

Inclusive Growth and Forward Looking Macroeconomic policies

Prof. Shereen Elshawarby*

I- Introduction

In spite of faring well on many aspects, the Egyptian economy continues to suffer not only from various acute structural imbalances, but also from inequality. As argued by many observers, the government was adopting a model where policies aim at accelerating economic growth through wealth accumulation of big business firms, with the hope that benefits will gradually trickle down the rungs of the socioeconomic ladder to improve the life of everyone, including the poor. But the model proved to be unsustainable. Even before the revolution of January 2011, the economy that was capital intensive, energy intensive and not inclusive could hardly sustain the financial crisis in 2008 and inflation reaped all the benefits that growth yielded. Economic growth with social progress lagging far behind people's expectations led millions of Egyptians to demonstrate in Tahrir Square in late January 2011. Since then, the country has been going through difficult political and economic transition.

The recent relative political stability has offered the current government an opportunity to receive Arab and international support to embark on an ambitious plan of boosting investment with a focus on improving infrastructure and creating jobs. As announced, this is expected to lead to a path of high growth rates at 7% by 2020. There are however legitimate concerns about whether the great attention given to large investments will be sufficient to promote employment, improve working conditions, and provide adequate social protection. There is thus a need to ensure that the

* Professor of Economic at the Faculty of Economics and Political Science. Cairo University.

old growth model is replaced by a broad and inclusive model of development.

Inequality is not only morally unfair, but it is also politically imprudent and economically unsound. Being at crossroads, Egypt has to decouple from the past trajectory of thinking of social policies as just corrective measures of the negative impacts of “slow” trickle-down effect of economic growth. Instead, Egypt has to formulate economic policies that integrate economic justice. Tradeoffs might take place between market-led economic policies that hinge on efficiency and economic-justice oriented economic policies that seek equity and may often require state interventions. This requires balancing between efficiency and equity, i.e. reorientation of economic policies that undermine equity. Egypt’s success in achieving this balance will fuel confidence in and mobilize support for the ambitious vision 2030 strategy. The main question then is how Egypt can achieve more resilient, inclusive and sustainable development?.

The paper is therefore divided into two distinct but integrated parts, apart from the introduction. The first part proposes the main pillars of an inclusive growth that stimulates productive structural transformation of the economy in order to support sustainable economic growth. This includes the role that enterprises, particularly MSEs and social economy enterprises, play in achieving a more just economic growth via a job-centered recovery. The second part discusses key elements of a macroeconomic strategy that integrates into the inclusive growth strategy with effective employment and equity outcomes.

II- Inclusive Growth in Egypt: How to make it?

There are four main aspects characterizing inclusive growth: (i) rapid pace(ii) broad-based pattern across sectors, (iii) coverage of the largest part of labor force and (iv) long-term perspective (World Bank, 2009).¹ This is

¹Inclusive growth approach focuses on productive employment rather than on direct income redistribution, as a means of increasing incomes for excluded groups.

the type of growth that can be translated into social outcomes and wellbeing, because it widens participation and benefit-sharing. Participation without benefit sharing will make growth unjust and sharing benefits without participation will make it a welfare outcome (Ranieri and Ramos, 2013).

Most commentators agree that the most common route to inclusive growth lies in shifting to more productive economic activities (structural transformation). This means reducing an over-dependence on a limited number of sectors, increasing thus economic stability through generating more and better jobs. Without economic transformation, most of the poor and vulnerable will likely remain captured in low-return activities, and any progress will likely be instable. Also, creating more jobs is transformational, in the sense it provides households income, enabling them to more resources to invest in their children's education and health (World Bank 2013). This would ensure higher share of total output to labor incomes, changing thus social and power relations and offering a sense of dignity and well-being. This is exactly what inclusive growth is about.

The concept of inclusive growth and the related policy instruments do not lack the needed political support in Egypt. In fact, some of these policies are in place, but a full implementation of a comprehensive inclusive growth strategy has not so far been seriously attempted. As illustrated in Figure 1, the common objectives of an inclusive strategy would include (i) increase in the number of jobs (principle of participation) of better quality and work conditions (principle of distribution), (ii) regional integration (principles of participation and of redistribution), (iii) social protection (principle of redistribution), and (vi) environment protection (principles of participation and distribution across generations). Since these elements are inter-related, their success to achieve economic inclusiveness requires concerted action and transformational policies that go well beyond "business as usual"

practices, and a good prioritization and coordination between medium and long-term policies and short-term high-impact initiatives.

Figure 1: Basic Objectives of an Inclusive Growth Strategy



In the following, we elaborate the main elements of an inclusive growth framework that should be useful for policymakers while designing and implementing growth policies. The focus is on the first three of the above mentioned common objectives of inclusive strategy, since environment is dealt with in another part of the report. Anyway, the proposed framework aims to maximize the success chances of economic policies to reduce poverty and share prosperity among the mass of population. This is reached by maximizing the positive impact of economic policies on growth and jobs while minimizing the risk for capture.

1. Creation of More Better Jobs

The most effective instrument to achieve economic justice is to create a large number of decent job opportunities that can absorb as many of the labor supply as possible. More better jobs would ensure increasing share of

labor incomes in the total national income. But, how does Egypt can achieve this?

The corner stone of an environment that is conducive to more of better jobs is investors' reassurance of a positive direction for Egypt's investment climate. There is strong evidence that the private sector is more efficient and better at job creation and economic growth, especially in general businesses without externalities. Therefore, there is a strong need for a well-designed reform strategy that aims to have an efficient, rule-bound, even-handed and inclusive set of institutions that encourages free and fair competition to drive private-led growth. This reform strategy can proceed on two tracks: specific targeted reform to address leading constraints to businesses (short and medium terms), and broader institutional reforms that sustain the process, assure effective design and implementation, and build Government credibility with investors (medium and long terms). These efforts should be associated with a clear communication strategy, open channels of informed public dialogue, and some initial measures and actions that credibly signal the government's commitment to private sector-led growth and competitive markets. These actions would include removing the main impediments to current and new investors.

No one can deny the recent progress in improving investment conditions, although this is still very little compared with what is required to make a significant shift in the investment climate, especially if it is to be inclusive. The agenda of already identified reforms, as proposed in many previous studies and reports, revolve around three pivots:

- (i) Opening markets to competition by removing barriers to entry and exit;
- (ii) Strengthening key institutions that interact with businesses and underpin markets. This would include better information, better dialogue, better planning, better procedures, better implementation, wider inclusion

of micro and small enterprises in the economic policies making, and more effective accountability for actions and results; and

(iii) Mobilizing private and public stakeholders around a long-term strategy.

In the meantime, the Corporate Social Responsibility (CSR) culture should be more widely adopted by firms so as to infuse all aspects of operations. This would include compliance with the legal requirements of social insurance and health care of workers, tax payment, environment preservation, etc.... There are many arguments in favor of CSR, which can be split into two broad categories: moral and economic.

Once the government is clearly committed to the central role the private sector has in an inclusive growth strategy, and once the private sector respects its responsibilities towards the society within which it is based, operate and make profits; the following steps are needed in order to ensure a society that is rich in decent job creation:

The first step is to identify the economic sub-sectors that are the most promising in terms of both growth and high labor intensity generation potentials (high job creation potentials). This requires a growth diagnostic analysis that includes the likely impacts of various policy reforms that would lead to economic transformation and the future trends in the global markets. Previous studies showed that manufacturing and services sectors have the highest employment elasticity. Growth diagnostic analysis should be undertaken at higher levels of disaggregation of these two sectors, to identify which types of manufacturing and services should be targeted by investment, technical support and training programs. Textile, ready-made garments, tourism and construction are traditionally the richest sectors in terms of job generation for all skill types of workforce. In spite of its low intensity generation potentials, agriculture also needs greater attention, because it absorbs more than one quarter of the Egyptian labor force, and hosts more than 70% of Egyptian poor. Usually, growth in unskilled labor

intensive sectors contributes significantly to poverty reduction (Loayza & Radatz, 2006). Anyway, *growth diagnostic analysis* should identify more other sub-sectors, and may go much deeper inside sub-sectors to recommend very specific products.

