

# **Economic and Social Impact of the Financial and Economic Crisis on Egypt**

A Study Prepared for the ILO

By Samir Radwan

April 2009

2009

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# Economic and Social Impact of the Financial and Economic Crisis on Egypt

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## Executive Summary

The financial and economic crisis that hit the global economy has been unfolding since the end of 2007, and its ramifications are yet to be understood. The genesis of the crisis and its dimensions are fairly well-known, and therefore fall beyond the theme of this paper. The objective is rather to gauge the impact of the crisis on the Egyptian economy with particular focus on the labor scene.

The crisis can be viewed against the backdrop of the strong economic performance that resulted from the reform drive which began in 2004 and resulted in an upsurge in almost all macroeconomic indicators, notably high rate of GDP growth of 7.2% in 2007/08. Moreover there has been an impressive progress in improving the investment climate which was reflected in the positive rating of the economy. However, three structural problems continued to vex the economy: high budget deficit; rapid inflation and a constraining quality of the labor force.

The global financial and economic crisis has negatively been transmitted to the Egyptian economy particularly since mid-2008. The impact has been more pronounced on the real economy rather than the banking sector. This was due to a number of factors most prominent of which is the limited integration of the Egyptian banking sector in the global financial market. Moreover, the Central Bank of Egypt had succeeded in reforming the sector since 2004 by consolidating the banks into larger conglomerates; restructuring bank management; and getting rid of toxic debts. The Central Bank also introduced stringent rules of governance to guarantee the disciplined functioning of the system. Finally, the banking system has not been short of liquidity with the lending-to-deposit ratio not exceeding 53%, which is well within the safe boundaries compared to the rest of the world.

The impact on the real economy has been reflected in the following indicators:

- Decline of GDP growth from 7.2% in 2007/08 to around 4% in 2008/09.
- Reduced flow of FDI and a decline in domestic investment.
- Increase in return migration and expected drop in remittances.
- Increased strain on the balance of payments.
- Capital market collapse.
- Decelerating sectoral growth especially for tourism, manufacturing and Suez Canal.

The prolonged labor market recession and the consequent social deterioration are the most serious aspects of the global financial and economic crisis as it reflects on Egypt. The most immediate impact of the crisis has been the inability of the labor market to adjust, thus exacerbating the problem of unemployment, and accentuating the position of different groups particularly women and youth. Unemployment, which has been a chronic problem even with the rapid growth of the pre-crisis period, is on the rise. Open unemployment increased from 8.4% to 8.8% over the last year, and expected to reach 10% by the end of this year.

Moreover, vulnerable unemployment is on the rise. Another factor affecting the poor is the prevalence of “vulnerable employment” defined by the ILO as “the sum of contributing family workers and own-account workers as a percentage of total employment”. Recent data are not available, but table 5 provides a strong indication of this widespread phenomenon which affects 28% of the employed labor force, and has, in fact, been on the rise in recent years. The impact has been more pronounced for women than for men where vulnerable employment among females amounted to 53% compared to 21% for men

# Economic and Social Impact of the Financial and Economic Crisis on Egypt

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A study prepared for the ILO

By Samir Radwan\*

## I. Introduction

The financial and economic crisis that hit the global economy has been unfolding since the end of 2007, and its ramifications are yet to be understood. The genesis of the crisis and its dimensions are fairly well-known, and therefore will not be discussed in detail in this paper. The objective is rather to gauge the impact of the crisis on the Egyptian economy with particular focus on the labor scene.

It must be pointed out at the outset that crises have been a recurring feature of the global economy since the Great Depression of 1929-32. The trigger that may have caused these crises may be different, but they usually impact the economies of developing countries through direct or indirect transmission mechanisms. Thus, the crisis of the mid-1970s resulted from the oil price hike following the October war; the recession of the 1980s was caused by the first mortgage crisis of the United States; the decline by the end of the 1990s was due to the loss of steam created by the digital boom; the 1997/98 Asian Crisis reflected the effect of financial

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\* Assisted by Dina Shaaban and Shaimaa Taha

permissiveness; and the 2008 galloping inflation was fueled by the unprecedented increase in food prices. However, the present crisis overshadows its predecessors both in terms of its depth and spread. The leaders of the Group of 20 (G20) who met in London on the 2<sup>nd</sup> of April 2009 declared that “ We face the greatest challenge to the world economy in modern times; a crisis which has deepened since we last met (15 November 2008), which affects the lives of women, men, and children in every country and which all countries must join together to resolve. A global crisis requires a global solution.”The Egyptian economy provides an example of how an emerging market responds to these crises. The purpose of this paper is to draw on the latest available data in order to document the consequences of the crisis; outline the response to it; and suggest some policy orientations that bolster the resilience of the economy to such external shocks, and protect the working population against the negative impact of these shocks.

The study will thus begin by a brief review of the economy prior to the crisis underlining the points of strength resulting from the reform as well as the challenges that characterized its recent performance. This outline of the initial conditions will enable us to understand the impact of the crisis given the structural characteristics of the economy. This will be followed by a full-fledged analysis of the impact of the crisis on three major aspects of the economy: growth and macroeconomic performance; impact on the financial sector and the real economy; and the labor and social consequences of the crisis. The responses to the crisis especially the stimulus package proposed by the government will be analyzed in terms of their adequacy to deal with the consequences of the crisis. The paper concludes with a speculation on future trends and some suggestions for long-term strategies.

## II. The Egyptian Economy Prior to the Global Financial Crisis

### II.1 The High Road to Growth <sup>1</sup>

The economic reform drive which began in 2004 has resulted in an upsurge in almost all macroeconomic indicators. GDP growth rates have been experiencing a quantum leap. In only four years, GDP growth accelerated its pace from an annual rate of 4% to 7.2%. This increase in economic momentum has positioned Egypt as one of the fastest growing economies in the MENA region.

International Reserves have been steadily increasing from US\$ 14.9 billion in 2004 to US\$ 34.7 billion by July 2008, or the equivalent of 9 months of imports. Similarly, the balance of payments has been showing signs of improvement particularly due to sustained increase in income from services and transfers. The end result has been a surplus of US\$ 5.3 billion, more than 4% of GDP. All this, together with judicious fiscal and monetary policies, has been reflected in remarkable stability of the Egyptian Pound

A distinctive characteristic of Egypt's growth performance has been the role of investment as the main driver of growth. Both domestic and foreign investments have been steadily accelerating over the period of the reform. Domestic investment has increased by almost 60% during that period, and this increase has been driven primarily by private sector investment which grew by 96%. Foreign Direct Investment (FDI) increased from US\$ 400 million in 2000/01 to US\$ 13.2 billion, or about 9% of GDP, in 2007/08 with half of it being new or greenfield investments. In fact, Egypt was ranked as the top country in Africa, and the second in the MENA region (after Saudi Arabia) in attracting FDI <sup>2</sup>, according to the UNCTAD, World Investment Report 2008. These testimonials have contributed to Egypt being the first country in the region to be accepted in the OECD Investment Committee last year.

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<sup>1</sup> For a detailed assessment of the recent performance of the Egyptian Economy see Samir Radwan, Study on the International Competitiveness of the Economy with Emphasis on Broad Strategic Issues, African Development Bank, December 2008.

<sup>2</sup> UNCTAD, World Investment Report 2008, Geneva, 2008.

Moreover, Egypt has been doing very well particularly in enhancing the ease of doing business. According to the World Bank/ IFC Doing Business Report 2009<sup>3</sup>, the country has continued to appear in the top ten league of reformers for the fourth year running. In 2009 it ranked 114 compared to 125 in the previous year (out of 181 countries).

An apparent paradox may be observed in the opposite directions suggested by these reports when compared to the analysis of the country's competitiveness indicators. According to the World Economic Forum, Global Competitiveness Report, Egypt's rankings have on the whole been low and, in fact, declining. The latest Global Competitiveness Index (GCI) shows Egypt going down from the 71<sup>st</sup> position in 2006/07 to the 77<sup>th</sup> in 2007/08 and to the 81<sup>st</sup> in 2008/09<sup>4</sup>. The question is how can this paradox be explained. In other words, how can the coexistence of fast growth, fueled partly by increasing FDI be reconciled with declining competitiveness indicators? The explanation of this paradox lies in a number of challenges that continue to vex the Egyptian Economy. Prominent among these are some aspects of macroeconomic instability especially high public debt and budget deficit, inflation; inadequate quality of human resources; low productivity; and unbalanced sectoral sources of growth.

The following is a brief discussion of those factors.

### A. Macro-economic instability

The robust economic growth since 2004 contrasts sharply with the declining ranking of Egypt on the macroeconomic stability competitiveness component of the Global Competitiveness Index. Despite minor improvements, total gross debt remains a major problem amounting to 85.1 % of GDP. Similarly, budget deficit continued to be a challenge despite concerted government efforts to reduce it, where it stood at 6.8% of GDP in 2008<sup>5</sup>. This is likely to increase as a result of the stimulus package of public spending of LE 15 billion to face the present economic crisis. In fact, the deficit-to-GDP ratio has increased to 8.4% in 2009 as a result of a rise in expenditure to 28% of GDP, and a decline of revenues to 19.3%<sup>6</sup>.

3 World Bank/IFC, Doing Business 2009, Washington D.C, 9 September 2008.

4 World Economic Forum, Global Competitiveness Report 2009, Geneva, October 2008

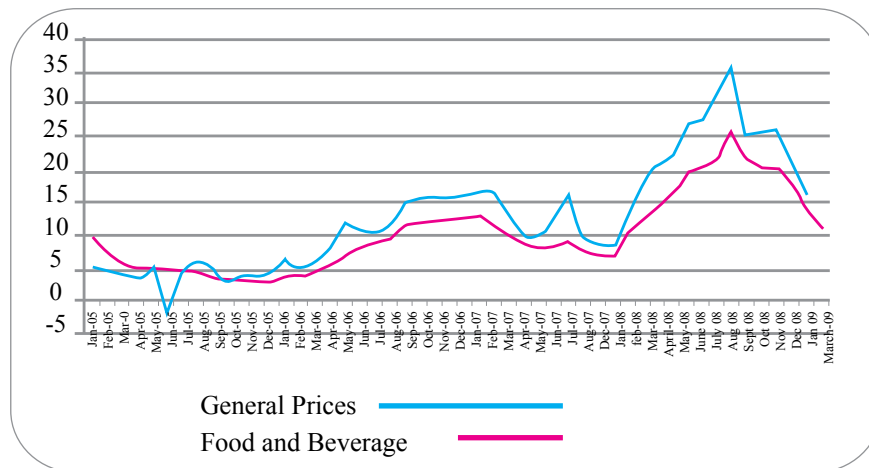
5 Economist Intelligence Unit, Egypt Country Forecast, March 2009

6 Statement by the Prime Minister to the People's Assembly, Monday 6th of April, 2009.

This chronic macroeconomic situation of the Egyptian economy reflects the tension in policy choices between requirements of economic efficiency and those of social welfare. One of the main reasons for budget deficit is the increasing bill of public servants, wages and of subsidies. This has increased from 64 billion LE in 2007 to 128 billion in 2008. The government has managed to reduce subsidies for energy, especially for energy-intensive industries, but this has been more than outweighed by the increase in subsidies for food, health and education as well as the 2008 rise of 30% in the salaries of 5.9 million government employees to make up for the sudden upsurge in prices especially food.

