing foreign or domestic private enterprises.

As might be expected, public enterprises in the Arab countries of the Middle East assume a wide variety of legal and organizational forms. In addition, they are subject to a variety of forms of official surveillance, direction and accountability. Laws pertaining to dispute settlement, labor relations, taxation and liability differ from country to country, largely depending upon the legal structure of the enterprise.

Given the great diversity of laws and legal arrangements that one finds in Middle Eastern public enterprises, there is a surprising degree of commonality in the types of problems and issues which arise.<sup>7</sup> In 1976, a conference on public enterprises and development in the Arab countries generated a rather lengthy list of the main areas of concern:

1. Inadequate articulation of the multiple objectives of public enterprises (e.g., production of revenue, government control of vital sectors of the economy, provision of public services, training of administrative and technical personnel, employment, etc.);
2. The need to develop more adequate criteria of enterprise performance;
3. Inadequate supervision and co-ordination at the policy level and faulty organization and management at the operating level;

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<sup>7</sup> Under the aegis of the Arab League, a number of technical committees and organizations have been established which focus upon key development issues with which the Arab countries are confronted. There have been several major conferences on public enterprise experience and, in general, there is a considerable interchange of information between members of the League on economic and social matters.

4. Failure to achieve proper balance between the requirements of policy making and the requirements of management performance;
5. The classic problem of control and autonomy and the complexity of the notion of control, especially in mixed economies and joint international ventures (e.g., control may be through ownership, management, technology, holding companies, marketing, etc.);
6. Insufficient accountability of public enterprises, for example, through legislative controls and public reports;
7. Decentralized planning at the enterprise level and the effectualization of worker self-management;
8. The settlement of disputes between public enterprises, for example, at the ministerial level or through arbitration; and
9. The inadequacy and unsuitability of traditional laws and lawyers.<sup>8</sup>

Such concerns demonstrate the dichotomy between social objectives and economic efficiency and the strong inclination of governments to seek resolution of any imbalance between these objectives through a further delineation of the legal constructs of public enterprises.

This particular conference concluded that "though a public enterprise may have political and social objectives in addition to its commercial ones, it ought to be evaluated in the first place by ordinary commercial standards."<sup>9</sup> If this were the case, then the main criteria of performance must necessarily be real economic costs "which reflect the economic value of all inputs and outputs of the enterprise in terms of goods and services, taking into considera-

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<sup>8</sup> Public Enterprises and Development in the Arab Countries, International Center for Law in Development 5 (1977). These proceedings list additional issues which are more pertinent to the oil-producing Arab countries, including the extreme shortage of entrepreneurial and managerial experience and the need to use public enterprises as training vehicles; the overdependence on oil and the need for industrial diversification of public enterprise activities; and insufficient concern for economic efficiency, induced by the exorbitant amount of capital available.

With regard to the problem of control and autonomy, joint ventures between Arab public enterprises and international investors and inter-Arab joint ventures has become a subject of great interest and importance in the Middle East. The basic thrust of Egypt's economic liberalization policy is towards the decentralization of public enterprises and the diminution of public enterprise influence through the encouragement of joint ventures with Western (primarily United States) private corporations. This is seen as a means of inducing greater economic efficiency within the public enterprise sector and stimulating a more rapid pace of technology transfer. Opponents of the new policy see it merely as a means of liquidating the public enterprise sector and returning to an economy largely controlled and operated by private interests.

<sup>9</sup> *Id.*

tion the direct and indirect costs and returns, and endeavoring to achieve the prescribed and implicit objectives with minimum costs and optimum utilization of resources."<sup>10</sup> Further examination of specific situations, however, indicates rather clearly that while there may exist a pronounced desire to have efficiency criteria form the principal basis of performance evaluation, many Arab states continue to absorb considerable losses from economically inefficient public enterprises. This trend is unabated by any attempt at more precise legal definitions of goals, purposes and performance criteria.<sup>11</sup>

### A. *Syria*

In the case of Syria, for example, the development of the public enterprise sector corresponded to the process of the establishment of independence from the French mandate as well as economic development. The economic development strategy was embodied in four development plans: 1961-65; 1966-70; 1971-75; and the current plan of 1976-1980. Relying on a series of nationalization measures—as did Egypt, Iraq and the Sudan—and beginning with the nationalization of the finance sector in 1961, Syria issued successive decrees in 1964 and 1965 to increase public control of the main production and service facilities.<sup>12</sup> By 1960, the public

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<sup>10</sup> *Id.*

<sup>11</sup> A particularly interesting proposal was made at the conference on public enterprises and development (*see note 8 supra*). It was suggested that where social objectives are maintained for public enterprises they should receive a direct government subsidy equivalent to the non-economic task(s) demanded of them by legal statute or other legal instruments (such as a ministerial decree). Alternatively, it was suggested that the aggregate costs of social tasks required of the firm should be calculated at the time of budget review and an appropriate adjustment made in the annual financing of the firm to cover what in effect is a social charge. Neither answers the issue of whether performing the social task indeed impairs the achievement of the purely economic functions of public enterprises. For instance, if a firm must employ 1,000 workers when it only needs 500 in order to maximize employment from a social standpoint, it must be recognized that the marginal product of the unnecessary workers may well be negative: overcrowding of the workplace, make-work projects and the like may well reduce the productiveness of that portion of the labor force gainfully employed. Further, the calculation of the appropriate charge for social tasks is often difficult to determine with any accuracy. Finally, such solutions are of little import for the public enterprise that is inherently inefficient; i.e., many public enterprises have insufficient economic justification for their creation in the first place, much less their continued existence.

<sup>12</sup> The private sector is small but active in the Syrian economy. Almost all large enterprises have been nationalized and those active in the private sector are careful not to grow so significantly that they attract attention or become eligible for nationalization. Syria has no specific criteria with respect to the latter; however, the private sector recognizes that "a rule of thumb" is exactly that.

sector was the leading contributor to national income, accounting for forty-seven percent of gross domestic product (GDP); by 1974, it accounted for seventy-five percent of total fixed capital investment.

Sweeping measures calling for nationalization of existing production and service capacity generally preceded any serious thought as to how, from a legal point of view, the public enterprise sector would be organized (again, a similar pattern prevailed in Iraq, Egypt and the Sudan).<sup>13</sup> In Syria, the nationalization phase was completed in 1965. The issuance of reorganization and consolidation laws and decrees has been more or less continuous since that time, falling into three rather distinct phases:

1. The nationalization phase of 1963-1965, during which the concept of a holding company was applied as basic in the legal organization of the various nationalized enterprises;
2. The reorganization phase of 1966-1973, during which a sectoral system was followed, [e.g.], banks, industry, foreign trade, domestic trade, etc.; in industry, the methods of horizontal . . . and vertical complementary were followed;
3. The phase of unification of the organization of public enterprises, initiated in 1974 [and continuing] with the enactment of unified principles for organization of the public sector.<sup>14</sup>

Continual legal redefinition of the structure of public enterprises has been occasioned by the general failure to attain the economic objectives set forth for the sector in the various development plans.

