



**CIVIL SERVICE WAGES AND REFORM:
THE CASE OF EGYPT**

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Abstract

This paper analyzes the causes and ramifications of excessive civil service employment in Egypt and makes recommendations for future reforms. It attributes the problem to past policies, which combined guaranteed government employment for all graduates of intermediate and higher education together with free schooling for all. These policies led to an excessive demand for education, deterioration of its quality and a mismatch between the supply and demand for labor. At the same time, the government wage bill has become a budgetary burden, despite a decline in productivity and real wages of civil service employees. To mitigate these adverse effects without compromising on equity and social stability, the paper advocates a new social contract that breaks away from past policies. The new social contract will address the civil service problem through rapid economic growth, a better human development strategy, and a host of other measures that go beyond simply reducing the number of employees or their wages.

ملخص

تقوم هذه الورقة بتحليل أسباب ونتائج تضخم الجهاز الحكومي في مصر وذلك بهدف طرح بعض المقترحات للإصلاح مستقبلاً. وتفسر الورقة هذا التضخم بالسياسات التي انتهجت في الماضي والتي جمعت بين ضمان التوظيف الحكومي لجميع خريجي التعليم المتوسط والعالي، وتوفير التعليم المجاني لمختلف مراحل التعليم، الأمر الذي ترتب عليه تزايد الطلب على التعليم وتدهور جودته من ناحية، وعدم الاتساق بين العرض والطلب في سوق العمل من ناحية أخرى. وفي الوقت ذاته، أدت هذه السياسات إلى تزايد عبء الأجور والمرتبات على الموازنة العامة للدولة، وذلك على الرغم من انخفاض إنتاجية العاملين بالجهاز الحكومي وأجورهم الحقيقية. وللتخفيف من حدة هذه النتائج السلبية، دون التأثير على اعتبارات العدالة والاستقرار الاجتماعي، تدعو هذه الورقة إلى عقد اجتماعي جديد يتعامل مع المشكلة من خلال النمو الاقتصادي السريع، واتباع استراتيجية أفضل للتنمية البشرية، فضلاً عن اتخاذ طائفة من الإجراءات الأخرى التي تتجاوز مجرد تقليل عدد الموظفين أو تخفيض أجورهم.

1. INTRODUCTION

Government employment in Egypt has grown exponentially since the early 1960s and has been closely associated with the ‘social contract’¹ introduced at that time. Free education was provided at all stages, and intermediate education and university graduates were assured government employment and tenure for life. This practice became known as the employment guarantee scheme. Although Egypt has long abandoned socialist economic principles, this practice has not been discontinued.

Two major negative outcomes have resulted from the employment guarantee scheme. On one hand, the pressures of demand for higher education caused a serious deterioration in its quality, as well as a great mismatch between demand and supply in the labor market. On the other hand, the government wage bill has grown uncontrollably and thus become a burden to the budget. In the early 1980s, the growing wage bill was described, together with the cost of subsidies and military expenditure, as a three-headed monster devouring any increase in state revenues (Handoussa 1991a). Since then, Egypt’s reform agenda has managed subsidies in an effective way and military expenditure has been stabilized in relation to the government budget. But expenditure on civil and social service wages has continued to grow. Meanwhile, the decline in real wages and productivity of government employees, accompanied by the unsustainable increase in government employment, has resulted in an impoverished middle class. Consequently, societal values are being undermined, since an efficient and productive civil and social service sector should be the model of good values in any society.

An equally serious outcome of the employment guarantee scheme is its negative effect on the aspirations and motivation of fresh graduates to seek employment in the private sector and/or to resort to self-employment. The minimum wage guaranteed in government jobs has acted as a disincentive for graduates to search for work opportunities in the real economy. Also, the shorter working hours and smaller work load in the government compared to the private sector have allowed for ‘moonlighting,’ whereby a government employee could undertake extra income-earning activities after working hours. Additionally, the backlog of graduates waiting for appointments in government jobs, as well as those seeking but unable to find jobs in the private sector after the employment guarantee scheme was abandoned, has created a generation of graduates who are disappointed and dissatisfied.

¹ The social contract is generally defined as an agreement between the members of the society, or between the government and the governed, defining and limiting the rights and duties of each.

This paper argues that while expenditures on government goods and welfare including free education, health and selected subsidies have had a positive impact, the long-term effects of continued excessive public service employment have had adverse effects on equity, efficiency and sustainability of the government budget. Moreover, the political economy aspects of the problem require developing rapid and viable solutions for balancing the budget.

A number of alternatives are explored to address the aforementioned issues. These include promoting economic development with emphasis on labor-intensive growth; reforming the civil service; enhancing productivity; encouraging self-employment; focusing on human resource development and poverty alleviation; decentralizing the budget; and redeploying civil service employees.

2. HISTORICAL PERSPECTIVE

A major attempt at structural transformation and economic growth took place in Egypt following the 1952 revolution in an effort to achieve an equitable distribution of income. Between 1956 (the Suez War) and 1973 (the October War), the country's institutional structure was affected first by a series of radical socialist measures, and then by the Open Door Policy (ODP), which reinstated private ownership but within a highly bureaucratized and inconsistent institutional framework. It was in the socialist era of the 1960s that the employment guarantee scheme was introduced leading to a serious decline in the efficiency and viability of public expenditure. The process was exponential and in the second half of the 1960s guaranteed employment, along with military expenditure, led to the first budget crisis experienced in contemporary Egypt.

Egypt rebounded as a result of the petroleum-related boom in 1973, which led to large positive spillovers for the economy. However, the surge in petroleum, tourism, and remittance income was not associated with a corresponding increase in the balance of payments, government budget or foreign reserves. Instead, fiscal policies were expansionary, in part because a large proportion of Egypt's windfall income accrued directly to the state in the form of oil exports (Egypt's share) and Suez Canal revenue. The rise in revenues was accompanied by an equal increase in current and capital expenditure, a significant portion of which went to fund additional jobs in the public sector.

