



**THE IMPACT OF RECENT MACRO AND LABOR  
MARKET POLICIES ON JOB CREATION IN EGYPT**

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## Abstract

This paper analyzes the impact of recent macroeconomic and labor market policies in Egypt on job creation. It shows that reform measures undertaken by the government in the last two years (2005-06) to promote investment, boost exports and improve public finances, have not increased employment adequately. Labor market policies did not correct for labor market failures due to the short-term nature of these policies and lack of coordination among them and with macroeconomic policies. To increase employment, the study emphasizes the importance of designing a national employment strategy with the objective of creating more jobs, especially in those sectors with the highest employment elasticity. The strategy should be made an integral part of Egypt's national development plan. Both macroeconomic and labor market policies should be aligned with the objectives of the strategy.

## ملخص

تتناول هذه الدراسة بالتحليل تأثير سياسات الاقتصاد الكلي وسوق العمل في مصر خلال الآونة الأخيرة على التشغيل. وفي هذا الإطار، توضح الدراسة أن جهود الإصلاح التي قامت بها الحكومة في العامين الماضيين (٢٠٠٥-٢٠٠٦) بهدف تعزيز الاستثمار، وزيادة الصادرات، وتحسين أوضاع المالية العامة لم تتمكن من زيادة معدلات التشغيل على النحو الكافي. فسياسات سوق العمل لم تنجح في تصحيح جوانب الإخفاق في ذلك السوق نظرا لغياب التنسيق فيما بينها ومع السياسات الاقتصادية الكلية، فضلا عن أنها سياسات قصيرة الأجل. ولزيادة معدل التشغيل تخلص الورقة إلى أهمية تصميم إستراتيجية قومية للتوظيف تهدف إلى توفير المزيد من فرص العمل، خاصة في القطاعات التي تتمتع بارتفاع مرونة التشغيل. كذلك، يتعين أن تكون هذه الإستراتيجية جزءا لا يتجزأ من الخطة القومية للتنمية، مع ضرورة ربط كل من سياسات الاقتصاد الكلي وسوق العمل بأهداف تلك الإستراتيجية.

## **1. INTRODUCTION**

There is growing consensus that job creation poses a major challenge for the Egyptian economy. Some 750 thousand new jobs need to be created annually to absorb new entrants to the labor market and reduce the annual unemployment rate currently estimated at 11 percent (CAPMAS 2006b). The labor market suffers from a demand-supply mismatch as well as a discrepancy between the outcome of the education system and skill requirements of businesses. Meanwhile, the government remains a major source of non-agricultural employment, as the private sector has fallen short of creating enough jobs to absorb the growing labor force. In addition, the informal sector continues to be the main refuge for low-productivity and low-income employment.

These trends started in the 1970s, became more intense during the 1980s, and have been aggravating since the 1990s. Two main reasons could be responsible. Firstly, with the government adoption of the employment guarantee scheme in the 1960s, job creation policies were overlooked and employment targets were never incorporated in macroeconomic policies. Moreover, the national employment scheme adopted in 2001 was not part of the national development plan. Secondly, the government tended to deal with job creation through piecemeal and scattered measures and only in emergencies. In other words, there was no comprehensive strategy for employment.

In light of poor government management of employment and job creation, the question is: what macroeconomic and labor market policies should be adopted to increase employment? To answer this question, the paper reviews recent macroeconomic and labor market policies, highlights their shortcomings, and suggests some broad measures that could help improve their impact on employment. The paper comprises five main sections. Following the introduction, section two presents a brief analysis of the Egyptian labor market. Sections three and four examine successively the impact and limitations of recent macroeconomic and labor market policies on job creation. They also offer a set of proposals to improve the impact of these policies on employment. Section five concludes.

## **2. MAIN CHARACTERISTICS OF THE LABOR MARKET IN EGYPT**

This section summarizes the main characteristics of the Egyptian labor market in order to identify key problems affecting employment creation. The following overview includes basic information on population, labor force, employment, unemployment, and the informal sector.

### ***2.1 Demographic Perspectives***

Egypt's population reached 71,348 million in December 2005, 51.2 percent of which are males. During the period 1995-2005, the population increased by almost 20 percent, despite efforts to reduce the annual population growth rate from 2.1 percent in the late 1990s to 1.93 percent in 2005 (IDSC 2007). The share of the age group between 15 and 64 years to total population increased from 57 percent in 1995 to 62 percent in 2005 (World Bank 2007).

### ***2.2 Characteristics of the Labor Force***

Egypt's labor force increased from 17 million in 1995 to 22 million in 2005, at an average annual growth rate of 2.8 percent. In addition, the participation of the population in economic activities measured by the ratio of the labor force to the working age population between 15 and 64 years increased from 29 to 31 percent during the same period (World Bank 2007 and CAPMAS 2006b). The higher growth of the labor force compared to population growth, and the increase in the participation rate of the working age population were translated into a rise of unemployment, especially that the necessary measures to create enough jobs were inadequate.

### ***2.3 Employment and Unemployment***

Employment among the 15-64 age group amounted to 19.3 million in 2005. The sectoral distribution of employment indicates that almost one third of the employed are working in agriculture and fisheries characterized by low value-added and productivity. The manufacturing sector, characterized by its forward and backward linkages, employs only 11.5 percent of total workers. The trade and maintenance, and construction sectors were able to absorb only 11.1 and 8.5 percent of employment, respectively. Employment distribution by sector of ownership demonstrates that almost 25.8 percent work in the government and 4.5 percent in the public sector, while the private sector employs 69.7 percent (CAPMAS 2006b).

