

Employment and Unemployment in Egypt

Policy Viewpoint is intended to contribute to the discussion of ideas and policy options for enhancing economic development in Egypt. The series is based on research conducted by ECES. The content and recommendations are endorsed by the Center's Board Members.

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Unemployment and job creation are among the most important challenges facing policymakers in Egypt today. Not surprisingly, the government has made these challenges the cornerstone of its reform effort. The emphasis follows the recognition that unemployment is a waste of society's human capital. It has direct adverse effects, especially on those with no physical assets. Furthermore, a high concentration of unemployment among the educated youth could be destabilizing. The question is: How can Egypt meet these challenges?

Answers to this question are not in short supply. They range from labor-intensive growth as the most viable solution in the medium run, to government employment and extending credit to SMEs as the most expedient ways of dealing with the problem. In this edition of *Policy Viewpoint*, the key argument is that partial solutions are inadequate at best and misleading at worst. Public sector employment could ameliorate the problem now, only to exacerbate it in the future. Similarly, providing credit to SMEs would generate some employment, but on a scale too modest relative to the size of the problem. Lasting and effective solutions require the adoption of a coherent reform program, even if implementation is phased over time. The program should aim at expanding the demand for labor through economic recovery, labor-intensive growth and effective migration policy; aligning the supply of labor with market demand through education reforms and effective training; and improving the functioning of the labor market by reducing segmentation and rigidities, while protecting workers' rights to decent wages and job conditions. This basic argument is outlined below, following a brief characterization of the problem.

The Nature of the Problem

Official statistics indicate that open unemployment in Egypt has trended downward from 12 percent in 1986, to 9 percent in 1996, and 7.4 percent in 2000, with the exception of last year when it rose to 8.8 percent. While these figures are not universally accepted, they remain high. In fact, they are twice the natural or friction rate of unemployment of about 4 percent, and translate into an absolute number of 1.5 million unemployed, comprised mostly of young graduates with secondary school education. Short of a serious reform effort, the situation will worsen in the future. Labor supply is expected to grow annually at 2.6 percent during 2001-10. This means that the economy should generate about 638,000 new jobs every year, a number that exceeds the annual average of 435,000 attained over the last decade.

Expanding the Demand for Labor

By definition, unemployment is the excess supply of labor over demand. Therefore, expanding demand is key to resolving the unemployment problem. This could be achieved through measures to activate the economy, labor-intensive growth, and meaningful migration policies. These dimensions are elaborated below.

Economic Growth

Economic growth in Egypt has been too slow to absorb the new entrants to the labor market. In the 1990s, growth rates averaged 4.4 percent, falling below the target rate of 7 percent. In 2000/01, economic growth slowed down to 3.5 percent and is expected to rise to only 4 percent in 2001/02. Equally important, productivity grew at an annual rate of 1.6 percent during 1988-98, while the annual growth rate of the labor force was 2.7 percent.¹ The combination of the high

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growth rate of the labor force and low productivity exacerbated unemployment and eroded real wages to the point that average wages in 1994/95 were only two-thirds their level in 1985/86.

Several factors have contributed to the modest growth rates and low job creation. Some are related to macroeconomic management, which in recent years has led to a considerable slowdown in economic activity. The main culprit is the exchange rate, which, until recently, the government attempted to keep fixed at all costs, including hiking up interest rates. The combination of tight monetary policy and fiscal expansion in public projects with limited backward linkages eventually led to a credit crunch, crowding out private sector activities and expansion in real estate. The recent shift toward a more flexible exchange rate regime has afforded the monetary authorities greater maneuverability, but concern about dollarization and inflation have produced little action.

Other factors behind the modest growth and job creation record are structural in nature. They include policies favoring production for the domestic rather than international markets, and capital at the expense of labor, as well as constraints in the business environment that discourage investment. The anti-export bias originates from high average tariff rates, high real interest rates, high tax rates, and high transaction costs emanating from inefficient institutional arrangements.² This bias has eroded the demand for labor because it deprived the Egyptian economy from selling in much larger markets abroad using the country's most abundant factor of production, which is labor. The bias in favor of capital stems from such policies as tax exemptions, relatively cheap land, and in some instances, subsidized credit. At the same time, the cost of labor regulations and lengthy disputes make labor expensive. As a result, investors tend to favor capital-intensive techniques and temporary hiring, both of which reduce the demand for labor. Finally, the sluggish and non-job creating growth can be traced to low investment caused by a business environment that is not as attractive as elsewhere. Reforms in recent years have removed a number of investment disincentives, but business sector surveys indicate that tax and customs administration, conflict resolutions, and policy predictability continue to increase the cost of conducting business and fuel uncertainty. Consequently, Egypt has not been able to mobilize additional foreign savings of about US\$ 5 billion per year necessary to attain a growth rate of 6-7 percent and offer the population the job opportunities they need.