Throughout the mid-1970s and mid-1980s, the regional oil boom provided a huge market for Egyptian workers, although domestic employment growth was limited. The growth

in investment was associated with a very low employment multiplier, especially in non-tradable sectors (utilities and real estate) and even more so in the domestic petroleum sector, which generated very few jobs due to high capital and import intensities (Handoussa 1991b). The serious imbalance in the allocation of public and private investment had negative repercussions on employment creation. The commodity-producing and real job-creating sectors met only a fraction of their employment targets and open unemployment increased.

Although the education and health sectors together accounted for over 60 percent of the government wage bill in the early 1970s, interest in these sectors declined among graduates. As a result, government administration began absorbing the bulk of the annual recruits among diploma and university degree holders. The increase in civil service employment and the related wage bill since the early 1970s could be considered a form of subsidy or transfer payment rather than a reflection of growth in welfare services. Moreover, the opportunity cost of the government employment scheme has been detrimental in terms of attitudes toward productive work, discipline and accountability among government employees as well as in the potential investment the state could have made toward development.

While government administration continued to follow the employment guarantee scheme, the public enterprises sector abandoned forced employment policies in 1978. Additionally, unpaid leave was encouraged for government and public sector employees who preferred to work in the domestic private sector or in Arab countries (El Khawaga 1993). These changes led to a significant improvement in the financial and economic performance of public enterprises, and with increased autonomy they were able to reduce their surplus labor force through attrition, raise their labor productivity in real terms, and set their own product pricing. However, there was continued pressure on central and local government administration to employ new graduates. Reducing the government's commitment to job creation has proved a difficult task for policymakers and the scheme has yet to be publicly discontinued.

In 1991, following another severe budget crisis, Egypt adopted the structural adjustment approach of the International Monetary Fund (IMF) and World Bank. This approach included, among other measures, reform of exchange rate and interest rate policies that previously discouraged the use of labor-intensive production techniques. The adjustment program was intended to cut current and capital expenditure, as well as raise budget revenues by

introducing sales taxes. Although major cuts were made to subsidies and other forms of public expenditure, the wage bill remained untouched.

3. THE EMPLOYMENT GUARANTEE SCHEME

The employment guarantee scheme was introduced in 1961/62 for university graduates and extended in 1964 to include vocational secondary school and technical school graduates (Hansen and Radwan 1982). With the exception of medical graduates and teachers, whose assignments were the responsibility of the relevant ministries, the law allowed graduates to apply to the Ministry of Manpower and Vocational Training for a public sector job (Assaad 1997).

The Ministry solicited requests for graduates from government agencies and state-owned enterprises. The requests always fell short of the number of applicants and by 1981 they had reached a ratio of 5:1 (Fergany 1991). The excess supply of applicants was usually allocated to local authorities to dispose of at their discretion (Hansen and Radwan 1982). After public enterprises were exempted from the employment guarantee scheme, the burden of employing thousands of new graduates fell on the government sector.

The government's overly generous employment policy led to growth in the government wage bill, which was not accompanied by an increase in revenues. In spite of the government's wage policy, which attempted to contain inflation by controlling the rise in nominal wages and allowing them to lag behind the cost of living index, the employment guarantee scheme led to a growing and unsustainable budget deficit. The deficit became a primary cause for inflation over the period of the Open Door Policy and throughout the 1980s. Therefore, in 1983 in an attempt to control the wage bill, appointments by the Ministry of Manpower began to decline significantly.

3.1 The Employment Guarantee Scheme and Unemployment

The Ministry of Manpower classifies a graduate as unemployed if his or her name remains on the registry of applicants on a specific date (Assaad 1997). Many applicants do not give up their position in the queue for public sector jobs, even if they are employed in the private sector, in order to reserve their right to a government position. The state increased the waiting period for a government job (up to 13 years) to increase the opportunity cost of public employment and in 1992 announced that graduates employed in the private sector would no

longer be entitled to government jobs. As a result, mass resignations from the private sector took place (World Bank 2003). In 2001, the government's announcement that 170,000 jobs were available led to a flood of over 3 million applications (Galal 2002b). These are strong indications public sector jobs are still valued more than those in the private sector.

In addition, a public sector job is preferred over a private sector job that pays the same salary due to greater job security, the lower number of actual work hours, access to subsidized commodities and housing, and access to free transportation among other perks (Assaad 1997). Females in particular are more inclined to continue waiting for a government job due to its relatively lighter work load, thus allowing them to fulfill their responsibilities at home. Initiatives to promote education for women have resulted in nearly double the number of female university graduates over the last decade, adding to the increasing demand for government jobs. Table 1 indicates the developments in government employment during the period 1994-1999.

Table 1. Development in Government Employment,* 1994/95-1998/99

	94/95	95/96	96/97	97/98	98/99
Administrative	1,115,517	1,179,780	1,217,596	1,314,909	1,259,634
Local Administration	2,500,755	2,624,955	2,688,989	2,860,480	2,799,512
Service Authorities	369,456	394,363	401,641	451,424	430,734
Economic Authorities	462,511	498,067	521,266	513,232	415,345
Total	4,448,239	4,697,165	4,829,492	5,140,045	4,905,225
Development (%)	-	105	103	106	95

* Includes employees under general cadre and special cadres, including the Ministry of Interior and its subsidiary institutions.

Source: Ministry of Administrative Development.

3.2 The Burden of the Government Wage Bill

Table 2 indicates the developments in public expenditure in Egypt during 1991/92-1999/2000. It also compares the ratio of government wages to total public expenditure and to total current public expenditure. As seen in the table, the wage bill increased from 16.3 percent to 23.3 percent of total budget expenditure, and from 24.3 percent to 31.8 percent of current budget expenditure. In fact, current budget expenditure increased by LE 36.7 billion during that period, 39 percent of which was absorbed by the rise in wages and salaries compared to 25 percent and 10 percent by increased interest payments and defense expenditure, respectively (Handoussa 2002).