The second step is to develop sectoral development strategies that identify successful targets for investment, especially for the sub-sectors that are important for job creation, to ensure that gains and spillovers are realized.

In general, improvements in the investment climate are integral, not only to attract more investment but also to keep the existing firms and avoid the move of some of their activities to the informal sector. In the parts of the economy where the private sector takes the lead GoE has to focus on firm age or innovation and not only on firm size, since startups and more productive firms create most jobs. In the programs and projects where the state takes the lead, the mistakes of the past have to be avoided and new policies—together with the administrative structure that implements them—need to minimize the scope for capture, promote competition, and tightly link support to measurable and verifiable performance (Schiffbauer et al., 2015).

The third step is to select public programs and projects based on rigorous cost-benefit analysis that proves that the community benefits significantly outweigh the associated costs. This is the only sensible way to proceed with the selection of programs and projects to be included in the plan. Cost-benefit analysis that is social justice oriented would count for consequences on different kinds of social justice gaps: income, special, gender, inter-generational, etc... This evaluation of government decisions is needed also for diverse areas as tax, the provision of public goods, the distribution of rationed commodities, trade or incomes policies, or the licensing of private investment.

The fourth step is to develop explicit employment and skills development strategies rather than relying on growth strategies to provide jobs. There is

evidence that the link between growth and more (or better) jobs is not automatic, because of typical lags and gaps in translating growth into better living standards, productivity and social cohesion (World Bank, 2013). Therefore, a focus on jobs is crucial in seeing the three principles of economic justice translated into tangible outcomes. Job and skills development strategies highlight the key jobs challenges, by sector, gender, region and age that might be overlooked by growth strategies. The employment strategy should promote active labor market policies (ALMPs) that target the youth and women.

In general, balanced labor market reforms are needed to both facilitate enterprises' adjustment to economic conditions (right of hire and fire) and ensure adequate workers' protection. These reforms should include the following measures:²

- i. *Upgrading the capacity of the Ministry of Manpower and Immigration (MoMI) to ensure enforcement and compliance with ALMPs.* The main role of MoMI has been perceived as containing and taming labor unions. The minister has been always selected from these unions. It is recommended to change this image. The name might become the Ministry of Employment and Migration, to emphasize the core mandate of the ministry. The minister should have a comprehensive understanding of the problems of the supply and demand sides of the labor market, and their relation with other economic policies. The Ministry should be able adequately develop and follow up the implementation of the employment strategy and inspect working conditions. The Ministry needs to have sufficient staff at the central and local levels to function its inspection roles. Such balance can only be achieved through tripartite social dialogue (the government, the business sector, and the workers), which should be introduced after a comprehensive social dialogue.

² Most of these recommendations draw on Barsoum, 2014 and Card et al, 2009.

- ii. *Strengthening labor unions functions* to ensure the effectiveness of collective bargaining institutions.
- iii. *Creating dispute settlement mechanisms*. For example, establishing oversight commissions, Labor Court, etc., with complaint and appeal processes for both employers and employees.
- iv. *Seeking acquisition of the right skills*. This requires matching the soft and technical skills provided by the education system with the skills needed in the labor market. Vocational trainings need to be based on a more targeted and market-oriented function (workplace-based or combined with school based). This can be achieved by involving employers in the identification of skills standards and training needs, establishing innovative systems for on-the-job training and youth apprenticeships, and raising awareness of the importance of quality education, TVET and lifelong learning. Also, training has to be well-targeted at specific groups and tailored to their needs. For example, the second-chance programs could be one sensible option to target training to the most disadvantaged and excluded youth, namely unskilled youth with low levels of formal education
- v. *Promoting career counseling* within schools and in employment service centers to help guide youth towards technical careers where demand is stronger
- vi. *Supporting entrepreneurship* among youth through both technical and financial support. Very few youths in Egypt are entrepreneurs, because of the limitations of lending programs, and lack of marketing expertise. Connecting start-ups to supply chains and building up business incubators can encourage more youth to become entrepreneurs.
- vii. *Improving labor market information systems and job search mechanisms*. Profiling needs to be taken for early identification of risky groups and the adoption of appropriate measures. This is much needed particularly for youth in the poorer rural and urban areas who lack

informal networks of family and friends that have become the most common means to find a job.

viii. Improving the social protection of young workers. Labor laws and collective agreements, including through sanctioning mechanisms, can protect young workers and facilitate their transitions into stable and decent employment. In parallel, there should be a system of incentives to encourage the registration of enterprises, while also providing incentives for employers to invest in improving their employees' productivity and their working conditions.

But, which government entities should assume these measures? The following is recommended:

- The Ministry of Planning undertakes the growth diagnostics analysis, and puts all sectoral strategies in one consistent framework through a consultation process with the line ministries. The evaluation of cost-benefit analysis of public programs and projects should be assigned to an independent committee. This committee may comprise independent experts and representatives of MOP and be affiliated with the supreme council of universities to ensure its independence from the government. The follow up function should be strengthened and accompanied with explicit measures of correction, when needed.
- The Ministry of Manpower (Employment) and Migration develops the employment strategy in close cooperation with the different sectoral ministries.

Finally, a comprehensive public dialogue and effective consultation process would ensure consistency, public support and consequently sustainability of needed reforms. In general, fostering tripartite social dialogue (the government, the business sector, and the workers) would increase the probability of these reforms' success.

2. Competition and Equal Opportunities

There is an urgent need to undertake reform policies that get rid of all impediments that unduly constrain competition and equality of opportunity for all individuals and firms. These policies include equalizing opportunities in access to basic services between all Egyptians and all firms, and across all Egyptian regions.

To promote inclusive development, the rule of resources' allocation should be based on governorates' needs which in turn can be determined by poverty rates and gaps in opportunities. In spite of unambiguous improvements in individuals' access to most of basic services, there are still significant gaps in opportunities for many of these services between income groups and between regions (rural/urban and geographical regions), with Upper Egypt and border governorates having the largest gaps. Public investment allocation has been progressively determined according to poverty shares rather than population shares. Yet, large cities and main governorates are still receiving a large part of public investment.

Resource allocation should be conditional to wider coverage and improved quality of services. The objective of resource allocation for basic services should be narrowing the gaps between regions with respect to access to basic services. Equal opportunities in access to basic services, especially education and health, increase the probability of today's poor children to get a decent employment when they enter the labor market. So, by ensuring just resource allocation (principle of redistribution), we ensure the rule of the principle of participation, though with a lag. Equal opportunities in access to basic services lead to narrowing injustice gaps between income groups, between regions, and across generations.

There is a need to reform policies that unduly constrain competition and equality of opportunity for all firms and entrepreneurs, in order to foster a level playing field. Needed reforms include removing barriers to firm entry and exit (resulting from restrictive hiring and firing laws, cumbersome

bankruptcy laws, etc...); firm growth; and access to judiciary, land, or industrial zones. Also, the space for discretionary policy implementation should be minimized and laws and regulations should be enforced equally across firms (World Bank, 2015). Egyptian Micro and Small Enterprises (MSEs), known to be the major job provider in the economy, face disincentives to grow (El Hamidi and Baslevent, 2013) and incur higher costs than larger firms as a result of these barriers. Yet, they are still able to offer large numbers of jobs at a low cost.

Most of the policy priorities identified as important to small businesses are those identified as important to inclusive growth (CAFOD, 2013). The most common five characteristics for a successful MSEs development strategy are infrastructure, regulation, capacity, finance and linkages:

1 *Improving infrastructure.* Comprehensive and navigable transport networks (from roads to trains, Nile and sea vessels and aviation), regular electricity, and decent telecommunication systems enable MSEs to have fair opportunities to produce and sell.

2 *Removing regulatory barriers.* These barriers make it too costly or too cumbersome for MSEs to grow their businesses. They include cost and time of formalization, legal structures to protect investors, the bureaucracy of labor policy and tax payments.