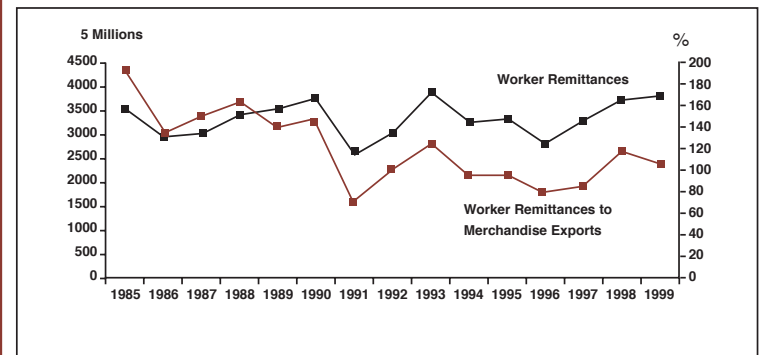
To stimulate the demand for labor, actions are needed to activate the economy in the short run and boost job-creating economic growth in the medium run. The measures advocated to activate the economy include a combination of expansionary monetary policy, a more flexible exchange rate regime, external borrowing and a prudent fiscal policy. Given the low level of inflation and excess capacity, this reform package will not

necessarily lead to dollarization and high inflation. The range of actions required to boost labor-intensive growth includes a reform program to reduce the bias against exports, rationalize the prices of capital relative to labor, and improve the business environment. In effect, Egypt needs to implement a second round of significant reform measures as it did in the early 1990s.

Migration

Migration, or external demand, has offered Egyptians an important source of lucrative job opportunities in Arab oil-producing countries in recent decades. Not only has migration absorbed a significant percent of excess labor of all types and various geographical locations, but it has also helped generate much-needed foreign exchange. However, workers' remittances have not grown over time (Figure 1), due to movements in oil prices, a shift in demand in oil producing countries to cheaper labor from Asia, and limited supporting migration policies at home.

Figure 1. Workers Remittances, 1985-99



Sources: World Bank (2001), "World Development Indicators," and "Global Development Finance," CD-ROM.

Clearly, Egyptian policymakers cannot influence shifts in external demand caused by oil shocks. But there is a range of actions that could be taken to stabilize or even expand Egypt's market share abroad. Among the actions that have worked so far is the arrangement made by the Ministry of Education to export teachers to countries like Saudi Arabia, Kuwait, and Libya; other ministries could follow suit. The government could also negotiate broad parameters with other governments concerning labor mobility, working conditions, and return policies. These negotiations could be undertaken on a bilateral basis or in the context of regional agreements. In addition, the government could make information about job opportunities available to potential candidates. These are but some examples. The more general point is that exporting labor requires a strategy similar to that developed for the export of goods and services.

Education Reforms and the Supply of Labor

The unemployment problem cannot be resolved solely by measures to stimulate demand. The education system should provide markets with the appropriate skill mix of graduates. Training could of course alleviate a number of deficiencies and provide job-specific skills, but it cannot substitute for effective education. Both issues are addressed below.

Education

Egypt has made impressive progress with respect to the enrollment of boys and girls at all levels of education. The data for 1970-97 show improvements of about 50 percent in primary schools, 175 percent in secondary schools, and over 200 percent in higher education. The gender gap has almost vanished, and virtually all children are enrolled in primary school.

Progress on quantity has, however, been at the expense of quality and the appropriateness of the mix of graduates relative to market demand. Although the government has allocated about 5 percent of GDP to education, school maintenance has deteriorated; the number of students per teacher has increased; and teachers have increasingly resorted to private tutoring. The proportion of students taking private lessons in 1997/98 was more than 51 percent of the total, including those from relatively poor socioeconomic backgrounds. Along with other incidentals, this converts “free education” to a “false entitlement.” Equally problematic is the systematic expansion in secondary school education, which is precisely the category of job seekers where unemployment is concentrated.

What could possibly explain the inadequacies of the education system? The key to the explanation lies in one word, namely, incentives.³ Teachers have limited motivation to teach in the classroom because their salaries are low and follow a rigid civil service code. Their career does not clearly depend on the performance of their students, and they are not penalized for poor results. They also find it rewarding to teach outside the classroom. At the same time, parents are not engaged in school activities nor the selection of teachers, and they frequently have no choice but to enroll their children in one school. Under these conditions, no policing measures would prevent private tutoring. As for students, they tend to focus on memorization to obtain high grades so as to qualify for prestigious branches of education. On top of all this, bureaucrats, like teachers, do not see a link between their salary and career development and the effectiveness with which they monitor, regulate, and improve the education process. With excessive centralization, there is a distance between those responsible for delivering education services and those who benefit from them. In addition to eroding accountability, this distance makes monitoring more difficult because information is costly to collect and process.

To align labor supply with market demand and reduce unemployment, reforms are needed to change the incentive structure. In public schools, teachers should be motivated through performance-based pecuniary and non-pecuniary rewards. Parents should be encouraged to participate in school activities, including the selection of teachers, as has been done in some Latin American countries. At the same time, reforms are needed to foster competition among schools, for example, by allowing students to enroll in the school of their choice on the basis of systematic information to be made available by the Ministry of Education.

