Executive summary

1. The Socio-Economic Context

Egypt has enjoyed a period of relative macroeconomic stability since the early 1990s which provided the basis for a recovery from the recession of the late 1980s. There has been a steady growth in GDP, a gradual reduction in inflation and the Egyptian Pound has stayed relatively stable against the US dollar. Historically, the Egyptian population was characterized by high birth rates and high death rates but both are now falling. Over the last 20 years, there has been a rapid growth in the working age population. This includes a relative increase in the female participation rate but the labour force still reflects a large gender imbalance. Agricultural sector shares a large portion of the labour market, and the industrial sector is dominated by state-owned enterprises. Privatization of state-owned enterprises was initiated in 1991 but progress has been relatively slow with the need to take into account of financial and labour force restructuring and their social and political consequences.

In spite of the economic stability during the last decade, Egypt remains a relatively poor country. Around 23% of the population live below the poverty line and 7% are classified as living in severe poverty. The high unemployment rate, estimated at 9.1% of the labour force in 1997, is closely linked to the apparent inability of new entrants to find a job rather than existing workers being laid off. Employers are restricted in the dismissal of their workers and unemployment is thus very high among first time job seekers particularly those with high educational qualifications. As a consequence, many seek work in the informal sector: it is estimated that 60 per cent of the private sector do not work in registered establishments.

The alleviation of poverty is one of the most important economic and social challenges for the Government. This needs to be tackled not only through measures aimed at improving the capacity to earn income. Employment promotion measures will take time to work and not everyone will be able to take advantage of them. Thus, the Egyptian social protection system should complement employment strategies by improving income security and providing income support and basic social services. There is a strong legal and societal foundation for social protection, which is recognised in the Constitution, and the social security system is one of the most comprehensive in Africa and in the Arab region. In spite of this, there is, somewhere between the legislative intention and its implementation, a loss of real impact in meeting social protection needs.

The present report seeks to identify that failing. Although, in some respects, only a preliminary analysis, it provides an analytical and quantitative basis for policy formulation and for the further development of the Egyptian social protection system. In reviewing the structure and the impact of the social protection system there is a need to consider two fundamental questions:

- Does the system provide the level of social protection that is envisaged by its structure and that is sustainable for the future?
- Is the present structure still adequate?

2. Existing Social Protection Provisions

Social Insurance

The current social security system in Egypt was established by the Law 79 of 1975 which covers civil servants and employees in public and private sector enterprises. The system was subsequently extended to the self-employed (Law 108 of 1976), Egyptian workers abroad (Law 50 of 1978) and casual workers (Law 112 of 1980). Law 79 of 1975 provides benefits in respect of old-age, disability, death, employment injury, sickness, medical care, maternity and unemployment whereas the other laws provide only old-age, disability and death benefits. The system is
administered by two separate Funds - one relating to Government workers and the other relating to workers in the public and private enterprises, the self-employed, casual workers and Egyptians working abroad.

Social Assistance and Welfare for the Poor

There are a number of programmes providing assistance to the poor who do not fall within the scope of the social insurance schemes. Most of these programmes are administered by or under the general supervision of the Ministry of Insurance and Social Affairs.

3. Analysis of the Current System and Key Recommendations

The existing social security scheme is very comprehensive in terms of coverage of workers and contingencies. Benefits are primarily financed by contributions collected from employers and workers, but there has been a substantial financial support from the Government. The benefits are not merely meant to prevent poverty: they are intended to provide a relatively high replacement rate for lost earnings and the contribution rate represents a high percentage of insurable earnings. It is clearly intended that the people of Egypt receive social security system through the public system. Although there are supplementary schemes operated by employers, opportunities for private insurance and savings are still limited.

The overall system is well established and is sustainable under conditions of a moderate economic growth. It has its weaknesses, but it is far from experiencing an acute crisis. A radical reform would be contentious. In these circumstances, it would seem preferable to opt for a course which seeks to reform the present system in a progressive manner rather than restructure it radically. The analysis and recommendations are based on this presumption but there is nevertheless both scope and, arguably, a need, for the encouragement of employer based or private social protection arrangements to supplement the reliance on public schemes.

