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

ECES MANAGEMENT

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Minimum Wage in Egypt: Striking a Balance Between Productivity and Social Justice

The issue of social justice has taken center stage post the January 25 Revolution, where many have argued for the need to establish a minimum wage policy that protects real income from deterioration. Over time, the minimum wage policy has failed to balance the objectives of employment creation and securing a dignified standard of living for many in Egypt. In the absence of such a coherent approach, raising the minimum wage could increase unemployment and informality, and heighten inflationary pressures if sectoral and regional disparities were not taken into consideration.

This edition of the *policy viewpoint* will analyze aspects of disparity in wage distribution across sectors and regions, based on indicators of productivity and cost of living. Subsequently, the *policy viewpoint* will draw on international experience to offer suggestions that could aid the formulation of a minimum wage policy that achieves social justice, taking into account productivity, employment, industrial policy, and investment across sectors and regions.

OVERVIEW

In 1985, the legal minimum wage was set at LE 35 for workers in the state sector, comprising the government sector, the public sector, and the public enterprise sector (Omar and Abdel Latif 2011). As the cost of living increased, it has become necessary to revise the legal minimum wage upward. However, for years, the government has been supplementing the basic minimum wages using variable components that included special, social, and Labor Day bonuses, and merit-based incentives. Factoring in the variable component of the wage, the effective minimum wage reached almost LE 400 before the January 25 Revolution, where the variable component accounts for the largest share of the take-home income.¹

It is clear from developments in the effective real wage (almost stable over time) that the variable component has been managed to protect workers in the state from rising cost of living. Nevertheless, the real wage proved to be inadequate to meet the basic demands of many Egyptians who suffered from continuous deterioration in the standard of living in the context of a growing economy and high inflationary pressures before the Revolution.

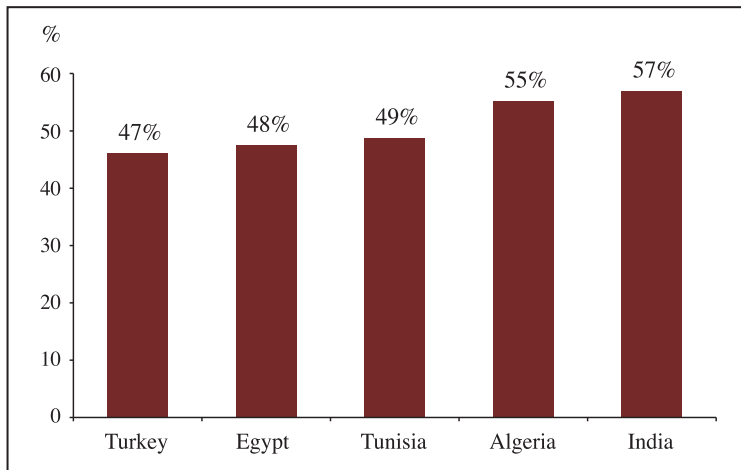
Against this backdrop, and in response to calls for achieving social justice post the Revolution, a minimum wage policy was instituted to bring the entry level wage in the state sector to LE 683 by raising the merit-based incentive by 200 percent. Subsequently, the hierarchy of

¹ This includes the employee's share of taxes and social insurance. The government has resisted adjusting the legal minimum wage to avoid higher cost of pensions and social insurance for civil servants.

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wages and salaries was adjusted upward by the same percent. It is estimated that the cost of this upward adjustment to the structure of wages and salaries amounts to an additional LE 9 billion out of a total budget for wages and salaries of LE 117 billion in the fiscal year 2011/2012. The recent adjustment of the minimum wage puts Egypt on a par with many comparators (Figure 1).