Unemployment increased from 10.3 percent in 2004 to 11.2 percent in 2005; 7.1 percent for males and 25.1 percent for females. Almost 92 percent of the unemployed were young

people in the 15–29 age group. The majority of the unemployed were new entrants to the labor market, who were seeking a job for the first time. Unemployment was distributed evenly between both urban and rural areas. It was mainly concentrated among secondary school graduates (62 percent) and university graduates (27 percent) (CAPMAS 2006b).

#### ***2.4 The Informal Labor Market***

The Egyptian economy is characterized by a large and growing informal sector that has been a major source of job creation for some time. However, the jobs created in this sector are not *decent* enough in terms of wage, sustainability and work conditions. Moreover, a lot of jobs in the formal sector lack security and stability due to the absence of social security coverage and work contracts, as employers refuse to enter into binding work contracts and complain about the high cost of the social security system.

Population census data<sup>1</sup> indicate that informal employment reached 2.4 million, 2.9 million, and 4.8 million workers in 1976, 1986 and 1996 respectively (El Ehwany and El Laithy 2006), as measured by the number of workers out of establishments and those working in establishments with less than 5 workers, exclusive of agriculture. Informal employment can also be measured using Labor Force Sample Survey (LFSS) data, in which case, it will be defined as the number of private sector workers employed outside establishments (including agriculture). Under this definition, informal employment reached 8.3 million in 2004, and rose to 9 million in 2005,<sup>2</sup> representing 47 percent of total employment. Approximately 20 percent of informal employment was among females, representing 48 percent of total female employment (CAPMAS 2006b).

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<sup>1</sup> Egypt carries out a population census every ten years. The preliminary results of the 2006 census were released recently, while the cross tabulation data that could be used to estimate the size of informal employment have not been disclosed yet.

<sup>2</sup> It is worth noting that the size of informal employment using the census and LFSS is not comparable. LFSS data do not provide cross tabulation of employment by sector, economic activities or “outside or inside of establishment” criteria.

## ***2.5 Labor Market Imbalances***

It is obvious that the labor market in Egypt suffers from major distortions, namely the supply and demand mismatch in terms of job quantity, and the mismatch between skills required by employers and those offered by workers. These distortions are mainly the outcome of prolonged policies that failed to promote economic growth and increase employment.

The employment guarantee program implemented from the sixties through the eighties resulted in overstaffed government and public sectors, which became unable to bear the burden of the increasing wage bill. The Open Door policy adopted since the seventies failed to create enough jobs despite the increase in growth rates, due to inadequate investment policies. Furthermore, the decline in oil prices and increasing dependence on foreign borrowing during the eighties slowed down economic growth and employment creation. Additionally, the economic reform and structural adjustment program (ERSAP) adopted in the early 1990s resulted in a slowdown of economic growth and reduction in employment.

Despite efforts exerted by the government to boost economic growth and promote job creation, the early years of the new millennium witnessed a sharp recession that negatively impacted job creation. The Egyptian economy was hit by several external shocks that affected its performance, including the East Asian financial crisis during the late 1990s, the decline in oil prices, as well as internal shocks such as the Luxor terrorist attacks against tourists in 1997. These shocks were also topped off by the negative consequences of the September 11 attacks in 2001 and the American occupation of Iraq in 2003.

It is also worth noting that the government failed to adopt adequate labor market policies to overcome the shortcomings of macroeconomic policies and to face the consequences of the different internal and external shocks. The following two sections analyze recent macroeconomic and labor market policies and their impact on job creation.

### **3. ASSESSMENT OF THE IMPACT OF MACROECONOMIC POLICIES ON JOB CREATION IN EGYPT**

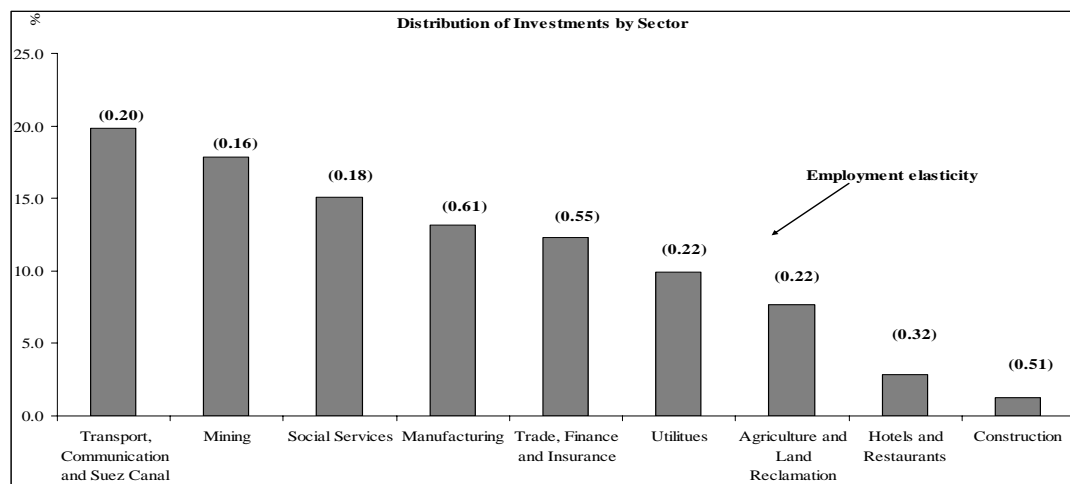
The following subsections evaluate the impact of recent investment, trade, and other macroeconomic policies on job creation. They provide policy recommendations in light of international experience.

