

Final Report on AFD-IDS Research Programme **'Culture, Trust and Development'**

This programme included two projects: first, a review of the literature on trust and economic development and second, a case study on Egypt. The aim of this report is to give an overview of the work carried under both projects.

Central to the programme was the appointment of Hela Yousfi, who was funded by AFD and worked at IDS as a Visiting Fellow from April 2007 to February 2008.

Project 1

'Culture and Development: a review of the literature - the continuing tension between modern standards and local contexts'. Paper by Hela Yousfi under the supervision of John Humphrey.

This literature review identifies the many ways in which culture has been considered in development thinking. It shows that there are many different perspectives, each with a relatively distinct interpretation of the concept of culture. Modernization theory was particularly influential: by establishing the tradition/ modernity dichotomy, modernization theory had a big impact on the framework in which culture has been deployed and debated in development thinking. The result is that culture has been seen either as a positive instrument or as an obstacle to development. For more than a century, culture has been viewed as a pervasive determinant of psychological traits, mentalities, and attitudes which in turn condition the way people behave and confine them to the realm of tradition. On the other hand, development has always been seen in terms of trade off between cultural traditions and access to progress which is conceived in terms of a "universal modernity". Thus, it is hardly a surprise that culture was often seen as opposed to modernity, and habitual forms of thinking opposed to rationality.

Following this, Hela Yousfi argues that many streams of research have offered different ways of overcoming the deterministic relationship between culture and development. However, she emphasises that these various lines of thought have one thing in common: they have difficulty in grasping the articulation between the role of culture — suspected of bringing back "tradition" — and individual autonomy as a condition of a "modern society". In fact, in these different conceptualizations of culture, variously referred to as "ideology", "informal institutions", "informal rules", "lifestyles", "consensus ideology", the concept of culture is closely related to the idea of social order (d'Iribarne 2007). This social order, whether inherited or imposed by the dominant group, is suspect because its stable and normative aspects are held to downplay the creativity of individuals and clawed back development.

When culture is seen as produced essentially by the actors, development occurs as a result of the creation of an enabling environment through social structure is transformed. Any continuity over very long periods of time seems inimical to development because it presupposes an absence of any kind of cultural learning or social transformation. When culture is seen as a set of values and attitudes, development works by calling into question traditional cultures and enabling the emergence of a modern mentality. It is evident that this perspective offers no basis for long-term stability. It assumes away phenomena capable of engendering continuities. Any kind of continuity would downplay individual autonomy and compromise the achievement of progress.

This review has emphasises the persistence of the tradition/ modernity framework which leads to the view that developing countries must shed their traditional structures to access modernity. However, empirically one finds evidence of both massive cultural change and the persistence of distinctive cultural traditions even within “developed countries”. Similarly, many scholars have argued that so-called “modern societies” are themselves embedded in specific cultures, even though their institutions are following “universal” principles. They show that the existence of such cultural continuity does not prevent a succession of forms of social organization in the same country that are different to each other in many respects. Therefore, the challenge for development thinking is still to better our understanding of how the heterogeneity of values or the transformation of social organization in a given society is articulated with more durable frames of reference. One possible way to overcome this impasse is to recognize the constructedness of culture and to pay more attention to how universal principles are understood and interpreted in local contexts.

Having traced the predominance of the dichotomy of tradition/ modernity through the time, and viewed them from a number of perspectives, what are the lessons that can be derived from this literature review? It changes the way we look at the relationship between culture and development in two important ways.

First, the new insights presented in this literature review recognize that the connection between culture and economic development is not causal but multiple and complex. It is widely acknowledged that the importance of culture cannot be instantly translated into ready-made theories of cultural causation. What is needed is not the privileging of culture as a variable that works on its own, but the integration of culture into a wider picture in which culture is seen as intimately connected to different aspects of development issues. Culture must be seen as an element that shapes the means of the development process as well as its goals.

In fact, culture does not only impact on social relations but also on the functioning of formal institutions and management techniques. For instance, for scholars

studying the issues of inequality and poverty such as Mary Douglass or Amartya Sen, the question is how interactions between diverse cultures within a society need to be managed democratically and in a manner that allows for free and fair debate. For d'Iribarne, the question is how to shape institutions which take into account in each society legitimate ways of behaving with authority, decision-making, managing inequality, etc. This is the way that culture affects the process of building appropriate institutions.