The weaknesses in the existing benefit and contribution structure as well as in the organization and the financing of the scheme need to be addressed to achieve a more effective use of resources, to provide adequate levels of social protection and to ensure that contributions are made with due regard to earnings levels. Key results of analysis and recommendations made in this report are summarised as follows:

(i) Coverage and Compliance

Although the social security provisions provide some protection for the majority of the labour force (17 million workers in total), there are significant gaps in coverage. First, this occurs in the scope of benefits available to certain groups such as the self-employed and casual workers. Unemployment benefit is unavailable to the vast majority of the unemployed since these are young job-seekers without a record of insurable employment. But more significant is the low level of compliance among certain sectors of the labour force such as workers in non-regular employment, the self-employed and those who work in the informal sector the majority of whom are in practice excluded from coverage. This serious problem is likely to require revision of the benefit and contribution structure supported by more rigorous compliance and enforcement activities.

(ii) Entitlement

Early Retirement Pensions and Unemployment Benefits

A significant feature of the Egyptian pension scheme is the facility for the receipt of early retirement pensions under generous conditions. Accordingly, the pensioners in receipt of an early
retirement pension are 26 per cent of the total public sector pensioners, and 23 per cent of the total private sector pensioners. There are potentially negative effects of early retirement for the financing of the scheme due to the increase in the number of pensioners combined with the low reduction rate (per year of pension receipt prior to normal retirement age) for early retirement. This issue of early retirement pensions needs careful consideration as there is a recognised need for increased mobility in the labour force and for a shift in employment from the public to the private sector. This, combined with significant unemployment among the younger members of the labour force, implies the need for some public sector retrenchment. However, it is undesirable that labour market problems be solved by generous early retirement provisions which place a burden on the Social Insurance Funds and, at the same time, encourage workers to choose lower level of social protection.

The current early retirement arrangements, together with the unemployment arrangements, need to be reviewed to ensure that they are better integrated with approaches to economic reform and structural adjustment and to ensure that policies are complementary and mutually supportive. In particular, the right to retirement pension before pensionable age should be restricted or discouraged. A rate of reduction of 6% per year of anticipation, instead of the present 1%, would be more equitable. Such measures would be seen as a policy response to a specific problem rather than permitting all insured persons to make individual employment/retirement choices which may be against their own interests or the interests of the funds.

Invalidity Pensions

The qualifying conditions for invalidity pensions for private sector workers require contributions for at least 6 months (or 3 months prior to the onset of the invalidity). Civil servants and employees of public sector enterprises do not have any qualifying period. These provisions are very generous for a long term benefit which in the context of difficulties in the medical determination process is open to abuse. It is recommended that the qualifying period for both funds should be standardised to, for example, 36 months of insurance of which 24 months of insurance immediate precede the contingency.

Survivors' Benefits

Survivors’ pensions are payable for a broad range of surviving dependents including a widow or an invalid widower, sons under age 21 (26 if students and no age limits for invalids), unmarried daughters and dependent unmarried sisters, parents and divorcees whose marriage lasted for at least 20 years. This wide range of entitlement for survivors' benefit makes it difficult to ensure that all the relevant facts have been obtained and that there is no significant change in the circumstances of the dependents. The process of establishing and verifying entitlement to the pension is complex and time consuming. The pension levels are low, averaging to LE 150 a month. If the entitlement to the orphans' pension would be paid only up to a maximum age and if siblings would be excluded from the entitlement, there would be a significant saving in expenditures. It is recommended that the provisions should be simplified and that the range of survivors' benefits in terms of the eligible dependents should be restricted. Despite the generous provision concerning the range of survivors, the rules of entitlement in respect of divorcees are very restrictive. Divorced widows with children are often required to depend on social assistance or other support. It would be advisable to reduce the qualifying years of marriage for divorced women.

(iii) Level of Protection

Replacement Rate for Pensions

The replacement rate under the principal pension schemes amounts to 80 per cent of the average earnings of the last two years prior to retirement after 36 years of insurable earnings. Although this replacement rate appears to be high in relative terms, in reality, the levels pensions are low in
absolute terms. This is partly because of the segregation of insurable earnings into basic wage and a variable wage and partly because of a widespread practice to understate earnings.

**Basic and Variable Salaries**

For the purpose of determining insurable earnings and contribution liability, it is recommended to aggregate the basic and variable salaries. This would extend the scope of insurable earnings and would ensure a closer relationship between earnings, contributions and benefits. And it would not be necessary to discontinue the two-tier wage system which is a feature of national wage policy.