Table 2. Ratio of Government Wages to Total and Current Public Expenditure

	Public Expenditure (LE million)	Government Wages (LE million)	Government Wages as a %* of Total Public Expenditure	Government Wages as a % of Total Current Public Expenditure
1991/92	49,177	8,029	16.3	24.3
1992/93	52,051	9,803	18.8	24.1
1993/94	56,571	11,096	19.6	24.2
1994/95	58,211	12,519	21.5	26.7
1995/96	63,777	14,045	22.0	27.4
1996/97	67,100	15,368	22.9	29.0
1997/98	70,924	17,025	24.0	30.8
1998/99	86,009	19,562	22.7	32.2
1999/2000	95,096	22,180	23.3	31.8

* Author's calculations based on data from the sources listed below.

Sources: El Gebaly (2000); Ministry of Foreign Trade (2001); Sobhi and Hamed (2002).

3.3 Government Salary Scale

With the exception of certain areas of the public sector that have some flexibility in terms of wages (such as the Suez Canal Authority and the Petroleum Authority), a uniform wage structure has been applied since the early 1960s in both government and public sector enterprises. This unified structure designates wage levels according to education rather than job content. Table 3 shows the salary scale for three different years: 1964, 1978 and 1999. As noted in the table, the salary scale was revised in 1978 to consist of six grades only, and grade 1 was no longer that of the Director General (Handoussa 1990).

Table 3. Basic Salary Scale in the Egyptian Public Service, 1964, 1978 and 1999 (in Egyptian pounds/year)

	1964	1978	1999
Grade	Salary range	Salary range	Salary range
First Under Secretary	1800 – 2000	2100	2603
Under Secretary	1400 – 1800	1500 – 2040	2100
Director General (DG)	1200 – 1500*	1320 – 1920	1500 – 2304
Grade 1		968 – 1680	1140 – 2088
Grade 2	876 – 1440	660 – 1500	840 – 1908
Grade 3	684 – 1200	360 – 1200	576 – 1608
Grade 4	540 – 960	240 – 900	406 – 1212
Grade 5	420 – 780	216 – 720	432 – 924
Grade 6	330 – 600	192 – 540	420 – 744
Grade 7	240 – 480	-	-
Grade 8	180 – 360	-	-
Grade 9	144 – 300	-	-
Grade 10	108 – 288	-	-
Grade 11	84 – 180	-	-
Grade 12	60 – 84	-	-

* In 1964, the Director General Grade was itself Grade 1.

Sources: for 1964 and 1978 data: Starr (1980); for 1999 data: The State Administrative Authority's budget for fiscal year 1998/99.

The table indicates that the salary increases for higher grades were smaller than those for lower grades. However, generous additional allowances supplement the basic salaries of high level bureaucrats. For example, in fiscal year 2003/2004, the budget indicates that ‘basic salary’ and ‘total remuneration including basic salary and various allowances’ totaled LE 10.7 billion and LE 38.4 billion, respectively.

Incentives and overtime payments in the public sector are used as a way of raising the average wage rather than as a reward for individual performance (Handoussa 1990). Promotion in the government and public sector depends essentially on seniority (through the system of wage increments), and also on budget constraints, which may restrict the number of positions allocated to various employment grades every year. In this case, the employee receives the same wage (the grade-wage limit) until budget conditions allow for promotion. There is usually no such limit in public enterprises where budgets are more flexible.

Currently, a variety of supplementary payments, which differ from one agency to another, constitute principal sources of income for some government employees. In some ministries, such payments constitute 83 percent of the basic salary. Although supplementary payments in the form of allowances may have kept employees in their government jobs, there is very little evidence to show that they are incentives for efficiency or productivity. Generally, the amount of such payments depends on the nature of the incentive schemes and the ability (i.e., influence) of the heads of these units to obtain requested funds. Also, the distribution of such payments seems to vary considerably within each agency (Valsan 1999). In general, when real incomes of the leaders of civil service are squeezed – as discussed in the following section – poor performance and dishonest behavior are major outcomes.

3.4 Developments in Real Government Wages

The employment guarantee scheme and the resulting labor redundancies had a detrimental effect on real wages as shown in Table 4. It is clear from the table that the government salary scales were maintained at levels far below rates of inflation.

Table 4. Real Government Wages in 1999 (in Egyptian pounds/year)

	1964	1999 in 1964 prices	1999 in 1978 prices
Grade	Salary range	Salary range	Salary range
First Under Secretary	1800 – 2000	73.51	179.44
Under Secretary	1400 – 1800	59.3	144.77
Director General (DG)	1200 – 1500*	42.36 – 65.06	103.41 – 158.83
Grade 1		32.19 – 58.96	78.59 – 143.94
Grade 2	876 – 1440	23.72 – 53.88	57.91 – 131.53
Grade 3	684 – 1200	16.27 – 45.41	39.71 – 110.85
Grade 4	540 – 960	11.47 – 34.23	27.99 – 83.55
Grade 5	420 – 780	12.20 – 26.09	29.78 – 63.70
Grade 6	330 – 600	11.86 – 21.01	28.95 – 51.29
Grade 7	240 – 480	-	-
Grade 8	180 – 360	-	-
Grade 9	144 – 300	-	-
Grade 10	108 – 288	-	-
Grade 11	84 – 180	-	-
Grade 12	60 – 84	-	-

* In 1964, the Director General Grade was itself Grade 1.

Note: The real wages for 1999 were computed using 1964 and 1978 prices as base years, respectively. For nominal wages see Table 3.

Sources: The real salary figures for 1999 (calculated using 1964 and 1978 prices) were computed using annual consumer price indices (1995=100) from the International Financial Statistics online database of the IMF accessed on Sept. 29, 2003. The CPI series was re-adjusted to calculate figures using 1964=100 and 1978=100, respectively.