For Syrian public enterprises, performance is evaluated within the context of established long-range economic plans which are enacted as laws. Under a "policy umbrella" established by the

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<sup>13</sup> Early development plans in Syria and Egypt called for a substantial investment role on the part of the private sector. For both countries, the 1961-1965 plan indicated that such a role was both anticipated and expected. It is puzzling, therefore, to find that shortly after these plans were launched both countries initiated a policy of nationalization of all major private holdings. See Roy, *Economic Liberalization and the Private Industry Sector in Egypt*, 1 MIDDLE EAST MANAGEMENT REVIEW 9, 10 (1977), for a further discussion of the Egyptian experience in this regard.

<sup>14</sup> See note 8 *supra*, at 127.

Holding companies have been proven to be one of the more ineffectual organizing vehicles for public enterprises in the Middle East. Initially, in countries like Syria, Iraq and Egypt, their convenience lay largely in providing a loose managerial and administrative framework within which to collect individual operating units with roughly similar product lines. However, in practice what often occurred was the gathering together of individual production units of vastly varying size, technologies, product lines, and management methods. Effective administration and planning was virtually impossible in such situations.



state planning authority (with appropriate political approval), each project or enterprise submits an annual production plan to which investment plans are attached. There is no coordination horizontally; i.e., the short-range targets of each public enterprise are formulated independently of one another. Within the enterprises, targets are coordinated by the appropriate public institution to which they report.<sup>15</sup>

Performance, given the absence of any horizontal integration of enterprise targets, can only stress two factors: the attainment of investment objectives (i.e., spending allocated funds), and production objectives. Since the enterprises are not required to prepare budget estimates, the evaluation of their financial performance is, in general, impossible. More importantly, performance evaluation in terms of their economic profitability is not a reliable indicator because the "bottom-up," or materials balancing, method of planning does not permit sufficient precision in the determination of appropriate production levels and the corresponding appropriate levels of enterprise investment. To this would have to be added the difficulties which ensue from "the fluctuation of prices, the mingling of profit with the surplus allocated for development, the lack of proper development of the financial supervisory systems, and the lack of a plan for costs and profits."<sup>16</sup>

The use of law, in the first instance, to establish a suitable framework within which to rationalize the achievement of social and economic objectives through the establishment and administration of the public enterprise sector and, in the second, to adapt to the exigencies which ensue from an inadequate or incorrect assessment of the economic consequences involved therein, generally has not worked well in the Syrian case. Serious economic problems have arisen which have created an imbalance between the social and economic goals being sought.

For example, the level of production of consumer goods has not kept pace with the money supply resulting in an increasing rate of inflation. Rising prices have had an adverse impact on the real incomes of members of limited income groups. In addition, the undermining of the value of Syrian currency has resulted in its de-

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<sup>15</sup> Under such a system it was possible to calculate and assess internal, but not external, economies and diseconomies that accrued to any individual enterprise activity. Lack of planning integration thus carried with it the likelihood that inter-industry dependencies could not be foreseen and hence that the resulting economic problems could not be corrected.

<sup>16</sup> See note 8 *supra*, at 138.

preciation. The trade balance deficit has increased, adding to an already substantial drain on much needed foreign exchange reserves precisely at the time when the ability to generate foreign exchange earnings was also decreasing.<sup>17</sup> There has resulted an absolute decline in the standard of living. The latter consequence is obviously not consistent with the social objectives implicit or explicit in the creation of the public enterprise sector.

Clearly, the laws which govern the Syrian public sector do not lead in and of themselves to the selection of inappropriate monetary policy. It can be argued that the cumbersome nature of numerous regulations reduces the flexibility and ease with which state enterprises can respond to the rapidly changing economic conditions with which they may be confronted. Conversely, it cannot be contended that the revision of laws which govern the public sector necessarily will bring about the required changes, given the fact of economic instability. Yet in the Syrian case, the response has been mainly legalistic.

Operating under a series of distortions of the types noted above, the marketplace gives signals which may evoke a legal response. This typically occurs in the public enterprise sectors of the Middle East. In Syria, improvements in economic performance have been sought through legal revisions of operating methods, including proposals for:

1. Revising the planning process that would lead to unified planning among the enterprises as well as between all major economic sectors (industry, transportation, foreign and domestic trade, credit, etc.);
2. Rationalizing state development planning machinery so that bureaucratic inconsistencies in its operation are reduced;
3. Strengthening planning and research in the state planning authority and all ministries, public institutions, and public enterprises; and
4. Integrating the annual planning exercise covering all aspects of economic activity: production, distribution, exchange, consumption; this plan would unify sectoral and corporate plans and serve as a control over operations, follow-up, supervision, and accountability.<sup>18</sup>

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<sup>17</sup> Syria is basically an agrarian economy. Seasonal fluctuations in its cotton, grain, and tobacco crops have a significant impact on its foreign exchange earnings capability and, hence, on its balance of trade position.

<sup>18</sup> See note 8 *supra*, at 155.

### B. *Kuwait and the United Arab Emirates*

By way of a contrast, for the origins of the public enterprise sector are substantially different, it is interesting to examine the situation in Kuwait and the United Arab Emirates (U.A.E.).<sup>19</sup> As essentially single resource economies (oil), these countries are particularly vulnerable in the long run. The burgeoning surpluses of capital, a relatively recent phenomenon, must be used to insure continued national political and economic viability as their oil reserves are depleted. This has led these governments to assume a dominant role in the planning and direction of economic development. What has emerged is an aggregate economy which is almost wholly dependent upon the oil industry. Economic activity outside of the oil industry is, in turn, almost wholly dependent upon the government.

Traditional in national character and often rather fundamentalist in religious outlook, both countries have developed public enterprises as a means of insuring both the establishment of an adequate social infrastructure to serve the public at large as well as to attain whatever diversification of the economy is feasible and practical. Neither Kuwait nor the U.A.E. (nor Saudi Arabia, for that matter) is committed to anything approximating socialism, but "based on the size of their public sectors, these countries appear to be more socialist than many a country which is committed to socialism."<sup>20</sup>

Virtually all public services—mail, telecommunications, electricity and water, and transportation—are totally government owned.<sup>21</sup> These services are provided on a highly subsidized basis according to a pricing system which is designed to attain the objective of "social advantage." In addition, these governments hold a majority ownership in oil production and oil-related enterprises (usually as joint ventures with Western firms). Beyond this, both governments have undertaken a wide variety of other economic activities.