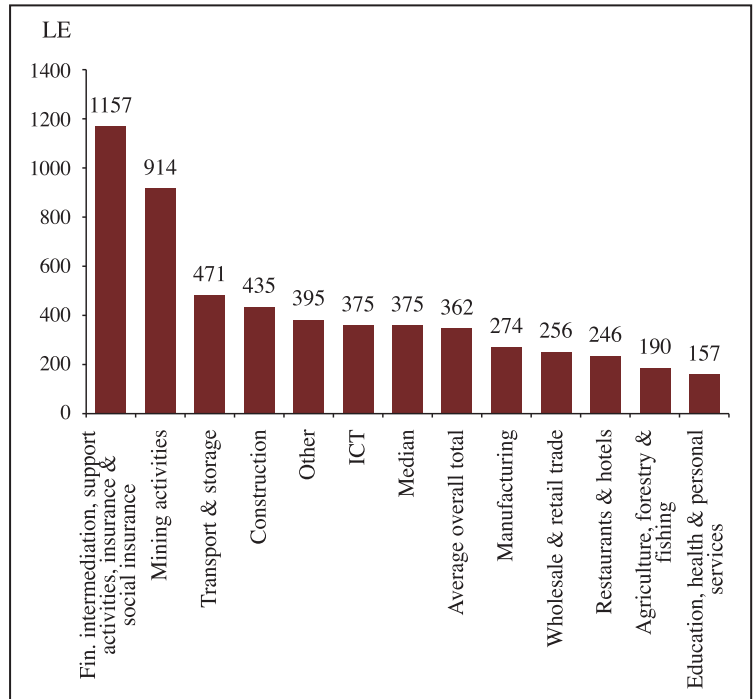
Figure 1. Minimum Wage in Egypt and Selected Countries in 2010 (% of Nominal GDP per Capita)



Source: The International Monetary Fund based on national sources.

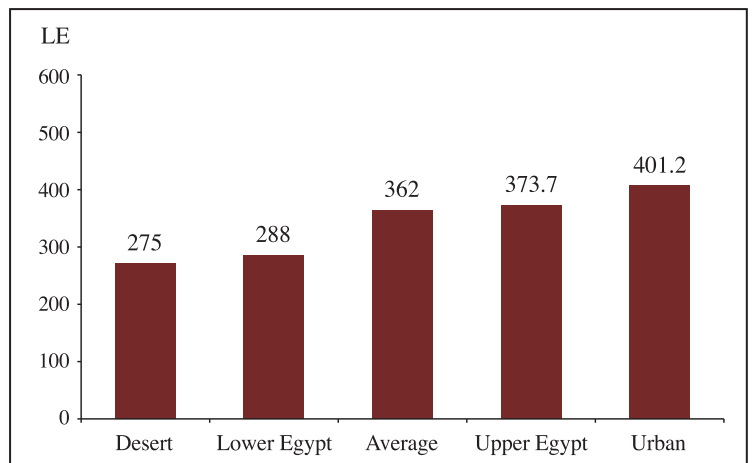
Nevertheless, wage disparity in Egypt warrants a careful evaluation towards sustaining a minimum wage policy that addresses social concerns without compromising prospects to create jobs or unduly increase the cost of production beyond the worker's productivity. Indeed, the average wage across sectors in 2009/2010 is inflated on account of significantly higher wages in the financial intermediation and mining sectors compared to other sectors (Figure 2). The disparity in wage distribution is also evident across regions (Figure 3).

Figure 2. Average Weekly Wage Disparity across Sectors in Egypt (LE, 2009/2010)



Source: CAPMAS, Annual Bulletin for Employment, Wages and Work Hours Statistics (2010).

Figure 3. Average Weekly Wage Disparity across Regions in Egypt (LE, 2009/2010)



Source: CAPMAS, Annual Bulletin for Employment, Wages and Work Hours Statistics (2010).

Note: Desert includes Matrouh, New Valley, and North and South Sinai. Cairo, Alexandria and Canal cities are classified as urban regions.

IMPLICATIONS OF DISPARITY ON WAGE POLICIES

There are glaring imbalances between sectoral contributions to real growth and employment over the period 2007/2008–2009/2010. The most notable examples are for the mining and financial intermediation sectors, where

contributions to growth far exceed those for employment. In contrast, contributions to employment in the general government and education and health services far exceed their contributions to output. Excess labor warrants a redistribution of resources to sectors where the job content of growth is the lowest and productivity is high.

Similarly, the evidence across economic sectors in the private sector illustrates imbalances between contributions to growth and employment. In general, contributions to growth exceed those to employment in many private sectors. Figure 4 illustrates contrasts between employment and productivity indicators across sectors of the economy. The evidence reinforces imbalances in the employment

At the core of the preceding imbalances across sectors in employment, compensation and productivity indicators, is variation in the investment strategy across sectors of the economy. The unbalanced distribution of real investment indicates there is scope to create jobs by aligning the investment strategy with the job content of growth.