3.5 Free Education and the Impact on Equity

Several studies have addressed the issue of distribution of public expenditure over the different stages of education.² These studies argue that the allocation of resources to higher education is biased against the poor since they constitute only a small fraction of such students compared to pre-university levels of education, especially primary (Zaytoun 1998). This is partly because primary education is obligatory, while higher levels are optional. Moreover, high indirect costs are incurred by the household for providing their children with higher education in addition to high opportunity costs in terms of the income that their children could have earned by joining the labor market at an early age.

Table 5 provides a comparison of higher and pre-higher education with regard to the distribution of public expenditure, the number of students, and the average cost per student. Average expenditure per student in higher education is equivalent to several multiples of that in pre-higher education. Also, while the ratio of students in higher education to total students has been decreasing over time and almost levels off in the mid-1990s, their share in expenditure has been continuously increasing (Zaytoun 1998).

² Jeminez (1986).

Further, a comparison is also made for the year 1986/87 among Egypt, the least-developed countries (LDCs) and advanced countries regarding the ratio of average expenditure per student in high education to that per student in pre-high education. The ratio was 9.7 in Egypt compared to 7.0 in LDCs and only 3.3 in advanced countries (Zaytoun 1998).³

Table 5. Distribution of Public Expenditure on Education, Ratio of Students and Average Cost per Student for Higher and Pre-higher Education, 1981/82, 1991/92 and 1994/95

Year	1981/82	1991/92	1994/95
Pre-Higher Education:			
Share in Expenditures	59.4	59.7	52.4
Ratio of Students to total	92.3	95.1	94.8
Average Expenditure per student (in LE)	LE 79.3	LE 264.7	LE 399.4
Higher Education (i.e. university):			
Share in Expenditures	40.5	40.3	47.6
Ratio of Students to total	7.7	4.9	5.2
Average Expenditure per student (in LE)	LE 645.2	LE 3474.8	LE 6638.0
Ratio of Average Expenditure per Student in Higher to the Average per Student in Pre-higher Education	8.1	13.1	16.6

Sources: Zaytoun (1998); Ministry of Planning, State Budget for expenditures; and CAPMAS, *Statistical Annual Yearbook*, various issues for ratio of students.

The above analysis indicates that the middle class, rather than the poor, benefits most from the employment guarantee scheme. Given that the poor represent a very small fraction of university enrollment, they are less eligible for the guaranteed government jobs. As such, there is a clear inequitable distribution of income, considering that it is the poor that should be the main recipients of budget allocations.

3.6 Employment Guarantee and the Business Climate

The free education system and the drop in its quality have led to an inefficient and unproductive civil service. From the perspective of private investors, the overstuffed government bureaucracy is not conducive to a healthy investment climate. Labor redundancy has resulted in a decline in the marginal productivity of the staff and has resulted in significant overlapping of responsibilities, which increase the transaction costs incurred by businessmen; a factor recognized as a major constraint to the private sector. Additionally, the substandard nominal and real wages that prevail in the government sector lead to corruption and unofficial payments, which result in extra costs to businessmen.

³ Sources: for Egypt: Ministry of Planning, State Budget 1986/87; for other countries: UNESCO (1991).

The Economic Research Forum for the Arab Countries, Iran and Turkey (ERF) conducted a survey on institutional impediments to export and investment promotion in Egypt (Handoussa and Abou Shnief 2001). The study was based on extensive opinion surveys of businessmen, government officials in export and investment promotion agencies, and various opinion makers in the media, parliament and the Shura Council. According to the business community, when dealing with government agencies, having "connections" and making additional payments are necessary to facilitate transactions (Ghoneim 2001).

Regarding the current size of government agencies, they are excessively overstaffed. For example, the General Authority for Free Zones and Investment (GAFI) employs over 1,400 workers, mostly in administrative positions, though it has been estimated to need less than half that number. This situation prevails in most government agencies where the lack of technically qualified personnel and inadequate wages are also problematic.

A self-evaluation taken by government officials in 15 investment and export promotion agencies revealed the belief that poor worker productivity was due to the lack of a merit-based system of promotion as well as low wages and meager benefits. It was suggested that increasing the existing level of wages and salaries for specialized staff would help improve performance and retain workers that are better skilled and trained.

The current incentives system does little to motivate workers (Handoussa and Abou Shnief 2001). One area of consensus among the sample of government officials and civil society is that budgetary allocations to incentives need to be increased. The incentive system should be tied to performance and productivity, and objective criteria should be adopted for evaluations as opposed to the current focus on connections and seniority.

4. PROPOSALS FOR REFORM

4.1 Economic Growth

Some recent studies have proposed a reform program including expanding the demand for labor through *labor-intensive growth* as well as following appropriate *migration policies* (Galal 2002a). Galal pointed out that in 2000/01 economic growth fell to 3.5 percent, and during the period 1988-1998 the rate of growth in productivity was only 1.6 percent annually, while the annual rate of growth in labor force was just 2.7 percent. He also noted that by 1995 average real wages were only two-thirds of their level in 1985. In recent years,

macroeconomic management has led to a considerable slowdown in economic activity. The exchange rate was a major factor, but other causes include policies favoring production for domestic rather than international markets (i.e., high average tariff rates, high real interest rates, and high transaction costs), capital at the expense of labor (i.e., tax exemptions, relatively cheap land, and in some cases subsidized credit), in addition to constraints in the business environment that discourage investment.

4.2 Civil Service Reform

Radwan (2002) has pointed out that with the transition to a high productivity economy there is a need for a lean but efficient civil service. He notes other countries' experiences and mechanisms including the 'Civil Service Examination' in India, which is administered to screen for and ensure high quality public employees, and the 'High School of Administration' in France, which trains its students to become highly skilled civil servants.

In this respect, a comparative study conducted by the United Nations Development Programme (UNDP 1998) highlighted the following: "Civil service reform aims at increasing the effectiveness and performance of the civil service by improving the quality of services to the population and enhancing the capacity of the civil service to carry out core government functions." Some favored reform measures include reducing the size of the civil service, decentralizing government services to local authorities, encouraging the private sector to take over public sector functions, increasing remuneration levels and differentials, and establishing clear relationships between performance and rewards.