In private schools, profit maximization and competition eradicate many of the motivational problems noted above. However, the government has an important role to play to ensure fair competition and the availability of accurate information about school performance. The government should also retain and strengthen its authority to verify equal access and a minimum curriculum for all students.

Finally, additional reforms are necessary with respect to funding. Several analysts have previously argued in favor of reallocating a greater percentage of public resources to primary rather than higher education. Beyond this point, the pressure of the growing population, the drying up of government resources and the recognition of false entitlement suggest greater reliance on the private sector and the relevance of charging fees to all students. To assure poor students access to the same education available to wealthy students, the government could use the voucher scheme adopted in countries like Chile. Alternatively, it could pay schools the economic cost of each poor student enrolled.

Training

Training is an important instrument for correcting certain imbalances between the supply and demand of labor. It helps upgrade specific skills to meet job requirements. The less effective the education system is, the greater the need for effective training programs.

Egypt does not lack training institutions, but these institutions are supply-driven, inadequately funded, and highly bureaucratic. The need for more effective training programs is apparent, and the government is engaged in such a process. Among the solutions advocated in this regard is the establishment of a National Training Fund.⁴ Such a fund has been created in developed countries (e.g. France), as well as in developing countries (e.g. Singapore, Cote d'Ivoire, India and Cyprus). Its organization and funding vary from one country to another, but the Fund seems to work best when it has managerial and financial autonomy and when it operates on the basis of demand. Egypt may well consider such an option.

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Improving the Functioning of the Labor Market

Even if demand is stimulated and supply is aligned, the labor market itself may create imbalances. This may occur because of wage rigidity, market segmentation or inefficient market institutions. These issues are addressed below.

With respect to wage rigidity, there is evidence to the contrary in Egypt. Minimum wages are not binding and there is no wage indexation. Although nominal wages are sticky downward, average real wages went down between 1985/86 and 1994/95. In contrast, the labor market is highly segmented, with the government being a major employer (Table 1). To be sure, the government abolished the Employment Guarantee Scheme for secondary and post-secondary graduates in the early 1990s. But the 5 million applicants for the recently announced 170,000 government jobs is evidence that those who can afford to wait have developed high expectations of eventually getting a secure government job with low working hours. If this interpretation is correct, the lingering effect of the government employment policy might have set an artificially high reservation wage, thereby diminishing the demand for labor in the private sector.

Table 1. Distribution of Employment by Education Attainment, (age 10 and above, percent)

Sector	Below Intermediate	Intermediate and above	University and above
Government	7	47.2	55.6
Public Enterprise	5.3	15.8	14.7
Private Agric.	57.6	9.6	2.6
Private non-Agri.	29.7	24.5	23
All sectors	100	100	100

Source: Bridesall, Nancy and Lesley O'Connell (1999) "Putting Education to Work in Egypt," Growth Beyond Stabilization: Prospects for Egypt, Conference Proceedings, ECES.

Turning to labor regulation, the rules have been more suited to a centrally-planned rather than market-oriented economy. These rules have effectively precluded firing for any reason other than grave misconduct. They have not provided the basis for collective negotiation of contracts, nor have they ensured efficient resolution of conflicts. Paradoxically, these regulations have not protected workers in the informal sector, although this is the sector with some 80 percent of total private sector employment. Employers in the private sector have found ways to circumvent these regulations. But large firms, especially foreign companies, have had to abide by these regulations or evade hiring Egyptians when possible.

The government is currently considering a new labor law to streamline the relationship between workers and employers and

improve the process of wage determination. Although this is a step in the right direction, it will not succeed without parallel reforms. Key reform areas include government employment policy, the efficiency of the civil service, and the informal sector.

Concluding Remarks

The preceding discussion suggests that resolving the unemployment problem in Egypt effectively amounts to reforming the entire economy. This conclusion is partially due to the approach adopted in this *Policy Viewpoint*, which focuses on finding a lasting and effective solution to the unemployment problem. It is also dictated by the reality of the Egyptian economy, which is still in transition toward a mature market economy.

The magnitude of necessary reforms should not, however, be a deterrent to beginning the process now. The recommended course of action does not require the implementation of all reform measures immediately, nor does it imply the need to wait for tangible results until all reforms are undertaken. On the contrary, measures to activate the economy should produce positive results in the short run. Meanwhile, Egypt should move forward with the rest of the structural reform agenda to ensure sustainable labor-intensive growth, a more rewarding migration policy, more effective education and training systems, and an efficient labor market. These are the reforms that will have a lasting impact on employment and unemployment.

This *Policy Viewpoint* was written by Ahmed Galal, ECES.

Endnotes:

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3. Galal, Ahmed (2002). The Paradox of Education and Unemployment in Egypt, ECES Working Paper Series, No. 67.
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