Inflation targeting has been a daunting task for the Central Bank of Egypt, particularly in view of the openness of the economy and its vulnerability to “imported inflation” resulting from the increase in international prices. Fuelled by the rise in food and energy prices, inflation rates averaged 9.5 % in 2007, and continued to escalate in the first quarter of 2008 reaching 14.4%. By the end of July, inflation rates were as high as 22%, and by August jumped to 25.6%. Inflation had been brought under control due mainly to the results of the reform, particularly of the monetary and fiscal policies. However, there were periods when inflation erupted beginning with the impact of the Avian Flu in 2006, followed by the effect of domestic price increases for commodities such as fuel, and finally the galloping inflation resulting from global increase in food and energy prices during last year.

**Figure 1: Inflation**

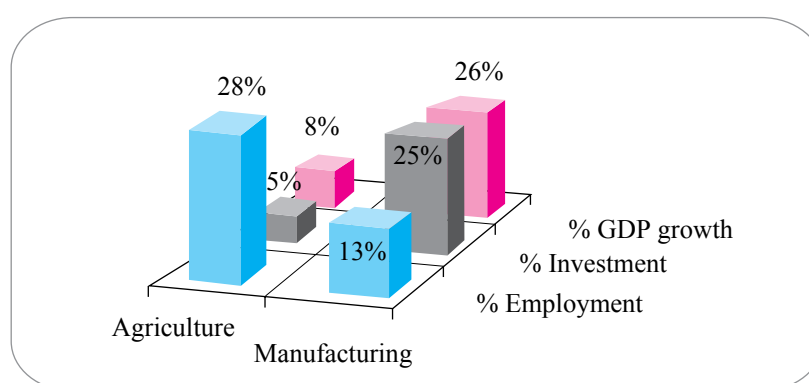


Source: Based on data from CAPMAS for the period Jan-05 to August 08, and Ministry of Economic Development thereafter

## B. Unbalanced Sectoral Sources of Growth

An analysis of the sectoral sources of GDP growth in 2008 shows that the major contributors were manufacturing (25.8%), trade and finance (21.3%), and transport (16.9%). With the exception of manufacturing, these sectors are not typically employment-intensive. The position of agriculture is puzzling. While its share of employment is around 28%, it contributed only 8% of GDP growth last year. Its share of investment is also low (7.2%). An illustration of an example of these discrepancies is provided in the figure below where agriculture and industry are compared in terms of their contribution to GDP growth, share of investment, and share of the labor force. The implication is that the sector with the largest labor force share is starved of investment resources and its productivity is low which curtails its contribution to growth.

**Figure 2: Comparison between the agricultural and the manufacturing sectors in terms of their contributions to GDP growth, investment, and employment.**



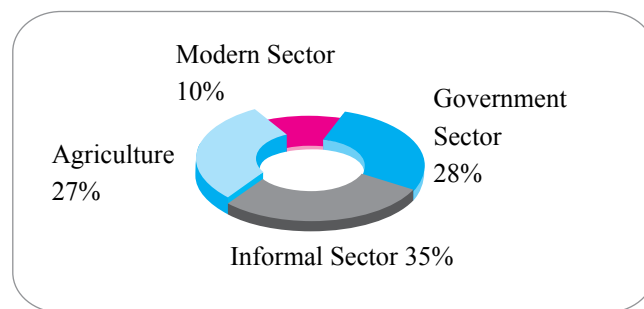
Source: Calculated from data provided by the Ministry of Economic Development, December 2008

## C. Inadequate Human Resources

A cross-cutting cause of the low and declining competitiveness in Egypt is due in a large measure to the quality of the labor force, and the efficiency of labor market institutions. A striking feature of the Egyptian labor force is the dominant share of the informal or unorganized sector in overall employment. As Figure 3 shows, out of the 20 million employed in 2006,

the informal sector accounted for 35%; government for 28.5% and agriculture 27%. These add up to 90% of the employed labor force, and they are to a large extent of low productivity and of low income. Only 10% of employment remains in what could be termed as the “modern sectors”. It is here that the major explanation for the country’s competitiveness position resides.

**Figure3: Structure of the Employed Labor Force**



Source: Samir Radwan, Impact of Investment on the Economic and Social Aspects in Egypt, memo. Cairo, 2007

That given, there is a mismatch between the supply and demand for labor. To gauge the order of magnitude, labor supply grows at 3% every year, while the demand for labor grows only at 2.8%, with the difference continually swelling the ranks of the unemployed. Furthermore, of those unemployed, 92.1% are first time job seekers<sup>7</sup>. The problem is partly created by the length of queuing period of the school-to-work transition. In 2006, around 75% of first time job seekers were only able to find jobs within 5 years of leaving school. As for females, the situation is much worse. The school-to-work transition rates for females from 1998 to 2006, never exceeded 25% even after 15 years of leaving school<sup>8</sup>.

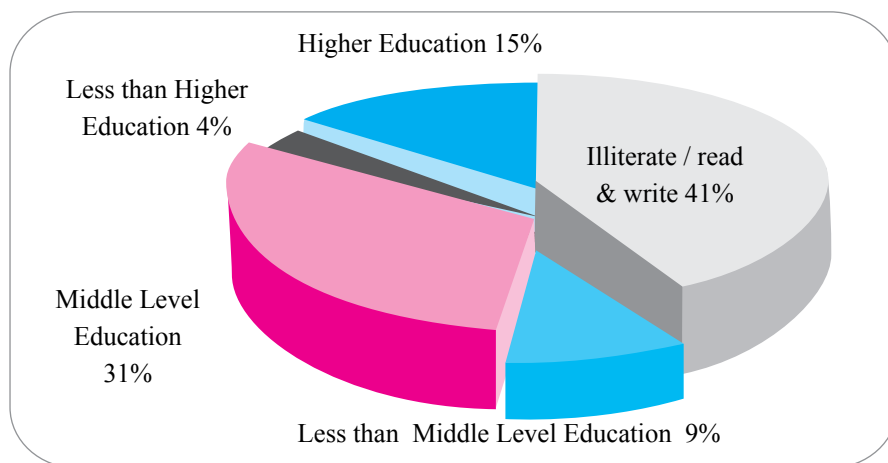
This phenomenon is mainly attributed to another mismatch which exists between the products of education, and the demands of the labor market. In almost all the reports related to economic

<sup>7</sup> Based on CAPMAS, Labor Force Sample Survey

<sup>8</sup> Ragui Asaad, Unemployment and Youth Insertion in the Labor Market in Egypt, ECES, working paper No 118, February 2007, p28

development in Egypt<sup>9</sup>, skill shortage has been underlined as a deficit that has to be compensated for through educational and training policies. As Figure 4 shows, some 41% of the employed labor force is either illiterate or semi-illiterate. This curtails the ability of the labor force to deal with technology and explains to some extent the low productivity and hence, low return to labor among these groups.

**Figure 4: Employed Labor Force by Educational Status**



Source: Based on data from CAPMAS, Labor Force Sample Survey, Quarterly Bulletin, November 2008. Table 5A,p50

The irony is that almost half of those employed are either illiterate or semiliterate, as they cannot afford to be idle; while more than half of those unemployed have received middle level education and more than one third have received high level education<sup>10</sup>.

#### D. Growth is driven more by investment than productivity

A strong correlation has been observed between investment and GDP growth over the last three decades<sup>11</sup>. Periods of strong growth performance were usually associated with higher rates of capital accumulation, rather than increases in Total Factor Productivity (TFP)<sup>12</sup>.

9 In addition to the Global Competitiveness Report, see, inter:alia, UNDP Human Development Report, 2005; ENCC, Egypt's Fifth National Competitiveness Report, 2008; and Samir Radwan, Employment and Unemployment in Egypt, ECES, August 2002.

10 Based on data from CAPMAS, Labor Force Sample Survey, Quarterly Bulletin, November 2008. Table 5B,p51

11 Samir Radwan, "Investment Impact Assessment", Egypt Investment Report 2008, Cairo, (Forthcoming).

12 Note: increases in total factor productivity (TFP) which embodies gains in output due to improvements in technological efficiency as well as levels of education, worker motivation, levels of health and education and change in overall efficiency with which factors are allocated in the production process For detailed examination of this framework see Mustafa Nabli, "Breaking the Barriers to Higher Economic Growth", The World Bank, 2007, Chapter 7; Hanaa Kheir-El-Din and Tarek Moursi, "Sources of Economic Growth and Technical Progress in Egypt: An Aggregate Perspective", in Explaining Growth in the Middle East, edited by J. Nugent and H. Pesaran, Elsevier, 2007; and Hanaa Kheir-El-Din and Heba El-Laithy, "An Assessment of Growth, Distribution, and Poverty in Egypt: 1990/91-2004/05" in Hanaa Kheir-El-Din (ed.), The Egyptian Economy: Current Challenges and Future Prospects, AUC Cairo Press, 2008, Chapter 2.

An analysis of the period 1990/91-2004/05 (Table 1) shows clearly that increased capital intensity has been predominant in explaining the observed changes in output per worker growth, with TFP lagging behind. It can also be observed that changes were, to a great extent, associated with growth in output per worker. The average GDP growth rate for the period as a whole was 4.2%, while employment grew at a remarkably stable rate of 2.6%, with output per worker growing at 1.5%. The contribution of TFP growth to output per worker was negative, while capital-intensity increases tended to exceed growth in output per worker by around 10%<sup>13</sup>. This analysis reinforces the point made earlier about the quality of education and efficiency of the labor force. These two combined explain the reason for low productivity. Achieving an improvement in TFP would require concerted action to improve education and to skill the labor force.