Civil service reform is clearly a political as well as a technical issue. The programs must derive support not only from the political and administrative leadership but also from the civil service and the private sector. Since retrenchment can have negative consequences on morale and productivity in the civil service, the UNDP found that linking retrenchment exercises with other measures to improve administrative capacity and also developing a dialogue with those affected is of great benefit. The challenge is to combine restructuring and capacity building to ensure improved overall performance of the public sector.

The experience of the Eritrean government in reducing its civil service by more than 10,000 workers from 25,000 demonstrates the benefits of a consultative approach to reform within the public sector when led by a committed government. This success has been attributed to the initial work done by a task force that performed a review of the internal

structure and functions of each ministry and achieved consensus on a redefinition of the role of the state before staff reductions were undertaken. Wage reform is also a key component of reform efforts and must be accompanied by the establishment of personnel information and control systems to prevent the re-employment of dismissed personnel. The UNDP-assisted project for reforming the public sector in Tanzania illustrates the complexity of such an effort. In 1986 the civil service was reduced by releasing 1,200 employees and by freezing new employment except for teachers and health care workers. However, in 1988, approximately 16,000 ghost workers were discovered on the government payroll. As a result, measures were taken to ensure up-to-date payroll data.

The Tanzanian case highlights the need for a careful review of the economic benefits of civil service reduction. It is important that the savings accruing to the government from reducing staff outweigh the costs of the exercise, not only in terms of implications for pension schemes and the financing of severance packages, but also in terms of their social consequences. Criteria for the dismissal of staff must be open and transparent, and severance packages must be adequate. The UNDP experience in civil service reform indicates that many governments have had limited success in improving the delivery of public services because of the lack of involvement by civil society. Key decision makers often lack an accurate understanding of what is required by the beneficiaries of public services and they are therefore unable to provide responsive, customer-oriented reforms. Consultations with stakeholders and beneficiaries can provide significant benefits, particularly when the privatization of services is under consideration.

In an effort to enhance government effectiveness in Egypt, *parallel systems* were established within the existing ministries in a number of cases (Bahaa El Din 2003). Ministers created new systems to achieve the goals set for their ministries instead of reforming the existing bureaucratic structures. Thus, parallel units co-existed: the original unit was kept in place and a new system was added, comprised of highly-educated, better paid employees who were personally accountable to the minister. The spillover effect of these units is often limited, due to the lack of communication with the existing staff (Bahaa El Din 2003).

The Social Fund for Development (SFD) plays a major role in the provision of a safety net for groups affected by economic reform. One of the programs introduced by SFD is the

Labor Mobility Program (El Khawaga 1993). This program establishes a unit or committee for labor restructuring in any firm that requests assistance in this regard. The committee is composed of workers, management and an expert in the area of labor mobility. The size of surplus labor is estimated and various alternatives are introduced such as early retirement, severance payment, provision of alternative jobs in the private sector, or obtaining credit for starting a small business. In 1986, the Ministry of Industry provided an excellent example of staff reduction through attrition. New hiring was halted in the public sector manufacturing entities, with the exception of night shift guards. During the mid-1990s, the Principal Bank for Development and Agricultural Credit (PBDAC) managed to reduce its staff countrywide from about 32,000 to 25,000 in 17 governorate banks, through normal attrition and early retirement schemes.

Government employees that choose early retirement can use their severance payments to start a business in the small and micro-enterprise sector (SMEs). In fact, as mentioned earlier, in many cases government employees work part-time jobs or ‘moonlight’ in the SME sector while still employed in the government. This sector has huge potential and can play a significant role in accommodating redundant government labor.

The vast SME sector operated for five decades with no support from the state. Then, in the 1970s and 1980s, the government provided a dramatic boost to rural and urban infrastructure, which increased the development of SMEs. Since the oil boom and the era of massive labor exports, rural incomes and savings have risen. Thus, net surplus labor found new channels for investing in rural non-agricultural activities and the process of rural-urban migration has declined since the 1970s. However, powerful trade unions are not present in Egypt and private sector wage levels have not increased ahead of productivity levels except during the oil boom (Handoussa 2002).

The growth in the number of micro firms (1-4 employees) has been phenomenal over the past two decades (Table 6). However, the sector is still not operating at its full potential because of market failures that prevent it from accessing credit, skilled labor, better technology, and larger domestic and export markets. The informal sector also lacks broad level accessibility to primary education and health care for the poor.⁴

⁴ An Egypt labor force survey conducted in 1998 showed that 30 percent of informal sector workers are illiterate versus only 6 percent in formal employment (El Mahdi 2002).

Table 6. Size Distribution of Establishments and Employment in the Private Sector, 1976, 1986 and 1996
(figures in parentheses are the shares in total)

Size*	Establishments			Workers		
	1976	1986	1996	1976	1986	1996
1-4	704,566 (95.1 %)	1,049,508 (91.1%)	1,531,212 (93.3%)	992,107 (70.2%)	1,585,971 (66.7%)	2,571,688 (64.7%)
5-9	25,995 (3.5%)	41,005 (3.6%)	82,646 (5%)	160,377 (11.3%)	252,778 (10.6%)	500,893 (12.6%)
10-49	9,526 (1.3%)	15,073 (1.3%)	23,454 (1.4%)	163,242 (11.5%)	267,560 (11.3%)	410,961 (10.3%)
50-99	518 (0.1%)	1,149 (0.1%)	1,730 (0.1%)	33,655 (2.4%)	74,567 (3.1%)	115,049 (2.9%)
100-499	269 -	511 -	1,174 (0.1%)	48,093 (3.4%)	91,969 (3.9%)	227,028 (5.7%)
500-999	17 -	53 -	102 -	12,400 (0.9%)	35,915 (1.5%)	64,891 (1.6%)
1000+	2 -	16 -	48 -	4,191 (0.3%)	68,930 (2.9%)	84,300 (2.1%)
Total	740,893	1,142,315	1,640,366	1,414,065	2,377,690	3,974,810

*Size of an enterprise refers to its number of workers.

