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REPORT

The Role of the Informal Sector In Shaping the Egypt... Economy Report



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This abstract is a part of a report published by the International Independent Organization, titled **"The Role of the Informal Sector in Shaping the Egyptian Economy Report"**. The report delves into various aspects of the informal economy, including its conceptual framework, economic interpretations, the evolution of the informal economy in Egypt, its size, components, characteristics, and features. Furthermore, the report examines the factors driving the expansion of the informal economy, as well as the negative effects it has on human rights and sustainable development. It also explores the advantages and challenges associated with integrating the informal economy into the formal sector, highlighting the positive outcomes from a human rights perspective. The report further assesses the Egyptian government's policy towards integrating the informal economy and concludes with a range of recommendations aimed at addressing the issues discussed.

Introduction

The phenomenon of the shadow economy is prevalent across countries irrespective of their level of development. It poses a significant challenge to global economic stability. Consequently, numerous societies are actively engaged in efforts to restrain the growth of the shadow economy and mitigate its adverse effects.

The informal economy has adverse implications for human rights. From a human rights perspective, one of the paramount impacts of the informal economy is the absence of social and health protection for workers, coupled with their limited legal rights. Furthermore, labor rights violations prevail in the informal economy, including forced labor, child labor, sexual exploitation, and deplorable working conditions. The informal economy also fuels the escalation of poverty and inequality due to the scarcity of formal employment opportunities and social safeguards. The informal economy is often intertwined with heightened levels of corruption and a lack of transparency. It is imperative, therefore, for all governments and the international community to collaborate in enhancing the informal economy, improving working conditions, strengthening labor rights, combating corruption, and fostering transparency.

In light of the foregoing, the process of integrating the informal economy into the formal economy entails numerous advantages with regard to human rights. It effectively upholds the rights of

workers by virtue of formal contracts that guarantee their social and insurance entitlements and enhance their living standards. Moreover, the integration process contributes to poverty reduction and stimulates economic growth. It also facilitates the creation of economic opportunities for the impoverished, fosters transparency, combats corruption, promotes access to justice, improves working conditions, strengthens the right to education and training, as well as bolsters the rights and safeguards of migrant workers, shielding them from exploitation and discrimination while ensuring their equality and access to social and healthcare protections.

The size of informal economy in Egypt

According to a recent academic study conducted to assess the size of the informal economy in nine countries in the Middle East and North Africa region, including Egypt, it found that the average magnitude of the informal economy in Egypt accounted for 21.43% of the total Gross Domestic Product (GDP) between the years 2000 and 2017. Furthermore, it constituted 19.1% of the total GDP in the year 2017.

On the other hand, there have been conflicting government estimates regarding the precise size of the shadow economy in Egypt. Nevertheless, all estimates point to approximately half of the economic activities in Egypt being informal. According to a study conducted by the Tax and Customs Committee of the Federation of Egyptian Industries (FEI), the informal economy in Egypt accounts for approximately 53% of the overall economy, with a volume reaching around EGP 3 trillion (equivalent to USD 192 billion), employing approximately 4 million workers.

This is consistent with the announcement made by the Chairman of the Egyptian Central Agency for Public Mobilization and Statistics (CAPMAS), Major General Khairy Barakat, that informal economic establishments constitute 53% of the total economic establishments in Egypt.

However, according to Minister of Finance, Mohamed Maait, the informal economy accounts for an average of 55% of Egypt's total economy, and it has the potential to increase to 60% or decrease to 50%.

In consensus, it is recognized that shadow economy activities provide employment to a considerable workforce, surpassing the combined workforce of the formal public and private sectors. This phenomenon becomes particularly evident during times of crises and market downturns, as shadow economy activities absorb workers who have been displaced from privatized government entities or distressed private enterprises.

The informal economy generates substantial employment, exceeding the combined workforce of the formal public and private sectors. This becomes evident in times of crises and economic downturns, when the informal economy provides employment opportunities for workers who have lost their jobs due to privatization of government enterprises or difficulties of private firms.

The Central Agency for Public Mobilization and Statistics (CAPMAS) conducted an annual survey on the aggregated labor force in Egypt for 2020. The survey revealed that informal sector employment engaged 43.4 per cent of the country's workforce. This amounted to 11.5 million workers, representing approximately half of the population employed in various economic activities.

The informal sector employs around 85 per cent of the workforce in four key economic activities: wholesale and retail trade, manufacturing, agriculture, fishing and food services. These activities are essential for ensuring food security and sustaining daily livelihoods for the population. The high dependence of the workforce on these activities poses significant challenges, most notably given their vulnerability to shocks and crises.

The informal sector employed an estimated 5.1 million people in Egypt in 2020, mainly in agriculture, forestry and fishing. These workers represented more than 95 per cent of the total labor force in this sector, with serious implications for the agricultural gross domestic product of Egypt and its development prospects in this vital sector.