**Table 1: Sources of output per worker growth**

	1990/1991- 2004/2005	1990/1991- 1995/1996	1995/1996- 1999/2000	1999/2000- 2004/2005
Output per Worker Growth	1.509	0.546	2.349	1.99
From TFP	-0.153	-1.09	0.08	0.78
From increasing capital-intensity	1.661	1.63	2.27	1.21
Investment/GDP ratio	21.17	19.82	23.82	20.69
Average annual growth rate of capital per worker	3.32	3.26	4.56	2.41

1990/91-2004/05” in Hanaa Kheir-El-Din (ed.), *The Egyptian Economy: Current Challenges and Future Prospects*, AUC Cairo Press, 2008, Chapter 2.

Source: Hanaa Kheir-El-Din and Heba El-Laithy, “An Assessment of Growth, Distribution and Poverty in Egypt: 1990/9-2004/05”, in Hanaa Kheir-El-Din (ed.): *The Egyptian Economy: Current Challenges and Future Prospects*, op.cit., p17.

<sup>13</sup> Kheir-El-Din and El-Laithy, op.cit., p.19.

The foregoing analysis of the performance and of the challenges that confront the Egyptian economy is crucial for understanding the impact of the global financial and economic crisis. It is important, therefore, to distinguish between the chronic problems that pertain to structural factors and those conjunctural problems caused primarily by the crisis and resulting recession.

### III. Impact of the Crisis and Global Recession

#### III.1 Dimensions of the Unprecedented Global Crisis

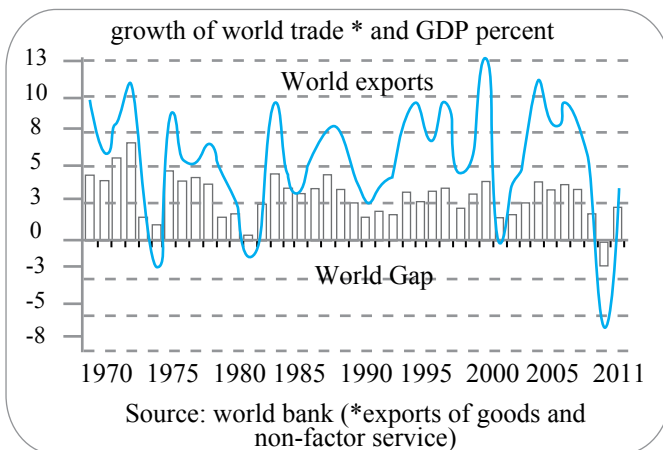
The crisis that began by the end of 2007 in the developed economies and spread into the rest of the global economy is the most severe crisis since the Great Depression of 1929-1932. The crisis began with the sub-prime mortgage problem in the United States and culminated in the financial crunch, caused mainly by the accumulation of toxic debts, and which threatened the banking system in the whole world. By the beginning of 2008, the repercussions extended to the real economy. The crisis was reflected in successive waves of decline in the growth of developed economies, reaching the level of recession by the end of 2008. Meanwhile, the robust growth in emerging markets was an important factor in achieving positive growth rates at the level of the global economy. Various projections of the prospects of growth have been continually revised downward suggesting that the year 2009 as the most difficult period facing the world. According to the latest update by the World Bank's Global Economic Prospects 2009 "What began six months ago with a massive deleveraging in financial markets has turned into one of the sharpest global economic contractions in modern history"<sup>14</sup>. The forecast can be summed up as follows:

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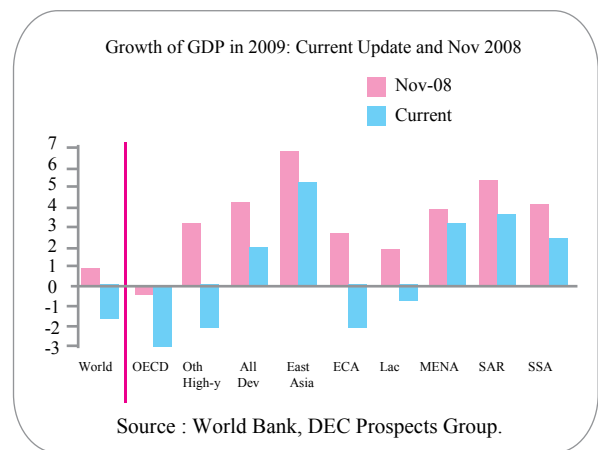
14 World Bank, Global Economic Prospects 2009, Forecast Update, March 30 2009.

- o Global GDP is expected to contract by 1.7 percent in 2009, which would be the first decline in world output on record (Figures 5 and 6). This marks a substantial 2.6 point deterioration from earlier GEP forecasts.
- o High-income countries are in deep recession this year, with OECD economies likely to contract 3 percent and other high-income countries 2 percent.
- o GDP among developing economies should ease from an advance of 5.8 in 2008 to 2.1 percent (contrasted with earlier projections for 4.4 percent growth). Two developing regions, Europe and Central Asia, and Latin America and the Caribbean will witness GDP decline in the year.
- o Volumes of world trade in goods and services are expected to drop 6.1 percent in 2009, with a significantly sharper contraction in trade volumes of manufactured products.
- o Oil prices are expected to remain more-than 50 percent below 2008 levels, averaging \$47 per barrel for the year, while the decline in non-oil commodity prices is forecast to remain in excess of 30 percent.

**Figure 5: The 2009 downturn  
in world GDP and Trade**



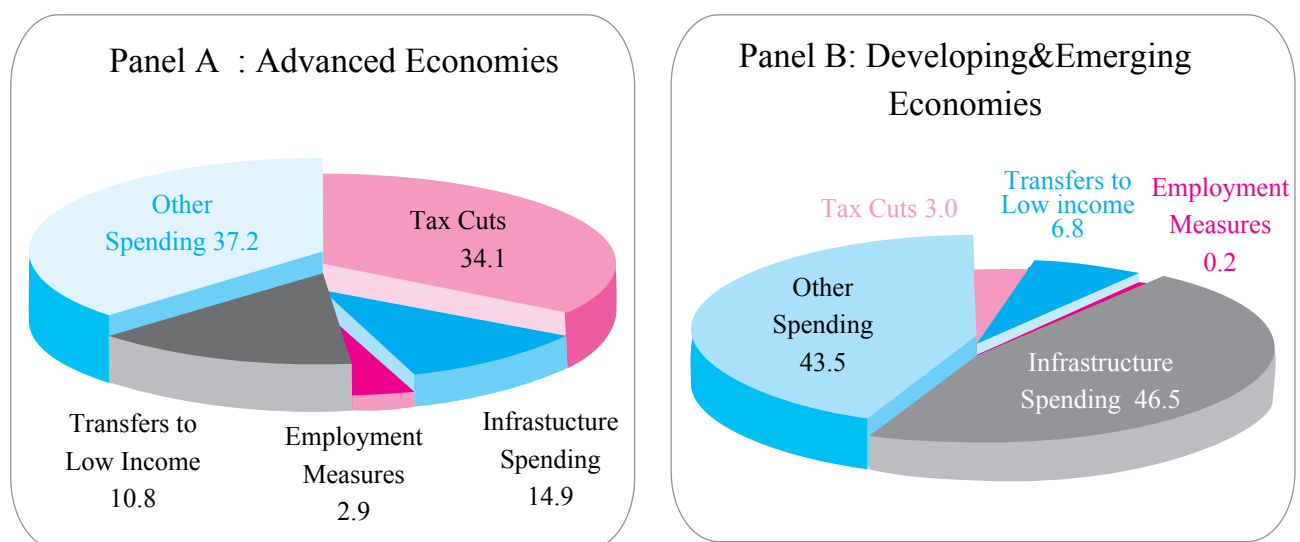
**Figure 6: Global Growth cut by 2.6  
points vs. November – 08 forecast**



Source: World Bank, Global Economic Prospects 2009, Forecast Update, March 30, 2009.

There has been a prompt and concerted response to the crisis reflected in the aggressive stimulus packages launched mainly by the developed economies. However, the fiscal stimulus introduced by 32 countries, developed and emerging stands at only 1.7% of GDP of these countries and 1.4% of world GDP. This falls short of the recommended stimulus by the IMF which should be of the order of 2% of GDP. Moreover, the stimulus as a percentage of GDP for advanced economies is only 1.3% - less than half that allocated by developing and emerging economies (2.7%)<sup>15</sup>. According to the ILO, these efforts are likely to be inadequate to avert a major jobs crisis in the light of deteriorating economic and social conditions<sup>16</sup>. As the figure below shows, little emphasis has been placed on allocating resources to direct employment measures. Such allocations amount to only 3% of total spending in advanced economies and 0.2% in emerging markets. It is difficult to assess the effect on employment of tax cuts in advanced countries which represents one third of the fiscal stimulus. Furthermore, social transfers to low-income households comprise a relatively small percentage (10.8% in advanced and 6.8% in developing and emerging countries.)