**Reference Period for the Determination of the Reference Salary in Pension Formula**

The reference salary used for the formula of the basic pension is defined as the average earnings of the last two years prior to retirement in case of old-age pensions, and the last year prior to invalidity or death in case of invalidity or survivors' pensions. Such a short reference period is usually regarded as undesirable. In case of old-age pensions, it may be to the disadvantage of the insured person since it is based on earnings over a relatively short time period close to retirement when capacity to work and to maximize earnings is limited. It also provides scope for manipulation between employer and worker so that insurable earnings could be manipulated or falsified. Ideally, the reference earnings should be the average earnings (revalued) throughout the total period of insured membership. It is therefore advisable to extend this reference period so that, first, a longer period is used and, second, the earnings are revalued based on the proposed national average earnings index.

**Automatic Indexation of Pensions in Payment, Contribution Ceilings and Minimum Benefits**

Although adjustments are made each year through special increments, the determination of the increases is ad hoc and there is no legally integrated mechanism to adjust benefits automatically in accordance with prices and/or average earnings levels. There is also no provision for the financing of such adjustments. For reasons of transparency and confidence in the system, it would be preferable to automatically adjust pensions in payment by linkage with a national index of average earnings.

Automatic indexation should also apply to the contribution ceilings and minimum pension amount. Such indexation would ensure a closer relationship between earnings, contributions and benefits, and it would guarantee the beneficiaries a certain value of the replacement rate of their former income.

**(iv) Schemes for the Self-Employed and Casual Workers**

The Egyptian Government has made significant effort to provide the self-employed and casual workers with the social insurance provisions which take into account the circumstances of those workers. In general, these schemes are difficult to design and implement, and are often subject to adverse selection and evasion which tends to undermine the laudable efforts to provide coverage on an equitable basis. Neither scheme is wholly successful in Egypt. Participation among the self-employed (Law 108 of 1976) is at a reasonable level but there is little to prevent members choosing their level of participation regardless of their real income levels.

The Casual Workers scheme (Law 112 of 1980) is a more serious problem. A flat rate pension of LE 63 a month is paid against a flat rate contribution of only LE 1 month for 120 months with relatively lax qualifying conditions. Not only is the contribution liability no more than a token towards a contributory scheme, it can be paid in aggregate after the commencement of retirement in order to provide immediate entitlement to lifetime pension which is higher than the minimum pension under the other schemes. Apart from equity and financial considerations, the temptation for abuse is probably irresistible.

Given the scale of the subsidy and the number of participants, the scheme has structural similarities to a universal flat rate scheme. Having regard to inadequacies of the social assistance system, it is questionable whether this comparatively privileged group should be subsidised by taxes. Many of
whose members clearly have the capacity to contribute more than LE 1 per month. It is rather preferable to finance this scheme exclusively through contributions and target tax revenues on the poor through the application of a means test. In this context, two alternative strategies are put forward in Chapter 5, both of which seek to increase the contributory basis for the scheme.

(v) Social Assistance

Social assistance is governed by a number of different laws and programmes and provided by a diversity of authorities. The various bodies and schemes seem to be unconnected and about entitlements. Only about 20 per cent of the poorest groups receive assistance via government social assistance schemes and the total expenditure of social assistance is low, only LE 351 million representing 0.14 per cent of GDP in 1997. Therefore, greater policy and budgetary priority should be accorded to social assistance, with a restructured and integrated system which sets out clear rules for entitlement and uniform methods for determining means and needs.

(vi) Governance and Administration

The social insurance provisions are operated through two funds, the Government Fund, the Public and Private Sector Fund. Even though the two Funds co-operate quite close particularly on issues of policy and administration, there are some critical administrative issues with regard to the separate operation of the two Funds. It is therefore recommended:

- To establish a unified database covering all contributors and beneficiaries of the two Funds to achieve administrative economies and facilitate a more integrated and effective approach to both management and customer service.
- To strengthen, as a short- to medium-term objective, the financial linkages between the Government Sector Fund and the Public and Private sector Fund. This should cover both the investment of funds and accounting procedures and presentation.
- To prepare, as a long-term objective, for the establishment of a fully integrated and self-financing Social Insurance Institution. On this basis the Public and Private Sector Fund and the Government Fund would be combined, including the financing of the two schemes, administrative establishment, methods of record keeping, accounting frameworks, computer systems, and regional network.