3 *Investing in human capital.* At the firm level, improved human capital and higher growth are correlated. Providing technical business services and assistance programs on the most basic capacity requirements, e.g. basic quality assurance standards and basic principles of accounting, strategy and marketing, is instrumental. As MSEs grow, more rigorous technical assistance becomes vital, especially to comply with procurement protocols of government or large corporates. Coordination between various government and non-governmental parties providing assistance programs is needed.

4 *Expanding access to finance:* Most of Egyptian MSEs rely on their own savings and private resources to grow their business, because they cannot access adequate capital. This makes MSEs capacity to meet demand (whether it's fulfilling their first large contract or expanding facilities to fit more customers) most often capped by capital constraints.

5 *Corporate supply chains:* Networks can play a pivotal role in enabling MSEs growth. Insertion within large corporate supply chains can help MSEs improve operational standards and reach scale through consistent cash flows. This is particularly true when revenues are derived from business-to-business sales. Networks can also help MSEs finding business partners, accessing capital, inputs, strategic information, widening their marketing potentials (whether in the domestic or foreign markets) and gaining other business opportunities. The role of local and international networks (ranging from chambers of commerce to investment facilitation organizations such as SFD) should be more effective in connecting entrepreneurs and make business opportunities more widely available. Business linkages should be one of the social performance metrics to be taken into consideration while deciding investment incentives.

Sustainable MSE development with targeted efforts would put Egypt on the trajectory towards booming, yet inclusive economic development. Level-playing field interventions are absolutely necessary to ensure equal opportunities to all firms, but it is not sufficient. It should be supported by more targeted efforts, since not all MSEs are innovative, efficient and free of strategic problems. So dealing with the MSE sector requires careful selection – cherry-pick and move cautiously. Efforts should target MSEs in *the growth driving sectors* in the economy, with the aim to increase productivity, create jobs and reduce poverty (World Bank, 2009). Also, targeting *clusters or communities where large groups of MSEs operate* makes the dissemination of new technologies, training, financial and technical support and production and marketing techniques easier and more

effective, especially when the cluster community is specialized in a certain production, like furniture in Damietta, textile in Mahalla, etc... Also, *established cash-positive firms and seasoned entrepreneurs* with a track record in the target sector or industry are worthy target as they are more likely to be able to navigate launching a new business or product.

It is worth mentioning that one common challenge in implementing successful labor market interventions is how to incorporate the workforce in the informal economy. Almost half of the Egyptian workers are in the informal sector (Assaad and Krafft, 2015). Most informal workers are not covered by social security schemes, occupational safety and health measures, working conditions regulations and have limited access to health services and work-related measures of social protection. Labor market interventions should work to integrate the different strategies to prevent and compensate occupational and social risks in the informal economy.

Should we have a new Ministry of MSEs? Clearly we need an entity to be responsible for creating a favorable environment for MSEs to thrive and to support the growth and employment goals of Egypt's five-year Economic and Social Development Plans; coordinating with various line ministries to ensure enforcement and implementation of plans, laws, decrees and regulations. Informal firms should be an integral part of the MSEs strategy, with adequate treatment that takes into consideration all their specific problems. Whether this necessarily means the creation of a new Ministry or Agency of MSEs, the answer is not definitive. The number of ministries is already large, and the creation of a new ministry may complicate further the administrative body of the government. Also, the Social Fund for Development has been assigned almost exactly the same roles by Law No 141 of 2004. So, changing the mandates of SFD and confine them to supporting MSEs may be a good idea. If SFD is not able to play effectively these roles, there is no guarantee that a new ministry will be so. Close

cooperation and coordination are integral to the success of MSEs strategy and of all policies.

3. Regional Integration³

Egypt's policies with respect to regional integration have been unbalanced. They have mostly been guided, historically, by spatially targeted instruments- for instance cash transfers for rural families in Upper Egypt, land allocation for industrial development, etc... Spatially blind measures (with universal coverage, like the regulation of the land market and housing market, taxation of land and real estate, provision of an equalization transfer to local governments, and functioning of cooperatives and land dispute resolution mechanisms) and spatially connective infrastructure (investment that facilitates the movements of goods and people) have been ignored and the unequal opportunities have not been addressed directly. Therefore, the main two pillars of the regional integration in an inclusive strategy are: equalizing opportunities in access to basic services and removing impediments to factor mobility.

3.1. Equalizing opportunities in access to basic services:

Public service provision in Egypt has not fostered regional integration because the resource allocation across different regions (i) has not been explicitly linked to results, (ii) has been primarily determined according to the population size, and (iii) has often been discretionary and politicized. To equalize opportunities, a combination of spatially blind institutions and a spatially targeted intervention are required. The first aims to act on the supply of basic services, while the second targets the demand.

Spatially blind institutions to promote inclusive development: Drawing on what other countries did to give all local governments a similar opportunity to provide a minimum level of public services, Egypt can use an equalization unconditional transfer, from the central government budget to the different governorate regardless of their ability to raise local taxes. As

³This section draws on the recommendations provided in World Bank, 2012.

previously mentioned, the allocation rule to use should be based on governorates' needs which in turn can be determined by poverty rates and gaps in opportunities. This would lead to increased public investment in social and physical infrastructure in rural areas particularly in Upper Egypt, supporting small-holder agriculture and family farming. This should be complemented by enhanced local governance in public spending, particularly in evaluation and monitoring. Also, better accountability of localities (*mahaleyat*) to its citizens and to central authorities overseeing the budget is necessary to ensure that the resource allocation and spending flexibility reduce poverty.

Spatially targeted policy to address the high density of poverty in specific Egyptian regions: This consists basically of using cash transfers, whether conditional (CCTs) or unconditional (CTs) to poor households in specific regions and areas. There are success stories of other countries that have successfully used CCTs to face regional justice gaps and had positive results in terms of nutrition, education, and health. The next section on the social protection scheme includes a more detailed discussion of this kind of interventions.

3.2. Removing impediments to factor mobility

Most of Egyptian poor are locked in lagging regions because of high costs of goods transport, barriers to labor mobility, dysfunctional markets for their land, and the limited availability of affordable housing in leading regions (urban areas).

(i) labor mobility: enabling households' consumption to catch up

Labor mobility in Egypt is low by international standards, and it has a limited role in equalizing incomes because of: (i) low education levels that impede labor mobility to different areas or to activities of higher productivity and income; (ii) high prevalence of subsistence agriculture, associated with low productivity and wages, which together tie down resources to home production, limiting the labor available for nonfarm

activities; and (iii) inefficient urban housing markets. These barriers can be overcome by promoting spatially blind institutions to enhance the productivity of small farmers, enabling their integration to markets to benefit from growth, and to improve the functioning of the housing market:

- *Enhancing the productivity of small farmers* includes contract farming, small farmer cooperatives, and rural productive alliances. Contract farming requires adequate land titling and functional mechanisms for dispute resolution. Land titling would provide not only tenure security but also a means of obtaining collateral for access to credit. Small farmers could also benefit from the capacity to collateralize mobile assets to obtain credit and build up the capital required to raise productivity.
- *Increasing the efficiency of the housing market* should start with unlocking the current stock of vacant housing (about 27% of all urban housing units). This requires reforming the property tax system and housing subsidies so that owners of vacant units would have incentives to release them to the market; and strengthening rental market registration and regulations, which includes streamlining tenant eviction procedures and accelerating rent decontrol.

(ii) Capital mobility: reinforcing market signals

For capital to be efficiently allocated, decisions should be made based on where capital is more productive. Unless market forces are in place, prevailed productivity signals will be misleading. This has been the case in many circumstances in Egypt. One striking example is public land management and allocation. The institutional landscape for public land management is complex and fragmented, with almost 45 laws and decrees that are directly and indirectly governing public land allocation. The problem is compounded by many differentiated, unclear, and seemingly arbitrary procedures related to public land allocation, pricing and development controls, the lack of a coherent public land information system, and the lack of clarity of which authorities control public land and

where this land is available. In addition, public land use is planned ineffectively, with no estimates of its opportunity cost.