### 3.1 Investment Policies

Increasing employment requires higher investment levels and allocating more investments to labor-intensive activities. Despite the slight increase in investment from 19.04 percent in 2004/2005 to 19.92 percent in 2005/2006, it is still below the level needed to create more jobs in the economy. For an incremental capital-output ratio of four, the investment rate must reach 28 percent to achieve a growth rate of 7 percent (Sakr 2003). Considering that the average employment elasticity for the whole economy was 0.3 in 2004/05, a growth rate of 7 percent would increase employment by 2.1 percent.

In addition, investments are mainly allocated to those sectors with low employment intensity of growth. The distribution of investment by economic activity (figure 1) shows that the sectors with low employment elasticities such as transport, communication and Suez Canal (0.20), mining (0.16) and social services (0.18) receive the largest shares of investments amounting to 19.9, 17.9 and 15.1 percent respectively, in 2004/05. While the activities with the highest employment elasticities that can create more jobs such as manufacturing (0.61), trade, finance and insurance (0.55) and construction (0.51) receive lower shares of investment, amounting to 13.2, 12.3 and 2 percent respectively, during the same year (MOP 2006). At the same time, the average cost per job in the economy increased from LE 60,000 in the 1980s to LE 100,000 in 2004, reflecting poorly on direct employment creation (IMC 2005; Fawzy 2002).

**Figure 1. Distribution of Investments and Employment Elasticities by Sector in 2005**



Source: [www.mop.gov.eg](http://www.mop.gov.eg).

During the last few years, the government made several attempts to increase FDI inflows and succeeded in raising it from US\$ 3.9 billion in 2004/05 to US\$ 6.1 billion in 2005/06. FDI in non-petroleum sectors increased from US\$ 1.4 billion to US\$ 4.3 billion,<sup>3</sup> during the same period (CBE 2006). In addition, FDI is expected to increase to US\$ 8 billion in 2006/07.

However, recent surveys by the World Bank (2006) and the World Economic Forum (Global Competitiveness Report 2006-07) ranked Egypt in a lower position in terms of business environment and competitiveness (World Bank 2006; WEF 2006). Both reports stressed the importance of improving the business environment by removing all bureaucratic impediments to investment, including dealing with local governments, and dispute settlement. It is worth noting that country experience has shown that improving the investment environment, in terms of starting a business, securing property rights, improving contract enforcement and dispute settlement procedures encourages foreign and domestic investment and induces employment (Lopez-Garcia 2006).

Boosting investment also entails increasing domestic savings, stimulating the capital market, reforming the banking sector, and accelerating the privatization process. Besides increasing the investment level, its pattern should also be altered towards increasing employability. Services and labor-intensive manufacturing industries should be encouraged since they have strong forward and backward linkages with other sectors. It is worth noting that establishing industrial clusters has positive effects on job creation, especially for labor intensive industries such as textiles, furniture and automotives. Production clusters for means of transportation in the Netherlands, information technology in Ireland and the automotive industry in Austria increased employment opportunities in these countries (Harasty 2004).

### ***3.2 Trade Policy***

During the last few years, the government undertook rigorous reforms to accelerate trade liberalization and increase exports through reforming the tariff structure, eliminating non-tariff barriers (NTBs) and adopting a more flexible foreign exchange regime. International experience has shown that the European and East Asian countries that succeeded in increasing employment were among the countries most open to trade. The share of exports to GDP in these countries ranged from 40 to 77 percent. Some of these countries, such as Denmark,

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<sup>3</sup> Of which US\$ 3.3 billion in greenfield projects and expansion of existing ones and US\$ 906 million as privatization proceeds.



devalued their currencies against the currencies of their major trade partners, to boost exports as a means of increasing employment. During the 1990s, Malaysia adopted a dual strategy for import-substitution and export promotion, which resulted in a rapid and sustained decline in unemployment. Labor-intensive, export-oriented industries absorbed the majority of unskilled labor and by the late 1980s Malaysia was a net importer of labor (Harasty 2004).