**Figure 7: Decomposition of Rescue Packages**



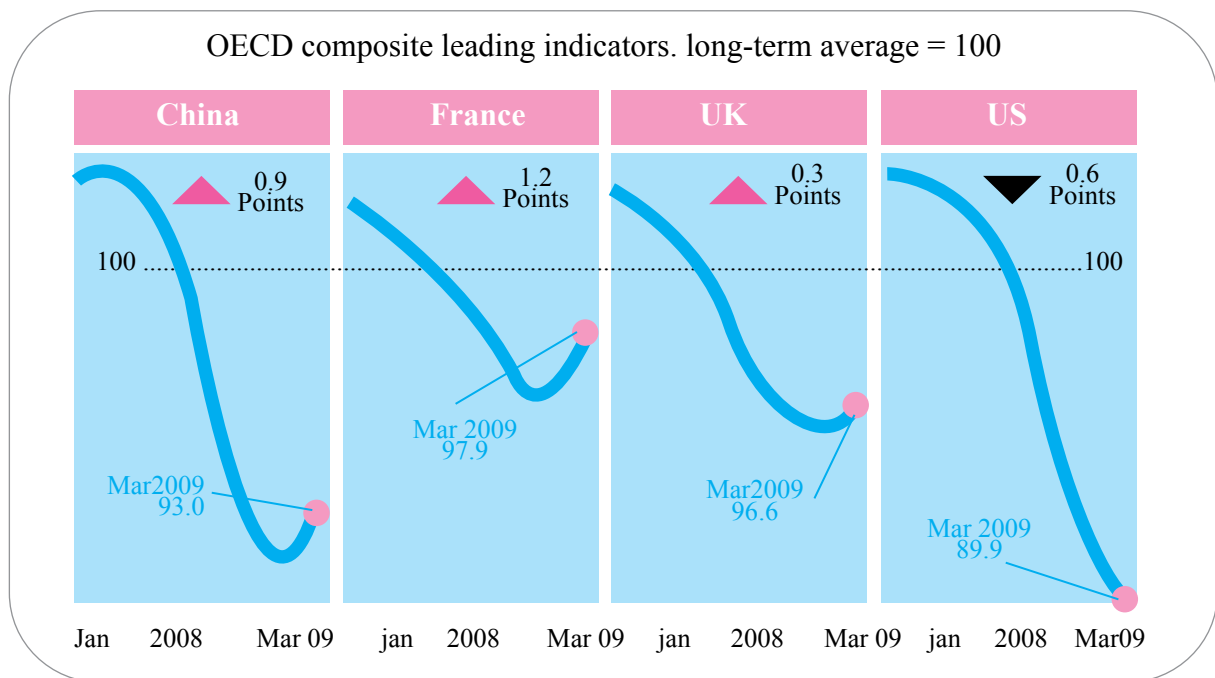
Source: ILO, the Financial and Economic Crisis: A Decent Work Response, Geneva 2009, p48

<sup>15</sup> ILO, the Financial and Economic Crisis: A Decent Work Response, Geneva 2009, p47.

<sup>16</sup> Ibid, p48

Notwithstanding these reservations, the prediction by the IMF is that the global economy would begin to restore its growth capacity by 2010, where it is expected to grow at 3%, most of which will be contributed by emerging markets, **providing the stimulus packages are introduced and implemented**. The forecast for the MENA region is to grow by 4.3%, and Egypt by 4.8% in 2010. The Program of Action adopted by the G20 aims at restoring the growth in world demand, thus reversing the declining trend which was the main source of the global recession in 2008. According to the OECD, the leading economies in the world, with the exception of the USA, have already shown signs of the downturn bottoming out by March 2009 .<sup>17</sup>

**Figure 8: "Downturn Bottomed-Out"**



<sup>17</sup> Reported by the Financial Times, Tuesday, May 12, 2009.

## III.2 Impact of the Crisis on Egypt

The global financial and economic crisis has negatively been transmitted to the Egyptian economy particularly since mid-2008. The impact has been more pronounced on the real economy rather than the banking sector. This was due to a number of factors most prominent of which is the limited integration of the Egyptian banking sector in the global financial market. Moreover, the Central Bank of Egypt had succeeded in reforming the sector since 2004 by consolidating the banks into larger conglomerates; restructuring bank management; and getting rid of toxic debts. The Central Bank also introduced stringent rules of governance to guarantee the disciplined functioning of the system. Finally, the banking system has not been short of liquidity with the lending-to-deposit ratio not exceeding 53%, which is well within the safe boundaries compared to the rest of the world.

In what follows, a brief account will be given of the impact of the crisis on the economy starting by macroeconomic indicators, followed by the performance of financial markets and the impact on the real economy, relegating the impact on employment and social aspects to a separate section as it is a core issue of this paper. It should be emphasized at the outset that the depth of the impact of the crisis can best be understood by taking into consideration the existing structural problems that confronted the Egyptian Economy. The crisis and the response to it have been conditioned by these problems.

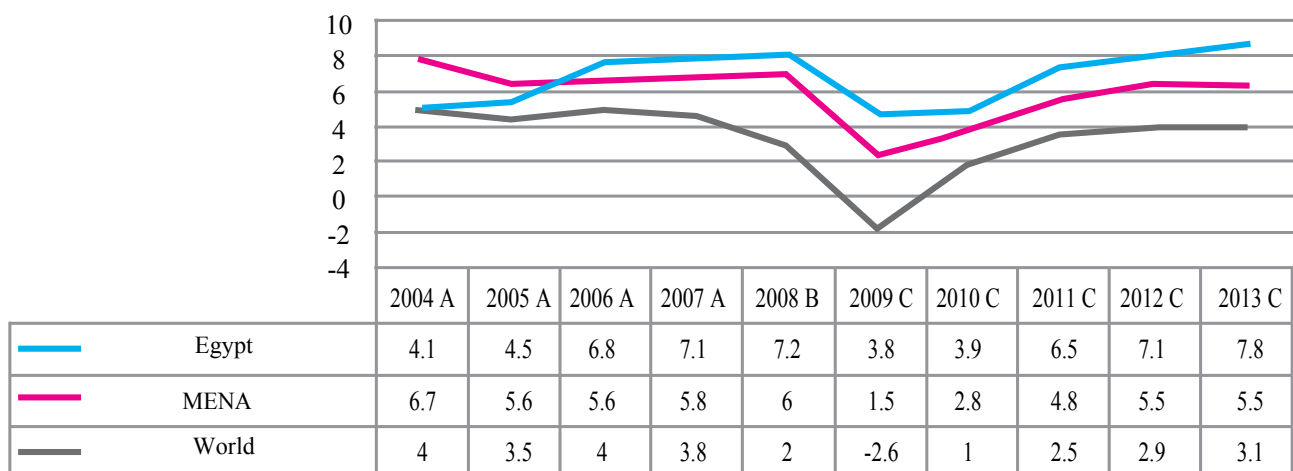
## 2.1 Macroeconomic Impact

The impact of the crisis has been mainly reflected in the decline in almost all the macroeconomic indicators representing almost a reversal of the impressive performance of the previous four years. In the following, a picture of this impact will be outlined.

### \* Decline in real GDP growth rates

In contrast to the previous four years when, almost all national and international reports point out to a reversal of the trend particularly during the first two quarters of the financial year 2008/09. The real GDP growth which amounted to 7.2% in 2007/08, declined slightly by the end of that year when it was 6.7% in the last quarter. But with the onset of the crisis GDP growth declined to 5.8% and 4.1% during the first and second quarters of 2008/09 respectively. This has been due to the decline in the major drivers of growth especially tourism, manufacturing, Suez Canal, and remittances of Egyptians working abroad. It is expected that the economy will begin its recovery by 2010 propelled by the renewed growth of the global economy and through the effect of the stimulus package by the Egyptian government designed to boost domestic demand.

**Figure 9: Real GDP Growth (2003-2013)**

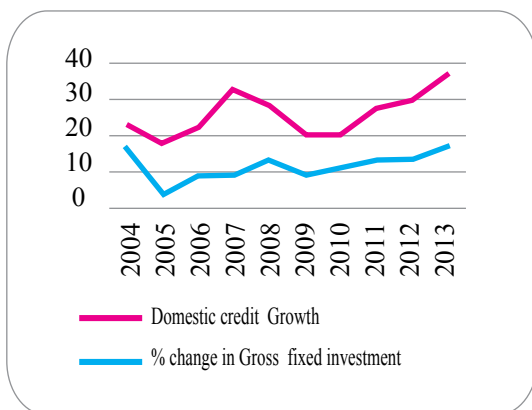


Source: IMF, International Financial Statistics, quoted by the Economist Intelligence Unit (EIU), London, March 2009.  
 Note: Official figures for Egypt's GDP growth in Q1 2008/09 is 5.8 %, and for Q2 is 4.1% according to the Ministry of Economic Development

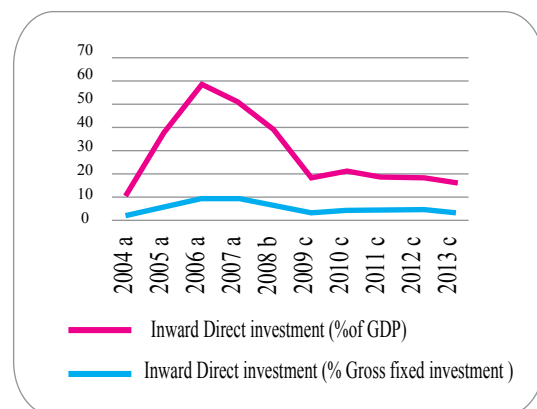
**\* Reduced flow of Domestic and Foreign Investment**

Total investment in the second quarter of 2008/09 amounted to LE 52.5 billion compared to LE 50.7 billion during the same period of the previous year. Though this represents a slight increase, there has been a notable decline in investment flow from 32% during the second quarter of 2007/08 to 3.6% only in the second quarter of 2008/09. This can be explained by a number of factors: first, despite the comfortable liquidity of the banking sector, the rate of growth of domestic credit has declined sharply during 2009; secondly, the flow of FDI which had amounted to almost 9% of GDP in 2007/08, declined during the first half of 2008/09 by 60% compared to the first half of 2007/08; and thirdly the reticence of the private sector to embark on new investments under conditions of uncertainty about market recovery.

**Figure 10: Domestic Credit Growth and the Change in Gross Fixed Investment**



**Figure 11: Foreign Direct Investment**



\* Sharp Drop in Remittances expected (increase in returned migration)

The global crisis has adversely affected the major sources of demand for Egyptian workers. Thus the decline in the activities in the GCC countries, which is the main destination of migrant workers, in addition to USA and EU, is likely to result in a sharp drop in remittances which went down in the first quarter of 2008/09 to about US \$ 1.950 billion compared to US\$ 2.285 billion compared to the last quarter of 2007/08. However, remittances increased again during the second quarter of 2008/09. This is not surprising as remittances may actually increase in the early stages of the downturn as returned migrants usually bring their savings with them.

There are strong indications that this trend would be reversed as the crisis unfolds in the destination countries. For instance In the US and Kuwait, where the global downturn and falling oil prices seem to have had a more pronounced effect early on in the global downturn, remittances fell sharply (by 22% and 17% year on year respectively), a precursor perhaps of developments elsewhere<sup>18</sup>. The impact would be most pronounced for Egyptians working in the construction sector of the gulf sector of the GCC states which account for around 54% of all remittances from these countries.