- *Public land management reform can go along the following staged process⁴:*

In the short term: Rationalization of the existing institutional structure by consolidating and harmonizing the fragmented and incoherent laws and regulations. This would include issuing a short-term moratorium on further allocations of public land to sectoral authorities until an independent audit of their public land stock and management performance is completed, and creating two commissions responsible for formulating public land management policy and consolidating the fragmented legal framework.

In the medium term: Consolidation of the control over public land within a new independent agency that would play the role of custodian of public land, acting as a state land assets bank. The governing strategy, policies and regulations for public land management and allocation would be set by a higher policymaking body to ensure separation of functions, transparency, efficient allocation, consistency between central and local needs for public land, and balanced objectives of growth, environmental sustainability, and equity and social development.

In the long term: There would be a gradual shift toward a decentralized model for public land management, empowering governorates to manage and dispose of the public land stock that they need for growth and economic development within their jurisdiction. This decentralized approach, with central government oversight, is in line with global experience and best suited to ensure that land use planning and allocation decisions reflect local needs and priorities for delegated control of public land management and development of national spatial strategies.

⁴ This part draws on World Bank, 2006.

- *Overhaul of property registration and taxation systems.* These two systems have many dysfunctional aspects. Yet, current systems and associated institutions and attitudes are deep-rooted, and far-reaching reforms may not be possible. Therefore, gradual reforms to introduce new, modern registration and taxation systems seem more realistic. Thus, in the short term the property tax law should be issued and applied to the richest locations—industrial estates and houses in resorts, new settlements, and other areas of particular commercial and business potential. In the meantime, a new title-based property registry should be introduced. As both smooth property registration and taxation systems are up and running in priority areas, other areas, mainly older urban and rural areas, could be gradually added to the system.

(iii) Reduce the diseconomies of agglomeration

Egypt's relatively high growth rates during the last decade were associated with congestion, pollution, urban informality, and land use conflicts. These diseconomies of agglomeration and the social and economic costs they entail can be attributed to the lack of good institutional environment for pro-growth agglomeration, urbanization, and concentration of economic growth. Reducing these diseconomies of agglomeration, especially in Greater Cairo, should be as crucial element as reducing poverty in Upper Egypt in Egypt's inclusive growth strategy.

Traffic congestion accounts for most of the negative consequences of agglomeration. Congestion in Greater Cairo only was estimated to cost around 1.2 percent of Egypt's GDP (World Bank, 2006). This is the cost of time waste, inefficient use of gasoline, and the increasing informality. Excessive demand for road travel is the most important explanation of the congestion problem. Therefore, solutions should be on both sides: demand and supply.

To rationalize and reduce the demand on roads, measure include: (i) increase subsidized public transport, (ii) reduce gasoline subsidies,

(iii) enforce proper driving etiquette that reduces random stops and illegal parking and (iv) increase the price paid for road travel.

On the supply side, increasing and improving the quality of roads is required. This in turn requires increasing the effectiveness of public spending on road in reducing transport costs. Among the proposed measure in this respect are: (i) improved road design to reduce the maintenance costs, (ii) routine monitoring and evaluation of public spending and (iii) a proper project selection process guided by a technical cost-benefit analysis in which transport cost reduction is prioritized. In fact, the government included in the last five-year investment plan projects to improve the roads of Cairo-Assiut, Sohag–Red Sea and the Cairo Ring Road. Also, in 2014 the national road network project was inaugurated. The project is estimated to save LE500 million/day in the timing cost of trips, and the regional ring road project would connect 20 governorates. This is a very ambitious project that targets to add 3,300 kms to Egypt's roads. Even if cost-benefit analysis shows the projects as having a positive net present value and can thus be funded, resource availability in Egypt is a binding constraint. Therefore, the ranking of the different sub-projects/phases is important. Equally important is making the cost-benefit analysis of the selected projects available, at least for specialists. This transparent process guarantees the buy in of a wider circle of experts, which is a corner step in getting the needed public support.

Containing the proliferation of urban informal settlements. One another challenge from growing density is the spread of slum areas, which are mainly due to the reluctance of the government to offer affordable housing. In the short and medium runs, the recognition of informality needs to be incorporated into urban policies. Specifically, informal settlements need to be upgraded for infrastructure, public services, and the environment, and they need to be better integrated into metropolitan transport and economic networks. Given that the large population in the Egyptian cities is younger

than the average, it is imperative to improve basic services, especially education and health, in these areas to ensure fair opportunities for their youth when they enter the labor market. Further, mobility of capital, goods, and especially labor between these areas and other parts of the metropolis must be warranted through integrated planning. A program for comprehensive upgrading of Greater Cairo's informal settlements was drafted in 2012. The total investment cost of implementing this strategy was estimated at between LE 16.2 billion (\$2.7 billion) and LE 19.8 billion (\$3.3 billion) in 2010 prices. If projected over 10 years, annual investments would amount to roughly \$300 million or only about 6% of annual Suez Canal revenues (World Bank 2012)

Better integration of the new towns around Cairo into the rest of the metropolis to ensure the most productive uses of both capital and labor. This requires the installation of rapid public transport, more realistic planning and building standards in the new towns, market price based land allocation policies, and complete avoidance of concessionary land allocation- except for justified social benefits. These recommendations are also valid for the new administrative and financial capital proposed in the recent economic conference of Sharm El-Sheikh. There should be geographical connectivity of this city and its five million inhabitants and the remaining part of the country. It may also represent an opportunity to develop social housing, including sites and services systems, small MSE industrial clusters, a range of public services, and commercial hubs built around transport nodes in the circle surrounding the new capital.

4. Social Protection

Effective policies to redress poverty, inequality and lack of opportunity are an urgent imperative. While building long-term structural policies is vital to ensure sustainable inclusive growth, the government of Egypt's commitment to equity requires faster results to address urgent social needs.

This can be done through social protection measures, especially the programs that have short-term but high impact.

Social protection comprises policies and programs designed to reduce poverty and vulnerability by promoting efficient labor markets, diminishing people's exposure to risks, and enhancing their capacity to manage economic and social risks, such as unemployment, exclusion, sickness, disability and old age (World Bank, 2001). The ILO has set out three main objectives that reflect the three main types of social protection:

1. Extending the coverage and effectiveness of social security schemes
2. Promoting labor protection, which comprises decent conditions of work, including wages, working time and occupational safety and health, essential components of decent work.
3. Working through dedicated programs and activities to protect such vulnerable groups as migrant workers and their families; and workers in the informal economy. Moreover, the world of work's full potential will be used to respond to the AIDS pandemic, focusing on enhancing tripartite constituents' capacity.

(i) Promoting labor protection

To promote the quality of jobs and equality in work, balanced labor market reforms are needed to both facilitate enterprises' adjustment to economic conditions (right of hire and fire) and ensure adequate workers' protection. These reforms, which should be introduced after a comprehensive social dialogue, include measures to strengthen labor unions functions to ensure the effectiveness of collective bargaining institutions. Such balance can only be achieved through tripartite social dialogue (the government, the business sector, and the workers).

With respect to wages, the government setting of minimum wage for government employees at level 30% higher than the then actual minimum wage has contributed to improving wages of this group of employees. Also, setting a maximum wage for government employees has widened the gap

between this sector's employees, though sometimes at the expense of risking losing skilled qualified staff. Yet, disparities among employees in the private sector, especially in the informal part of it, were not affected, so was the number of low-wage workers. Applying a minimum wage policy to the private sector employees, if designed carefully and contains supportive adjustment measures, would boost workers' productivity and income and improve long-term job prospects without adversely affecting businesses. Setting the level of minimum wage needs to be determined after assessing the likely impact of increases in minimum wage on employment growth and real GDP growth. There might be a scheme of different levels of minimum wage (and maximum wage) for different economic sectors. Also, there is a need to restore the link between wages and productivity, requiring strong social partners and effective collective bargaining institutions.