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<sup>19</sup> The United Arab Emirates are comprised of the Trucial States in the Persian Gulf excluding Qatar and Bahrain. While minor variations occur in the organization and performance (and the laws adopted therein) of public enterprises of Kuwait and U.A.E., the former exerts great influence over the latter. Therefore, it is possible to address their experiences collectively.

<sup>20</sup> See note 8 *supra*, at 10.

<sup>21</sup> An exception here is the state of Dubai, which is part of the United Arab Emirates. Only the postal service is owned by the government; all other services are provided by the private sector.

While countries such as Syria and Egypt had substantial private sectors which were capable of contributing to economic development (albeit that they chose to sharply curb their role), neither Kuwait nor the U.A.E. were so endowed, at least not in sufficient strength to assume a major role in converting huge capital flows into viable economic projects. However, the private sectors in these countries have not construed the government role in the development of the economy as inimical to their interests.

Public enterprises in the service categories are organized as normal government departments administering monopolies. Industry operations can fall into several organizational categories, depending upon the extent of government ownership or the degree (irrespective of the extent of ownership) to which the government chooses or is able to participate in the actual operating decisions. Accordingly, the legal form of an organization can take the form of a government company, a public corporation, or a foreign joint venture. Less orthodox ideologically than Syria, Kuwait and the U.A.E. show considerably more flexibility in the type of organizational structure adopted in response to the circumstances and choices with which they are confronted. Although both governments are prominent in establishing and implementing economic development priorities, they nevertheless are not required to conduct the exercise within a holistic and consistent ideological framework. One must bear in mind that in both of these countries, public enterprises have been created to assist, not to compete with or replace, private enterprises.

The legal documentation which establishes the various forms of public enterprise organization specifies their objectives in general terms. With respect to the issue of economic performance as compared with social objectives, the degree to which either set of criteria is applied varies according to legal form:

1. The objectives of government subsidiaries which are formed in joint ventures with foreign partners are carefully defined and commercial profitability is both accepted and expected as the leading indicator of performance.
2. Government operations in the services sector have objectives incorporated into the laws creating them. These objectives are none too precise and are often expressed in rather vague language specifying broad social purposes.

A somewhat crude "rule of thumb" is that the closer public participation in an economic undertaking approximates a private endeavor (in this case, the foreign joint venture), the more sharply

defined are the acceptable criteria of performance; among these, commercial profitability would rank very high. At the other end of the spectrum, where industries or services are wholly owned and operated by the government, the enabling legislation is far less precise and rather vague; here, social criteria are predominant. From a structural point of view, the organization of both the foreign joint venture and the wholly-owned government corporation may bear striking similarities. Their economic performances, however, can and do differ markedly.

The question of economic efficiency is placed in a different perspective for the oil-rich Arab nations than it is for poor nations such as Syria and Egypt. Yet the reluctance with which countries such as Kuwait and U.A.E. have initiated public undertakings and the intent to turn over such undertakings to the private sector when feasible carries with it an obligation to adhere to some form of efficiency criteria. Enabling legislation and the various legal forms of enterprise that have emerged reflect this ambiguous attitude toward efficiency. As might be expected, the ambiguity finds expression in the management of those enterprises which operate under vague social criteria.

With respect to the performance issue in Kuwait and the U.A.E., two additional points are relevant:

1. Given the need to train nationals and in general develop human resources, the need to transfer modern industrial technology, and the need to diversify a single resource economy, the contribution of government enterprises cannot be calculated only in financial terms. The "profit motive" is not the principal consideration.
2. Although the rate of return of such enterprises might be inconsequential—possibly even zero or negative—other alternative uses of so large funds of capital may not have been conducive to development objectives and goals.<sup>22</sup>

Hence, in the capital surplus economies, vague social objectives are both more affordable and perhaps as effectively addressed as they can be.

The cases discussed thus far broadly establish the two poles of public enterprise experience of the Arab countries and the manner in which law relates to the organizational character of each. Syria, committed to socialism, has undertaken to establish the dominance of the public enterprise sector, eliminating or restric-

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<sup>22</sup> See note 8 *supra*, at 52, 53.

ting private activity so that all basic economic decisions rest with the state. A highly centralized planning and administrative structure has been created to administer these enterprises and successive periods of administrative and legal reform have sought to elicit managerial and firm behavior consistent with the social and economic goals established for the public sector.

The Persian Gulf states of Kuwait and the U.A.E. have been drawn more reluctantly into the utilization of public enterprises as a means of promoting economic development. However, the capital rich character of their economies and the paucity of trained and experienced human resources have nevertheless led to the creation of extensive public economic operations. The social purposes for which public enterprises have been created are possibly more palatable because they are affordable and the broader goals of training indigenous personnel and effecting a more rapid rate of technology transfer transcend the goal of pure profitability. Put another way, profitability is not measured solely according to the standard measures of commercial gain. The private sector is not threatened by the state's intent to establish public enterprises and the state adopts the profit motive in those operations where it appears to be more appropriate to do so, i.e., in foreign joint ventures. As in the case of Syria, the law reflects the multiplicity of purposes being served in the public sector and the legal form of an enterprise corresponds to the social and economic intent of the specific public undertaking.

### III. THE REFORMULATION OF PUBLIC ENTERPRISE GOALS: THE CASE OF EGYPT

Perhaps in no other Arab country has there been such an exhaustive and comprehensive attempt to legally define, and redefine, the goals and purposes of public enterprises as in the case of Egypt. By the early 1970's, the bold economic and social initiatives that Nasser had launched in the late 1950's had resulted in the creation of a public enterprise sector, the basic problems of which were so deeply entrenched that the some 150 official "administrative revolutions" announced throughout the period had had little or no measurable effect.<sup>23</sup> This led President Anwar Sadat to at-

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<sup>23</sup> Administrative reform programs, of both major and minor scope, are formulated by the Egyptian government. Usually headed by a minister of state, such programs encompass a sweeping mandate for bureaucratic reform and reorganization. A main difficulty has been that those officially heading these programs have seldom commanded a sufficient amount of power or enjoyed the degree of high level support required to bring about much change.

tempt to resolve Egypt's economic problems by adopting a philosophy which sought to preserve the gains in social justice and the basic character of Arab socialism and also sought to re-establish a sufficient degree of private incentive and initiative so that the economy could once again establish a growth momentum. It was recognized that this could not be achieved without a considerable revamping of public enterprises.<sup>24</sup>

In 1973, Egypt embarked on this new economic experiment, the "infatih,"<sup>25</sup> more commonly known as the Open Door Policy, in an effort to revitalize the national economy. The main aim is to combine Arab surplus capital, Western industrial technology and Egyptian entrepreneurial and managerial talent and labor into a development equation which would lead to economic growth.<sup>26</sup> At the core of Egypt's economic problems lay the body of ill-conceived and poorly administered policies that had evolved since the late 1950's. Sadat, sensing that fundamental changes in the operation of the economy could only come through renewed emphasis on private initiative, set in motion an increasingly heated debate

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The character of the Egyptian bureaucracy in terms of its pervasiveness and lethargy makes radical administrative reform virtually impossible. At best, then, the continuing parade of reform movements has only brought about marginal improvements.