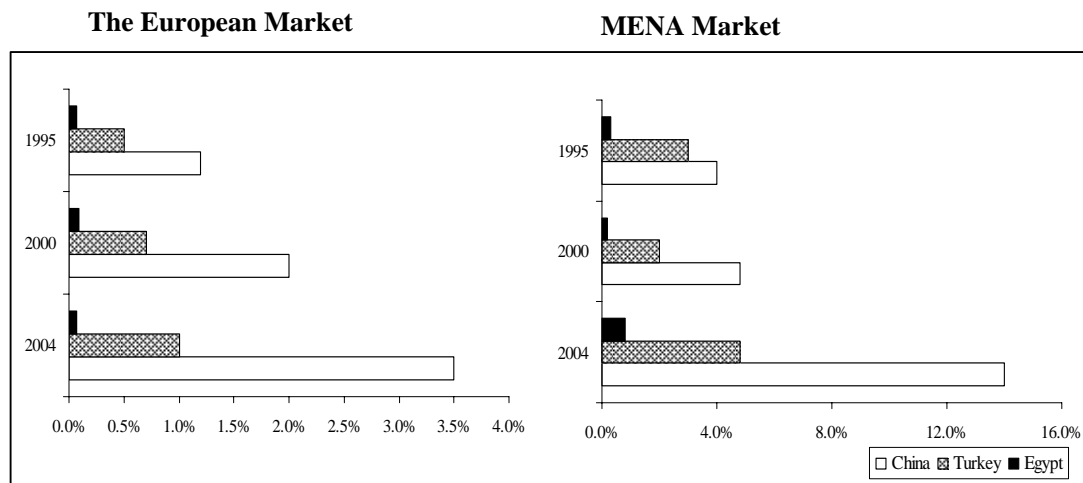
To increase exports, the Egyptian government implemented two rounds of tariff reduction. In 2004, tariffs were cut to 9.1 percent on average, and the number of ad valorem tariff bands was reduced. In addition, service fees and import surcharges were removed (Ghanem 2006). In February 2007, customs tariffs were reduced on 1,114 articles, including raw materials, and intermediate and consumer goods. The new modifications reduced the average tariffs by almost 25 percent. Moreover, Egypt concluded a number of trade agreements with its main trading partners, namely the EU, the US and Arab countries. It was expected that the dynamic effects of these agreements would stimulate growth, trade, competition, investment and employment.

Despite trade liberalization efforts, which resulted in increased non-oil exports, Egypt's export structure remains heavily dominated by resource-based and low-tech exports, which account for nearly 90 percent of manufactured exports.<sup>4</sup> The dominance of resource-based and low-tech exports and the slow pace of diversifying Egypt's export structure into medium- and high-tech activities signal a risk of a gradual decline of its international market share, as the share of low-tech exports in the world market is retreating rapidly.

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<sup>4</sup> Out of Egypt's most important 20 groups of exports (those with the highest average export value during the period 1990-2004), eight product groups are primary exports. These include crude oil and natural gas, cotton, rice, aluminum, unprocessed vegetables and fruits, as well as stone, sand and gravel. The other 12 export groups are concentrated in the resource-based and low-tech export categories. A few exceptions are in the medium-tech export category, such as further-processed iron and steel; sanitary, heating, and lighting equipment; plastics, packaging material, automotive components, and some household appliances (Noureldin, Albaladejo, and El-Megharbel 2006).

**Figure 2. The Share of Egyptian, Turkish and Chinese Manufactured Trade in European and MENA Markets, 1995-2004 (%)**



Source: Nouredin, Albaladejo, and El-Megharbel 2006.

In addition, Egypt is losing its share in both the European and MENA markets to competitors such as China and Turkey, especially in labor-intensive textiles and clothing industries.<sup>5</sup> Figure 2 shows that Egypt's share of manufactured trade in the European market remained almost stagnant during the period 1995-2004, standing at less than one percent; while the shares of Turkey and China doubled then tripled during the same period. Although Egypt enjoyed a higher share in manufactured trade in MENA market compared to the European market, that share remains low despite the slight increase in 2000 and 2004.

The impact of Egypt's trade agreements on employment is so far negligible. The Egypt-EU Partnership Agreement was restricted to Egyptian tariff dismantling and to the reduction of barriers to EU imports of agricultural products. The Agreement did not address the issue of employment directly; it was only through the funds that Mediterranean Development Aid (MEDA) projects received that employment was targeted. These projects include mainly the Social Fund for Development (SFD) and the Industrial Modernization Program (IMP). In addition, the European Neighborhood Policy (ENP)<sup>6</sup> aims to support the neighbors' priorities regarding political, security, economic and cultural cooperation. Obviously, employment is not directly targeted (Kamel Rizk and El-Megharbel 2006).

<sup>5</sup> It should be noted, however, that Egypt was able to increase its exports of textiles and clothing to the US mainly due to the QIZ protocol (Pigato and Ghoneim 2006)

<sup>6</sup> ENP was adopted by the EU and its Mediterranean partners, Russia, Ukraine, Byelorussia, Moldavia, Azerbaijan and Georgia.

The Ministry of Trade and Industry estimated that 150,000 workers in the textile sector would lose their jobs due to the elimination of the Agreement on Textiles and Clothing (ATC). In a counter move, the government signed the Qualifying Industrial Zones (QIZ) protocol in December 2005. An analysis of the impact of the QIZ protocol revealed that few firms benefited from the agreement. Survey results<sup>7</sup> showed that the majority of firms that export under the QIZ protocol were already exporting to the US and to other markets as well. However, these firms were able to increase their exports to the US under the QIZ protocol, contributing to higher employment (Refaat 2006; Ministry of Trade and Industry 2006).

Despite these short-term gains, it should be noted that these agreements are relatively new and their full impact cannot be assessed accurately. Moreover, to increase their expected benefits, with respect to exports and job creation, a major improvement is required in the performance and competitiveness of the Egyptian manufacturing industries. Moving from low technology to medium and high technology and to higher value added exports, as well as competing on quality rather than on prices are important prerequisites for export promotion and creation of *decent* jobs.