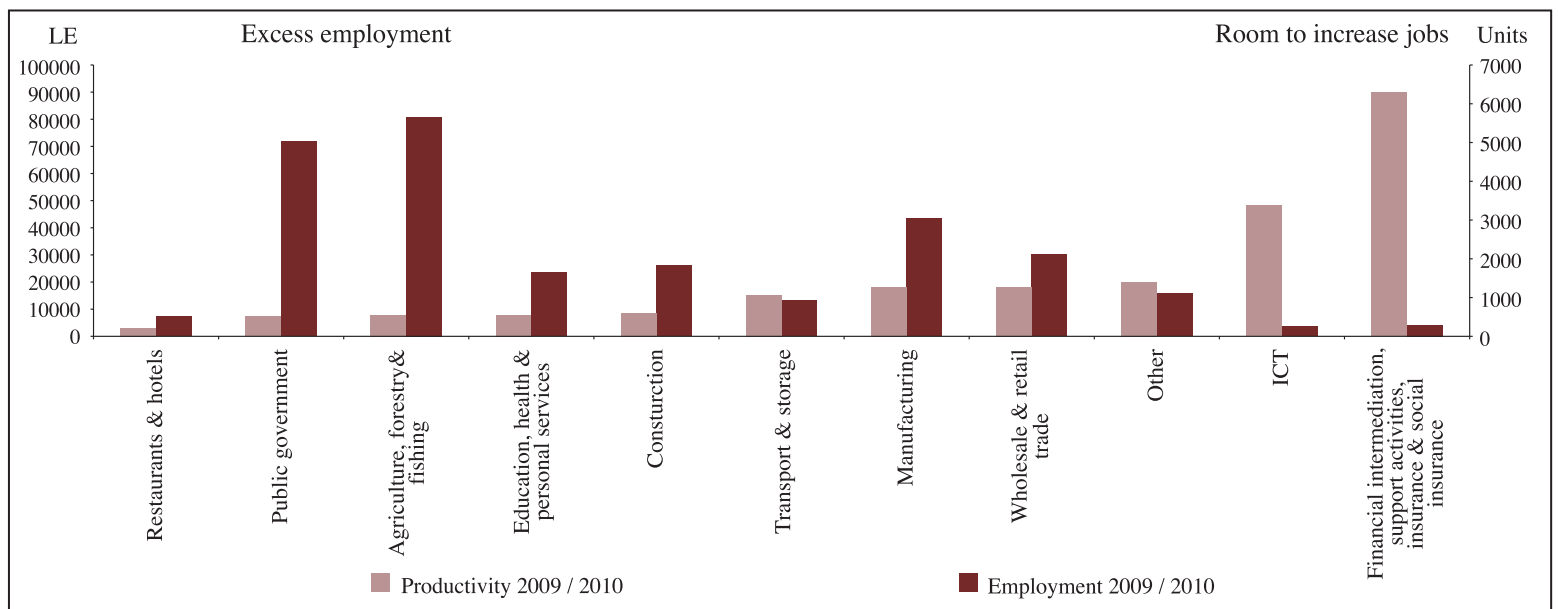
Based on the above evidence, a few points are worth emphasizing. First, the unbalanced distribution between sectoral employment growth and other sectoral indicators warrants a

targeted government intervention towards measuring and mobilizing the job content of growth. Second, as sectors grow at inconsistent rates with the job content, there are striking imbalances between workers' compensation and productivity across sectors. Third, there is room to increase wages and employment in the private sector where sectoral contribution to growth significantly exceeds the contribution to employment. However, excess employment in the government and a few private sectors warrants a redistribution of resources towards increasing productivity and supporting higher wages. Fourth, sectors with a high job content receive the lowest investment shares, while recipients of the highest shares of investment do not produce compatible employment figures and productivity is low, demanding a redistribution of investment in line with employment priorities.

REGIONAL ANALYSIS: DISAGGREGATE GOVERNORATE ANALYSIS

Wage distribution in Egypt is characterized by variation across regions/governorates. Such variation is dependent on the shares of employment in various sectors and the earnings attributed to these shares. Figure 5 further illustrates that wage distribution across various governorates increases (decreases) with higher (lower) shares of employment in sectors that earn above (below) the national average.