Furthermore, administrative deficiencies at the operational level reduces the impact of the scheme. There is a need for greater accountability at all levels within the administration and for a review of work processes and administrative requirements for structural changes in personnel policy and management techniques. Any system which seeks to be redistributive and to provide earnings related benefits is undermined by weak compliance. A Strategic Compliance and Fraud Control Plan would be advisable which should include the setting up of a greater number and quality of labour inspections, a review of the methods of collection of data and a better assessment of incorrect payments and inhibit fraudulent behaviour.

(vii) Financial Management and Investment

Both the Government Sector Fund and the Public and Private Sector Fund were established on a fully funded basis and the surplus of funds was, in accordance with the legislation, deposited with the National Investment Bank. The present financing of the system, however, shows some inconsistencies. Although the reserves of the Funds represent a significant share in the national economy (currently 37% of GDP), they consist almost exclusively of accumulated debt of the National Investment Bank and the Treasury for various long-term development projects. As the legislation does not provide for pensions to be adjusted after award and although this has
necessarily to be done by statute, the financing for pension adjustments comes from the Government. This Government subsidy represents about 20 per cent of the Government expenditure. The following recommendations arise out of the financial assessments made in the report:

- The State subsidy to the Social Insurance Funds should be reduced – or could be abolished ultimately. Government subsidies are justified in case of nation-wide schemes with universal coverage or means-tested social assistance programs as a minimum safety net for all nationals. In view of the currently high contribution rates, it can be questioned whether the Government should be responsible for the financing of the costs of pension adjustments representing the major share of total benefits payments. It would also be questionable whether the treasury is able to continue to allocate a substantial component of the Government expenditure to subsidize the social protection system in the future.

- Any net cash surplus in the Social Insurance Funds should be used for “real” investments to help finance future benefits payments. In order for the schemes to retain reserves which are readily realisable when needed to meet expenditure and to achieve reasonable high yield, the recent arrangement for the investment of surplus through the Social Insurance Funds should be extended. At the same time, both Funds should develop the investment strategy and enhance their capacity of investment management.

- The portion of the reserves that is attributable to past surplus contributions (estimated about 36 per cent of total reserves) should be gradually shifted from the National Investment Bank to Social Insurance Funds for investment management. This could be attained, for example, by shifting the matured investments as they are due. In view of the expected liquidity shortage of the National Investment Bank, a sufficiently long transition period should be allowed.

- In the short- to medium-term, the financial linkages between the Government Sector Fund and the Public and Private sector Fund should be strengthened. This should cover both the investment of funds and accounting procedures and presentation. The cash surplus of the Government Sector Fund should no longer be transferred to the NIB and it should be used to meet the expected cash shortage of the Public and Private Sector Fund. As said earlier, in the long-term perspective, consideration should also be given to the amalgamation of the Government Sector Fund and the Public and Private Sector Fund with the objective of having a unified self-financing Social Insurance Organisation. Any subsidy required for a restructured casual workers scheme could be provided direct to that scheme by the Treasury.

- The Treasury should continue to function as a financial guarantor of the social insurance scheme. Where contributions are not sufficient to cover expenditure, the Treasury should cover the cash deficit from general revenues until necessary cost containment measures are taken.

- Actuarial valuations of the social insurance schemes should be undertaken on a regular basis, which should involve long-term final projections. They should test alternative long-term reform strategies to ensure that Egyptian social insurance schemes as a whole are placed on a reliable long-term financial basis.

4. Suggested Next Steps

The recommendations set out in this report differ in terms of their complexity and priority. Many require further consideration and some have not yet been fully explored. The following four issues are considered to be priority areas:

- Financial management - determining roles and responsibilities for the financing system, and building capacity to manage the investment of the reserves.
- Governance and administration - further in-depth study to make the system work better and improve compliance is required.
- Structural changes on entitlement and liability - reform of the self employed and causal workers schemes and some tightening of entitlement (e.g. early retirement provision)
- Social assistance - the comprehensive social insurance provisions need to be complemented by stronger protection for the poor.

The ILO stands ready to provide further technical expertise to assist in these follow-up actions. The ILO provided an opportunity to the Minister of Insurance and Social Affairs to comment on the draft report. These comments and suggestions for follow-up are set out in an Addendum to Chapter 5 of this report.