While the full picture is not clear, there are estimates that the performance of the past few years where remittances reached some US\$ 8.6 billion, or 6.5% of GDP, is likely to be reversed. A study published by the Centre for Economic Studies in Egypt estimates that around 500,000 Egyptian migrant workers will lose their jobs in the Gulf by end-2009<sup>19</sup>.

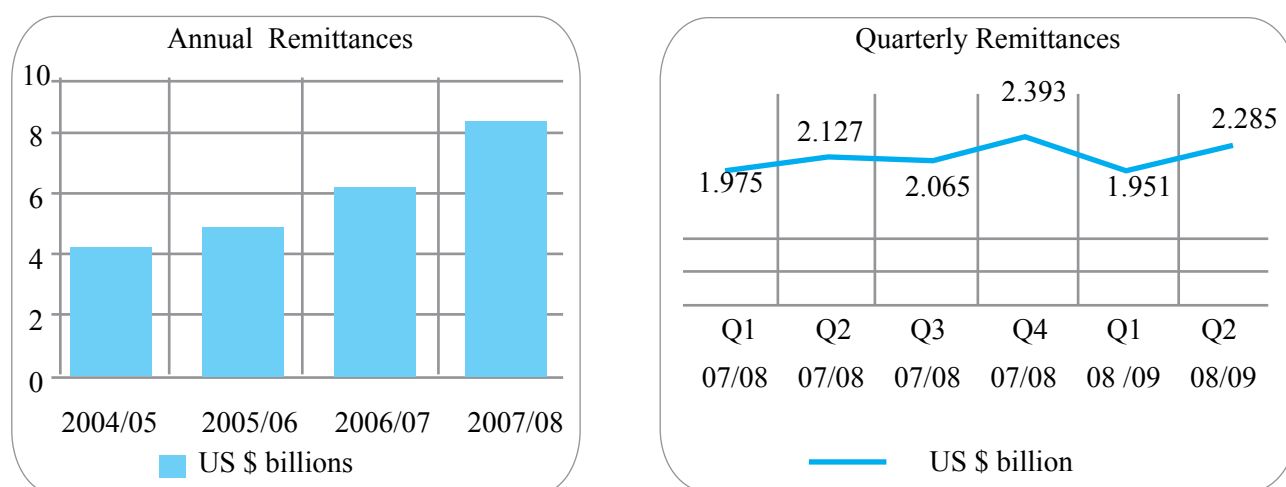
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18 Economist Intelligence Unit (EIU), Egypt Country Report, April 2009

19 Naglaa EL Ahwany, Present Imbalances in the Egyptian Labor Market and the Potential Impact of the Economic Crisis, memo, ECES, Cairo, March 2009

Another recent estimate suggests that around 30% of Egyptian construction workers have already returned home, but few of these workers are expected to find alternative employment in Egypt where domestic construction activity has started to weaken. The net result would be a decline of remittances of between 10 to 20% as a result of the crisis.

**Figure 12: Worker Remittances**



Source: Based on Data from the Central Bank of Egypt, Monthly Statistical Bulletin

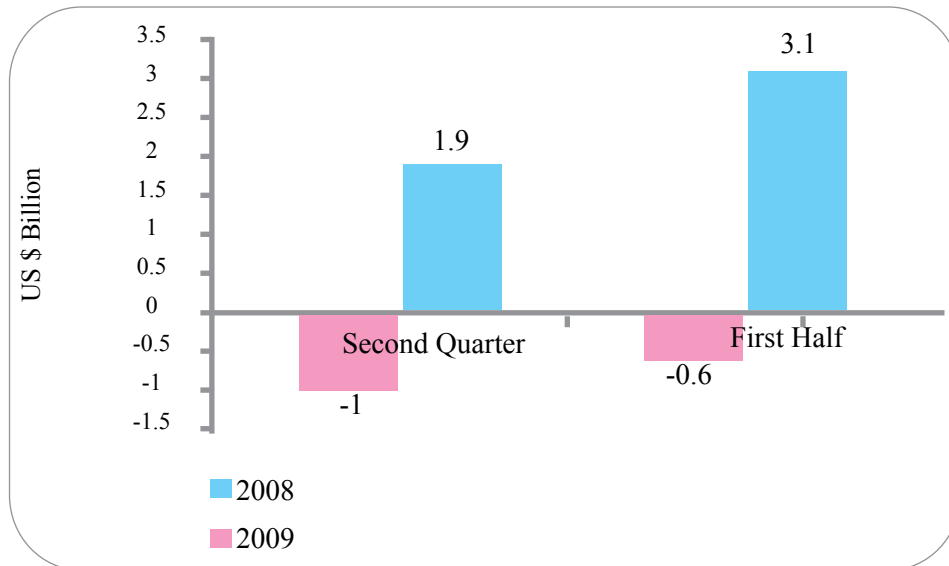
#### \* Balance of Payments Strained

The decline in demand for Egyptian goods (exports) and services (Suez Canal, tourism, workers abroad) has been negatively reflected on the external balance of the country, thus ending the short-lived surplus of the pre-crisis period. Exports have been severely hit. The growth rate of exports is expected to slow down by more than a third of its current pace from 25.5% in 2008 to 5.9% in 2009. Although imports are also slowing down from 27.9% growth to 14%, they will not be hit as hard as exports. Furthermore as services and transfers drop as a result of the crisis, the current account is being significantly impacted. According to the Egyptian Central Bank, the current account deficit for Q1 2007/08 has increased 7 folds in Q1 2008/9 where it jumped from US\$131 million to US\$ 966 million <sup>20</sup>.

<sup>20</sup> Central Bank of Egypt, quoted by the Economist Intelligence Unit Egypt Monthly Report, January 2009, p15

The impact of all these factors on Egypt's balance of payments is quite severe, where the 2008 surplus has been converted into a deficit in the first half of 2009.

**Figure 13: Balance of Payments**



Source: Ministry of Economic Development, Follow-Report Q2/H1 2009

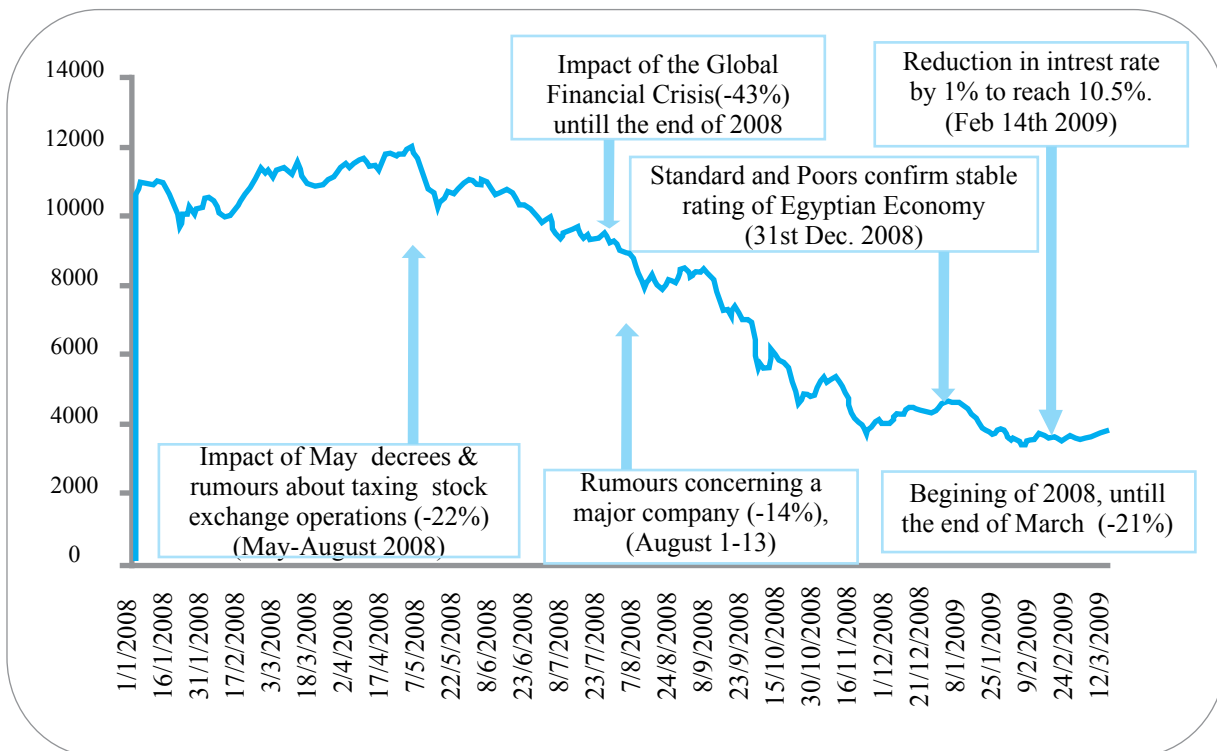
Furthermore, the strain on Egypt's international reserves has been amplified. International reserves currently cover only half of the year's imports, while it used to cover at least 9 months last June.

## 2.2 Capital Market Collapse

A number of factors have combined to exacerbate the performance of the Egyptian Stock Exchange which began its decline long before the crisis. By late 2007, there was a rush by foreigners to liquidate their assets in order to bail out their enterprises in their home countries in the wake of the mortgage crisis. This was followed by a second shock caused by the so-called May economic decrees which were interpreted by investors as a sign of rolling back reform especially those related to investment incentives. Added to that was the unprecedented inflation wave resulting from the increase in food prices which negatively affected investors

expectations about the performance of the stock exchange and the Egyptian economy as a whole. As a result of these factors, the EGX 30 index dropped by 20% at the beginning of August 2008. The situation was made worse by the onset of the global crisis which led to the continued drop estimated at 43% up to the end of 2008. The total decline is thus estimated at 56% in one year which suggests that the Egyptian Stock Exchange was one of the worst hit, exceeded only by Dubai and the Russian Union.