Sources: Prepared by ERF, based on the last three Censuses of Establishment from CAPMAS for 1976, 1986 and 1996.

As shown in Table 6, firms with up to 9 employees provide 77 percent of jobs in the non-agricultural private sector. Therefore, the strategy should be to capitalize on the dynamic features of micro-enterprises including the low cost of capital per job created and flexible production methods. Informal sector employment opportunities are not very consistent, but according to some studies,⁵ they offer wage levels that are relatively higher than those in formal employment.

Regulatory constraints discourage the bulk of SMEs from registering or abiding by most of the rules of formal firms. From the perspective of employees, work in the SME sector lacks security because of the absence of social security coverage and work contracts. Conversely, employers consider social security costly and feel the rigidity of the labor law makes a binding work contract too risky in terms of dismissing labor. To overcome the problem in the medium-term, the government could revise downward the amount of money that the employer and employee contribute to social security and step in on behalf of the SME sector to provide the balance of the insurance contribution (Handoussa 2002). However, lack of social security coverage is only one of several constraints encountered by the SME sector in Egypt, and other efforts should be made to remove constraints in areas such as accessibility to credit, to markets, and to technology.

⁵ Ibid.

4.3 Productivity Enhancement

Experts are calling for a shift in the way labor is viewed: as having “potential” rather than as a “problem,” and focusing attention on the continuous need to invest in human capital (Radwan 2002). In the long-run, the fiscal and monetary policies aimed at achieving full employment will have to be complemented by microeconomic policies such as adequate education, training, and labor market flexibility.

As a result of low productivity, the labor force in Egypt is far from reaching its full potential. International comparisons of employment in growth-enhancing activities indicate that Egypt has low manufacturing value-added per capita, low share of medium and high tech products in both manufacturing value-added and manufacturing exports, and low tertiary technical education and enrollments relative to the population (Radwan 2002).

The primary objective of an employment strategy should be skill upgrading, which requires establishing a modern and demand-driven training system (Radwan 2002). Current training institutions are numerous but inadequately funded and highly bureaucratic (Galal 2002b). International experience suggests that establishing a National Training Fund to replace the present supply-side system would be an effective tool to help correct the imbalances in the labor market and the inefficiencies in the training system (Radwan 2002). The establishment of a semi-autonomous National Training Fund in Egypt has been proposed, in which the private sector (the major source of demand) would have a major say.⁶ The Fund would help reduce the chronic mismatch between supply and demand in the labor market. This disparity is the result of an imbalance in the allocation of the education budget across formal education and technical training, and the misallocation of resources to basic and tertiary training (Handoussa 2002).

To deal with the huge expansion in secondary school education, the graduates of which comprise the bulk of the unemployed, several analysts have proposed reallocating a greater portion of public resources to primary rather than higher education (Galal 2002b). The Labor Market Survey⁷ conducted by the Central Agency for Public Mobilization and Statistics (CAPMAS) indicated that out of 1.7 million unemployed in 1998, 55 percent had an

⁶ ILO/UNDP (2001).

⁷ CAPMAS (1998).

intermediate education. In contrast, this category was the least in demand, constituting only 4 percent of the estimated labor demand in 2001-2005.

Education reforms constitute a basis for productivity enhancement. In spite of significant progress in the enrollment of both boys and girls at all levels of education, such progress has been at the expense of quality and the appropriate mix of graduates required in the market (Galal 2002b). Teachers' low remuneration is a disincentive to teach, private tutoring is widespread, parents have no say in the selection of teachers or schools, and monitoring is difficult. Reforms are needed, particularly in the area of teacher incentives.

5. SOCIAL DEVELOPMENT

The employment guarantee scheme has led to increased poverty as reflected by the government salary scales that fall below poverty lines (see Tables 2 and 3 for nominal and real government wages, respectively). Reducing redundant government labor will result in increased poverty unless alternatives are made available as noted previously.

To achieve social development in Egypt reform of the civil wage structure is necessary in the context of enhancing labor productivity and re-deploying civil service employment. Higher levels of private sector investment and GDP growth are necessary but not sufficient for solving the problems of malnutrition and illiteracy. There is a need for the government to dedicate more of the budget to the deprived subpopulations (Handoussa 1999). This would include higher levels of cash transfers to the ultra poor;⁸ more expenditure on supplies and maintenance for health centers, elementary schools, and vocational training centers; an overhaul of the system of accountability of incentives to raise the quality of delivery of public services; and a rectification of the distorted division between administrative and productive jobs in the civil service.

5.1 Human Development and Poverty in Egypt

Social progress is measured by human resource development indicators, nutritional levels, income distribution, and gender disparities. When all measures and indicators are considered, about one-third of the population is still below the poverty line (Handoussa 1999). Egypt's

⁸ The ultra poor are defined in some literature as those whose income is below \$1 a day (UN 2002) or as those below the Food Poverty Line, i.e., unable to meet essential food requirements (UNDP 1996). The poor are referred to in other literature as those whose income is below \$2 a day (World Bank 2002) or as those who cannot afford the cost of essential foods and other basic needs (UNDP 1996).

investment in human resource development – the ‘software’ for economic growth – has been insufficient and of poor quality.