Second, the challenge for the development thinking is how to adapt "best practices" to the diversity of cultural contexts. The task proposed is complicated by the fact that the starting points for each society's conception of a well ordered society are different. Meanwhile, the ending points, in terms of the precise articulation between what is achievable and what corresponds to the desires of each society show considerable variation. "Universal" or "modern" standards of aid donors and those who received the aid are culturally embedded. The objectives of reformers and the programmes of action they adopt do not exist independently of the way in which they see the world. Their actions take on meaning, in their own eyes and in those of the people they have to rally to their cause within a given structure of meanings. By referring to fundamental principles of that structure, they make the changes they advocate appear sensible, and in so doing they help to ensure the survival of those principles.

This in no way leads to complete relativism; it does help place the lessons from certain valuable cultural theories into a more grounded and realistic sociological framework. There is an urgent need to evolve an innovative development discourse underpinned by solid comparative methods and not by simple analogies. We cannot continue to read the histories of the South through the histories of the North. We can only break away from the so-called best practices so prevalent in the mainstream discourse if we understand the complexity of the relationship between individual agency and cultural continuity in institutional change. Only when we accept the existence of different cultural "traditions" across societies can we begin to understand that what people believe and do matter in the real sense and then effectively adapt universal standards to local contexts. An approach that is less focused on the superiority of any particular model and more cognizant of the context-specificity of desirable reforms is needed. Work on gradual improvements in institutions or on small institutional practices may help to see exactly and concretely how beneficial institutional arrangements are promoted or held back and how universal standards can be adapted to the local contexts. Such an approach may help to open up a new way of looking more realistically and more effectively at development challenges.

This paper was published as AFD Working Paper No 50 in November 2007 and disseminated at the AFD Conference 'Culture and Development', held in Paris in December 2007. Abla Abdel Latif, Hubert Schmitz and Hela Yousfi were active participants at the Conference. Lawrence Haddad chaired one of the sessions.

Project 2

This project concentrated on the investment climate in Egypt. Improvements in the investment climate are seen as critical for economic development in poor countries. This is a field in which best practice – derived from the OECD model – is often recommended to developing countries. More governance through formal rules and less governance through informal relationships is seen as key to raising investment and accelerating economic development. Egypt provides an excellent case for examining this proposition.

Egypt has been at the receiving end of much donor advice on the investment climate and has carried out a number of policy reforms to improve the investment climate. The levels of private investment remained nevertheless disappointingly low. They improved however when a new Government came to power in 2004. The research carried out under 'Project 2' seeks to understand what actually changed between before and after 2004. It also seeks to understand why investment in some sectors is higher than in others, examining whether and how the how the relationships between policy makers and investors made a difference.

Two papers were produced under this project:

'Common Interest between Policy Makers and Private Investors (CIPI) – The food and furniture industries in Egypt' by Abla Abdel-Latif with guidance from Hubert Schmitz.

'Conditions for durable reform of the investment climate in Egypt: Institutions or relations? An ethnographic approach' by Hela Yousfi and John Humphrey .

This report gives a brief overview of the contributions which these papers make individually and brings out how they complement each other.

The first paper is part of a bigger project which re-examines the Egyptian experience of fostering investment and growth. The AFD programme supported the primary research on the food and furniture industries, but the paper presents the sectoral findings in the wider context. Abla Abdel Latif is the main author, conducting the interviews and writing up the material but Hubert Schmitz played an important role in the analysis and successive re-drafting of the paper.

Abla Abdel Latif suggests that the 2004 change in government contributed to a general increase in investment because first the government improved customs and tax rules and second because the investors had greater trust in the new cabinet which – for the first time ever - included several business people.

Her main concern however is to explain inter-sectoral differences in investment, paying particular attention to the role of a Common Interest between Policy

Makers and Investors (CIPI). To this end, she develops a conceptual framework for the potential role played by CIPI and then tests the validity of hypotheses drawn from this framework against the realities of two specific industrial sectors in Egypt: the food industries and the furniture sector. The specific questions addressed by the empirical research are as follows:

- What are the specific reasons behind the increase in investments in some sectors/sub-sectors?
- Is the potential role of CIPI - based on initial observations - confirmed by close analysis of the sectors?
- If CIPI actually has a role, how much of the increase in investment in individual sectors is due to it? And how much is due to other factors, and what are these factors?
- If there is a role for CIPI, how does it work? How does CIPI get to be constructed?
- Are the effects of CIPI limited to enterprises involved in the special relationships or do they extend to other enterprises in the same sector and other sectors?