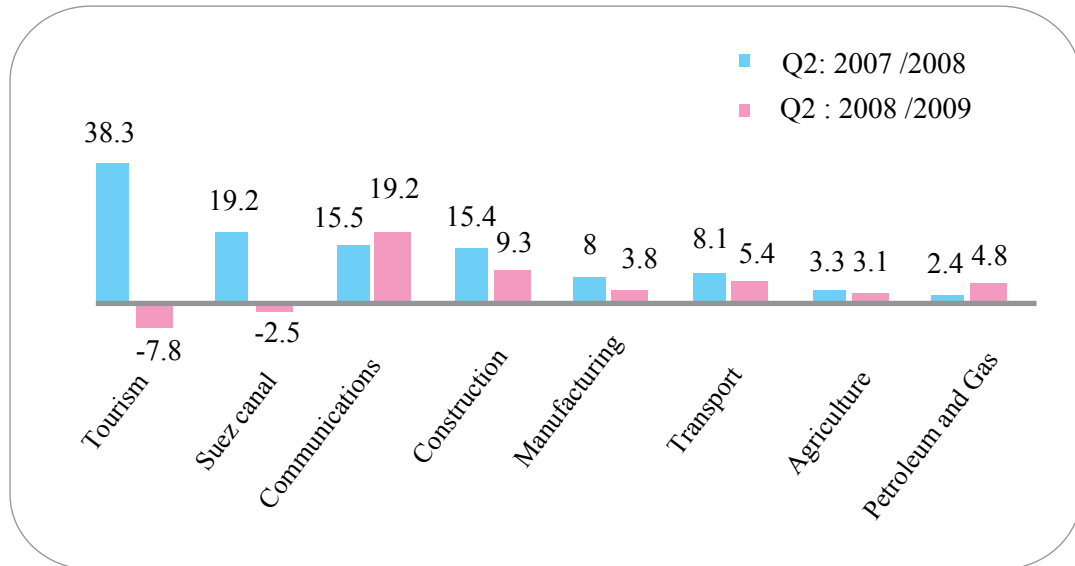
**Figure 14: EGX 30 Index**



Source: Mohamed Omran, The Financial Crisis and the Egyptian Economy: A Macroeconomic View, Cairo, memo, March 2009.

### 2.3 Impact on the Real Economy

The impact of the crisis began to show on the different sectors of the real economy by the middle of 2008. Most of these sectors registered a pronounced decline in growth starting with tourism which declined to a negative growth of -7.8%, followed by the Suez Canal -2.5% as well as manufacturing (where growth was halved) and building and construction (which dropped from 15.4% to 9.3%). The only sectors that escaped this fate were communications and petroleum. In other words, the growth of employment-intensive sectors declined thus aggravating an already serious unemployment situation.

**Figure 15: Economic Growth by Sector, Q2 2007/2008 – Q2 2008/2009**

Source: Ministry of Economic Development, quoted by the Ministry of Investment, Quarterly report, 2008/2009, p10

This performance has serious implications for the future growth of the Egyptian economy as well as the welfare of the population. As can be gleaned from Figure 16, both GDP per head and labor productivity, which are the main foundations for future growth, have plummeted in 2009. Growth in income per capita is the main source of consumer spending, and the rise in labor productivity is the precondition for increased output and income.

**Figure 16: Growth and Productivity (%)**

Source: Based on data from the Economist Intelligence Unit, Egypt: Country Forecast, January 2009,p10

#### IV. Labor and Social Consequences

The prolonged labor market recession and the consequent social deterioration are the most serious aspects of the global financial and economic crisis as it reflects on Egypt. As outlined above, the crisis is spreading throughout the real economy by means of three mutually-reinforcing channels: the credit crunch caused by the limited availability of credit for working capital, trade finance and viable investments; the viscous cycle of depression resulting from declining demand, leading to lower output, employment, and incomes, and thus affecting

confidence among consumers and investors; and the globalization channel caused by weakening international trade and investment linkages and receding remittance flows.

In this section, we shall focus on the cycle of depression as illustrated in such areas as the labor market response to the crisis; the dynamics of poverty and vulnerability; and social cohesion

#### IV.1 Labor Market Response to the Crisis

The most immediate impact of the crisis has been the inability of the labor market to adjust, thus exacerbating the problem of unemployment, and accentuating the position of different groups particularly women and youth. Unemployment, which has been a chronic problem even with the rapid growth of the pre-crisis period, is on the rise. Egypt shares this problem with the rest of the world. According to the ILO “ the number of unemployed increased in 2008 by 14 million. As the crisis continues to spread and job losses mount, world-wide unemployment could increase by at least 38 million by the end of this year”<sup>21</sup>. The Shadow of unemployment is reminiscent of the situation in the 1930s where the influential report “Men Without Work” gave rise to what was later known as the “Keynesian Revolution”. The report emphasized that “it should never be forgotten that the enquiry was concerned with the actual experiences, too often the sufferings of human beings and that the formal array of figures in the statistical tables which have been compiled relate to living men and women, not to abstractions.”<sup>22</sup>

It is expected that the decline in GDP growth as a result of the crisis will curtail the ability of the economy to create new jobs. It has been estimated that the reduction of GDP growth from 7.5% in the first half of 2007-08 to 5.0% in the first half of 2008-09, i.e. by 2.5 percentage points, will result in the decline in employment opportunities by 1.6 percentage points, or 348,000 jobs<sup>23</sup>

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21 ILO, Decent Work Response, op.cit p.vii

22 Samir Radwan, “Employment and Development “, in David Sapsford and John-ren Chen (eds.): Development Economics and Policy, A Conference Volume to celebrate the 85th birthday of Professor Sir Hans Singer, Macmillan Press Ltd., London 1998.

23 Based on Manal Metwaly and Nihal El Megharbel , The Economic Crisis and its Impact on the Industrial Sector in Egypt, paper presented to the Conference on “The Social Impact of the Global Financial Crisis on the Egyptian Economy, and Means of Confronting It” , Cairo University, 12 April 2009, (Arabic), p34.

Table (2) provides the estimated employment impact of the crisis at the national and sectoral levels.

**Table 2: Estimates of the Employment Impact of the Crisis at the National and Sectoral Levels**

Sector	Employment Intensity to GDP	GDP Growth during the first half (%)		Employment growth during first half (%)		Change in employment after crisis (percentage point)
		2007/2008	2008/2009	2007/2008	2008/2009	
(1)	(2)	(3)	(4)	(5) = (2) * (3)	(6) = (2)*(4)	(7) = (6) – (5)
Agriculture	0.34	3.4	3.1	2.6	1.6	-1
Industry	0.56	7.8	4.5	4.4	2.8	-1.6
Petroleum & Electricity	0.42	3.8	6.8	1.6	2.2	0.6
Building & Construction	0.48	15.6	9.4	7.5	5.0	-2.5
Productive Services	0.73	11.5	5.3	8.4	2.5	-5.9
Social Services	0.79	3.3	3.5	2.6	2.0	-0.6
Total	0.62	7.5	5.0	2.1	1.6	-5.0

Note: The expected job loss as a result of decline in GDP growth has been calculated using the point elasticity of employment to GDP growth over the period 1980/81 to 2006/07. The figures suggest that the decline of GDP by one percentage point would lead to a decline in employment by 0.62 percentage points at the national level

Source: Manal Metwaly and Nihal El Megharbel, The Economic Crisis and its Impact on the Industrial Sector in Egypt, paper presented to the Conference on “The Social Impact of the Global Financial Crisis on the Egyptian Economy, and Means of Confronting It”, Cairo University, 12 April 2009, (Arabic), p34.

These trends have been underscored by official statistics published by the Ministry of Economic Development where job opportunities during the second quarter of 2008-09 have dropped to 128,000 jobs compared to 181,000 in the same quarter of the previous year, i.e. by 30%. Similarly the unemployment rate has increased to 8.8% in the second quarter of 2008/09 compared to the same quarter in the previous year. The expectation is that unemployment may rise to 10% by the end of the year<sup>24</sup>, and it may even rise further as a result of the return of 300,000 migrant workers or about 1.5% of the labor force, who would lose their jobs due to the contraction of demand on Egyptian workers in the receiving countries, especially the GCC countries, that were hard hit by the crisis. Furthermore, there are sporadic reports of worker layoffs in the major industrial centers such as the 6th of October and the 10th of Ramadan cities,<sup>25</sup>

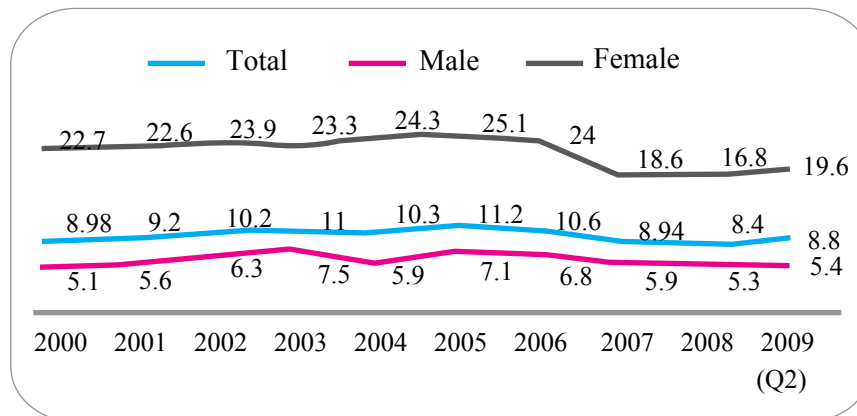
24 Statement ascribed to the Minister of Manpower, Al Masry Al Youm, Wednesday 1<sup>st</sup> April 2009.

25 A press release by Trade Union Services House, Al Masry Al Youm, ibid.

and main tourist resorts such as Sharm El Sheikh and Hurghada. Exact estimates are difficult to come by especially as the main casualties are temporary and part-time workers whose contracts do not include serious protection clauses.