A number of reliable investigations of poverty have been undertaken in Egypt since 1995.⁹ Recently, the UNDP presented their findings based on the Subjective Poverty and Social Capital Survey of 4,000 households.¹⁰ The ‘objective’ poverty line was set as the cost of a normative ‘basic needs’ bundle of goods and services. The concept of ‘subjective poverty’ was introduced, referring to the individuals’ perceptions of themselves. The average per capita lower-objective poverty line in 2002 was LE 1,116 per annum and the corresponding upper poverty line was set at LE 1,574. About 20.4 percent of the Egyptian population was objectively poor, approximately 13.7 million people. Using the upper poverty line, the figures were 43.8 percent or 29.3 million people.¹¹ Based on people’s perceptions of themselves, the subjective poverty line was estimated at LE 1,723. The subjective poverty rate was highest in the metropolitan region (42.5 percent) due to the nature of the *milieu* and higher income inequality. The study further concluded, *inter alia*, that the poor – particularly women – have little or no voice in decision making: they are dependent on services by the government and local authorities. Increasing the participation of the poor in ‘social capital’ must be a key component of an effective poverty-reduction strategy. The study conducted interviews with 20 respondents and found a striking absence of community participation and political activity. Policy implications of the UNDP study included involving the citizens in community action starting from the early project design and the planning stages – thus building trust in the government – and upgrading the social services and NGOs’ efficiency in delivery.

⁹ See El Laithy and Osman (1997); IFPRI (1998); Nagi (1998b); and INP (1999). The poverty line ranges from LE 1,055 to LE 1,332 per capita annually (IFPRI 1998). Poverty incidence is between 27 percent and 48 percent of the population (El Laithy and Osman 1997). The ultra poor constitute 8.6 percent of the population (El Laithy and Osman 1997). Rural areas are home to 63 percent and 74 percent of the poor and ultra poor, respectively (IFPRI 1998). The number of poor ranges from 15.7 million (IFPRI 1998) to 28.3 million (El Laithy and Osman 1997). About 7.7 percent of households have monthly incomes below LE 100 (Nagi 1998b).

¹⁰ UNDP (2003). The sample used in survey was a stratified multistage random sample distributed among five regions: metropolitan, upper rural, lower rural, upper urban and lower urban. The 4,000 households included 1,720 and 2,280 in urban and rural areas, respectively.

¹¹ Rural Upper Egypt is the poorest region according to objective poverty criteria: 34.9 percent are unable to satisfy basic needs.

5.2 A New Social Contract

The evolution of 'state-labor relations' has been ongoing. Between the 1940s-1970s, the social contract in the Middle East and North Africa (MENA) region promoted redistribution and equity in economic and social policy, and states over markets in managing national economies. Labor-management relations eroded employers' authority to set wages and working hours, and to hire and fire, while state-supervised arbitration procedures were established to resolve workplace disputes. Along with these protections came restrictions on the political activity of labor, including limits on the right to strike. This is in addition to import substitution strategies that created constraints and incentives influencing investment and production with implications for labor demand (World Bank 2003). In Egypt, the government employment guarantee scheme, which has proved unsustainable, still forms an element of the social contract.¹²

If current trends continue, economic performance and the well-being of workers will be further undermined by rising unemployment and low productivity. However, if states no longer serve as the employer of first resort, they will be better able to create and sustain employment opportunities. In the new social contract the state must play a strong role in improving social services mainly health, education, social security as well as governance. Governments must link economic performance to the quality of governance in a way that ensures their own accountability and transparency. The government's support of the private sector as an engine for job creation should include strengthening collective bargaining frameworks and extending the benefits of formal employment to a larger share of workers (World Bank 2003). The new social contract should also link reform to the principles of poverty reduction, income equality and income security.

Egypt is one of the MENA countries that recently introduced reforms to labor market regulations, with a balance between greater flexibility (in hiring, firing and wage setting) and enhanced recognition of trade union rights for workers. However, there has not been widespread acceptance, especially since business owners fear the threat of legal strikes and because their *de facto* hiring and firing rights have not really improved. In any case, it is doubtful whether the factors of political stability and social peace that prevented policymakers from undertaking comprehensive reform during the last 15 years are still as constraining:

¹² Assaad (1997).

reforms are no more a source of political risk than the problems they are intended to address (World Bank 2003).

5.3 Poverty Alleviation Policies

With the Economic Reform and Structural Adjustment Program (ERSAP) of the early 1990s, total reduction in public expenditure on the poor should have amounted to 10-12 percent of GDP. This percentage included a reduction in food subsidies by 5 percent of GDP, with the remaining balance comprised of the elimination of explicit subsidies on electricity, fuel, water, transport, public sector consumer goods, as well as the introduction of regressive sales taxes (Handoussa 1999). But the government's social assistance cash transfers were not increased in line with the rise in the cost of living, which compounded the problem for the ultra poor. An intended social safety net scheme for the poor was not introduced (Egypt Consultative Group Meeting 1991) and the funds earmarked for direct compensatory cash transfers have increased marginally in nominal terms and decreased in real terms (Zaytoun 1991). The SFD approaches poverty alleviation via employment generation, but excludes by definition the poor who cannot work and those who are too poor to apply for project funding. The Ministry of Insurance and Social Affairs' (MISA) 'Daman' and 'Sadat' Pension Schemes have good coverage but meager payments. The World Bank claimed that expenditure on food subsidies alone was more than the total transfers required to bring every poor person in Egypt above the poverty line.¹³

5.4 Target Beneficiaries and Institutional Reform

The proposal for the new social agenda targets women, youth and micro-entrepreneurs. Female literacy, health and participation in the economy are critical factors in determining outcomes in terms of return to children's education, children's health, and family income. Poverty is more concentrated in female-headed households. The gradual reduction in guaranteed government employment has affected women in particular as the government sector was their major employer (Handoussa 1999). Also, the family support system is gradually disintegrating due to modernization, thus increasing the need for social assistance programs for female-headed households.

¹³ World Bank (1995).

Regarding institutional reform, appropriate legal and administrative environments are needed for the success of economic and social policies. However, critical difficulties exist such as the fact that most urban and rural dwellings are informal with no legal title or building license,¹⁴ most micro-enterprises have chosen to remain informal, and teachers have resorted to private tutoring rather than organizing as a pressure group to improve their remuneration.¹⁵ This was described by Harik (1999) as ‘uncivic culture’ that will only be remedied by developing closer ties between government policy and the realities of the market, and by encouraging open dialogue and debate.

