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Policy Viewpoint reflects the stance of ECES on key policy issues in Egypt.

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Job Creation in Egypt: A Short and Medium Term Outlook

Although Egypt has made significant progress towards reviving economic growth, unemployment remains persistently high and a significant increase in job opportunities is still needed to absorb the increasingly growing labor force. Egypt's labor market is characterized by significant annual increases in the labor force, with the challenge to absorb around 700,000 new entrants to the labor market annually. In addition, unemployment has significantly increased following the January 25 Revolution and subsequent lingering uncertainty that has halted recovery. It is estimated that the economy is in need to create a million jobs a year in order to absorb new entrants to the labor market and reduce unemployment.

While job creation should be the focus of the short-term agenda for economic reform in the near term, other chronic labor-related problems that should be integrated in the reform agenda over the medium term include policies to address problems related to low female participation, excessive government employment, high percentage of people in non-decent employment, low productivity and wages, and high unemployment among youth and women. In addition, there is a significant mismatch between available skills and labor market requirements. Last but not least, weak social protection programs preclude the generation of enough decent work opportunities.

This edition of the *policy viewpoint* embraces the results of a collection of ECES research papers that cut across various timely challenges in the labor market and shed light on possible solutions going forward. The implications build on the analytical findings towards mobilizing job creation in the short term and addressing structural imbalances and rigidities over the medium term.

The Nature of the Problem

Job creation is the most important challenge facing Egypt today. Economic performance has been uneven over the last three decades, but even in periods of high growth, the job content of growth has not been strong enough to absorb new entrants. The problem became more critical once the government began to restrict its guaranteed employment policy and to practically end it in the late 1980s. Consequently, the unemployment rate was fairly low during the 1980s (5-7 percent). Since 1990 till 2010, Egypt's unemployment rate has remained stubbornly high, in the range of 8-11 percent, over economic cycles, major structural changes in the Egyptian economy and a number of external shocks.

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The 1990s and early 2000s saw acceleration in the pace of structural adjustments. The fast growing role of the private sector and the contraction of the public sector are considered the most important characteristics of this period. This process generated notable sectoral shifts. In late 2010, survey data of the Egyptian labor market estimated the labor force at 27.9 millions, of which nearly 2.5 millions are unemployed, 6.6 millions are in the public sector, 18.7 millions are in the private sector, of which 12.2 million are out of establishments, including 7.5 million in the agriculture sector, and the remaining 6.5 million are in established entities.* Clearly, the public and agriculture sectors remain the main sources of employment. However, the scope for employment growth is rather limited, suggesting the need to take action to speed up employment creation, both in the short and medium runs.

TOWARDS MOBILIZING JOBS IN THE NEAR TERM

Affordable Credit and Export Promotion

To speed up the process of job creation, Hassan and Kandil (2011) emphasize the importance of policies that aim at channelling more credit to private sector activity and promoting exports towards creating more jobs. Also, it is noteworthy that output growth is highly concentrated in capital intensive industries. Hence, it is necessary to provide incentives to increase the job content of output growth by offering tax incentives that are tied to the employment agenda and providing affordable credit to small and medium enterprises that represent the largest share of the economy and have the capacity to mobilize high employment.

Fiscal consolidation should help these objectives by reducing evidence of crowding out, namely in the form of higher cost of borrowing and inflation, and providing higher incentives for financial institutions to extend

more credit to the private sector. The continued drive to reform public institutions with a view to reducing unproductive employment should be better managed in the context of a comprehensive economic strategy that aims at absorbing excess labor in a growing private sector and providing training to increase the adaptability of laid-off public workers to employment in the private sector. Reducing unemployment and increasing income in line with productivity are key pillars towards sustaining high growth and achieving social equity.

Skill Demand Polarization: Hollowing of the Middle

By tracking changes in employment and wage structure over the period 2000-2009, Helmy (forthcoming) provides evidence that skill demand polarization is growing in Egypt. The employment and wage structure has become more polarized between high skilled occupations requiring considerable education and low skilled elementary occupations (Figures 1a, b). The demand for middle skilled occupations (manufacturing and routine jobs) fell relative to high (professional and managerial) and low skilled occupations (personal services). This “clustering around extremes” resulted in a rise in wage disparity, creating political tension and threatening the social fabric of the nation.