To promote safe and healthy working conditions, there should be measures of protection of occupational safety and health (OSH). This needs resources that might seem unduly cost burden, especially at difficult economic times like what Egypt is currently facing. But, this is nothing but false "cost", because occupational accidents and diseases have very high economic costs compared to the spending "cost" on OSH. There is, rather, a need to strengthen labor inspection and ensure it is effective in order to achieve safe working conditions and address the increased risk of undeclared work. This drives us back to the importance of building the capacity of the Ministry of Labor/Employment and Migration mentioned earlier.

(ii) Social Insurance

Egypt's social insurance system covers around 25 million members and is administered by the National Organization for Social Insurance (NOSI) through two separate funds – one covers the government employees (civil servants and military and police forces) and the other covers workers in the public and private enterprises, self-employed, casual workers and

Egyptians working abroad. The two funds have been confronting various challenges that threaten their sustainability. Some of the challenges are exogenous to the system, like the increase in life expectancy which places significant strain on the pension system. But, most of the challenges are embedded in the system design.

On top of these challenges come the following:

- 1) The high cost of the social contributions: Employees contribute 14% of base earnings and 11% of variable earnings⁵, employers contribute 26% of base earnings and 24% of variable earnings⁶, and the government contributes 1% of earnings plus the cost of any actuarial deficit. The cost to the government of financing the actuarial deficit alone was 1.5% of GDP in FY14 and FY15, and is expected to reach around 2.5 per cent of GDP by 2027.
- 2) The maximum monthly earnings for contribution purposes are capped at EGP 1,120 for basic earning and EGP 1830 for variable earning.
- 3) Benefits are calculated according to the salary in the five years preceding retirement for workers in the private sector, or the two years preceding retirement for civil servants and public-sector employees. The final salary scheme creates an incentive for workers in the private sector to under-report salaries to reduce contributions until just before retirement when employers start to report higher salaries to increase the benefits.
- 4) Large sectors of the population have limited or no coverage – the informal sector is currently estimated to be around 40% of the labor force. Moreover, in spite of annual increases of at least 10%- and sometimes reaching 30%, benefits for those who are covered are considered inadequate and have failed to keep pace with inflation. Meanwhile,

⁵ 1% of earnings in each case are for health insurance, making the contribution for pension purposes 13% and 10%, respectively.

⁶ These rates include 4% of the earnings for health insurance, 3% for work injury insurance and 2% for unemployment insurance; leaving 17% and 15% for pension insurance in the case of base earnings and variable earnings, respectively.

increases in the pension benefits outweighed the present value of the contribution paid by pensioners.

In response to these challenges, a new pension law (Law No. 135 of 2010) was issued to be fully into force in January 2012. Law No. 135, as announced, aimed to overcome the actuarial problems implied in the Law No. 79 for 1975 by improving compliance, addressing the demographic challenge, encouraging individual savings, ensuring efficient asset management and more importantly carrying various positive social aspects. Law 135 was however abolished in 2013 because it was seen to be a saving rather than insurance system, favoring employers rather than employees and concealing the government debt due to the social insurance funds (estimated at between EGP 460 and 600 billion). Only the article concerning the increase of the pensions lower than the amount of social solidarity assistance was taken and added into law 79 for 1975 by law 79 for 2013. This must have increased the fiscal burden, leaving all other problems with no solution.

Egypt's social insurance system hence continues to face structural shortage in funding, with the increasing borrowing of the central government, and low nominal rates of return (Nassar and El- Laithy, 2004). With the increase in life expectancy rates and the limited investment alternatives of the trust funds, the financial situation of this system is not sustainable in the medium term. Therefore, a new law that fosters a social insurance system that strikes a balance between fiscal budget sustainability and the protection of workers against expected and unexpected risks associated with unemployment, poor health, disability, work injury and old age, actuarial viability is crucially needed.

(iii) Social Assistance (Social Safety Nets)

Egypt's social safety nets (SSNs) programs are highly fragmented and do not provide adequate protection to the poor. Egypt's SSNs rely heavily on fuel and food subsidies, leaving relatively marginal funding for non-

subsidy SSN programs (at 0.2 percent of GDP). Furthermore, both subsidy systems are very poorly targeted: the richest 20% of Egyptian households receive 36% of total energy subsidies, and 73% of non-poor Egyptian households have access to food ration cards. In 2010, leakages in the food subsidy system were estimated at 29% (World Bank, 2010). Nevertheless, food subsidies have played an important role in protecting the poor from the impact of high food prices, and without them more 9% of the population would have fallen in poverty.

Major improvement in the food subsidy system's leakages has been achieved by the introduction of modern technology (smart cards) and point system, thereby reducing waste. There is still yet a need to limit the coverage of the food subsidy system to a narrower segment of the population, i.e. to target following specific criteria. The new system needs also a good M&E to fix any weakness as it proceeds.

Another major improvement was in the design of non-subsidy/cash SSNs directed to the poor. The government has recently launched two new programs in a number of Upper Egypt governorates. The first program-named "Takafol" (Solidarity)- targets the poor households with children in schools, and provides the necessary income to support the demand for basic services, such as education and nutrition, to enhance the portable (human) assets of the children generation, breaking thus the inter-generational poverty circle. The second program- named Karama (Dignity)- targets elderly and disabled and is therefore unconditional. A good monitoring and evaluation system is crucial to ensure the cost effectiveness of these programs, its fiscal sustainability, and its scalability at the national level.

The consolidation of all types of SSNs extended to Egyptians together with other subsidized public services in one coherent and consistent social services framework is needed. Modern information and technology should help the government and citizens recognizing how much every Egyptian

citizen/household receive from the government. This information could serve identifying how equitable is public spending.

III- A New Approach of Dealing with macroeconomic policies

Historically, macroeconomic policy policies have both stabilization and development roles. Yet, between the early 1980s and until recently, the macroeconomic policy paradigm dominating the scene had been emphasizing only stability and the avoidance of shocks. The importance of macroeconomic stability is unquestionable. Shocks and variability damage poor people who are less able to adjust to downturns (Bird et al., 2010). However, when conventional macroeconomics sees stability as an end in itself (e.g. keeping inflation at a very low single-digit level, achieving a primary budget surplus or a very low deficit-to-GDP ratio, a debt to GDP ratio of 40% or less, and foreign exchange reserves that can meet at least three months of import coverage) regardless of the likely effects on diverse socioeconomic groups (e.g. income, gender, spatial, and generational groups), it in fact narrows the conceptualization of economic stability (Islam and Kusera, 2014). Instead of engendering ‘market confidence’ that is key to fostering investment, growth, employment and poverty reduction- as argued by international institutions, adopting this narrow approach of macroeconomic policies- called “stability first”- has often been at the cost of growth and equity, especially in developing countries (UN-ESCAP, 2013).

This has led to a paradigm shift in the thinking of managing macroeconomic policies from focusing on macroeconomic stability to judge the success of macroeconomic policies, and then try to mitigate- if possible- the social consequences, to a policy-making process that founds macroeconomic policies on how they serve the wellbeing of individuals and families (Atkinson, 2013). The new approach in pursuing macroeconomic policy is called “forward-looking” or “stability plus”.

Forward-looking macroeconomic policy approach focuses not just on smoothing peaks and troughs and on return to growth, but also on enabling equitable initial distribution and subsequent redistribution of the benefits from growth to the largest part of the population, especially the poor and vulnerable (Harris et al. 2005). It also supports the arguments that unregulated market liberalization will not necessarily yield optimal economic outcomes, that safeguards and appropriate regulations are indispensable and that active monetary policy and fiscal stimulus can help ensure economic wellbeing for all citizens (Bird et al., 2010). Accordingly, “soundness” of macroeconomic policies would be judged not on market-based (i.e. efficiency) criteria per se, but also in terms of whether they ultimately succeed in bringing societies closer to achieving justice.

The question now is how to adopt this new “stability plus” approach in the case of Egypt? In order to answer this question, two key issues are discussed in this section: (1) how to integrate Egypt’s macroeconomic policy and inclusive growth strategy in a consistent framework and (2) the main policy measures to turn the “stability plus” approach into regular practice, taking into consideration all the challenges the Egyptian economy faces.