The benefits of trade agreements cannot be fully realized unless Egyptian firms become more competitive in international markets. A more comprehensive export promotion strategy that coordinates the different trade agreements is required. These agreements should be used as a catalyst to upgrade and modernize Egyptian manufacturing industries to meet international market standards and gain a foothold in the global production and supply chains. In addition, agreements could be negotiated with the Arab oil-rich countries concerning labor mobility and working conditions as part of the Greater Arab Free Trade Agreement (GAFTA) (Handoussa and El-Oraby 2004).

### ***3.3 Monetary and Fiscal Policies***

Promoting economic growth and investment and ultimately increasing employment requires that monetary and fiscal policies be aligned with these objectives. Monetary policy influences job creation through inflation, foreign exchange and bank credit, while fiscal policy affects employment through public spending, taxes and transfers.

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<sup>7</sup> Namely two surveys: the Egyptian Center for Economic Studies Survey (49 firms) and the Ministry of Trade and Industry/Industrial Modernization Center Survey (257 Firms).

### *Monetary policy*

The attempts of monetary policy to stabilize the foreign exchange market and curb inflation<sup>8</sup> during the past two years had a positive impact on economic growth and investment. However, the lack of bank finance remains a major shortcoming. Credit extended to the private sector has been declining over the past few years, despite the increase in banks' liquidity. This could be explained by the increase in non-performing loans (NPLs), lack of information about the creditworthiness of borrowers, and banks' preference of low risk investments (Abdel-Kader 2006).

Lack of finance has been repeatedly cited by private sector firms as the main constraint facing business in Egypt. Firms, especially SMEs, claim that tight credit terms, especially collateral requirements and high interest rates are the main impediments they face in acquiring bank credit. However, banks are still the main source of finance for these firms due to the lack of other sources of finance such as the capital market (Abdel-Kader 2006).

International experience has shown that the availability of banking credit has a positive impact on job creation. In a survey carried out by the Canadian Federation of Independent Business (CFIB) in October 1998, one out of four firms surveyed said they were willing to hire more staff if the terms and conditions of banking credit are improved (CFIB 1999). A recent World Bank study showed that easy access to finance for European and Central Asian firms contributed the most to employment creation in the private sector. The study also noted that high real interest rate or cost of credit negatively affected employment in these countries (Lopez-Garcia 2006).

In light of international experience, a more developed financial market will have positive effects on employment creation in the private sector. Lowering interest rate, easing credit policies, and speeding up the privatization of banks will encourage the establishment of new firms and the expansion of existing ones, ultimately raising employment.

### *Fiscal policy*

The new income tax law enacted in July 2005 reduced the tax burden by 50 percent, eliminated tax exemptions and benefits, and simplified the tax structure and administration. These reforms aimed at increasing disposable income, widening the tax base and enhancing

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<sup>8</sup> However, these positive effects could very well be reversed by the recent increase in inflation during late 2006 and early 2007.

economic growth. In addition, the government adopted a two-year plan to streamline and modernize the tax administration and increase the efficiency of collection. Unlike previous reports, the recent 2006-2007 Global Competitiveness Survey indicated that tax regulations and tax rates are not considered the most problematic factors for doing business in Egypt (WEF several issues).

These results are consistent with empirical evidence showing that increased taxes in European countries contributed to the decline of employment (Dhont and Heylen 2004). In addition, the previously cited World Bank study noted that lowering taxes and applying a simple and transparent tax system would encourage the establishment of new firms and raise employment in European and Asian countries (Lopez-Garcia 2006).

Despite the expected positive impact of recent tax reforms on investment, employment and growth, the large fiscal deficit and public debt that the Egyptian economy witnessed recently represent major constraints for growth and investment. The net outcome of these contradicting effects could not be predicted. Consequently, more efforts are needed to reduce public debt and to control the fiscal deficit in order to promote economic growth, increase investment and create more jobs (Refaat 2007).

To sum up, the reform measures that the government undertook in the last two years to promote investment, boost exports, curb inflation, and improve public finances, fell short of increasing employment. More rigorous and continuous reforms are required to improve the business environment, encourage labor-intensive investment, promote medium- and high-tech exports, create a more developed financial market and reduce public debt and government deficit. In addition to the role of macroeconomic policies in stimulating employment, it is also important to examine the impact of labor market policies on job creation. This will be discussed in the next section.

#### **4. ASSESSMENT OF LABOR MARKET POLICIES IN EGYPT**

Labor market policies are defined as government interventions used to correct for failures in the labor market. There are three sets of labor market policies: active, passive and institutional policies. Despite the extensive use of these policies in most developed countries, empirical evidence has shown that they do not succeed in developing countries, due to the lack of administrative capacity and scarcity of the monitoring and evaluation tools considered crucial

for their implementation. The following sub-sections evaluate the impact of both active and institutional labor market policies<sup>9</sup> on the Egyptian labor market.

#### ***4.1 Active Labor Market Policies (ALMPs)***

Active labor market policies (ALMPs) might affect the demand side by creating additional jobs directly through public works programs. They might also be supply-side interventions by training the unemployed to meet the requirements of the labor market. In some cases, they are used to correct for failures in the education system. Further, they can provide a link between both sides of the labor market through employment offices and labor market information. During the 1990s several countries, including Egypt, used different active labor market programs to overcome labor market malfunctions.