The Egypt Human Development Initiative was an essential bridge, building a common language between policymakers and researchers. An effective core team of development agents proved to be essential mediators between national think tanks and senior government officials at the local governorate level. Public administrative officials must learn how to work in collaboration with local communities, NGOs and the private sector. To develop a strong civil society, individuals, families, and civic organizations must be empowered to express their preferences and to propose solutions as well as monitor the efficacy of state services (Handoussa 1999).

5.5 Migration

A new migration policy needs to be tailored in a way that promotes and encourages *regulated non-permanent* migration flows. This form of migration provides an opportunity for countries to reverse the ‘brain drain’ and to build human capital when the emigrants return. This form of migration presents governments with a new revenue source: a charge or fee in return for the services and expenditures the governments have borne in order to educate and build the skills of national migrants before they migrate.

Regarding intra-regional migration (Galal 2002a), while policymakers cannot influence shifts in external demand caused by oil shocks, bilateral negotiations or regional agreements could be made with the oil-rich countries concerning labor mobility and working conditions. The government can also provide information on job opportunities abroad.

¹⁴ De Soto (1997).

¹⁵ Harik (1999).

5.6 Best Case Scenario for Budget Allocation

The huge burden on the current account caused by the wage bill has forced the government to reduce its investment spending, thus aiding the recession. Between 1991/92-1999/2000, the wage bill increased from 24 percent to 32 percent of current budget expenditure rather than falling to a manageable level (i.e., 20 percent) as intended by the ERSAP. It is worth noting that the ERSAP stipulated an annual 10 percent reduction of government staff – but this did not take place. One way of releasing resources from the current account is to gradually reduce and re-deploy up to 1 million redundant civil servants across the central and local government. This would allow up to 10 percent of the current budget to be allocated for increasing the budget of the social sectors, including insurance coverage for SME employees. This is equivalent to an increase of more than one-third of the actual budget resources allocated to education, health, social assistance and the Social Fund.

Critical analysis of Egypt's public expenditure on the poor and unemployed suggests that the government should review and increase the social assistance budget from its current level of about 0.5 percent of GDP. What is advocated is to move away from the unsustainable and inequitable policy of providing artificial government jobs, and instead, direct budget resources of up to 2 percent of GDP toward shouldering part of the social insurance burden of wages in the SME and informal sector. A targeted program of incentives, including NGO promotion, could help as many as 1.5 million micro-enterprises graduate to formality, earn higher incomes and generate more jobs.

The age distribution of unemployment indicates that the bulk of job seekers are 16-30 years old.¹⁶ Compared to countries with an aged population, Egypt can still afford to provide incentives for young labor force entrants to find employment in productive activities, especially if this is done through a system of social insurance in which the government provides a substantial and sustained contribution that covers employer and employee shares. This would encourage the formalization and growth of work contracts in favor of targeted age brackets. However, economic growth has to be maintained at high levels with policies that direct investment into labor-intensive activities (Handoussa 2002).

¹⁶ Based on: CAPMAS (1996).

5.7 Reducing and Re-deploying Civil Service Employment

Egypt has one of the highest levels of government employment among developing countries, with 42 percent of aggregate non-agricultural employment in 1995 compared to 10-15 percent in countries such as Indonesia, Pakistan, Philippines, Singapore, Tunisia, and India.¹⁷ The objective should be to gradually reduce the surplus employment in administration, while improving the wage and salary payment for productive government employees. The timetable could be a 10-year target.

The structure of government employment will also have to improve in favor of local government employment in social sectors. Improved access to elementary education in rural areas and restructuring health expenditure in favor of preventive care and basic health would mean an increase in the number of jobs for teachers, paramedics and social workers serving poor communities in rural and urban Egypt.

Although Egypt had an impressive ranking of second among 174 countries in terms of improvement in the Human Development Index (HDI) over the past two decades,¹⁸ some surveys indicate serious education and health gaps between the poor and the non-poor. For example, the International Food Policy Research Institute (IFPRI) reported that the literacy rate of the poor is 27 percent lower than the non-poor, and their average years of schooling are 2.6 years less. According to a social spending household survey conducted in 1998 by the Institute of National Planning (INP),¹⁹ almost half of the parents surveyed claimed the high cost of education was the reason they did not send their children to school (Handoussa 1999). The organizational structure of the education sector suffers from resource misallocation, inefficiencies, and lack of accountability.²⁰

There are also large disparities in access to health services, intensified by an inefficient targeting system of the Ministry of Health, poor planning, and an ineffective delivery system. A serious drop in bed occupancy was observed in the early 1990s compared to the early 1980s. In a Health Expenditure Survey conducted in 1995, drugs were a major cost to inpatients in spite of free beds. The ratio of physicians to nurses was only 1:1 compared to an

¹⁷ Van Ginneken (1991).

¹⁸ UNDP (1999).

¹⁹ INP Survey was conducted in 1998 for the Egypt *Human Development Report*.

²⁰ For example, 38 percent of Ministry of Education personnel are in administrative positions, an effective teacher/student ratio is officially underestimated, teachers are poorly trained and poorly paid, and parents are passive actors in the system.

international norm of 1:3. This reflects the low level of enrollment in nursing institutes, as the salaries of nurses compared to physicians discourage many from entering the profession (Nassar 1997).

Since the number of women in occupations like nursing and teaching is significant compared to their share in other fields (e.g., manufacturing), directing more employment to these two areas would have the dual positive effect of improving health and education services and absorbing the female employment that is particularly affected by civil reform.

It is necessary to review the state budget allocation to education and health care as these two sectors are vital to both social equity and investment in human capital and productivity. There is a need for the decentralization of services and localization at the governorate level, which will positively affect the quality of services. The budget should also be transferred to the local level in a way that stimulates participation as well as cost-sharing.

Redefining civil service employment would entail transferring redundant labor to the local levels in order to become more productive and undertake service delivery. Many civil servants may prefer to take advantage of the early retirement scheme, which in itself would be a positive outcome.

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