1. Consistent Framework of IG Strategy and Macroeconomic Policies

The macroeconomic framework and IG strategy objectives need to be explicitly integrated at the conceptual stage. This cannot be done by simply adding policies that facilitate distribution of income, assets, and well-being to a pre-designed sound macroeconomic framework. It rather requires a full understanding of the tradeoffs and of both the short and long-term impacts of macroeconomic policies on social outcomes and vice versa. This understanding cannot be achieved without an interdisciplinary approach that draws on economic, social, political and institutional analysis (Harris

et al. 2005) to identify the links and transmission mechanisms between macroeconomic policies, inclusive growth, and wellbeing.

The proposed conceptual framework should ensure consistency between the objectives of IG and macroeconomic policies, through iterative processes. The first step is to articulate the *IG strategy* (i.e., specify objectives, sectors and policies), as illustrated in the IG section, and develop an action plan taking into consideration *priority measures* regarding governance, structural reform, and any other pertinent areas. The second step is to estimate the *full costing* of each of the measures included in the IG strategy. Here comes the need for an assessment of the government's spending program with regard to priority spending, and of domestic and external sources of budget finance. This includes *impact assessment analysis* of any foreseen reforms and changes in spending and revenue items, as well as in financing the deficit on the objectives of the IG strategy. Preserving adequate availability of credit to the private sector in support of private sector development should be taken into consideration to ensure macroeconomic stability and increase prospects for sustained growth.

Usually, the estimated financing of the IG policies exceeds available resources. In this case, the intermediate objectives of the IG strategy should be revisited and priorities should be reexamined. This process is repeated as many times as needed until available resources cover all financing needs of the IG strategy. There is usually some space for flexibility in setting short-term macroeconomic targets. In brief, macroeconomic stability as objective should not be the only focus of macroeconomic policies; nonetheless it should not be compromised, as the alternative may be worse. *An informed public debate would ensure effective allocation of public resources.* The preparation of scenarios of aggregate spending could help revealing trade-offs between different macroeconomic, fiscal and social policy options. This would better inform the public dialogue about the

allocation of resources. The expertise of the members of the people's assembly, responsible for scrutinizing plans and budgets, should be built to assume this responsibility with good understanding of trade-offs. Resuming the publishing of the citizen budget, initiating the Pre-Budget Statement publication and the wide distribution of Egypt's Five-Year Macroeconomic Strategy Note (Strat-EGY) during Egypt's Economic Development Conference are all commended initiatives by the Ministry of Finance that give Egyptians an idea about the budget revenues and spending, fostering transparency and encouraging the public to debate allocation of public resources and participate in the decision making. To make the outcome more effective, it is recommended to prepare the citizen budget at the governorate level, and the communication channels between the Ministry and Egyptians work in a two-way fashion to better inform citizens about what they should expect and demand.

To better translate macro-fiscal objectives and constraints into broad budget aggregates and detailed expenditure plans, a Medium-Term Expenditure Framework (MTEF) is needed. MTEF is currently implemented, but partially and only in the education and health sectors. MTEF allows not only the determination of the level and composition of public expenditure given emerging needs, but also the restructuring of spending to best serve established policy objectives (World Bank, 2013). Traditional annual budgeting, which is currently in place in Egypt, often falls short of meeting all these advantages.

To ensure that macroeconomic policies reach their full potential contribution to social justice through stability and inclusive growth, there are two essential conditions: sustainability and effectiveness of macroeconomic policies. Enhancing the sustainability of policy implementation requires policymakers to pay more attention to the timing of introducing new macroeconomic measures, redesigning existing policies, and using complementary measures to attenuate unintended

adverse impacts on particular groups (Harris et al. 2005). This, in turn, requires a good understanding of the impact of transmission mechanisms on these groups. The overall effectiveness of macroeconomic policies requires (i) an effective legal and regulatory framework, well-functioning markets, contract enforcement, and transparent, accountable governance; and (ii) efficient administrative body responsible for the formulation and implementation of various macroeconomic policies, and the quality of the management of public resources. This accentuates the crucial need for institutional and technical capacity building.

2. Linking the macroeconomic policies and social objectives in Egypt

In light of the huge developmental challenges Egypt faces, there is clearly a need to rethink the focus of our macroeconomic policies. There should be a shift toward balancing stability and social justice objectives of macroeconomic policies. Such balance entails changing the way fiscal, monetary and exchange rate policies are viewed, designed and implemented. In the following we will discuss examples of how some of the most critical macroeconomic policy measures that can make a significant shift to this new approach of “stability plus” macroeconomic policies.

2.1. Fiscal Policy

There are some signs that Egypt’s fiscal policy started to care more about social aspects of fiscal measures. For instance, the increase in public spending on health, education and R&D, the prioritization of investment spending on infrastructural projects (such as low income housing, public transport and roads), the introduction of more effective targeting mechanisms, the gradual reform of subsidies from in-kind to semi-cash and cash transfers. However, these efforts are still fragmented and need to be put in a broader framework that includes all fiscal measure in a consistent manner.

Egypt's public finances need cautious management to better influence inclusive growth. The fiscal deficit continues to be large- estimated at 10% of GDP in FY15⁷, in spite of its decline since FY14. The gross public debt reached almost 93% of GDP by end of FY14 up from 76% of GDP in FY10. Unless the deficit, translated into borrowing, is spent fairly across various socioeconomic groups (including regional) on enhancing human, physical or social capital that improves, productivity and hence inclusive growth, these high levels of fiscal deficit and public debt become really worrying. Spending borrowed resources without producing social and economic yields in the future, means that a generation decided to transfer the burden of its difficult public finance stance to the following generations, breaching thereby intergenerational justice. There is, therefore, a need to examine the debt-growth relationship to know Egypt's debt tolerance levels beyond which long-term growth and consequently employment might be harmed. Also, the government may consider to prepare an intergenerational report every four years (at the end of each presidency term) to evaluate the impact of its policies on long-term sustainability⁸, including the major demographic changes and their implications for fiscal and budgetary policies.

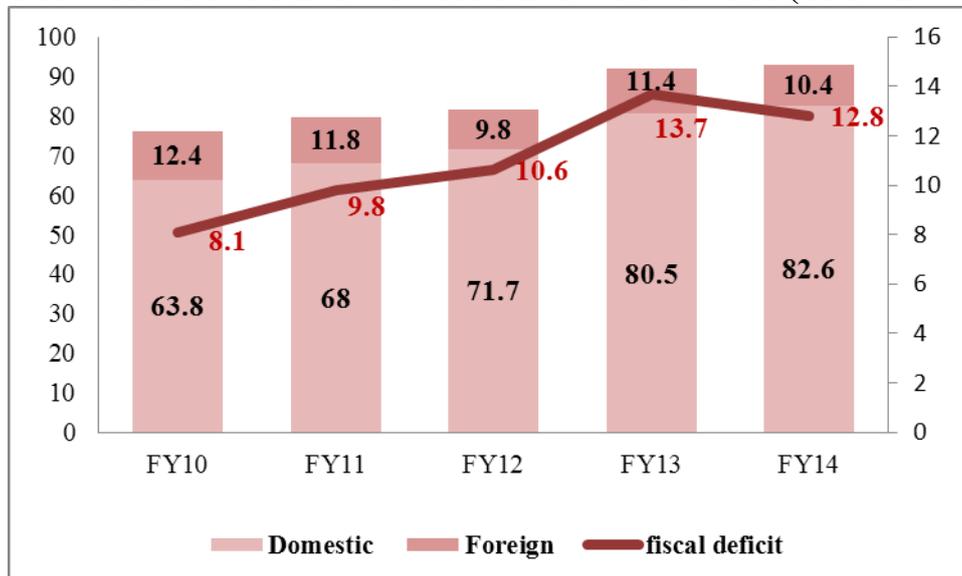
The composition of public spending in Egypt has been predominated by compulsory current expenditure items. Almost 80% of total public spending goes to wages, subsidies and social benefits and interest payments, which have more or less equal shares. These items have been considered as being compulsory, with a very little space for fiscal adjustments. Wage benefits go to more than six million government

7 This is the estimate in the Financial Statement of the Ministry of Finance. However, as per officials' announcements, the Ministry expects actual deficit outturns to be higher than budgeted due to previously unplanned spending and postponed measures on the revenue side (such as the VAT).