<sup>24</sup> Sadat's advisors were considerably influenced by the type of public enterprise organization to be found extant in the more moderate Arab states such as Saudi Arabia, Kuwait, and the U.A.E., i.e., the extensive use of foreign joint ventures. Revamping Egyptian public enterprises along such lines held several potential advantages: economic performance criteria could be applied with greater specificity; the oil-rich Arab states would be more attracted to investment possibilities in such cases; both the managerial and production technology of the Western industrialized nations might be transferred more expeditiously and effectively; and the social emphasis of public enterprises would not be lost entirely. As such, Egypt was seeking to establish a revitalized public enterprise sector within the context of a continuing socialism but consistent with a return to market economics sufficient to make the public sector more efficient and productive. For a discussion of Arab oil-nation investment objectives in Egypt, see generally Proceedings of the Seminar on Investment Policies of Arab Oil Producing Nations, Arab Planning Institute and Kuwait Economic Society (July 1979).

<sup>25</sup> Meaning, literally, "openness" or a return to a more "open" society. The implications of the term go beyond an economic definition and encompass both a religious and political note. Figuratively speaking, "infatih" corresponds to the renaissance or rebirth of the Egyptian nation.

<sup>26</sup> A number of articles and papers have been written on Egypt's new economic policy. See generally note 13 *supra*; Roy, *Private Industry Sector Development in Egypt: An Analysis of Trends, 1973-1977*, at 1 JOURNAL OF SOUTH ASIAN AND MIDDLE EASTERN STUDIES 11, 33 (Spring 1978); Salacuse, *Egypt's New Law on Foreign Investment: The Framework for Economic Openness*, 9 INT'L LAW. 647 (1975); Salacuse & Parnall, *Foreign Investment and Economic Openness in Egypt: Legal Problems and Legislative Adjustments of the First Three Years*, 12 INT'L LAW. 759 (1978); Waterbury, *The Opening, Part I: Egypt's Economic New Look*, 20 A.U.F.S. NORTHEAST AFRICA SERIES (1978), *Public Versus Private in the Egyptian Economy*, 21 A.U.F.S. NORTHEAST AFRICA SERIES (1979).

on the issue of private versus public control. Thus, the coming of economic liberalization to Egypt represented to many the recognition of the fact that Arab socialism, as conceived and practiced by the government during the Nasser era, had failed to bring about the economic transformation that was so boldly envisioned. Setting forth his perception of the economic future of the country in what has become known as the October Paper,<sup>27</sup> Sadat initiated a major reversal of an anti-private investment attitude that had prevailed for some fifteen years.

The sequence of events leading the government in a socialist direction with respect to the economic, political, and social development of the country had begun in the early 1960's. The nationalization of the private sector, first of the foreign owned enterprises (in 1956) and subsequently of the domestically owned enterprises (in 1960 and 1961) and the imposition of strong government control in virtually all aspects of the economic life of the country had given a decided socialist orientation to its future development. The bureaucracy which was created to manage the economy evidenced little ability to cope with the rapid increase in its responsibilities.

Egypt's adventure in the Yemen in 1962 and its defeat there, as well as in the 1967 War, proved extremely costly and effectively limited a promising trend toward economic growth. Nasser's policies exacted increasing prices in domestic terms that the population was unwilling to pay. The strains placed on the economy by rapid population growth, the decay and breakdown of domestic services and the growing disaffection with a ruinous international policy increased the political pressure on Nasser to redirect the energies of the government. The pressure was to liberalize not only the economy but the society at large.

The interaction of these various pressures and the increased accumulation of Arab capital among the oil-rich nations ultimately led Nasser's successors to re-examine past policies regarding foreign investment in Egypt and to question the likelihood that the bureaucracy could ever effectively provide central direction and stimulation to an economy so beset with major problems. Nevertheless, care had to be exercised in continuing to nurture the image of the state as a protector of the poor and underprivileged, thereby preserving the gains of the Nasser era in terms of the atmosphere of social justice which prevailed at that time.

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<sup>27</sup> For the text of the October Paper, see *al-Ahram al Iqtisadi*, supplement, May 1, 1974.



It is not surprising, then, that in discussing his philosophy of the future economic and political development of the country, Sadat has had to admonish those who sensed a greater change than was intended: "There are some people who try to depict the economic 'opening' as a basic change in our ideological framework, that is our socialism; but this is a grave error."<sup>28</sup> Sadat, keenly aware of the extent to which this policy would prove unpopular with those with vested interests, has gone to great lengths to indicate that private investment would not compete directly with the nationally owned enterprises. Rather, liberalization would establish a framework within which modern (i.e., Western) industrial technology could be transferred to Egypt and coupled with Arab capital and Egyptian manpower and resources. It was believed that such a transfer of technology would have positive effects on the economic performance of the public sector companies and result in a substantial reduction of the degree to which the bureaucracy controlled the operation of the economy from a centralized vantage point. This is the critical, if not central, theme to the policy of liberalization.

#### A. *The Legal Framework of Egyptian Public Enterprises*

It was noted that, in the case of Syria, the establishment of the public sector through nationalization of private interests preceded the formulation of any ideological or legal framework within which to operate these new public entities. Egypt had a similar experience, as a 1970 Rand Corporation study of the public sector notes:

The public sector . . . evolved without a pre-planned policy—from a period of traditional economic freedom, characterized by small scale government direct investment, to a period of directed capitalism, in which the growth of the public sector was due mainly to Egyptianization of foreign assets, to the present [1970] period of socialism, characterized by nationalization and a defined role of the public sector.<sup>29</sup>

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<sup>28</sup> *Id.*

<sup>29</sup> S. FARID, TOP MANAGEMENT IN EGYPT: ITS STRUCTURE, QUALITY, AND PROBLEMS 5 (1979) (Rand Corporation). Egypt has pursued a course of state capitalism in which enterprises were expected to play an economic role similar to that of a private sector. It was assumed that the state was better able to articulate and manage large-scale and complex development projects. Hence, the government, initially at least, did not seek to eradicate the initiative that one might find in private capitalism. Rather, it sought to collectivize this initiative.