The paper shows that while governance through formal rules (stressed in the investment climate debate) remains the long-term objective, governance through informal and formal relationships can play an important role in getting the economy out of a low-investment- situation. This is, however, a very tricky field for analysis and advice. The paper shows the need for differentiating between sectors and stages. It presents some initial results which will need to be re-analysed once further sectors have been researched.

Five conclusions stand out as the most important emerging from the empirical research on the food and furniture sectors:

- CIPI does play a critical role in attracting PPI to sectors or sub-sectors. Specifically, it plays an indispensable role in unleashing the profit potential of the sector, thus encouraging investors to invest where investment levels are low and governance of the economy is problematic. CIPI is essential for unblocking the way forward at least in the short and medium runs. Empirical research, however, firmly denies that CIPI can solely be THE direct cause for investment.
- CIPI can substitute the need for a general enabling environment in the short run and even the medium run. On top and more importantly, it provides a level of trust and credibility in the government – related to the specific sector and beyond - that might never be reached in an LDC setting even if all the elements of a typical general enabling environment are there on paper.
- CIPI plays its role through providing proxy governance benefits to specific sectors or sub-sectors.

- CIPI does not develop, or at least does not have an impact, where the private sector lacks leadership and organisational capacity.
- Exclusive relationships in the construction of CIPI do not necessarily lead to exclusive benefits to the sector. It depends on the level of organisation of the sector and also the level of development of its value chain. In the case of food industries the exclusive relations between policy makers and key investors had a positive impact on the whole sector. In contrast, in the furniture sector, exclusive relations between industrialists and policy makers led to exclusive benefits with very little positive effect on the sector as a whole.

These overall conclusions can be elaborated with the following findings concerning the dynamics of CIPI's emergence and impact:

- CIPI often has its roots in previous informal relationships but there are significant exceptions. In other words, informal roots are not a precondition for CIPI to develop.
- CIPI does not fall out of the blue sky and is not necessarily a short process. It can take many years to develop.
- The empirical analysis also emphasised the key role of informal relationships between policy makers. Where they know each other and trust each other, they are not only willing to work together and take action but are also actually able to take action. The outcome is a network that allows quick decision making including changes in policies. The network is referred to in this research as the investment friendly circle. The benefits of the circle lie in quick response of the whole group to the request of one policy maker. This, however, does not mean that there are no problems as different players can have different priorities and thus friction can emerge as detected from different interviews.
- CIPI is of impact on investment only when it reaches the stage of common understanding of problems and willingness of both the policy makers and investors to take action triggered by perceived interest. According to all interviewees, 2004 marks a turning point for the case of Egypt in CIPI reaching an effective stage.
- At the sectoral level, the willingness of the policy makers to take action in favour of a certain sector is conditional upon the potential of the sector itself and to what extent it can achieve visible and tangible results in terms of increased investment, exports and job creation that would give the policy makers credit. In other words, if the sector is not promising and ready to deliver results provided certain supportive measures are taken

the policy makers would not be willing to give it any support even if previous informal relations existed and CIPI as such is established.

- Initial interactions between the key policy makers and investors are informal and then become institutionalised – as the alignment of interest becomes clearer. Specific examples supporting this claim are provided in the paper, such as the case of reclaimed land allocation to big investors and the transformation of the ineffective commodity councils to think tank export councils.
- As already stated, CIPI plays its investment enhancing role by providing proxy governance to specific (sub) sectors. Proxy governance granted through CIPI can take the form of: protection of specific property rights, specific policy changes of technical relevance to the sector, removal or at least reduction of uncertainties in relation to transaction costs, reduction of public duties, provision of support services and infrastructure, and adoption of a clear long term vision for a particular sector.
- Two important general features of proxy governance granted through CIPI emerge: 1) benefits to specific sectors can lead to benefits for all sectors; and 2) proxy governance granted by CIPI can be very fragile and discontinued after being granted due to conflicts of interest.
- The impact of CIPI on investment features itself in a tipping point (sharp increase in investment in the sector) and sectoral knock on effect (attraction of FDI to the same sector). Both stages are influenced by how inclusive versus exclusive relations within the business community are.
- Disturbance of CIPI through conflict of interest between private investors and government will not affect investment if it has already taken off. This reflects the temporary but effective nature of CIPI.

It is worth noting that the whole CIPI phenomenon in Egypt is recent and a longer period of time is needed to assess its full impact. Moreover, empirical evidence from other sectors is needed to further confirm the above conclusions. Nevertheless, the research conducted so far suggests that CIPI plays a key role in raising investment to substantially higher levels. Once achieved, CIPI does not necessarily have to continue. A new economic and political dynamic takes over.