8 Australia initiated the preparation of such report following The Charter of Budget Honesty Act 1998. Accordingly, a report is produced every 5 years to evaluate the government policies sustainability over 40 years.

employees, securing them high probability of remaining out of the poverty. Poverty rate among government employees is one-half (13%) of the national rate (26.3%). The size of civil service in Egypt is too big, and many of employees are underemployed. This results in inefficient bureaucratic public administration that hampers growth, and unfair distribution of income since underemployed get rewards that exceed their contribution in the production process. In our opinion, a part of the wage bill can be considered as cash transfers, i.e. income redistribution rather than distribution. Sharing these pieces of information with the public would

Figure 3: Fiscal deficit and Domestic and Public Debt (% of GDP)



raise awareness about who has the right to claim for wage increases and who has not. To control the wage bill, the government restricted new hiring through official channels in 2014/2015, and announced the freezing of allowances and bonuses during 2015/2016. The recently issued new civil service law serves to reform Egypt's civil, but only very gradually.

A medium-term fuel subsidy phasing out plan should be articulated. Subsidies constitute almost 88% on average of the line of “subsidies, grants, and social benefits” over the last five fiscal years. Around 70% of the subsidy bill goes to fuel subsidy that was proved to be not only distortive to market signals, but also a very regressive spending, benefiting more the well-off. A phased reduction of fuel subsidies started in July 2014. Prices were increased by 40%-80% for fuel products and 20% for electricity, saving EGP 44 billion (USD 6.2 billion). In October 2014, fertilizer (energy intensive product) subsidy was also reduced. Because of fall in fuel international prices, the fuel subsidy bill is estimated to fall from around 6% of GDP on average during the last years to 2.1% only in 2015/2016 budget. This might be a good occasion to resume the system’s reform, as the needed incremental increases to reach the cost recovery over a certain period (say, 3 to 5 years) will be relatively small.

The food subsidy system has been overhauled during the last year, requiring an assessment of its social impact. The new systems of ration cards and baladi bread have become quasi cash transfer system. Households carrying ration cards are currently entitled to purchase the equivalent of EGP15/family member/month of their choice between more than 60 commodities (to reach 100 items in a year). Various new measures were introduced to incentivize beneficiaries not to let leak their entitled subsidies. The system yet needs to be assessed to quantify the savings, benefits and leakages and to draw lessons for reforms of other subsidies, like bottled gas system, for instance.

Cash transfer programs are expanding and are better targeting the poor, but they need to expand further. The Ministry of Social Solidarity increased the social solidarity pension by 50% in mid early 2014 and has just adopted a targeting methodology⁹ that has become increasingly popular in developing countries. Consequently, for the first time an objective targeting

⁹ Known as Proxy Means Test (PMT).

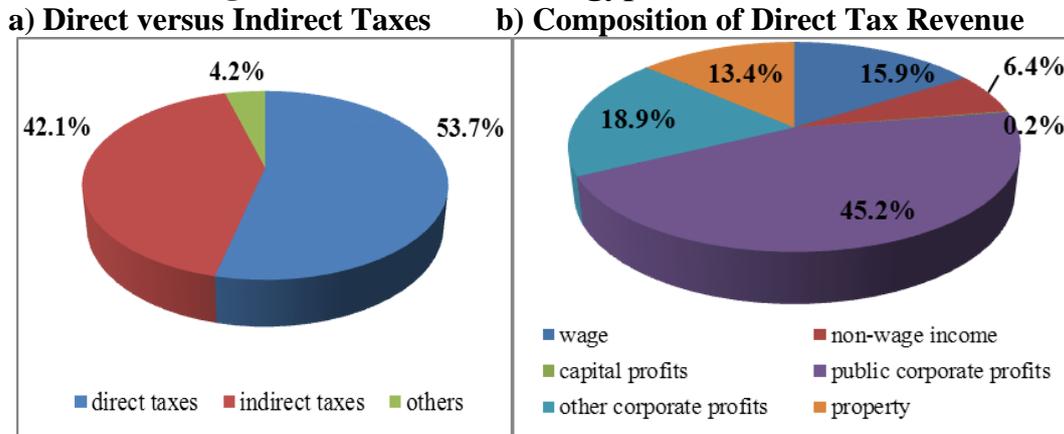
mechanism is being applied in the two new programs “Takafol” and “Karama”. Allocated resources for cash transfer programs increased accordingly from EGP 3.8 billion in FY2013 (0.2% of GDP) to more than EGP 11 billion in FY16 (0.5% of GDP).¹⁰ The new programs cover poor households with children, elderly or disabled. They have covered until now a few hundred thousand households. Expanding further cash transfers is needed, whether in terms of the number of beneficiaries under the existing programs, or in terms of new programs which target other different types of poor households. This requires an assessment of the ability to sustain the scaled up programs through domestic resources. Also, there is a need to evaluate the strengths and weaknesses of the new targeting methodology, in terms of its accuracy, objectivity, transparency and ease of implementation. We should aim to use one unified targeting mechanism in all targeted programs across the country, be it used by government or non-government actors in the social protection area. This should be accompanied by providing all the needed support to the efforts seeking to build a national unified registry database that can serve in targeting all kinds of public programs, monitoring the benefits received by households from various sources, minimizing thus the under-coverage and inclusion errors.

Public spending decrease should be associated with raising those revenues which have positive social justice impact. In principle, reducing the fiscal budget can be achieved in various ways, i.e. reducing expenditure, raising revenue, or some combination of the two. However, the social consequences of each choice are different. As discussed earlier, adjustment of different expenditure items probably have a differential impact on social outcomes. For example, reducing current spending in primary education will have different social impact from that of an equivalent cut in spending on tertiary level (Harris et al. 2005). Similarly, changes in different taxes have different direct and indirect distributional consequences. For example,

¹⁰All the figures are from the Financial Statement of the MOF for 2014/2015 budget.

the social impact of increasing sales tax is different from increasing property tax. Furthermore, a change in both revenues and expenditures can serve as dynamic equitable redistribution means. For example, an increase in taxation on rich can fund an increase public investment in human capital that benefits disproportionately poor people, enabling thus a pro-poor distribution of growth.

There is a social need to increase the progressivity of Egypt's tax structure. Revenues from indirect taxes in Egypt counts for more than 40% of total tax revenue. There is evidence that indirect taxes are less progressive than direct tax system (Decoster, 2010). The major reason is that direct taxes are often stepped up through the income brackets, while indirect taxes are not. Also, within direct tax revenue, corporate tax revenue from private sector profits accounts for almost 19% in FY2014, while that from public sector profits accounts for 45%. This is in spite of the fact that the private sector contributes with around 70% of GDP. Also, the share of income tax on wages is quite close from that of private sector corporate tax revenue, in spite of a large gap between their shares in GDP. Progressivity of the tax system does not necessarily mean an increase in the tax rates, but more importantly the elimination of tax avoidance and evasion to widen the tax base to include all who must pay taxes for their revenues. Finally, the effective application of the property tax law will contribute significantly in ensuring more social justice oriented tax scheme, especially that 50% of tax receipts will go to slums and municipalities development.

Figure 4 : Structure of Egypt's Tax Revenue

Recently, the government backed away from a host of tax-raising measures, putting doubt on its commitment to the social justice agenda. In July 2014, a host of tax-raising measures was announced, including a temporary 5% rise in the top rate of corporate and individual income tax. This was however abolished by the announcement of declining the ceiling on income taxes from 25% to 22.5% during Egypt Economic Development Conference in March 2015¹¹. Two months later, the government suspended for two years a 10% capital gains tax introduced a year earlier, seemingly responding to investor pressure. Whether these cuts in the tax rates will increase Egypt's competitiveness and spur investment is not certain, because there are many other problems in the investment climate and business environment of Egypt that weigh much more than just tax rates. But, there is certainly skepticism about how committed the Egyptian government to social justice, i.e. how much the government can do to ensure that the well-off bear the larger cost of needed reforms.