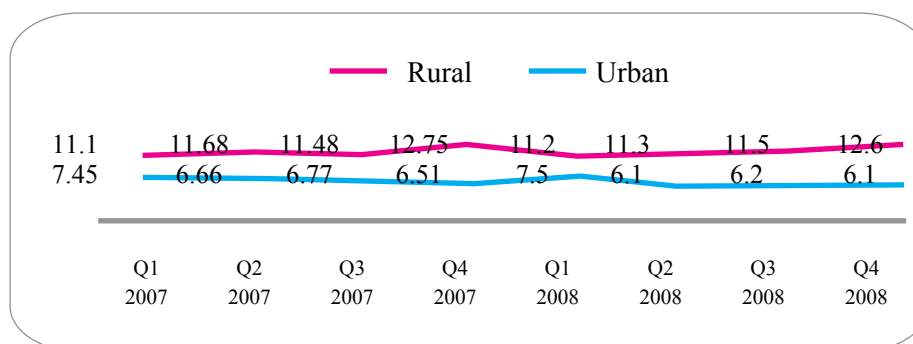
A closer examination of the unemployment profile reveals that the labour market outcome of the crisis has been uneven as it affects certain groups disproportionately- notably women, youth and migrant workers, and a higher incidence for urban workers. An examination of unemployment by gender shows that **women were more affected than men** (Figure 17). At a time where unemployment rates for men remained more or less constant before and after the crisis (5.3% in 2008 and 5.4% in Q2 of 2009), that of women increased (from 18.6% to 19.6% during the same period). This is partly due to a structural characteristic of the labour market where female unemployment has always been higher than that of males, but also due to the fact that women are usually the first to suffer during the crunch. Moreover, women are concentrated in the export-oriented sectors (textiles, food processing and services) which face the prospect of rapidly shrinking world and domestic markets.

**Figure 17: Unemployment in Egypt**



Source: CAPMAS, Labour Force Sample Survey, several issues

Unemployment also appears to be concentrated in the urban rather than rural areas (Figure 18).

**Figure 18: Unemployment by Region**

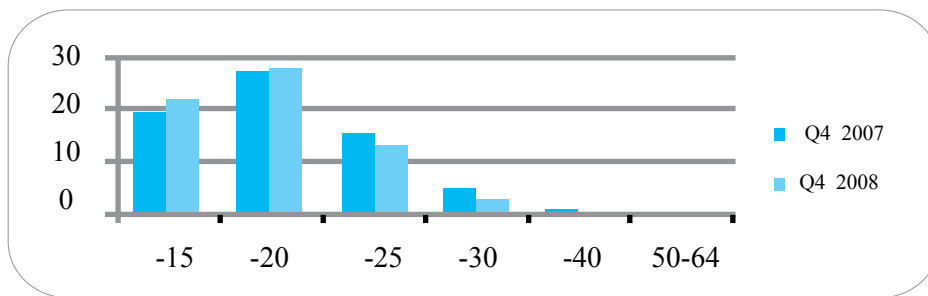
Note Calendar years

Source: CAPMAS, Labour Force Sample Survey, several issues

This reflects the prevalence of urban employment in the sectors that have suffered most during the crisis such as tourism, Suez Canal, building and construction, and manufacturing that recorded negative growth rates, and thus negatively affected employment (Table 2). By contrast, rural employment is primarily dependent on agriculture where growth remained more or less constant (3.1% in the first half of 2008/09 compared to 3.4% for the comparable period of the previous year).

The most alarming aspect of the unemployment profile is that it continues to be essentially a **youth problem**. Unemployment rates for the age groups 15-20 and 20-25 who are the new entrants to the labor market, amounted to 22.2% and 28.0% respectively for the last quarter of 2008 (Figure 19). In fact, they were the two age groups where unemployment rates went up as a result of the crisis, thus aggravating an already serious situation since first-time-job-seekers make up 92% of total unemployment<sup>26</sup>.

26 Samir Radwan, Arab Youth Employment: Economic, Social and Institutional Exclusion and its Impact on Employment, 2009, p19

**Figure 19: Unemployment by Age (Q4 2007 Vs Q4 2008)**

Source: CAPMAS, Labour Force Sample Survey, several issues

Another facet of labour market recession is the likely rise in the incidence of **informal employment** and working poverty, thus aggravating pre-existing challenges. The majority of urban-non-agricultural labour force in Egypt is employed in the informal sector. On the whole, more than half of the non-agricultural labour force find employment in low-income occupations, with little or no protection, and this phenomenon is shared by males and females alike (Table 3).

**Table 3: Informal Sector Employment**

Informal employment as a % of non-agricultural employment			
	Total	Female	Male
Latin America	51	58	48
Asia	65	65	65
Sub-Saharan Africa	72	84	63
North Africa	48	43	49
Algeria	43	41	43
Morocco	45	47	44
Tunisia	50	39	53
Egypt	55	46	57
Syria	42	35	43

Source: Arab Labor Organization, First Arab Report on Employment and Unemployment in the Arab Countries: Towards Effective Policies and Mechanisms, Cairo 2008, p245

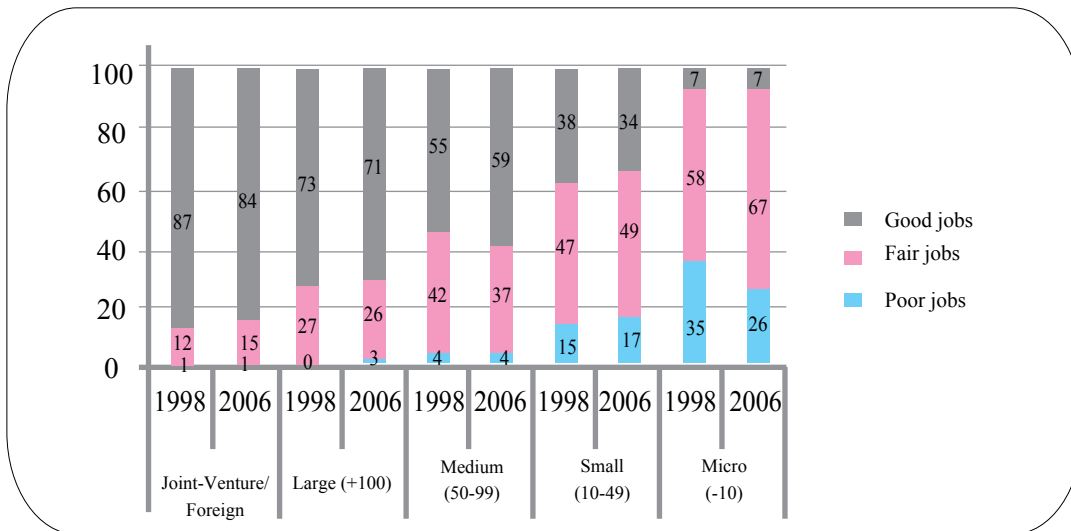
As was the case in previous crises, the pressures on the labor market could lead to an increase in informalization as formal sector employers search for flexibility in order to adjust to the crisis, and laid-off workers from the formal sector seek employment in informal activities as a survival strategy to hedge against falling in poverty. Moreover, as the ILO speculates, the crisis could

generate substantial pressures on informal-economy wages, which before the present crisis were already declining, and substantially lower than regular workers<sup>27</sup>.

This together with a reduction in the number of days worked, will reduce incomes at the household level and erode purchasing power, leading to an increase in the phenomena of working poor. Based upon a threshold of \$2 per day, 7 million will be added to the working poor in the MENA region between 2008 and 2009<sup>28</sup>.

A corollary of informalization is the likely erosion under the pressure of the crisis of “decent work” defined by the ILO to mean productive, remunerative and freely-chosen employment. An analysis of jobs created in Egypt based on two sample surveys (1998 and 2006) shows that “poor jobs” are concentrated in microenterprises that are the core of the informal sector, and that “good jobs” increase with the size of the enterprise (Figure 20).

**Figure 20: Distribution of Private Non-Agricultural W&S Employment by Firm Type and Size and Job Quality**



Source: Ragui Assaad, The Dynamics of Decent Work in Egypt, Population Council, June, 2008.

27 ILO, Decent Work Response, op.cit p.8

28 ILO, Decent Work Response, op.cit Fig3, p.9

## IV.2 Poverty and Vulnerability

Fighting poverty has been a continuous challenge to policy makers in Egypt. The rapid growth over the last five years has certainly led to the decline of poverty incidence from 23.4% in 2005 to 18.9% in 2008<sup>29</sup>. But it has also been noted that the dynamics of poverty are such that as certain groups get out of poverty, others fall into the poverty trap. A recent study by the World Bank and the Ministry of Economic Development, has shown that between 2005 and 2008, some 12% ( about 9 million) went out of poverty while 9% (or about 7 million) fell into poverty( Table 4).

**Table 4: Population by Poverty Dynamics 2005 – 2008 (All Population=100).**

	Percentage	Population, millions
<b>Chronic Poor</b> – Poor in 2005 and 2008	<b>10</b>	<b>7.4</b>
<b>Into Poverty</b> - Non Poor in 2005 and poor in 2008	<b>9</b>	<b>6.7</b>
<b>Out of Poverty</b> – Poor in 2005 and Non Poor in 2008	<b>12</b>	<b>8.9</b>
<b>Never Poor</b> – Non Poor in 2005 and 2008	<b>69</b>	<b>51.0</b>

Source: World Bank, Economic Growth, Inequality and Poverty: Social Mobility in Egypt between 2005 and 2008, December 2008, p.6

It is against this backdrop that the impact of the crisis on poverty can be assessed. First, large numbers of households are just above the poverty line (some 20% so called “near poor”), who are likely to fall into poverty as a result of external shocks. Secondly, the position of the poor is fragile as they suffer disproportionately of unemployment (12% for the poor compared to 7% for the non-poor). Moreover, the poor are concentrated in agriculture, construction, and manufacturing-particularly in the informal activities of those sectors (the informal sector absorbs 24% of the working poor in the urban areas, and 42% in rural areas, most of whom are women).

Another factor affecting the poor is the prevalence of “vulnerable employment” defined by the ILO as “the sum of contributing family workers and own-account workers as a percentage of total employment”. Recent data are not available, but table 5 provides a strong indication of this widespread phenomenon which affects 28% of the employed labor force, and has, in fact, been

<sup>29</sup> World Bank, Economic Growth, Inequality and Poverty: Social Mobility in Egypt between 2005 and 2008, December 2008

on the rise in recent years. The impact has been more pronounced for women than for men where vulnerable employment among females amounted to 53% compared to 21% for men. There is no doubt that the crisis will increase the incidence of vulnerability with the mounting pressures on the labor market. The ILO estimates that vulnerable employment is expected to rise in the world by 25 million, of which one million will be in the MENA region <sup>30</sup>.

**Table 5: Vulnerable Employment in Egypt (% of total employment)**

Total	Male	Female
28	21	53

**Definition:** the share of vulnerable employment is calculated using the ILO definition as the sum of contributing family workers and own-account workers as a percentage of total employment

**Source:** Based on raw data for ILO, Global Employment Trends, January, 2009.

All this points out to the importance of social protection, and the role of economic and social safety nets in coping with the repercussions of the present crisis.