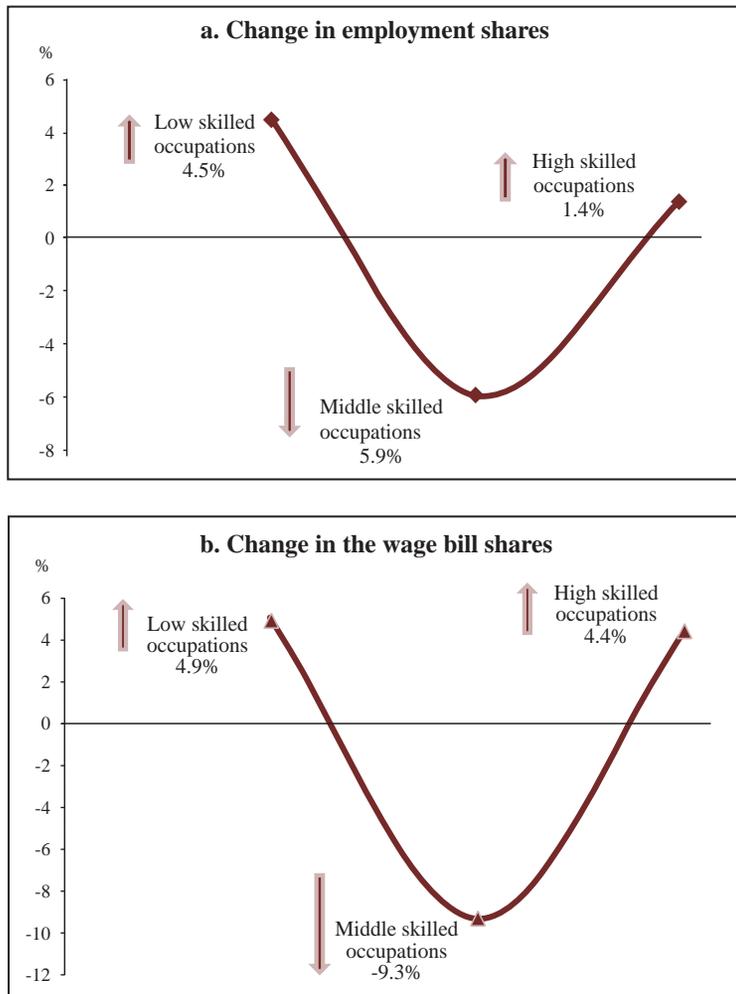
The analysis implies that deindustrialization in Egypt has occurred over the past decade, contributing at least partly to the decline in the employment and wage bill shares of the middle skilled occupations, which are usually clustered in the manufacturing sector.

Based on the research findings, Helmy notes that an inclusive job-rich growth strategy is needed whereby employment criteria are integrated in sectoral strategies, and incentives for employment in the formal private sector are devised towards revising the structure that has

* CAPMAS, Quarterly Bulletin of Labor Force Survey, the third quarter, 2010.

led to capital intensity of investments. Supporting economic activities with high job content, such as manufacturing, would lead to higher growth of employment.

Figure 1. Change in Employment and Wage Shares of High, Middle and Low Skilled Occupations Between 2000 and 2009



Source: Helmy (forthcoming) calculations based on CAPMAS data.

Public Works Projects

While the focus of government spending should aim at improving the investment climate and mobilizing support for private employment, including SMEs, any stimulus plan should be further reinforced by embracing an agenda for public investment that includes high job content. Kanbur (2010) has emphasized the importance of public works programs that could be administered by the

government in the short term as a way of offering quick employment for large numbers at a relatively low wage. Such schemes are widespread in developing countries. Most recently in 2005, the Government of India passed the National Rural Employment Guarantee Act targeting the poor. By their very nature, public works provide a temporary scheme for employment, eliminating the risks of burdening the state budget and fiscal insolvency over the medium term. During a crisis, applications at the public works site will increase, reflecting higher unemployment and limited opportunities in the private sector. Subsequently, such applications decline with the prospects of recovery and better employment opportunities in the private sector.