Hence, the formation of the public sector antedated the creation of any definition of national socialism.

The non-ideological definition of the public sector did not long remain. The National Charter of Arab Socialism, issued in 1962, sought to define more sharply the role of public enterprises in the future economic (and political) development of the state:

1. Social overhead capital, such as railways, highways, airports, energy, dams, means of sea, land, and air transportation, and other public utilities must be under the public sector.
2. Heavy and medium industries and most of the mineral industries must be under the public sector. Private ownership might be allowed, but it should be subject to control by the government. Light industry is allowed as long as it is not a monopoly and provided that the public authority directs it toward public interest.<sup>30</sup>
3. Import trade must be fully controlled by the state. The private sector may have a share, however, of up to 25 percent in the export trade. In domestic trade, the public sector must have a share of 25 percent in order to prevent monopoly.
4. Banks and insurance companies must be under the public sector.<sup>31</sup>

While agriculture remained largely a private activity,<sup>32</sup> industry, trade, finance and the public services sector were placed under the direction of the state.<sup>33</sup>

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<sup>30</sup> Investments in the private sector must register with the Ministry of Industry, General Organization for Industrialization. A Private sector company applies to the Industrial Licensing Department for approval of projects involving the establishment of new productive facilities or the expansion of existing plant where the investment exceeds LE 8,000. Projects of less than this amount come under the supervision of the High Committee for Handicrafts and Artisans. Within the private sector, the generally accepted guideline when a firm might be considered for nationalization was fifty employees. Once a private company went beyond this figure, it was generally believed that it would attract the attention of the authorities. In practice, several private industrial undertakings considerably exceeded this number; one private textile plant employed as many as 400 workers.

<sup>31</sup> See note 29 *supra*, at 5.

<sup>32</sup> Even though the agricultural sector is essentially private, the government is active both in providing inputs such as fertilizers, seeds, and equipment at subsidized prices and in controlling the prices of outputs, largely through agricultural cooperatives. The overall effect has been to severely limit private discretion and initiative.

<sup>33</sup> Although a good deal has been written about the ideological strains prevalent in Egypt during the decade of the 1960's as it sought to industrialize under the name of "Arab Socialism," in effect the economy has maintained at least the semblance of a mixed character since that time. By 1973, the private industry sector accounted for approximately 37 percent of total industrial output in Egypt according to Ministry of Planning figures. See note 15 *supra*, at 9-17.

Organizationally, the public enterprises were combined along sectoral lines; within each sector, industries and services were further grouped by field of activity. A corporation could consist of a single plant or service operation. However, a holding corporation was more frequently used, which administered combinations of related product lines.<sup>34</sup> Each industry group was administered by the appropriate ministry (e.g., the Egyptian Electrical Corporation was managed by the Ministry of Electricity).

The line of authority, responsibility and direction of each enterprise proceeded from the Ministry, which was responsible for implementation of national political policy and economic development plans, to the holding corporation, which had the vaguely defined responsibility to act as "the Minister's apparatus for helping him . . . discharge his responsibilities,"<sup>35</sup> to the board of directors of the individual state enterprise, which was responsible for actual production and related economic and social objectives.<sup>36</sup> To the extent that specific criteria of performance were adequately articulated and enunciated in the various public enterprise laws and regulations, they related primarily to the direct management functions performed within the economic production units.

Prior to the establishment of the new economic policy, state economic activities could take the following forms:

1. State-owned corporations: independent units carrying out economic, industrial and commercial, financial, and agricultural functions, and related services such as construction and transportation;
2. Government agencies or bureaus: administrative units charged with directing basic social services and certain economic activities such as managerial and financial auditing of state enterprises and other bureaucratic organizations; and
3. Associated companies: wholly state owned or state majority joint ventures administered by foreign interests. The establishment and administration of these companies were subject to the laws regulating public corporations.

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<sup>34</sup> In 1964, the public banking sector was reorganized so that each of the five public banks was responsible for the financing needs of specific sectors (e.g., the National Bank of Egypt handled all foreign trade transactions).

<sup>35</sup> See note 29 *supra*, at 7.

<sup>36</sup> Law No. 32, 1966. See also ARAB REPUBLIC OF EGYPT, THE GENERAL AUTHORITY FOR INVESTMENT AND FREE ZONES, LAW NO. 43 OF 1974 CONCERNING THE INVESTMENT OF ARAB AND FOREIGN FUNDS AND FREE ZONES AS AMENDED BY LAW NO. 32 OF 1977 art. 3(i). Published officially in Official Gazette, June 9, 1977.

After 1973, a number of modifications were introduced which significantly altered or modified several of these forms.<sup>37</sup>

As in the case of Syria, the objectives to be pursued by the public enterprise sector in Egypt are formulated through a development planning exercise, even though after the disastrous 1967 War any long-range planning was difficult to conduct effectively. These objectives are defined each fiscal year, with the draft annual plan originating in the public enterprise. This first phase of planning emphasized the commodities to be produced, the quantity scheduled for production and the investment (in local and foreign currencies) required to achieve these objectives.

The public authority which supervises the activities of the public companies within its purview must simultaneously seek to determine the needs of all other economic sectors which will consume the commodities produced. Thus, raw materials, labor, capital and foreign exchange are balanced within the firms comprising a sector as well as among the various economic sectors. The individual company must conduct its planning with regard to the commitment to meet the goals of producing strategic commodities (for national defense), for public consumption, or for the production needs of other public companies (i.e., intermediate capital goods).<sup>38</sup>

Individual company, industry sector, and economic and social sector plans are then incorporated into a national program for production and investment. The state's general plan and its implementation are governed by law.<sup>39</sup> Public institutions and public sector companies are, accordingly, legally required to carry out the programs, projects and general objectives of the approved plan. Companies also are required by law to reach all of the plan's goals according to a time schedule affixed thereto. In particular, the companies are required to realize:

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<sup>37</sup> Semi-independent public commissions replaced government agencies. Legally, they have complete independence and have a special budget similar to the general budget of the state. Two new categories of associated companies were established: that with joint ownership by the state and the foreign private sector (i.e., a foreign joint venture), and that with joint ownership by the state and the Egyptian private sector. *See* Law No. 111, 1975, at art. 50 (law related to the reorganization of government agencies).

<sup>38</sup> In periods of highly limited resource availability, as Egypt has had to operate under in recent years, it follows that the final allocation of resources is often a matter of political bargaining. Consequently, even if the national planning framework was well conceived, distortions would inevitably occur because resource allocation was significantly affected by political power distribution. Only where economic priorities corresponded to the presence of political influence might one expect a positive outcome in purely developmental terms.