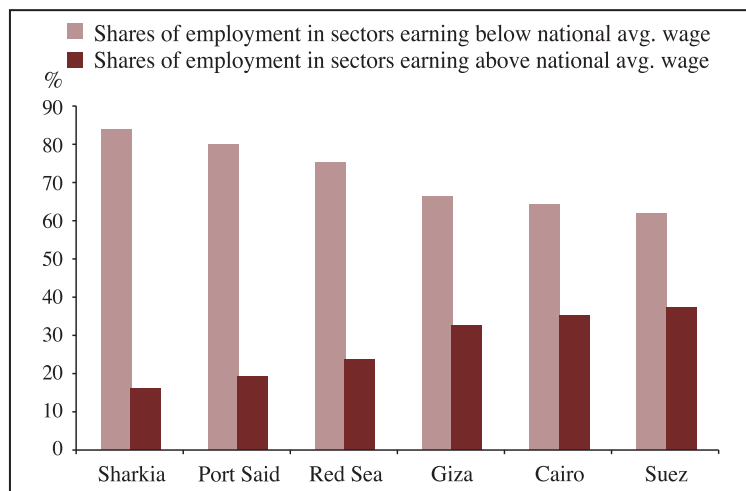
Figure 4. Employment and Productivity across Sectors (2009/2010)



Source: Ministry of Planning, series of real output and employment, 2009/2010.

Note: Productivity is indicated by the primary axis in LE, while employment is represented on the secondary axis in units.

Figure 5. Variation in Wage Distribution across Governorates with Employment Shares



Source: Authors' calculations based on data from CAPMAS (2011a).

Having analyzed the disparity in wage distribution across sectors and regions, the remainder of the analysis will introduce three scenarios for variation in minimum wages, drawing on international experience.

The first scenario considers disparity in the wage policy based on variation in the cost of living across regions. The second scenario considers variation in the wage policy based on productivity indicators across sectors and sectoral employment shares across governorates. The third scenario factors in the weights attributed to the cost of living and productivity indicators to establish variation in wage policy across governorates. Finally, policy implications are established towards enforcing and capitalizing on wage policies to achieve sustainable inclusive growth.

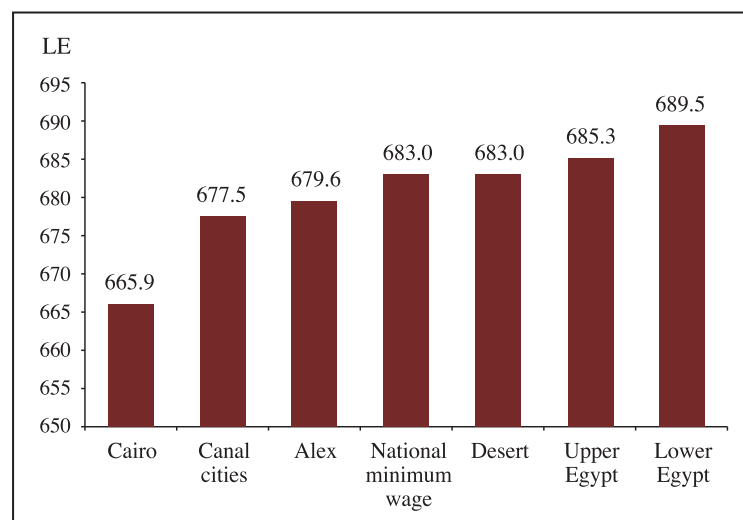
MINIMUM WAGES: INTERNATIONAL EXPERIENCE AND POLICY IMPLICATIONS FOR EGYPT

Disparities across regions in the cost of living, main economic activity and workers' productivity entail different minimum wages. In countries with large regional variations in the cost of living (for instance, Indonesia, Japan and Mexico) and/or productivity levels (for example, Austria, Denmark, Finland, Germany, Italy, Sweden and Switzerland), a national statutory minimum wage is set and then made higher in regions with higher cost of living and/or productivity.

In India, a national minimum wage floor was introduced following the Minimum Wage Act in 1948. In addition to the national minimum wage, state governments set regional minimum wage rates through consultations by five regional committees to account for regional disparities in the cost of living and workers' productivity. Unlike India, Egypt has a "one-size-fits-all" minimum wage, currently set at LE 683, that has yet to be adjusted based on the cost of living and productivity.

Indonesia sets different minimum wages depending on the cost of living in every region. Lower Egypt, with the highest percentage of rural population, has the highest inflation rate, suggesting the need for higher minimum wage in contrast to urban areas. Using step deviation from the national average inflation, we introduce our first scenario for variation in the minimum wages with the cost of living across regions. In Figure 6, deviation in the minimum wage from the national average is calculated based on the standard deviation of the governorate's inflation rate from the national average.