##### *Public works programs*

The public works program (PWP) implemented through the SFD aimed mainly to improve infrastructure in rural and deprived urban areas as well as to create jobs. However, these projects which included roads, water supply and sewage were capital intensive and the share of workers' wages did not exceed 30 percent of total cost on average. During the period 1994-2000, PWP created more than 6,000 permanent jobs and more than 100,000 temporary jobs. Yet, the extension of these jobs beyond the duration of the project is questioned (De Gobbi and Nesporova 2005).

The National Program for Integrated Rural Development known as the Shorouk program is another example of PWPs. This program aimed at providing job opportunities in rural areas in order to close the socio-economic gap between rural and urban areas. The investment required for this program was estimated at LE 267 billion during the period 1994-2017. The program provided more than 4,000 villages and rural communities with potable water, waste water treatment, lighting, and health and education services. In addition, it created 59,000 permanent jobs and 123,000 temporary ones during the period 1994-2000. This confirms doubts about the continuity of the jobs created by public works programs (Abdel Fatah 2004).

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<sup>9</sup> The passive labor market policies are income support policies that include early retirement schemes, workers shareholders associations, social protection programs, and unemployment benefits. They will not be discussed since they are generally used to protect the unemployed and the laid-off workers without increasing their employability.

PWPs implemented in Hungary present a good example of the impact of these programs on job creation. In 1996, Hungary established the National Council for Public Works, including representatives of different ministries to assess projects and allocate funds for the selected ones. Moreover, regional public works councils were established to supervise the implementation of the different projects. In 2000, 52 programs were approved hiring around 5,000 workers, with a total cost of HUF 2 billion. The most important advantage of these programs was the on-the-job training supported by the labor market fund to improve the employability chances of workers after the completion of the projects (Harasty 2004).

It should be noted that in order to improve the employability effect of PWPs, projects must be carefully designed to ensure labor-intensity. In addition, on-the-job training must be provided to upgrade workers skills according to market requirements to increase their opportunities to land decent jobs after the completion of these projects.

#### *Micro and small enterprise (MSEs) development programs*

These include the Mubarak Solidarity Program launched in 1996, which extends loans to small projects. This program allocated LE 65.3 million at an interest rate of 3 to 4 percent to 2.6 million beneficiaries. The Small Enterprise Development Organization (SEDO) affiliated to the SFD is another example of these projects. During the period 1994-2000, SEDO created around 465,000 permanent jobs and almost 59,000 temporary jobs. The Productive Family Program, Bank Nasser, businessmen associations and credit guarantee programs also provide financial support to MSEs, to promote job creation.

These programs are not very effective in terms of employment creation and their impact does not go beyond the loan duration. Further, the impact of these programs on job creation is limited due to the lack of follow-up and evaluation mechanisms. The death rate of these firms is very high due to limited expertise, lack of demand, and constrained borrowing procedures (De Gobbi and Nesporova 2005). In 2005, the government launched “The National Strategy for Microfinance” with the main objective of providing financial services to the poor and MSEs. The strategy also aims to establish a microfinance industry and integrate it in the development of the financial sector. However, the impact of this strategy on MSEs development and employment creation has yet to be assessed.

In what follows, the study will present some success stories for MSEs development. In 2000, the International Labor Organization (ILO) and a number of non-governmental

organizations (NGOs) collaborated on a project to provide business development training to four ethnic groups in Vietnam. The program was successful as 80 percent of the trainees received loans to start a business. More than 67 percent of these loans were invested in non-farm projects. The effectiveness of these programs depended on the loans extended to trainees to establish businesses and on closely monitoring and evaluating the development of these projects (Christensen and Lamotte 2001).

The Philippine Exporters Confederation provided training programs for new entrepreneurs and sub-contracted them to produce some products that were exported through well-established exporters. These programs increased employment, especially for females (Philexport Pioneers 2003). The Japan Small Business Corporation supports MSEs by enhancing the capacity of policy makers, local government representatives and NGOs working in the field of MSEs development (Harasty 2004).

The main lessons learned from these experiences are related to the problems that MSEs encounter in Egypt. These firms lack expertise and could benefit a great deal from capacity building programs and from establishing close links with exporters and large firms, to overcome weak demand and the need for marketing plans. Moreover, a large number of NGOs is providing technical and financial support to MSEs, therefore raising the capacity of these NGOs could reflect positively on MSEs.

#### *Availability of labor market information*

The Ministry of Manpower and Migration (MoMM) gathers information through its network of local employment offices regarding job vacancies and announces them in its monthly bulletin. Most of these vacancies are blue-collar jobs with low salaries. In addition, these offices lack the skills required for proper screening of jobseekers. Consequently, the placement rate reached through the monthly bulletin is usually very modest. Table 1 shows that government employment offices provided only 16 percent of the main and secondary jobs, while 33 percent of these jobs were made available through direct contacts and applying directly for jobs and 26 percent by friends and relatives (CAPMAS 2006a).



**Table 1. Distribution of Channels of Getting Jobs**

<b>Getting main and secondary jobs</b>	<b>Share of total (%)</b>
Contacted firms, applied for a job vacancy	33
Friends or relatives	26
Governmental recruitment office	16
Competition	12
Private recruitment office	5
Other	5
Newspapers and other ads.	3
<b>Total</b>	<b>100</b>

Source: CAPMAS (2006a).