<sup>39</sup> Law No. 70, 1973, at art. 12 (in effect, the enabling act for five year development plans).

1. The investment targets for investment projects within the expenditure estimated in the plan;
2. The objectives of commodity production and services, qualitatively and quantitatively, considering the averages of production requirements;
3. The objectives of the plan in relation to salaries and work productivity; and
4. The objectives regarding imports and exports, as they appear in the plan.<sup>40</sup>

From an administrative standpoint, plan performance within the public company is evaluated quarterly and annually by the supervising government institution, the ministry supervising the holding companies and the Ministry of Planning.<sup>41</sup>

It must be borne in mind that while all of the relationships described thus far are legally defined, there exists the most complex problem of insuring that the economic signals passing within and between all economic activities and sectors do not undermine the achievement of these company duties and responsibilities. The successfully administered economy must, therefore, develop appropriate pricing, production and investment policies that abet, rather than detract from, managerial performance with regard to their responsibilities. It is precisely here that the lack of bureaucratic expertise is so readily evident in the Egyptian economic and social development experiment.

#### B. *Economic and Managerial Performance Under the Legal Framework*

Given the past and continuing attempt to legally define the macro- and micro-economic and social objectives of public enterprises in a manner that would elicit the desired performance and management behavior, what has been the actual experience in Egypt?

It has been argued that, in the Egyptian case, it is unfair to apply the traditional return on investment criterion as the sole yardstick of performance. As long as the market was not allowed to operate to determine the products and services to be demanded

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<sup>40</sup> See note 8 *supra*, at 73-74.

<sup>41</sup> Article 17 of Law No. 70, 1973 stipulates: "Regular quarterly and annual reports are presented by Ministries, Commissions, public institutions, public systems, and regional units, to the Ministry of Planning, including the progress toward the achievement of the plans and objectives." *Supra* note 39.

and supplied, the allocation and distribution of productive resources, and the prices at which goods and services were to be exchanged, a purely economic definition of return on investment would prove somewhat meaningless. However, even allowing for the need for other criteria of performance, the evidence strongly suggests that many state enterprises have, for years, incurred both substantial economic losses and have achieved only somewhat marginal accomplishments socially.<sup>42</sup> Attributable to many factors, not all of which lie within the control of the management of public sector companies, this situation has had significant negative effects on the growth of the economy.

Industry growth and the contribution of the industrial sector to Gross Domestic Product virtually stagnated after 1965. Accounting for about twenty-one percent of GDP, this share has remained constant until 1975. Real GDP growth was around two percent from 1965 to 1974. Since then it has shown considerably better growth but this has not been due to marked improvement in the economic performance of the public sector. Industrial output in the period 1965 to 1974 fluctuated between a negative growth rate up to four percent. Labor productivity has been uniformly low in public sector companies, largely as a result of overemployment (estimates range as high as a 6:1 ratio of labor redundancy), inadequate training, lack of incentives, an excess of technical and managerial personnel, and poor organization of the labor force.

From the time of the inception of the public sector, the government has attempted to determine administratively price-product relationships. Lacking sufficient economic expertise and experience to orchestrate the multiplicity of complex relationships involved, major portions of the public sector have lapsed into a pattern of inefficient operation, conducted at a relatively high cost and producing low quality goods. The impediments stemming from the pursuit of inadequate and inappropriate economic measures have led to the further development of constraints in the environment: excessive bureaucratic and legal procedures; price controls that were often unevenly applied and contradictory; intermittent and highly restricted availability of foreign exchange;<sup>43</sup> an antiquated and oppressive system of taxation; restric-

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<sup>42</sup> This is not to suggest that there has not been a positive social contribution by Egyptian enterprises to overall economic development. However, the cost effectiveness of this contribution is subject to question.

<sup>43</sup> The industrial sector is highly dependent upon imports of machinery, spare parts, and raw materials. The lack of availability of foreign exchange in the economy led to unfulfilled economic plans, severe depreciation of plant and equipment, and inadequate raw materials to allow efficient use of established industrial plant.

tive and counterproductive labor laws;<sup>44</sup> and weak institutional support systems. The attempt to rectify these basic and fundamental shortcomings in the policy and bureaucratic environment often took the form of a still further legal delineation of the responsibilities and duties of the public sector. A labyrinth of controls, regulations and policy directives grew up around the enterprises, with predictable results.

Quantitative controls proliferated, but increasingly represented an inadequate response and an inappropriate approach to rectifying the more deepseated and fundamental economic problems in the country. Such controls could not have the desired effect, either because of limitations inherent in the policy instruments and their uses or because of the failure of policymakers to view the corrective action needed in its totality. The necessary changes in policies in support of quantitative controls did not take place. The net effect, then, is that too much was asked of the policies involved in establishing state control of the economy.

The difficulty of managing the economy was compounded by the sheer number of policies and regulations that the authorities had to administer and monitor. This accumulation of policies, old and new, made it most difficult to evaluate accurately the cause and effect of economic relationships. Subsequent corrective policy action entailed a degree of bureaucratic sophistication, political support and economic management capability that simply did not exist. As difficulties increased, with the policy package more gerrymandered and the managerial capability *in situ* overtaxed, it was inevitable that a high degree of randomness entered into the interpretative and implementative phases of policy direction. Policy makers became crisis managers, short term in outlook and "band-aid" in mentality; planning in the large was abandoned in the press of planning in the small.

The major problems of management behavior which have arisen in the public enterprises attest to the degree to which the further promulgation of laws only serves to exacerbate the situation. As already noted, an excessive number of government organizations, such as ministries, authorities, agencies and departments, participate in the planning, decision making, project implementation and

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<sup>44</sup> The most cited instance of a particularly odious government policy in the labor field is the government's policy of guaranteeing a job to all college graduates. Largely politically inspired, this policy results in the assignment of thousands of recent graduates with little or no experience and little relevant education to government offices and companies. Irrespective of their needs, government units are nevertheless required to absorb this unwanted supply of labor.

operation of the public companies.<sup>45</sup> Even though one particularly cumbersome aspect of this bureaucratic arrangement was removed in January, 1976, when the general holding companies were abolished, plant managers have found that the plethora of rules, regulations and policies to which their enterprises are subjected has not changed.<sup>46</sup>

With the centralization of authority and decision making has come a decided lack of managerial incentive to improve and increase productive efficiency and profitability. This lack of incentive is perpetuated by the government's policy of taking profits away from the efficient firm (either to finance the inefficient firm or provide additional resources for the National Budget) or absorbing such profits by making a change in the relation of their input and output prices.<sup>47</sup> The result is that the large majority of enterprises are ineffectively managed. Their subjection to fixed input and output prices, with the consequent difficulty of making and keeping profits, is a leading cause.

