



POLICY BRIEF # 4

Social Security for All Employees

Employees working in the government and the public enterprise sectors are socially insured. However, about 30% of private sector enterprises do not pay contributions for their employees at all or restrict their payments to some of them only and 40% of private sector employers and employees contribute a percentage of official salaries far below their actual wages. This lack of social insurance and other non-wage benefits in the private sector are part of the reason people still seek government jobs and the security associated with them.

The Egypt Human Development Report 2005 proposes a major new initiative that will redirect the flow of young job seekers from government employment to employment in the private productive enterprises, and whereby the government would shoulder part of the contributions paid by employers as social insurance. The primary targets are Small and Medium Enterprises (SMEs) — since they absorb over eight million workers (a third of the labor force), and youth (under 30 years of age) — in order to induce them to be productive, formalized and reap social security benefits later on.

I. The Present System

In common with many systems applied elsewhere, the social insurance system applied in Egypt can be characterized according to the method of funding, the way pensions are determined, and the entity responsible for administering the funds.

Egypt's social insurance system was changed substantially following the July 1952 revolution to become a widely stratified and universal system as a fully funded scheme¹ whereby contributions are collected from employees, deposited in a pension fund, invested, and finally used to pay pensions. However, the system is now only partially funded since it is increasingly dependent on financial support from the Treasury in fulfilling its pension obligations. Determining the

value of pensions is based on defined benefits, meaning that pensions represent a certain percentage of the average monthly salary an employee earns during a certain number of years of his/her service (in Egypt, this is represented by the last two years of employment).

The system in Egypt is entirely state-run, controlled and administered by the National Authority of Insurance and Pensions (EHDR, 1997-1998) in cooperation with the National Authority of Social Insurance, which are both affiliated with the Ministry of Insurance and Social Affairs (MISA) through two funds:

- The Government Sector Fund (GSF) which deals with civil servants and government authorities employees, and
- The Public and Private Business Sector Fund (PPBSF) which deals with all other categories of the population (e.g. public and private sector employees, employers and self-employed persons, and nationals working abroad)

II. Rationale for Public/Private Shared Social Insurance Cost

The EHDR program is conceptualized on the premise that a key deterrent to formal job creation in the private SME sector is the high cost of insuring workers — whether to employer or employee. The employer's contribution to the social security of workers is calculated on basic and variable wages or salary. Rates in Egypt are very high (between 14% and 26%) compared to Tunisia (7.37%), Lebanon (8.5%), South Africa (none) or the US (6.2%). Employer contributions represent 26% of the basic salary and 15% of the variable salary which is one of the reasons responsible for the extremely high evasion rates (see Table 1).

1. The Benefits of the Proposed Support from Government

One of the proposals of the EHDR 2005 is therefore to overcome the consequences brought about by the high contribution rates by introducing a cost sharing mechanism whereby the government would shoulder part of the contributions paid by employers as social insurance. The primary targets are Small and Medium Enterprises — since they absorb over eight million

workers (a third of the labor force), and youth (under 30 years of age) — in order to induce young entrants to the labor force to be productive, formalized and to reap social security benefits later on.

The main problems this policy intervention will address are the current public sector crisis and the volatility and insecurity of the private sector. The aim is not just to reduce unemployment, but to create an environment where the informal private sector has incentives to become formal and provide security and where people are encouraged to move from the public to the private sector. This could occur through a shift to change existing cultural perceptions, which have so far portrayed the government job as being the ideal occupation in terms of security and respectability. Through proper education and training, pension support, and formality, SME workers could be given the respect granted to government employees.

Some of the advantages of such a policy intervention are that:

- It represents a potential job creation mechanism since it offers employers a wage subsidy;
- It forces workers to save via their own contributions, thereby bringing about all the macroeconomic advantages associated with increased savings. In South East Asia, a major engine of growth has been savings, mostly compulsory;
- It is superior to granting unemployment benefits, which go to the white-collar class and do not help the poor. Therefore, it covers the educated as well as the uneducated and most needy, who have a right to be insured and supported;
- The increased formalization caused by this proposal would expand the tax base and contribute to cost recovery of the mechanism;

- Through the creation of a new cultural identity for SME workers, it potentially contributes to civil service reform by reducing the pressure to create civil servants, who represents a huge wage cost, not just to the government, but also to the economy in terms of the opportunity cost of employees.

A major assumption and policy recommendation of the EHDR 2005 is the reduction in annual civil service appointments which will be compensated for by the increased attraction of jobs in the private sector.

2. A Demographic Window of Opportunity

At present, Egypt has a demographic advantage which represents an actuarial gift. A huge portion of the population will be paying social insurance contributions for quite some time before becoming beneficiaries. This presents the government with a window of opportunity for implementing social insurance reforms and activating a social cover as an element of social welfare and prudent financing for an aging population.