¹¹ The measure entails the increase of the tax ceiling applied on Free Zones's companies from 10% to 22.5%. But, one would wonder why the streamlining of the ceiling tax rate should be at a lower level.

Unfortunately, it is unlikely to see any legislative changes in the income tax rates¹², at least during the next couple of years.

The government should broaden the tax base and resolve the tax administration shortcomings. Taxing well-off groups helps redistribute wealth and promote greater equity and more justice. New property tax and mining taxation law are two options for the government to confirm some commitment to social justice. It should try to apply swiftly the tax property in the new cities and resorts, sending one positive signal to the population eager for social justice. Also, the tax administration should be bolstered to contain tax evasion and fraud. This can be achieved mainly through the integration of the income tax and sales tax departments, automation of a large part of the system, establishment of medium and small taxpayer offices in all governorates, and improvement of tax compliance and control systems. This, together with simplified tax regime for MSEs (simple lump-sum tax), can help with gradually modernizing these firms, especially the informal ones. The main purpose of including them in the tax system is not to raise revenue, at least in the short and medium terms, it should rather be to observe these firms and support them to get upgraded, modernized and abiding by the basic production standards.

Some caution is needed while shifting to reliance on Value Added Tax (VAT). The Egyptian government was planning to replace the current sales tax with a full-fledge VAT in last spring. This did not happen for various reasons. Anyway, once VAT is implemented, a significant increase in revenue is expected since it is easier to implement and to ensure compliance. However, the VAT can be regressive if it is extended to items consumed by the poor. Therefore, it is recommended to use exemptions,

¹² Egypt currently imposes individual income tax at a rate of 10% for personal income of between EGP12,000 (USD1,741) and EGP30,000, at a rate of 15% for those earning between EGP30,000 and EGP45,000, at a rate of 20% for income of between EGP45,000 and EGP250,000, and at a rate of 25% for income in excess of EGP250,000.

zero ratings, or lower tax rates for the items used by the poor. Also, the government can benefit from the increase in VAT revenues to make it more progressive. This can include lowering income tax rates for low income Egyptians, giving them more disposable income to spend on goods and services, which will be more expensive because of the VAT; and increasing spending on investment in poor people's human capital, through targeted investments in health and education, and in infrastructure which help poor people make use of their assets, as well as on transfers and subsidies for those who are left behind by the market forces. Such expenditures are vital to inclusive growth, as they build poor people's effective capabilities for employment and entrepreneurship (Bird et al., 2010).

2.2. Monetary policy:

Inflation targets should not be determined independently by technocrats, because without jobs and income, there is no economic and social benefit from price stability. It is widely agreed that high and fluctuating inflation does damage the poor more than the rich and can undermine economic performance, and that it should thus be kept to relatively low levels. There are yet different views on what is a reasonable level of inflation¹³ and how rapidly inflation should be reduced toward the target rate (Harris et al. 2005). But, policy makers may do more damage than they realize if they strive to curb inflation, as the economy may be driven to a "stabilization trap" (Chowdhury, 2003). For example, tight monetary policy may increase real interest rates, and thus the real cost of borrowing, consuming and producing to levels that can impede growth and employment through a self-reinforcing downward spiral of prices and profits. This hurts the poor more than any other group. Therefore, there should be clear understanding of the

¹³ Many studies bring evidence that the threshold level beyond which inflation harms growth ranges between 5% and 18% given the level of development in a specific country. The threshold is usually higher in countries at an early stage of development. For example, the Republic of Korea was growing by 8% in the 1960s and 1970s while inflation rates were at double-digit levels. Similarly, Indonesia was growing by 7.7% in the 1970s while the inflation rate was above 17% (Chowdhury, 2013).

inflation-growth relationship and accurate estimates of the relative elasticities of real wage and employment to infer the net effect of inflation on poverty. This means that the decision on inflation targets should be taken by government-wide and democratic decision-making in consistence with the IG strategy's objectives, leaving to the monetary specialists the articulation of the means (Mckinley, 2004).

The differential impact of anti-inflation policies across socio-economic groups should also be taken into consideration. For example, because women have already scarce assets, high interest rates diminish their access to credit for production and household emergencies more than for men. Also, as small and medium-sized enterprises are the hardest hit by high interest rates and overall economic slowdowns, women workers may be more likely to fall victim to unemployment because they predominate in these firms. Women also are often laid off before men in both public and private downsizing (Harris et al. 2005).

Promoting access to finance and financial inclusion will reduce poverty and inequality. Access to finance of MSEs, as well as of agriculture, is critical. Lack of access to finance can lead to poverty traps and inequality. Also, providing individuals with access to savings instruments increases savings, productive investment, consumption and female empowerment. The government should therefore consider the following:

- i. encourage the commercial banking sector to come up with schemes that appropriately target the rural poor;
- ii. enhance rural banking and develop an innovative tailor-made financial products and services intermediation mechanism for the poor;
- iii. ensure that credit does not feed speculative activities, especially in the capital market, and does not generate property bubbles;
- iv. create a deliberate policy platform to enhance the relation between formal and informal financial institutions without jeopardizing the existence and the role of the informal institutions;

2.3. Exchange Rate Policy

The relative rigidity of the Egyptian pound exchange rate and its misalignment can affect negatively pro-poor growth. The Egyptian pound has been under pressures since early 2011. As usual, the Central Bank of Egypt (CBE) tends to first supply enough amounts of foreign currency to defend the national currency value. When international reserves are depleted and reach the minimum required level (like the equivalent of 3 months of merchandise imports), the CBE administers a devaluation of the Egyptian pound. Such devaluation is often perceived as shocking, especially to consumers. The prices of almost all goods and services increase significantly, though the pass-through effect of the exchange rate changes to domestic prices was proved to be moderate (Al-Shawarby and Selim, 2013). As expected, this harms consumers and producers, especially the poor and vulnerable.

More flexible moves of the exchange rate would smooth price increases and may result in less negative effects on the poor. Although there is no concise policy recommendation with respect to poverty-reducing exchange rate regimes, there is evidence that intermediate regimes have at least non negative and possibly positive effects on the poorest 40% in developing countries (Reinhart and Rogoff, 2003). Also, the negative relationship between exchange rate misalignment and growth is confirmed (Sawada and Yotopoulos, 2006). This means that inclusive growth, which takes into consideration the interests of the poor and vulnerable, should be accompanied with a macroeconomic policy that keeps exchange rate stability at around the market level, ensuring thus availability of foreign currencies that matches the demand. Otherwise, producers' ability to pay suppliers is crimped, bringing down production and employment and damaging rather than helping individuals' wellbeing. This is what has happened during the last months in Egypt.

IV- Conclusion

In sum, in order for Egypt to achieve more economic-justice oriented development, there is a need for a comprehensive integrated approach that balances efficiency and equity, achieving economic justice. We proposed an economic policy framework that is founded on two main pillars (i) inclusive growth strategy and (ii) a "stability plus" approach of macroeconomic policies. Egypt's growth strategy should focus on creating more better jobs across all regions in the country, while protecting poor and vulnerable who will be left behind during the process. As to macroeconomic policies, they should focus on sustainable and inclusive development, while keeping inflation and public debt tolerable and the balance of payments sustainable. The fiscal policy should give priority to large scale public investment in both physical and social infrastructures to reduce poverty.

It should be noted that none of these elements is a panacea on its own. They are inter-related. Their success to achieve economic justice requires, thus, concerted action and transformational policies that go well beyond "business as usual" practices, and a good prioritization and coordination between medium and long-term policies and short-term high-impact initiatives. Egypt's problems, including those related to social justice, are deeply rooted and the solution will come with a comprehensive treatment that includes all the above mentioned areas among other areas, like the appropriate institutional infrastructure, including good governance. A 'new Egypt' cannot be realized unless a "new thinking" and "new behavior" from both sides- the government and the public- are there.

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