The Canadian International Development Agency (CIDA) and the United States Department of Labor (USDOL) initiated a project to upgrade public employment services in Egypt. The project developed 27 employment offices, one per governorate. In addition, more than 60 offices were developed by MoMM with the assistance of CIDA. The new offices focus mainly on employment services and are not concerned with other activities such as labor inspection and labor relations (Kamel 2006).

The Australian Job Network, established in 1998, provides an example of best practices in the field of employment offices and labor market information. The job network included around 200 government and private institutions, with the main objective of securing long-term jobs for the unemployed. The network provides training for job seekers in job search skills and assists them in writing and updating resumes, preparing applications, and preparing for interviews. In three months, the network secured jobs or provided training for 73 percent of job seekers. Korea also provides a good example in providing labor market information and job placement services through its Employment Stabilization Program (Harasty 2004).

Employment offices play an important role in providing information and advice for job seekers. Upgrading employment offices and raising their technical capacities will help bridge the gap between labor market demand and the supply of skills.

#### *Human resource development policies*

The 2006 Egypt Labor Market Panel Survey (ELMPS) revealed that 15.5 million workers, representing 69 percent of total employment (around 22.5 million workers) acquired their skills through technical education and vocational training (TEVT). Table 2 shows the distribution of the skills acquired by these employees through different channels. Public

sector firms were the least interested in acquiring skills. Government and formal private sector employees gained skills mainly through regular vocational education. Informal private workers received on-the-job training through the craftsmen with whom they work and through family members (CAPMAS 2006a).

**Table 2. Distribution of the Skills Acquired by Employees in Different Employment Sectors**

Employment Sector	Channels of Skill Acquisition					Total
	Regular Vocational Education	Regular Vocational Training	Through Contractors	Through Craftsmen	Other	
Government	67	36	2	4	4	26
Public Sector	8	14	1	3	2	5
Formal Private Sector	17	22	4	18	10	14
Informal Private Sector	7	15	14	51	71	41
Unidentified	1	13	79	25	13	14
<b>Total Shares</b>	100	100	100	100	100	100
<b>Total Number</b>	<b>5,185,995</b>	<b>718,674</b>	<b>533,209</b>	<b>3,161,194</b>	<b>5,942,442</b>	<b>15,541,514</b>

Source: CAPMAS (2006a).

In general, private sector firms do not provide their employees with adequate training, with the exception of very limited on-the-job training for basic production skills. Only a small number of large local firms and transnational corporations (TNCs) allocate some resources for training and use modern training methods. This could be explained by lack of awareness of the benefits of training, and the fear of poaching trained workers by other firms. In addition, the government does not provide any incentives to encourage firms to engage in training programs, such as sharing the costs of training, or providing tax holidays for firms involved in such activities. A major problem facing TEVT is the large number of informal workers who do not receive proper training, except on-the-job training, which is usually incomplete and outdated, and limited training courses offered by some NGOs. In addition, despite the large

amounts of funds available to TEVT, it still suffers from fragmentation of efforts and the large number of various bodies involved.<sup>10</sup>

These market failures could be addressed through incentive schemes for in-house training, disseminating best training practices, and awareness campaigns of the benefits of training in improving efficiency and cutting costs, especially overseas training. There is an increasing trend to involve private sector firms in the design and delivery of training, but these efforts are still limited and require more involvement of businesses. Despite the initiatives undertaken, the impact remains limited due to lack of coordination among different stakeholders active in this field (ETF 2005). Spain, Malaysia and the Philippines are good examples of countries that adopted skills development and vocational training programs that succeeded in increasing employment (Harasty 2004).

To conclude, ALMPs have not been effective in creating jobs. This could be explained by the fact that these programs are dispersed and lack coordination among them. Moreover, ALMPs should be considered as short term solutions to overcome labor market failures. Consequently, the impact of these policies on job creation should not be overstated. These policies must also be aligned with macroeconomic policies in a global framework of a national employment strategy that aims at increasing employment.

#### ***4.2 Institutional Policies of the Labor Market***

Institutional policies include labor market regulations and wage policies. This section analyzes the impact of the labor law and minimum wage policy on job creation in Egypt.

##### ***4.2.1 Labor market regulations***

Theoretical analysis has shown that the effect of labor market regulations on employment and unemployment is ambiguous. Consequently, researchers turned to focus on empirical investigation to reach a conclusion. The majority of these studies suggested that labor market

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<sup>10</sup> The funds allocated to TEVT include the Training Finance Fund (TFF) established under the Labor Law. According to the law, a one percent levy on net profits of firms employing 10 or more workers will be allocated to this fund. The levy is expected to yield between LE 300 million and LE 400 million a year. Another fund was provided through the EU Technical, Vocational and Educational Training Reform Program with a total amount of €33 million from the EU and an equal amount from the Egyptian government. Moreover, the World Bank offered a \$15 million loan for the Skills Development Project (SDP), which started in 2004 and is expected to continue for 4 years. Other TEVT projects include the National Skills Standards Project (NSSP), the Productivity and Vocational Training Department (PVTD), and the training programs provided by the Ministry of Reconstruction and Housing, the Ministry of Social Solidarity, and the Ministry of Military Production. There is also the Mubarak-Kohl Initiative (MKI), the human resource development program under the Industrial Modernization Centre (IMC) and the Industrial Training Center.

regulations have two conflicting effects: they reduce unemployment while at the same time represent a major barrier for employment. In addition, empirical evidence has shown that the high labor cost associated with stringent labor market regulations affect employment negatively, especially female and youth employment (OECD 2004).