An additional source of management frustration is the government's labor policy, which virtually guarantees employment and job security to all workers. This policy has been pursued since 1961.<sup>48</sup> It is impossible for management to dismiss a worker except

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<sup>45</sup> Presidential Decree No. 3546, 1962 (related to organization of public enterprise companies), established a highly centralized decision making process but one in which there was no clearly defined pattern of authority. Authority and responsibility being vague, enterprise managers would seldom be willing to exercise any individual judgment or discretion. Rather, they tended to push all decisions upward through the organizational hierarchy. Law No. 32, 1966, clarified to some extent the question of authority. However, the flexibility which it allowed managers at the plant level was often proscribed by the political risks inherent in exercising one's own judgment.

<sup>46</sup> The General Organizations (holding companies) were replaced by Supreme Councils. These large boards meet only once a year and do little more than collect statistics; hence, they play a much less active role in the day-to-day operation of the enterprises.

<sup>47</sup> Such changes in the prices of any given firm's raw materials and other inputs or the prices of final products are made with no reference to their possible impact on other economic activities. A profitable firm would have its prices altered to abolish its profits. Whether or not this change impacts on other firms is simply not considered.

<sup>48</sup> See, e.g., Law No. 91, 1959 (labor law) and Law No. 61, 1971 (amending Law No. 91). Law No. 61, governing public sector employee performance, is indicative of Egypt's labor policy. Article 16 provides for periodic rating of employees. Those who are graded average or lower must be notified in writing and have a right to appeal, in writing, within two weeks. The appeal is sent to the Chairman of the Board of Directors, who must make a final decision within one month. When the Chairman decides that an employee's grades are below average for two consecutive reporting periods, the employee can be transferred to another job (which suits his abilities). Two consecutive poor grades leads to the employee's being downgraded and to the lowering of his salary (but the cut cannot exceed one-fourth of his salary). Upon receiving a third grade, the employee may be terminated. The rigorous rules of article 45, which cover both on the job (e.g., revealing classified information) and off



where a criminal offense may have been committed. Even in such an instance, resort to a court is not really feasible, for the adjudication of a case can take several years.

Sound management of basically uneconomic investment projects cannot be viewed as a reasonable expectation. In Egypt, there is no clear and established set of priorities for the evaluation and selection of investment projects in the industrial sector. For example, although it is continually stated that industry must assist in reversing the adverse balance of payments situation, any importance attached to this priority is preceded in importance by the need to satisfy consumer wants. Thus, good management will not reverse the outcome of the government's poor economic decisions.

Since there are no real selection criteria for investment projects, even the social objectives are approached in an inconsistent manner. Job creation is an avowed social objective. Accordingly, one might expect strong advocacy of labor intensive projects. Yet there is evidence of the use of technology that would be more appropriate in a high-wage, labor-scarce economy than in Egypt, with its relatively low-wage rates and plentiful supply of most types of labor. Current plans speak of providing employment on a substantial scale, but there is little evidence that employment creation is a specific criterion of project selection or that a high level policy decision has been made to use intermediate and other labor intensive methods of production whenever possible.

Public sector companies provide a substantial amount of employment by carrying out government instructions to employ more workers than needed and because of the difficulty of terminating workers even for unsatisfactory performance or consider-

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the job behavior (e.g., having another job if it will adversely affect his duties), increase the probability that disputes over grading will arise under article 16.

An employee's violation of the rules of the company can lead to disciplinary action under article 46, but no penalty may be imposed without a written investigation and a hearing (article 47). Penalties, listed under article 48, include in increasing severity: reprimand; wage cut for up to two months; suspension from work with half pay for up to six months; exclusion from wage increases for up to three months; wage reduction in excess of two months; downgrade in employee's position; downgrade plus wage reduction; and finally, termination.

Egypt's labor policy regarding the private sector also may present problems. Law No. 26, 1954 requires joint stock companies to retain Egyptians in 90% or more of the positions or to pay 80% of the payroll to Egyptians, unless exempted by the Minister of Finance, Economy and Trade (article 94). Further, article 96 requires that Egyptians who are employed in Egypt must account for no less than 75% of the total number of employees of corporations, or the payroll for Egyptians must be no less than 65% of the total company payroll, unless exempted by the Minister.

able decline in product demand. The improvement of enterprise efficiency and the reduction of production costs would undoubtedly involve a significant reduction in the industrial labor force. Since investment allocation decisions do not favor labor intensive methods of operation but do favor certain highly capital intensive projects, they do not contribute either to more productive employment opportunities or to the more equal distribution of income, to the extent that it might have been possible. Therefore, Egypt's tendency to overman public sector industrial enterprises must compensate for the failure of its investment allocation process to favor labor intensive projects. Such contradictions, in effect, lead neither to the maximization of productive employment, to technological improvement, nor to the minimization of production costs.

### *C. Toward a Redefinition of Law and Development*

The situation in Egypt is not dissimilar to that of other countries that have been prone to use law as a means of initiating broad and sweeping programs of economic and social change. What is being recognized increasingly is that the use of more stringent legal definitions is a totally inadequate means of rectifying the problems that ensue from inadequate policy formulation and from the poor and cumbersome administration of economic activity. Precise legal language is no panacea for poor economic planning and economic management.

The policy of economic liberalization in Egypt represents a significant shift in the economic and social development strategy which was pursued from 1952 to 1974. This shift imposes a variety of demands and constraints on the policymaker charged with effecting this transition. The limited reentry of private enterprises, domestic or foreign, onto the scene cannot be viewed as a primary means of resolving the incentive and efficiency issues. An integral part of these issues is the existence of the inappropriate legal framework within which public enterprises are required to operate. If this framework is left intact, the privatization of limited industrial activities can have only a marginal effect.

Privatizing the economy, on the other hand, poses additional burdens for the policymaker. Private investment is especially sensitive to market incentives and to market prices. In Egypt, a delicate balance of policies is essential if these market incentives are to reflect social costs and benefits to the greatest extent possible. In a situation where market signals are misleading as to these

social costs and benefits—as is definitely the case in Egypt—it cannot be clear what is expected of private investment.

As Egypt has implemented its new economic policy, it has been decidedly unclear how the fundamental issue of protecting and furthering social gains while stimulating new efficiency through partial privatization of industry is to be effected.<sup>49</sup> It is perhaps axiomatic that the resolution to this complex issue requires both a reexamination of the existing legal context and the formulation of new laws which are consistent with the intent of the changed policy. That process is taking place but, in a sense, getting the new legal framework “right” has become virtually an exercise unto itself. Accommodating the new law to the old, involving as it does considerable compromise, and preserving social gain while stimulating economic efficiency have so far merely perpetuated the inconsistencies and contradictions.

