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Informal Economy in Egypt: Problems and Solutions

Mohamed Ahmed Abbas

Since 2015, Egyptian government has announced several initiatives to integrate the informal economy into the country's formal economy. To achieve this goal, five-year tax breaks as well other incentives have been declared by government officials more than once during this period.

First: What is informal economy?

The informal economy is defined as all economic activities (including barter of goods and services, mutual self-help, odd jobs, street trading, and other such direct sale activities) carried out by individuals and / or institutions outside state controlled or money-based transactions. The income generated by the informal economy is usually not recorded for taxation purposes and is often unavailable for inclusion in gross domestic product (GDP) computations. Workers at this sector are not subject to any [social security system](#).

Second: Size and nature of informal economy in Egypt

The rate of informal economy activities in Egypt reached 35% of GDP in 1997-2006, according to a [World Bank](#) study prepared by Friedrich Schneider et al. This percentage is indeed extremely large. To realize this, it should be noted that the same report stated that the weighted average size of informal economy in the OECD countries was 13.5%.

The informal economy was estimated at 18.4 per cent of GDP in 2013 in the European Union and 8.6 per cent on average in Australia, Canada, Japan, New Zealand and the

United States, according to a report by the [International Labor Organization](#) Office in Geneva (2013).

Third: Reasons for the expansion of informal economy

Any economic activity aims at achieving profits, where successful cost-cutting brings about an increase in revenues and, accordingly, in profits. Economic activities compete in the free market (under some government controls); where the profit motive drives all commerce and forces businesses to operate as efficiently as possible to avoid losing market share to competitors. The role of the State here is to ensure fair competition of these activities, protect the rights of workers, and collect due taxes.

However, when corruption becomes rampant within state institutions, citizens, whether investors or workers, do not find any positive effect for the taxes they pay. When bureaucracy and the complexity of government procedures are the dominant features of government institutions (For example, in business registration), citizens tend to engage in informal economic activities that operates outside the government control, to avoid the complicated government procedures on the one hand, and reduce the costs, by escaping taxes, on the other.

Following are some causes of the expansion of informal economy in Egypt:

- a- Bureaucracy, which has become a characteristic of all government institutions in Egypt.
- b- Corruption: In 2014, Egypt occupied the 94th. position out of 175 countries, according to the [Transparency International's Corruption Perceptions Index](#). In 2015, Egypt's ranking improved to 88th, where much of this improvement was due to the fact that the number of countries covered by the report was only 168 countries, compared to 175 countries in 2011. However, in 2018, Egypt ranked 105 out of 180 countries.

c- Inefficient tax system: The tax system in Egypt suffers from chronic problems, including its laws and regulations, and the process of collecting taxes.

d- Disruption of the labor market environment: The labor market environment in Egypt has experienced many disturbances since 2011, that escalated sharply since 2013. Some of the economic manifestations of these disruptions can be monitored as follows:

- The poor economic growth rates.
- The political unrest and changes in labor markets in the surrounding Arab countries.
- The low rates of foreign direct investment, which led to reduction of employment opportunities, further disturbed the labor market environment in Egypt, and drove many workers to resort to the informal sector.

e- Illiteracy: The number of illiterates (10 years +) dropped from 17.6 million in 1996 to 17 million in 2006, but rose again to 18.4 million in 2017 according to a press release by the Central Agency for Public Mobilization and Statistics. It is known that a high illiteracy rate leads to an increase in the informal economy rate.

Fourth: Negative effects of the informal economy

The negative effects of the informal economy can be summed up in the following points:

1- Disadvantages threatening the social peace: The informal economy provides fertile ground for the black economy, which is a good money laundering environment. The informal economy can be used to finance any suspicious activity, away from the government control.

2- Disadvantages that threaten the labor market and fair competition between companies and investment projects operating in the formal economy and those

operating in the informal economy, which leads many international companies to think a lot before investing in Egypt.

3- Disadvantages that threaten development of any economic reform plan: Plans mainly depend on availability of accurate data. When the government does not have accurate data on the size of economic activities because of the expansion of the informal economy, this leads to speculation, which may produce incorrect results and therefore make erroneous decisions leading to the failure of any efforts targeting achievement of economic reform.

Fifth: The positive side of the informal economy

The informal economy has had some positive effects, especially since the outbreak of the January 2011 revolution and its subsequent transformations, most notably the changes in the country's economic situation, including an increase in the unemployment rate and an acute shortage of foreign investment, especially since July 2013. At this sensitive time, the informal economy has been a strong supporter of the Egyptian economy, providing job opportunities and additional incomes for low-income people, such as teachers and civil servants.

This leads to the benefits of the integration of a significant proportion of the informal economy into the country's formal economy. These advantages can be summarized as follows:

1- Economic benefits: including an increase in the State's tax revenues, and thus reducing the budget deficit and improving services provided by the government to its citizens.

2- Social benefits: when workers in any informal economy activity are treated unfairly by their employers. But, when this activity is integrated into the umbrella of the formal economy, managers cannot easily abuse their workers.

3- Health benefits: as street-based restaurants (beans and others) are not subject to any kind of health control.

Sixth: Egyptian Policies for the Integration of the Informal Economy (2015-2019)

The most important policies taken by the Egyptian administration in integrating the informal economy can be reviewed through the following points:

- In December 2015, a presidential decree was issued to form a higher committee for national database clean-up. According to the decree, "the committee deals with the shadow economy and controls the tax system."
- In November 2016, the Egyptian Minister of Investment announced that Abdel Fattah al-Sisi approved an initiative to integrate the informal economy to be announced in December of the same year. This initiative includes tax exemptions and free allocation of land to entrepreneurs of the informal economy.
- In July 2017, the governor of the Central Bank (CBE) of Egypt announced that the CBE signed an agreement for data exchange with the Financial Supervisory Authority, which would, according to media reports, significantly contribute to the integration of the informal economy and thus improve the economic situation in Egypt.
- In May 2018, Abdel Fattah al-Sisi announced a 5-year tax break for the informal economy entrepreneurs.
- In December 2018, Major General Khairat Barakat, head of the Central Agency for Public Mobilization and Statistics (CAPMAS) announced that a committee was under

formation to develop a unified definition of the informal economy. According to Barakat, the committee was due to start work mid-January 2019 and that the integration of the informal economy will be launched after October 2019, which means that the informal economy is not likely to be integrated into the GDP of 2020/2021.

- In January, 2019, the head of the Tax Authority announced taxes on the "tuk tuk" vehicles

Seventh: Suggestions and Recommendations

- 1- Facilitating business registration procedures.
- 2- Making comprehensive legislative reforms
- 3- Reforming the tax system in Egypt
- 4- Encouraging banks to grant loans to integrated projects.
- 5- Establishing trade unions or cooperatives for workers of the informal sector.
- 6- Raising salaries of civil servants.
- 7- Enhancing the role of municipalities in the control of random labor and street vendors.
- 8- Rehabilitation and training of workers of the informal sector.
- 9- Opening up new markets for the marketing the informal sector products.

*Read the complete study in Arabic [here](#)