TOWARDS MOBILIZING JOBS IN THE MEDIUM TERM

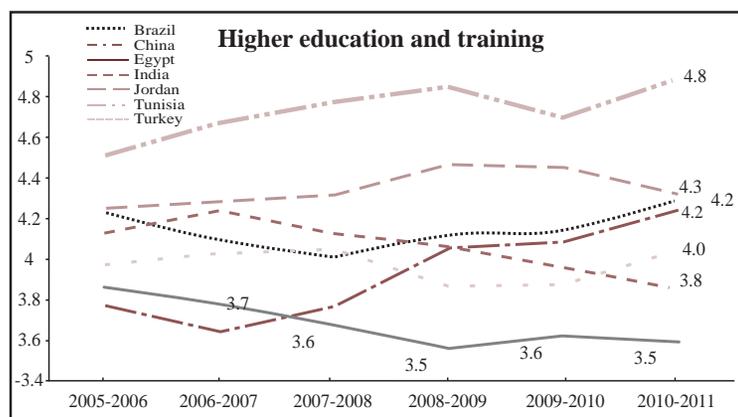
But while the above short-term solutions are needed as a matter of urgency to speed up the process of job creation following the January 25 Revolution, policy makers are also well advised to extend their scope of attention to the longer horizon by addressing structural imbalances and reducing rigidity in the labor market. Such imbalances have widened the gap between supply and demand in the labor market and increased youth unemployment and poverty over time. At the root of these imbalances are structural differences that need to be addressed in the context of a longer-term comprehensive reform strategy that embraces the key areas of education, training, innovation; decent work attainment; boosting productivity and curbing inflation; addressing the public-private wage differential; introducing a minimum wage policy; labor market flexibility; and reducing informality and vulnerability in the labor market.

Education, training and innovation

Egypt should invest heavily in education, training and innovation towards addressing structural bottlenecks that have long hampered progression in competitiveness

(Figure 2). Increasing the efficiency and actual expenditure on education and R&D is a priority. Addressing the chronic mismatch between supply and demand in the labor market and employing the youth, especially those with vocational training and university graduates, are essential for greater productivity and output. Moreover, there is a need to reexamine labor market policies to allow for policies that are conducive to employment. Increasing female participation in the labor market, increasing the opportunities for qualified and talented labor and professionals to reduce the brain drain and reducing firing costs are all recommendations for a more flexible and efficient labor market.

Figure 2. Egypt Compared to Selected Countries in Higher Education and Training Indicators



Source: World Economic Forum, World Competitiveness Report (several issues).

In their study of the productivity of education in Egypt, Herrera and Badr (forthcoming) conclude that education in Egypt does not pay off as evident by its declining rate of return. They have found out that unemployment increases with the level of educational attainment and the coefficient of variation of wages decreases with the level of education. Exploring and solving these puzzles demand a thorough review of education policies towards closing the gap between demand and supply in the labor market and restructuring spending priorities to ensure higher return on educational attainment.

The impact of education on labor market outcomes in Egypt is further investigated in Said (forthcoming), which focuses on returns to vocational secondary and technical higher education. Said believes that encouraging private businesses to invest in vocational education will be of little use if the trainees are still faced with the social stigma that relegates them to low-paid jobs. An overhaul of vocational and technical education should concentrate on the two main objectives of any school system: promoting social mobility and equity while being the cornerstone of economic and social development of the society.

Regarding innovation, Reda (2012) believes that enhancing it, whether by increasing the expenditure on R&D or by augmenting the collaboration between industry and universities, and facilitating the patents registry and increasing the quality and quantity of scientists and engineers are all measures that could lead to greater innovation enhancement and would, in turn, lead to greater productivity and competitiveness.

Decent Work Attainment

Investing in education is of paramount importance to reduce growing unemployment among college graduates and align supply and demand in the labor market. In parallel, there is a need for policy makers to address growing concerns about deteriorating job conditions and increasing vulnerability of unskilled and informal workers in the labor market.

The decent work agenda rests on four distinct pillars: (1) fundamental principles and rights at work and international labor standards: the promotion and realization of standards and rights; (2) employment and income opportunities: the creation of greater opportunities for men and women to secure decent employment and income; (3) social protection/security: the enhancement of the

coverage and effectiveness of social protection for all; (4) social dialogue and tripartism: the strengthening of social dialogue in handling work-related issues. All four pillars expectedly bear positively on labor productivity, which, in turn, strengthens the prospects for achieving social and economic upgrading, leading eventually to more and better employment opportunities.