## V. Working Out of the Crisis: A Decent Work Agenda

For Egypt, as for almost all emerging markets, the crisis may offer an opportunity to deal with the structural problems that have beleaguered the economy and reduced its capacity to cope with external shocks, and to lay the foundations for the post-crisis economy and society based on a coherent vision of the future of the global economy and the place of Egypt in it. This would imply that immediate, short-term actions, necessary as they are, must be consistent with, and reinforce the long-term vision.

The premise is that immediate action deemed necessary to cope with the shrinking demand, should contribute to post crisis reconstruction, and that for any policies to succeed they must address the urgent needs for achieving decent work for the majority of the population in order to gain broad-based support for these policies.

<sup>30</sup> ILO, Decent Work Response, op.cit. pp 7-8

In terms of objectives, the overriding aim should be to regain the high road to growth, by reaching a 7% GDP growth per year as of 2011, compared to 4.9%, and 4.5% forecast for 2009 and 2010 respectively. This would require much more ambitious stimulus program to boost investment to at least 25% of GDP. All this is necessary to create sufficient jobs to absorb the new entrants to the labor market, and make a dent in the backlog of unemployment. This would require a policy mix ranging from immediate to medium-and-long-terms.

## V.1 Immediate, Short-Term Action

The immediate task is to deal with the impact of the crisis through three venues:

- a) Stimulating effective demand to compensate for the shrinking external demand;
- b) to provide incentives to mobilize domestic investment and FDI; and
- c) to protect vulnerable groups against the adverse effects of the crisis.

From this perspective, the stimulus package of the government proposed in the 2009/10 Budget is certainly a step in the right direction. This package aims at stimulating domestic demand based on three major pillars.

1. Increasing public expenditure to the tune of LE 15 billion by the end of 2008/09, followed by a similar stimulus in 2009/10;
2. Reducing interest rate over two successive stages by 1% and 0.5% as inflation goes down; and
3. Providing the private sector with other incentives especially to stimulate new investment.

The LE 15 billion stimulus package to be spent by the end of this fiscal year is distributed as follows<sup>31</sup>.

- LE 13.3 billion in public investment to increase demand .
- LE 1.7 billion to account for the reduction in customs on imports of intermediate and capital goods.

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31 Statements of the Prime Minister to the People's Assembly on 15 February 2008 and 3 February 2009

The debate about the stimulus program, however, raises the question of its adequacy to compensate for the negative impact of the crisis. At the centre of the debate is the issue of financing the program. The government is careful not to bail-out the economy at the cost of running an excessive increase in budget deficit, predicted to increase from 6.9% of GDP last fiscal year to 8.4% this year. The private sector, on the other hand, argues for a more aggressive stimulus package, a further reduction of interest rate, and, even, an eventual devaluation of the exchange rate to boost exports. Whatever the point of view may be, the experience of stimulus packages introduced by developed as well as emerging markets, suggest that granting this “bail-out” should be time-bound and conditional on the beneficiaries keeping employment, and avoiding worker lay-offs.

But the question, then, remains, is this package sufficient to lay the foundations for the post crisis situation? The answer certainly points to the need for a much broader package that goes beyond public expenditure on infrastructure and some incentives for the suffering private sector, to one based on a coherent vision of the post-crisis economy and society.

## V.2 The Future: Laying the Foundation for the Post-Crisis Economy and Society

The experience of “Men without Work” following the Great Depression of 1929-32, and the Asian Financial Crisis of 1997-98 point to the fact that the road to recovery depends primarily on addressing the job challenge. It is proposed that the long-term-view should take as its objective the regeneration of **employment-intensive-growth** . This would imply enshrining employment creation as the overriding objective of economic growth, and that jobs created should be productive, remunerative, and freely-chosen. This is the essence of the concept of **decent work**.

In specific terms, the post-crisis recovery should take as its objective the creation of 950 thousand to a million jobs every year in the medium term as suggested by the labour force projections in Table 6.

**Table (6): Projections of annual increase in the Labour Force, 2004-2013**

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Labour Force (m)	20.9	21.8	22.9	23.9	24.6	25.9	26.8	27.6	28.5	29.6
Annual Increase (m)		0.9	1.1	1	0.7	1.3	0.9	0.8	0.9	1.1
% Increase		4.3%	5.0%	4.4%	2.9%	5.3%	3.5%	3.0%	3.3%	3.9%

Source: EIU, Egypt Country Forecast, March 2009, p 12

To achieve this objective, a multi-stranded recovery strategy needs to be put in place with the following components:

## 2.1 Restructuring the Economy

The crisis provides Egypt with unique opportunity to restructure its economy benefiting from the upheaval that has taken place at the global level, and which will certainly result in a new configuration in production and trade patterns. Signs are already clear that the advanced economies of the OECD countries are embarking on a process of transformation of their industries and other activities. This will result in the relocation of some of these industries and activities to the developing countries, and especially emerging markets. Countries like China and India have already started to explore the possibilities of benefiting from this situation, and Egypt should position itself to participate in the process. An obvious endeavor will be the restructuring of Egyptian manufacturing industry in two strategic directions: first, the deepening of manufacturing activities in order to fulfill the growing demands of the domestic market, and being able to compete through exports to the global market benefiting also from its unique geographical proximity. Secondly, expanding the process of industrialization through joining Global Production Chains. This would require far-reaching structural changes in order to reach what UNIDO has termed “breaking in and moving up” which means enhancing competitiveness in order to occupy the manufacturing space vacated by developed economies, or even by some of the dynamic emerging markets such as China <sup>32</sup>. There are several preconditions for this structural transformation to take place. Important among these are the removal of remaining obstacles to investment in general and FDI in particular; providing incentives to investors through availing land and infrastructure; and achieving a breakthrough in improving the skill of the Egyptian labor force which has consistently been cited as the main constraint on productivity and competitiveness.

32 UNIDO, Industrial Development Report 2009, Breaking In and Moving Up: New Industrial Challenges for the Bottom Billion and the Middle-Income Countries, Vienna, 2009.

The question of the employability of the labor force is a crucial determinant of the restructuring of the economy. As argued earlier, the educational and training systems are not sufficiently conducive to the creation of skills suitable for the domestic labor market as well as the demand for Egyptian labor from other countries. Studies taking the long-term perspective on employment within the likely development of the global labor market point to the fact that the world is heading towards greater integration of labor markets similar to that of capital markets<sup>33</sup>. Projections to the year 2050 suggest that the internationalization of production of goods and services, reduced communications and transportation costs, and global demographic developments will lead to higher international mobility of labor and jobs in the coming decades. “Over the long-run, income growth and the prosperity of nations will depend on the availability of a sufficiently large work force with a range of skill levels and the ability to adapt to the changing needs of society”<sup>34</sup>. Within this perspective, Egypt can adopt a proactive approach to prepare for these global changes, seize opportunities and address risks head on. Recognizing the urgency to invest massively today in order to increase the future pool of medium-and-high skilled workers is a precondition to participate in the global recovery and beyond. The task is all the more urgent in view of the projection that future demand for skills both domestically and abroad is not likely to be satisfied given the present skill profile of the labor force (figure 4 above). A crash **national training program** must be at the top of the agenda if the objective of great transformation is to be achieved.

## 2.2 Improving Labor Market Policies and Institutions

Building the post-crisis economy would require a concerted effort to reform labor market policies and institutions. Experience with previous crises shows that labor markets take a much longer time adjusting to the aftermath of the crisis than output markets. According to the ILO “Banking Crises typically have long-lasting effects on employment. Earlier crises caused, on average, a drop in GDP for approximately 2 years and increases in unemployment for a much longer period- 4 to 5 years”<sup>35</sup>. To speed up labor market response to the crisis, a number of actions are imperative. First, the legal framework provided mainly by Labor Law No. 12 of 2003 while representing an improvement on previous legislations, it contains articles that amount to an impediment to attracting investors, do not provide for workable training facilities (the

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33 World Bank, *Shaping the Future: A Long-Term Perspective of People and Job Mobility in the Middle East and North Africa*, Washington D.C, 2009

34 Ibid,p.xv

35 ILO, *Decent Work Response*, op.cit p10

Training Fund) and sanctions an inadequate provision for social protection (the Emergency Fund). Secondly, the wage policy is outdated and cumbersome reflecting various amendments to the laws with the result that it has become difficult to use wages as an instrument of economic and social policy. Thirdly, the institutions for settling labor disputes are presently ineffective as they not provide for proper social dialogue that makes strikes the last resort for workers after exhausting all other possibilities through mediation. Representative organizations for workers and for the private sector should find an appropriate platform for negotiations concerning major issues of labor policies.

### 2.3 Towards a Jobs Pact

Economic recovery is a necessary condition for working out of the crisis, but certainly not a sufficient one. The major lesson of the Asian Financial Crisis of 1997/98 is that the suffering resulting from the economic crash was heightened due to the lack of adequate social policy. By the same token, the recovery from that crisis was made possible through establishing mechanisms for social dialogue and introducing viable social safety nets. An analysis of the Asian Crisis came to the conclusion that “the sudden unraveling of the South-East and East Asian economic miracle has caused wide spread misery and has imperiled social and political stability in the region. Millions who labored to forge the miracle have become innocent and bewildered victims of the unfolding economic collapse...Repairing the economic damage requires action on many fronts...but it would be foolhardy to ignore the lessons for social policy that have been so painfully driven home by the crisis. A fundamental rethink on the social dimension of economic development is as important as the purely economic and financial issues that currently occupy centre stage”<sup>36</sup>.

It is proposed that Egypt’s road to sustained recovery and to building the post-crisis economy and society should be done within the framework of a **national jobs pact**. The emphasis on jobs emanates from the fact that it will not be possible to reactivate the economy in a sustainable manner unless greater emphasis is placed on decent and productive employment for women and men, well-designed social protection and workers’ rights. These measures are best introduced through the creation of a platform for social dialogue centering on the twin objectives of enhancing productivity and strengthening social protection. The time has come to create an effective **tripartite social council** representing government, workers, and the private sector to work out the details and modalities of the **jobs pact** in post-crisis Egypt.

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36 Eddy Lee, *The Asian Financial Crisis: The Challenge for Social Policy*, International Labour Office, Geneva, 1998, p88.