Figure 6. Minimum Wages based on Variation in the Cost of Living across Governorates

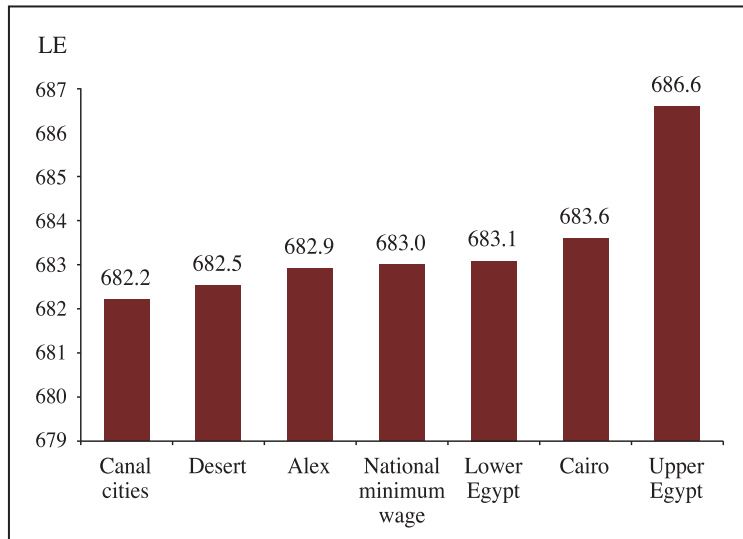


Source: Authors' calculations based on Ministry of Finance data.

To protect vulnerable workers in low-paying industries, several developed countries, including Austria, Denmark, Finland, Germany, Italy, Sweden and Switzerland, set industry wide minimum wages through legally binding collective

agreements. Similarly, there is scope to vary wages based on workers' productivity across industries in Egypt. To anchor variation in the minimum wage based on workers' productivity, we calculate the standard deviation of the industry's productivity from the national average. Subsequently, we calculate deviation in the industrial minimum wage from the national average, factoring in the deviation of industrial productivity from the national average. Using a weighted average of the shares of sectoral employment within regions and their respective wages, Figure 7 illustrates the second scenario for variation in the minimum wage.

Figure 7. Regional Minimum Wages in Egypt based on Variations in Sectoral Productivity and Shares of Employment across Governorates

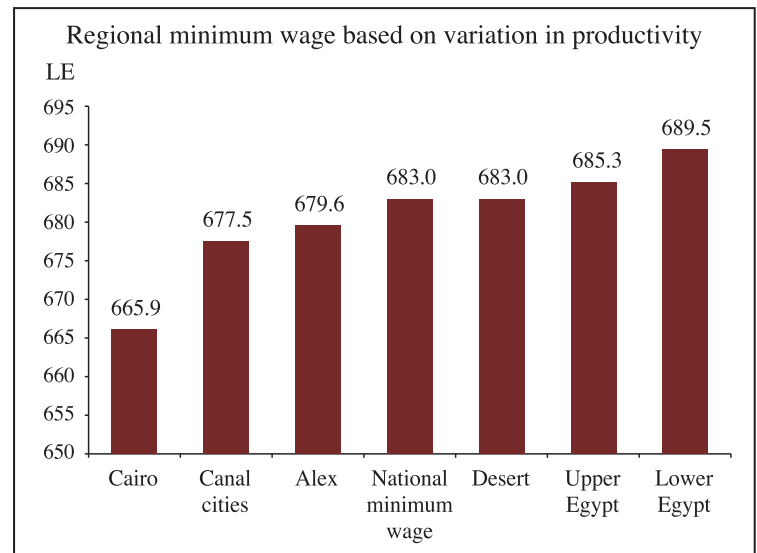
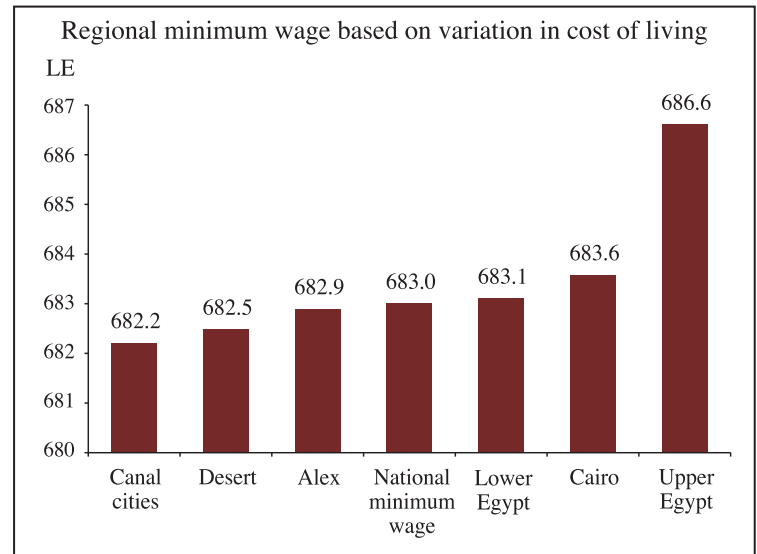


Source: CAPMAS (2011b).