The proposed gradual civil service adjustment consists of a large reduction in government employment of 1 million which is implemented over the decade via the process of attrition, with new recruitment required to decline to an annual average of 75 thousand per year in government. Among the losers are thus those who have felt that jobs in government are an entitlement. The excess number of employees in urban areas is estimated at 394,370 employees in 2003. In contrast, in the best case scenario, new government jobs created in rural areas over the period 2003 to 2015 are 549,009. This is part and parcel of the vision's new pro-poor strategy. The beneficiaries of the proposed EHDR vision are not only the poor, but the entire next generation of Egyptians.

The share of government in total employment outside agriculture declines from 43% to 24%. The distribution of government employment itself also changes in favor of the rural sector (an increase in rural of 14% versus a decline of 23% in urban Egypt over the ten year vision). The bulk of employment generation is in the private non-agricultural sector. In absolute terms, private activity outside agriculture is responsible for an impressive 8 million jobs. Out of the increase 4 million will be in rural areas and 4 million in urban areas.



There are several measures that are vital for realizing the benefits of the proposed scheme:

- Setting up privately managed insurance accounts independent of the General Authority for Insurance and Pensions;
- Establishing insurance accounts at the governorate level to promote decentralization;
- Training subsidies would form an accreditation package. This might take place by utilizing and upgrading existing low-quality training centers;
- Providing employers and employees with non-cash incentives to subscribe to the system. For example, insurance funds could be used by the contributors as collateral for loans and mortgages;
- Better governance measures and transparency will instill trust in public policy.

This scheme is complementary to the measures included in the Poverty Reduction Action Plan (PRAP) — a joint UNDP, MOP and Economic Research Forum initiative — pertaining to social safety nets and employment generation. These measures include the reform of micro-credit organizations and programs, upgrading training institutions and strategies and raising the contributions paid by casual workers under the 112/1980 Social Insurance Law (see Table 2).

The proposed policy is also complementary to the World Bank strategy, which includes a component on social safety nets. The strategy includes better targeting of transfers according to income levels and geographical location, increasing government social spending, and institutional development.

The focus on youth employment is intended to meet the challenge posed by Egypt's demographic transition. About 51% of the Egyptian population now fall within the working age bracket of 15-64, and an estimated 35% of workers are under the age of 24. A vast majority of the unemployed are young potential first entrants to the labor market who now find themselves waiting in the wings until fortune smiles upon them. The Government of Egypt is aware that this is a waste of valuable human resources as well as potentially dangerous to stability.

But demographic trends can be a window of opportunity. Since the working population as a whole is only ageing slowly, the Egyptian government has time to address the situation

through the introduction of prudent financing and wider economic and social reforms. The pool of young and relatively well educated workers (60% have at least a secondary education) can represent a significant advantage rather than constitute a problem, in that they are better prepared to move from flagging areas of the economy, to sectors with high potentials for growth and job creation.

EHDR 2005 has proposed a comprehensive employment strategy based on sustainable growth, a higher employment intensity of growth, and improved training and skills. A higher employment intensity of growth would ensure that labor incomes constitute a higher share of total output thanks to the higher level of employment, and could be achieved through identifying potential growth sectors and implementing trade and labor market reforms.

3. Actuarial Analysis of the Proposed Policy Intervention

An actuarial analysis is presented, estimating the costs to the government and benefits of the policy, represented by the contributions made by the government and employees, respectively. The sectors included in the estimation are manufacturing, electricity, trade, transport, finance, and services, construction and mining.

Employee contributions are a benefit since they represent savings and provide funds available for investment. Since the targeted segment of SME workers is those in the 15-30 age bracket, they will not be eligible for pension payments for the next 30 years, meaning that during that period, the policy will result in a surplus.

Assumptions

- Average real wage = LE 1758
- Annual increase in basic salary = growth rate GDP
- Best case = 7%
- Worst case = 4%
- Subscribers to the social insurance system are those aged 15-30 (based on projections made by the EHDR)
- The targeted SMEs are those in the informal sector which is equal to 84% of total SMEs.9
- The government splits contributions evenly with employers so that each party contributes 13.5% of basic salary and 7.5% of variable salary
- Employee contributions are 14% of the basic



salary

- The number of workers per SME is 2.7 workers

Projections

These are made under two scenarios reflecting different growth rates of SME enterprises:

- best case scenario: 1.97% annual growth rate;
- worst case scenario: 1.3% annual growth rate.

It is obvious that because workers contribute a higher percentage of their salary (14%) than the government (13.5%), there is a surplus measured by the difference between the contributions of each in both scenarios (see Table 2).

As to the cost to the government, at least part of it will be recovered through the decline in the number of young government employees, who will be encouraged to move to the private sector. Another source of cost recovery will be the increase in tax revenues with the expansion of the tax base associated with formalization.