In this respect, Al-Ayouty (2011) believes that enhanced labor productivity is directly related to increased job satisfaction. Such satisfaction embraces the enjoyment of basic rights, assurance of non-discrimination (on basis of gender or otherwise), abolition of child labor, provision of work environment that meets basic health and safety standards and is physically conducive to better job performance, provision of benefits and incentives, provision of adequate pay and pension scheme, and the availability of a sound venue for voicing employee concerns—all building towards the mobilization of additional human capital in a more efficient production process. Hence, investing in conditions that boost workers' productivity is a fundamental pillar towards increasing private investment, creating jobs and raising the standard of living.

Boosting Productivity and Curbing Inflation

Egypt has been suffering from chronic problems related to low worker productivity and high inflation. The underlying roots stretch to wage policies and compensations of workers in the economy, including public and private sectors.

Al-Nashar (2011) points out that tying wages to the price level is at the heart of the ongoing debate around erosion of real income with the cost of living. While this is important for social purposes, adjusting wages to the price level without a corresponding increase in productivity may have negative implications for the economy.

Addressing concerns about the rising cost of living should be carefully evaluated in the design of wage policies towards achieving more social justice and higher employment growth post the January 25 Revolution. Automatic adjustment of wages to inflation is bound to create further inflation and erode incentives for higher growth. In contrast, increasing wages in line with productivity is bound to increase incentives to create jobs and mitigate inflationary pressures towards achieving a higher standard of living and increasing welfare.

Public-Private Wage Differential

At the core of the wage policy is the differential in wages between the public and private sectors. Traditionally, many workers had resorted to employment in the public sector for security and easier adaptation to the job requirements. More recently, there has been more of a drive to seek employment in the private sector where the rewarding scheme has proven to be more attractive and opportunities have become increasingly tight in the public sector. Such a transition in the structure of the labor market in Egypt warrants a thorough evaluation regarding compensation schemes and returns on education and experience in the public and private sectors.

In their analysis of wages in Egypt, El-Ghamrawy and Amer (2011) assess the effect of informality in the private sector on the public-private wage gap. The study also evaluates the factors affecting wage determination in each sector. More specifically, the study is concerned with the extent to which wage determination is efficient in each sector. Their analysis finds out that private formal wages are higher, on average, than those of the public sector and private informal wages. Therefore, they posit that policies should be aimed at increasing incentives and decreasing the cost of formal employment in the private sector. The scope for higher employment is much wider in the private sector and the potential to increase wages in line

with productivity should be key to increasing social justice and raising the standard of living for a larger segment of the population to reap the benefits of higher growth.

Minimum Wage

Minimum wage has become a hot issue in Egypt post the January 25 Revolution. Raising the minimum wage level is usually accompanied by controversial views from the economic and social perspectives. The proponents of an increase in the minimum wage claim that low wages are partly responsible for low productivity of Egyptian workers, as they are not financially motivated to exert the required amount of effort. Also, in a developing country that suffers from high poverty rates and low wage levels, a high minimum wage is necessary towards reducing poverty and securing a stable standard of living. In contrast, opponents argue that wages must be determined by market forces without any government intervention, as setting a wage floor would put a financial burden on the government and private businesses. This will have adverse effects on employment according to traditional economic theories. Setting a minimum wage below the competitive wage level could foster both employment and economic activities.

Omar and Abdel Latif (2011) solve this dilemma by suggesting the introduction of multiple minimum wages, instead of a universal one. The experiences of a number of developing countries and the results of the research regarding diverse wage and employment effects across sectors advocate the need for variation in the minimum wage based on gender, skills, location, age, the inflation rate, the poverty line, the specifics of economic activity regarding productivity, the share to GDP and sectoral growth rate.

Labor Market Flexibility

Problems pertaining to unemployment, mismatches between supply and demand in the labor market and

growing informality have been exacerbated by rigid rules and regulations that have hindered demand progression. As many employers have struggled with inadequate flexibility to align labor resources with the business cycle, informality has increased providing a larger scope for vulnerability of unskilled labor and underemployment of skilled workers.