The Labor Law enacted in 2003<sup>11</sup> accorded employers more flexibility, especially in relation to termination of contracts for well established economic reasons. However, the impact of this law on job creation is so far uncertain. It is evident that public sector jobs are still more attractive because of the high level of protection they provide in relation to termination of workers' contracts, social insurance, and other benefits such as the comfortable working hours that allow workers to moonlight to raise their income. In addition, informal employment reached 47 percent of total employment according to the 2005 LFSS. These facts reflect the limited impact of labor regulations on creating jobs in general and *decent* jobs in particular.

The social security system in Egypt provides wide coverage as it includes government, public and private sector workers, informal employment, employees working abroad and some vulnerable groups.<sup>12</sup> In 2004/2005, employees covered by the social security system were estimated at 93 percent. However, the social security system is criticized for its high contribution rates, which discourage both employees and employers from paying their contributions and reporting actual wages. In addition, the maximum wage according to which the social security contributions are calculated is very low. Another significant disadvantage of the system is the lack of financial sustainability (Helmy 2006a).

Empirical evidence has also shown that labor market regulations support protected workers and raise their bargaining power. Recently, a number of public and private sector firms witnessed strikes by workers protesting against late payment and complaining from delayed promotion, among other things. The government met some of the workers' demands and promised to consider their employment situation in the near future.

Broadly, labor market regulation should strike a balance between increased labor market flexibility and relatively high social protection for workers. The Danish model of labor market regulation presents a good practice in this respect. Labor market regulations in

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<sup>11</sup> This law relates to private sector workers and employees while civil service workers are governed by Law 47 of 1978.

<sup>12</sup> Those who receive Sadat pension.

Denmark provide a mix of flexible labor market, generous welfare system for the unemployed and active labor market programs that help the unemployed to join the labor market, especially for the young unskilled unemployed. However, it should be noted that this system is expensive, as the Danish government allocated 5 percent of its GDP to both active and passive labor market programs (OECD 2004). Labor market regulations in Egypt might need to be revised to include more incentives for employers to increase employment, especially for females and young graduates. More importantly, these regulations should also be integrated into a national employment strategy.

#### *4.2.2 Minimum wage policy*

The impact of minimum wage policy on employment is controversial. Several studies claimed that minimum wage affects employment positively, while others showed they have negative effects on employment. Empirical evidence suggests that minimum wage is close to the average wage in developing countries, suggesting that minimum wage regulations are not enforced. Consequently, raising the minimum wage would harm young, unskilled and female workers. In addition, labor regulations are poorly enforced in these countries, hence a large proportion of workers are engaged in the informal sector earning less than the minimum wage. When unemployment is relatively high, both workers and employers will not have any incentive to comply with minimum wage regulations (Neumark and Wascher 2004).

The actual average monthly minimum wage in the public sector enterprises amounted to LE 168, while it is only LE 154 in the private sector. Usually, private sector firms ignore the minimum wage and the social insurance requirements determined by the Labor Law. In addition, the non-wage benefits offered by public sector jobs make them more attractive than private sector jobs. In general, wages have declined significantly in real terms over the past few decades (Helmy 2006b).

In order to raise minimum wages and at the same time avoid the negative effects on vulnerable groups, it might be useful to reduce the social insurance contributions of both employer and employee, especially for females and young people. In addition, labor market regulations in general and those related to minimum wage in particular should be enforced to ensure compliance by private sector firms.

## 5. CONCLUSION

Job creation is among the most important challenges facing the Egyptian economy. Despite increased economic growth, unemployment is still high and the capacity of the economy to generate enough jobs especially in the private sector remains limited. In addition, the labor market suffers from a mismatch between demand and supply of adequate skills. The poor performance of the labor market can be explained by a number of factors including macroeconomic and labor market policies. The government undertook several reform measures to boost economic growth, increase investments and raise the competitiveness of the Egyptian economy. However, the Egyptian economy is still suffering from major shortcomings, such as unfavorable business environment, poor export performance, severe fiscal imbalance and low level of investment. In addition, labor market policies have so far been unable to address the mismatch between demand and supply and resolve other market failures. The impact of active labor market policies and regulations has been limited, reflecting poor policy design and lack of coordination between macroeconomic, labor market policies and regulations. Moreover, it should be noted that macroeconomic and labor market policies were not adequately coordinated to serve the objective of increasing job creation.

In order to increase employment, a national employment strategy should be designed with the objective of creating more jobs, especially in those sectors with the highest employment elasticity. The strategy should also attempt to address the mismatch between labor supply and demand. More importantly, it should be made an integral part of Egypt's national development plan.<sup>13</sup> Finally, both macroeconomic and labor market policies should be revised in light of the shortcomings highlighted, taking into consideration the lessons drawn from best practices and international experiences.

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<sup>13</sup> It should be noted that Egypt is part of the ILO Youth Employment Network (YEN) and MoMM is currently working on designing a national plan of action for youth employment.

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