In “An Economist’s Preface” to Pozen’s work on the legal aspects of public enterprises, Anthony Killick asks, “if the revealed defects of state enterprises are so universal, if they are normally used to promote the particular interests of pressure groups instead of public interest, if legislators and their legal advisors are so powerless to remedy this situation, what then remains the case for state enterprise?”<sup>50</sup> Pozen suggests that lawyers do not always ask the right questions or have simply focused on the wrong questions. If he is correct, it follows that any legal framework for public enterprise which is established without “asking the right questions” is most probably doomed to elicit the wrong response in managerial and, ultimately, corporate performance.

There is more than adequate evidence to support the view that the legal framework in which Egyptian public enterprises, and those of other Arab states, has not brought about the desired results. This has not led, however, to the rejection of further legal exercise as a means of attaining development objectives. The Open Door Policy of Egypt is, after all, a legal redefinition of the development strategy to be pursued in the coming decades.

Clearly, what is required is that the primary relationship between law and development which is assumed to exist, i.e., the in-

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<sup>49</sup> For a further discussion of the policy conflicts inherent in this situation, see W. Wahba, *The Transfer of Technology to Developing Countries Under Joint Venture Arrangements (with Special Reference to Egypt)* 45-57 (1977) (unpublished research monograph, Center for Middle Eastern Studies, Harvard University).

<sup>50</sup> See note 4 *supra*, at xiv.

ducement of behavioral change through legal change, is in need of considerable re-examination. David Smith notes that "lawyers, economists, and other development practitioners have often ignored the impact of legal infrastructure on public enterprise effectiveness, and lawyers, untrained in examining informal legal systems, have not been attuned to unearthing the subculture of legal systems that may facilitate or frustrate public enterprise performance."<sup>51</sup> He might have added that there is seldom sufficient dialogue among and between the practitioners as well.

In the Egyptian context, this lack of understanding of the more informal aspects of legal systems is particularly pronounced. Although the new laws associated with liberalization provide a sufficiently flexible framework for the facilitation of private investment, there has been very little inclination on the part of the Egyptian bureaucracy to exercise its discretion or judgment in approving investment projects, especially those that may compete with the public sector.<sup>52</sup> Long versed in decision avoidance, the same bureaucracy that has been found to impede past development is now asked to take the initiative in restructuring the character and direction of future development.

The extensive use of law and the legal process in the attempt to foment change and growth necessarily has conditioned the large bureaucracies, which have evolved in order to direct development strategies, to avoid risk. In this respect, law has failed to take adequate account of the rigidities which are induced by the use of legal prescriptions for all economic and social relationships. This is often the case even when the provisions of a particular law are essentially correct, cover all contingencies and, *ceteris paribus*, logically lead to the objectives for which it has been promulgated.

#### IV. CONCLUSION

Legal instrumentalism and economic policies which seek to wrest from the public sector the qualities of initiative and efficiency have been at loggerheads in the Middle East. The limitations inherent in instrumentalism have in many cases been well documented by the

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<sup>51</sup> See note 5 *supra*, at 600-601.

<sup>52</sup> The framework for foreign and domestic private investment in Egypt was established by Law No. 43, 1974, as amended by Law No. 32, 1977. ARAB REPUBLIC OF EGYPT, THE GENERAL AUTHORITY FOR INVESTMENT AND FREE ZONES, LAW NO. 43 OF 1974 CONCERNING THE INVESTMENT OF ARAB AND FOREIGN FUNDS AND FREE ZONES AS AMENDED BY LAW NO. 32 OF 1977. Published officially in Official Gazette, June 9, 1977.

law profession itself; Egypt is but one example of the potential outcome of this type of legal exuberance.<sup>53</sup>

It is perhaps oversimplistic to conclude that the attempt at the reintroduction of market determined prices and incentives in the Egyptian economy is anathema to further legal instrumentalism. However, the main failings of liberalization to date can be traced in part to this continuing failure to recognize the limitations of law in shaping societal or human behavior. Smith makes a compelling case for the "reconstructed lawyer," one

who has recognized the need to examine the role of law in terms of the interrelationships between society and economy on the one hand and law on the other, and has also recognized that the transfer of laws and legal institutions is fraught with peril because we do not know enough about how law operates in Western societies.<sup>54</sup>

Few such lawyers have appeared on the post-liberalization Egyptian scene, fewer still who can recognize the vital link between a liberal economic policy and the requisite easing of the legal framework so inimical to past development efforts. In the terms of one scholar, "law and economics as scholarly disciplines would seem to conflict in more ways than they complement each other."<sup>55</sup>

This is the essential point. "Economics . . . logically positivistic, scientifically rigorous . . . generally indifferent to normative issues" and "law . . . traditionally a morally oriented, mechanistic system of dispute settlement which, by standards of economics, generates apparently random results"<sup>56</sup> have come together to produce rather ineffective chemistry in the public sector in Egypt. Economics seeks to predict future outcomes; law is far more concerned with process than result.

The potential complementarity of law and economics is only beginning to be acknowledged and explored in the United States. It is essential that this process encompass and seek to analyze the same potential complementarity in the developing countries. The direct cross-cultural transfer of the methodologies and societal

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<sup>53</sup> See Berg, *Law and Development: A Review of the Literature and a Critique of "Scholars in Self-Estrangement,"* 25 AM. J. COMP. L. 492 (1927); Trubeck & Galanter, *Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States*, 1974 WIS. L. REV. 1062; J. Salacuse, *Towards a Framework for the Study of the Role of Law in Social Change*, 18-20 (December, 1976) (paper presented at the Aswan Workshop on the Sociology of Law).

<sup>54</sup> See note 5 *supra*, at 598-99.

<sup>55</sup> H. MANNES, *THE ECONOMICS OF LEGAL RELATIONSHIPS*, at vii (1975).

<sup>56</sup> *Id.*

processes of the industrialized nations to the developing world has lost much of its attraction. Nevertheless, the dependency relationship has not abated a great deal. If the impetus to put law and economics in the proper perspective and combination is to begin in the developing world, it most probably must begin first in the Western (i.e., developed) world.

The reform of the public sector already begun in Egypt, and most certain to follow in other countries soon, provides a unique opportunity for more rigorous contemplation of the possibilities for integration of the two disciplines. The alternative is neither attractive nor likely to produce significantly different results than have been achieved thus far by legal instrumentalism.