Ehab (forthcoming) points out that market rigidity is a major problem for the Egyptian economy, constraining the flexibility of firms' performance in response to changes in the economic environment. Governments usually enact labor laws to protect the rights of both workers and employers. However, these laws sometimes create labor market rigidity that hinders firm performance and, therefore, provides incentives for informality. Ehab is of the belief that higher flexibility of hiring and firing in the labor market will help increase employment growth which has been significantly lagging behind real growth. Hence, priorities should be focused on policies that could be targeted to ease the rigidity of the labor market in light of survey results and econometric analysis. In light of country comparison, Ehab further confirms that Egypt's hiring and firing regulations, and other employment benefits, are too generous to employees and burdening employers. The relevant rates should be revisited to strike a better balance between workers' rights and flexibility of doing business.

Informality and Vulnerability in the Labor Market

In light of high unemployment and widening informality, attention has been focused on the state of informality of labor in Egypt. As a way of speeding up the process of job creation, Abdul Fattah (forthcoming) emphasizes the importance of motivating the informal sector to become more formal. According to him, this may be achieved by linking upstream informal entities to downstream formal ones. Such linking may gradually bring

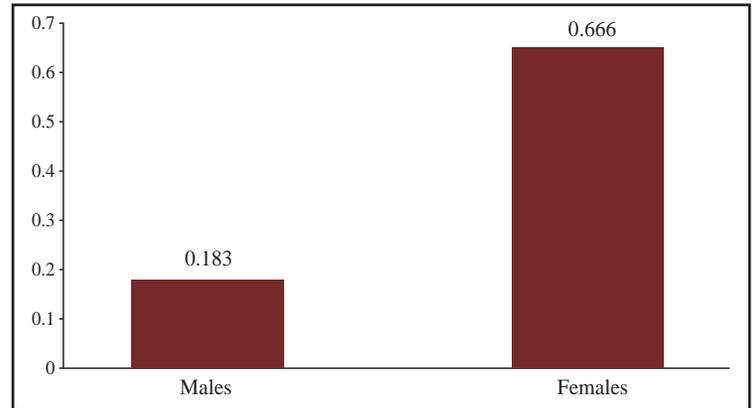
about the acquisition of knowledge, efficiency and adherence to specifications, which could motivate and promote the formalization of these entities. Also, the role of civil society organizations in promoting such linkage cannot be overestimated by offering credit facilities, promoting business planning, encouraging training and marketing as well as the adoption of innovative sales techniques and raising the awareness of the decent work environment implications for productivity enhancement. The move to formalization against the background of decent work environment should allow the transformed informal sector to absorb excess labor in a way that sustains higher growth with lower rate of unemployment.

While providing jobs for informal labor is important, the state of vulnerability that has captured many informal workers is worthy of policy attention. Vulnerable employment refers to those who are employed under relatively precarious circumstances. Abdel Mowla (2011) views vulnerable employment as one of the main labor market challenges. Vulnerability worsens decent work deficits and negatively affects productivity. Moreover, workers in vulnerable employment suffer from inadequate earnings and difficult work conditions. They are saddled with low wages and are usually excluded from the social protection of minimum wage laws. They are subject to unfair deductions and illegal retention of wages and are usually asked to work "off the clock". Due to the lack of social protection, they carry a higher economic risk, especially during economic downturns.

According to the empirical results by Abdel Mowla, the most important three determinants of vulnerable employment are education, working in the agriculture sector and being a female (Figure 3). The study suggests that investing more in expanding female vocational schools in rural areas— especially vocational agricultural schools—is likely to equip women with the skills needed to qualify for

good jobs in the labor market. Increasing investments in rural areas, especially in Upper Egypt governorates, would help reduce poverty and vulnerability.

Figure 3. Average Predicted Probability of Being in Vulnerable Employment by Gender



Source: Author's calculations based on the Egyptian Labor Market Panel Survey (2006).

CONCLUSION

Detailed analysis of the labor market in Egypt has yielded important results to tackle the pressing need to create jobs in the short term and address imbalances and structural rigidities towards closing the gap between supply and demand and increasing the job content of growth over the medium term.

To be sure, it is important to strike a sustainable balance between short-term concerns about social justice and long-term vision for economic and employment growth. The scope for higher employment is much wider in the private sector and increasing formality will help raise the standard of living for a larger segment of the population to reap the benefits of higher growth. Increasing the quality of labor, and investing in skills that are in high demand will also help close the gap between supply and demand and cater human capital investment to address key shortages. Reducing unemployment and increasing income in line with productivity are key pillars towards sustaining high inclusive growth and achieving long-lasting social equity for many Egyptians.

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