The second paper, by Hela Yousfi and John Humphrey, confirms the findings of the first paper in one respect: it shows that the introduction of business people into the state apparatus in 2004-05, *in conjunction with* the bureaucratic reforms and simplifications of rules and procedures and rules, improved the general investment climate.

The specific contribution of this paper lies in providing insights into how the Egyptian stake holders view the changes in rules and changes in relationships between public and private actors. How does culture influence their perceptions and actions? This was done by using an ethnographic approach which does not just analyse what respondents say but how they express it and using it to investigate in more depth than is commonly the case how the investment climate reforms were introduced.

At first sight, the investment climate reforms introduced by the Egyptian government in 2004-05 appear to support the thesis that universal principles can improve the investment climate. Fiscal reform, simplification of procedures and the introduction of clearer decision-making were presented by the government itself in the language of universal principles and the standard international recipes for reform. However, in-depth interviews with key actors in Egypt present a different picture. The paper utilised insights from the Public Action and Private Investment research programme at the Institute of Development Studies — particularly the distinction between business climate reforms, aimed at reducing the costs of doing business, and investment climate reforms, which are more directed to the degree of confidence that investors have, and the level of uncertainty that they face, about government claims on future income streams. One of the arguments elaborated by Moore and Schmitz is that investment climate indicators are hard to quantify and investigate, given that they relate to trust between political actors and private investors. This problem was addressed by detailed ethnographic analysis of the key respondents in Egypt, which was designed to understand the way in which investors understood and represented investment climate issues. This was done in order to investigate how investors and public actors situated their understanding of investment climate reforms within the context of a more general conception of a well-ordered society and the proper bases for relationships within such a society.

The Egyptian case shows that the investment climate reforms were effective because they corresponded to local conceptions about how the state and the private sector should cooperate. Clearly, collaboration requires trust, but the foundations of trust vary between cultures. In the Anglo-Saxon world, contractual relations are given priority as the basis for cooperation between both actors and organisations. In contrast, in France, each party is expected to behave as a good professional according to the demands of their profession and the task to which they have been entrusted. In the Egyptian case, the critical elements of cooperation are to show transparency and be capable of maintaining a dialogue that understands the partner's constraints and demonstrates confidence in the partner's capacity for establishing and maintaining the relationship. Therefore, the Egyptian investors interviewed, irrespective of whether they were positive or critical of the government, put the bases of collaboration with the government not in terms of contracts or a division of labour, but rather in terms of its capacity to maintain a dialogue with them and to recognise and adjust to the constraints faced by business.

The consequence of this was that the reforms introduced by the government with respect to issues such as taxation, tariffs, investment rules and the operation of the customs system were necessary, but not sufficient. They were necessary because they allowed simplification and provided a clear basis on which to dialogue — as well as simplifying the dialogue by reducing the complexity of government decision-making itself. But these reforms were not sufficient, because it was still important to ensure space for dialogue. With respect to this, the introduction of business people into government Ministries was important, as was the role played by GAFI. This intermediary organisation was regarded as an efficient body by the respondents because it created the space within which trust relations could be established. Its capacity to create clear rules and its role in institutionalising intermediation between business and government was critical. It enabled investors to accept the new, simplified rules, while at the same time maintaining some degree of flexibility in the system through its capacity to consult effectively with business, provide an effective space for dialogue and to resolve problems for the business by engaging with various levels of the state apparatus.

In consequence, it was possible to improve cooperation, fight against corruption and improve the investment climate without waiting for a root-and-branch reform of the state apparatus. The bases for trust between business and the state depended on both sides feeling that they were being treated within the terms of a shared conception of how collaboration should be managed. This conception is society-specific, indicating how the bases for the construction of common interests between private actors and public investors, as discussed by Moore and Schmitz, has to be based on specific conceptions of what constitutes a basis for efficient collaboration.

In conclusion, the key issue in the investment climate debate is that investors need assurances that they can keep future fruits of investments made today. In this respect the two papers provide complementary insights. The first paper, by using a sectoral political economy approach, disaggregates the economy and shows that in some sectors investors receive assurances which come from their close relationships with the holders of political power. The resulting investment then unleashes a dynamic of its own which can include institutional change. The second paper, by using an ethnographic approach, also questions the strong emphasis on institutional reform in the investment climate debate, suggesting that relationships remain important and that there are cultural specificities in the reform process. Understanding these specificities is important for assessing whether and to what extent investors feel that investments made today will bring them corresponding benefits in future.