It is worth mentioning that trade union density and collective bargaining coverage in Egypt are significantly lower than in other countries. To factor in workers' productivity by industry in setting minimum wages, Egypt could benefit considerably from increasing trade union representation towards reinforcing the process of negotiating wages in the context of structured collective bargaining.

The different minimum wage systems identified above are not necessarily mutually exclusive. To illustrate, Figure 8 shows variation in the minimum wage across governorates by cost of living and productivity.

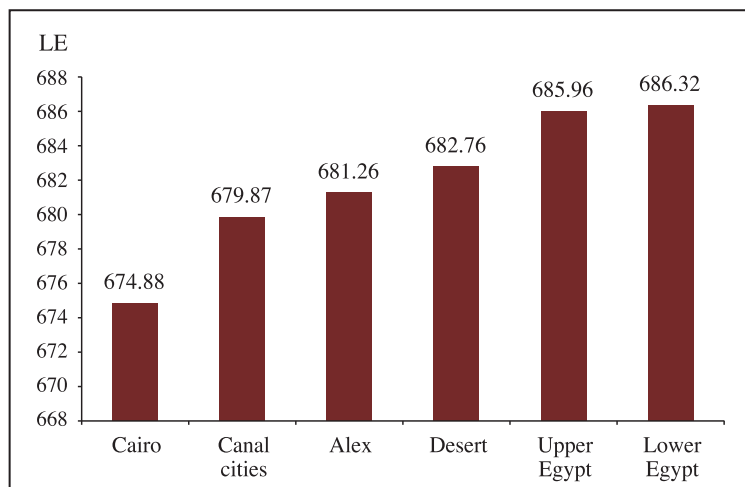
Figure 8. Regional Minimum Wages in Egypt based on Variations in the Cost of Living and Productivity



Source: CAPMAS (2011b).

In the third scenario, the proposed minimum wage strives to close the current gap between the existing average wage and cost of living across regions by factoring in the shares of productivity and cost of living in the respective minimum wage of each region. Specifically, as Lower Egypt suffers from the highest inflation rate and the lowest average wage, its minimum wage is the highest. In contrast, the proposed minimum wage is the lowest for urban regions, where inflation is the lowest and average wage is the highest (Figure 9).

Figure 9. Regional Minimum Wages in Egypt Based on Variations in Both Cost of Living and Productivity



Source: Authors' calculations based on CAPMAS (2010).

Ideally, the minimum wage should cover all workers, allowing for no or only minor exceptions from the minimum wage. However, notable international experiences have allowed for large exceptions, as in China, where the public sector and the agricultural sector are excluded (Herr and Kazandziska 2011; Fontes and Pero 2010). In other country experiences, policies vary based on conditions of supply and demand in the labor market. For example, in the Netherlands, Belgium, France, Luxemburg, New Zealand, Norway, Portugal and Spain, a lower minimum wage is instituted for young workers who are less experienced and skilled and, therefore, have lower productivity (Helmy 2006).

In some countries (e.g., Portugal, South Korea and Nigeria), the minimum wage policy varies based on firm size. To protect small enterprises from shutting down, enterprises with less than 10 workers may be exempted from applying a minimum wage. Exemptions from the minimum wage also apply to part-time employees, seasonal workers and companies where workers are paid on commission or piece-rate basis. However, it is important that the minimum wage policy will not overstretch protection for those who are formally employed at the expense of increasing unemployment and informality (Trade Union Rights Centre 2010; Saget 2006).

CONCLUDING REMARKS

The minimum wage policy in Egypt needs to strike a balance between productivity and social justice. It should be flexible to account for variations in the cost of living and productivity across regions and economic sectors. Mobilizing demand for employment requires increasing investment in sectors where there is scope to increase jobs based on productivity and increasing incentives for formalization. To that end, macro policies should be conducive to private activity where there is a scope to mobilize formal employment. More importantly, there is a need to invest in training and capacity building to upgrade skills and reduce dependency on the minimum wage policy for social protection. Mobilizing demand for skills and increasing the scope for matching supply and demand in the labor market will ensure a sustainable path of inclusive growth.

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