The causes of the shadow economy expansion

[Graph no.1]

The negative impacts of the informal sector on human rights

As the available data and reports indicate, the informal economy adversely affects human rights in various ways. However, these data may vary across countries and depend on the economic and social situation. The main human rights implications of the informal economy are:

[Graph no.2]

- **Absence of social protection:** Workers in the informal sector lack social protection measures that secure their rights and benefits, such as health insurance, retirement plans, and social security schemes. This means they have limited access to essential healthcare services and face greater social risks such as unemployment, disability, and old-age hardships.
- **Labor rights violations:** Many labor rights are violated in the informal economy, which include forced labor, child labor, sexual exploitation, and inhumane working conditions. These violations pose risks to human rights and undermine the dignity of individuals. According to the International Labour Organization's 2020 report, approximately 24.9 million individuals worldwide are compelled to work under conditions of forced labor, encompassing forced labor, sexual exploitation, and child labor. Furthermore, certain reports indicate a substantial correlation between forced labor and the informal economy.
- **Poverty and inequality:** Poverty and inequality may be exacerbated by the informal economy as it lacks the formal employment protections and social safety nets. Workers engaged in the informal sector frequently face challenging economic circumstances and are deprived of essential services, which impede their ability to exercise their rights to food, shelter, healthcare, and education. The United Nations reports underscore that the informal economy exacerbates poverty and inequality, as individuals participating in this sector encounter limited prospects for economic growth, sustainable income, and access to critical services.
- **Lack of transparency and expansion of corruption:** Corruption and lack of transparency are more prevalent in the informal economy. This is because there are no effective governance and accountability systems to prevent or punish bribery, fraud, money

laundering, illicit financial flows, and tax evasion. These illegal activities violate human rights, as they deprive the public of essential resources, impede sustainable development, and worsen economic inequalities. The informal economy widens the gap between the rich and the poor, and infringes on people's rights to equal opportunities and inclusive economic participation. International organizations such as the World Bank and Transparency International have highlighted the strong connection between the informal economy, high corruption levels, and low transparency. This complex situation makes it difficult to track economic activities, measure incomes accurately, and ensure proper tax compliance, thus enabling illicit practices and money laundering.

- **Insufficient legal protection:** Workers engaged in the informal economy may experience inadequate legal protection, despite the existence of laws and policies. Such legal provisions often fall short in safeguarding the rights of workers and effectively regulating informal activities. As a result, these workers are vulnerable to unjust treatment, exploitation, and are deprived of access to arbitration mechanisms and legal frameworks. The World Bank report in 2018 unveiled that a significant number of workers in the informal economy lack sufficient legal protection and social guarantees, leaving them exposed to exploitation and poor treatment. Efforts must be made to strengthen legal frameworks and social safeguards to ensure the protection and well-being of workers in the informal economy.
- **Limited economic opportunities:** The informal economy affects the chances of economic advancement for people and societies. It can have an adverse impact on formal sector investment and economic growth, consequently diminishing employment prospects and impeding sustainable economic development.

Hence, it is imperative for governments and the international community to undertake measures aimed at strengthening the formal economy and enhancing the working environment. This entails facilitating access to formal employment opportunities, promoting labor rights, fostering transparency, combating corruption, and fostering an environment conducive to innovation, economic entrepreneurship, and sustainable and inclusive growth. These efforts are crucial for safeguarding human rights and realizing sustainable development goals.

The negative impacts of the informal sector on sustainable development

Alongside the aforementioned concerns on the negative implications on fundamental human rights, including the right to health, education, protection, social security, among other human rights, the informal sector significantly undermines the right to development. Such adverse effects tend to hinder sustainable development, manifested through various means. The following are among the most notable:

1. **Public revenues shortfall:** The informal economy leads to a decrease in public revenues as it involves non-compliance with tax and fee payments. This, in turn, hampers the ability

to fund vital projects and provide essential services, such as education, healthcare, and infrastructure.

2. **Poor socioeconomic inclusion:** It is commonly acknowledged that the informal economy tends to thrive in societies grappling with poverty and economic inequality. While it may serve as a means of survival for vulnerable segments of the population, it can also exacerbate economic disparities and impede genuine opportunities for socioeconomic advancement.
3. **Insufficient inflow of Foreign Direct Investments (FDIs):** Foreign Direct Investment (FDI) is recognized as a crucial catalyst for sustainable economic development, as it fosters improvements in infrastructure, information technology, and employment opportunities. Nevertheless, foreign investors may exhibit reluctance to invest in countries with a substantial informal economy due to instability and ambiguous legal and trade frameworks. Such caution has adverse effects on the country's capacity to attract substantial FDI inflows, which are instrumental in advancing sustainable development objectives.
4. **Poor infrastructure:** The informal economy emerges in regions with insufficient public goods, such as power, water, and mobility. These factors lower the welfare and constrain the growth potential of these regions.
5. **Rise of unemployment:** The informal economy can serve as a coping mechanism for individuals amidst the challenges posed by a weak formal labor market and high levels of unemployment. Nevertheless, this sector is often characterized by instability and a lack of formal employment opportunities and social protection, thereby exacerbating financial and economic vulnerabilities for individuals and communities.
6. **Expansion of corruption:** In the context of the informal economy, there can be a correlation with the expansion of corruption and lack of transparency in commercial and financial activities, which negatively impact the business environment and erode trust in the economic system. Consequently, this hampers the prospects of sustainable development and economic stability.

In General, informal economy hampers sustainable development by limiting access to finance, worsening income distribution, undermining infrastructure quality, fostering rent-seeking behavior, reducing capital accumulation, and increasing unemployment. Hence, policy interventions should aim at increasing transparency, formalizing economic activities, creating decent jobs, improving public services, fighting corruption, and promoting a conducive business environment. Additionally, education and training are vital for enhancing human capital and facilitating labor market transitions to formality.

Promoting the formal economy and reducing the informal economy can undoubtedly achieve sustainable development, enhance social justice, and increase opportunities for all. This needs collaboration among governments, the private sector, civil society, and international organizations to address the informal economy challenges.

The positive impacts of the informal sector integration from a human-rights perspective

The integration of the informal economy into the formal economy can result in various beneficial outcomes from a human rights perspective. Some of the main positive effects are as follows:

1. **Workers right to protection, safeguards and the promotion of social solidarity:** The informal economy integration increases labor market efficiency and productivity by ensuring decent work conditions, rights protection, and social protection for workers. It also reduces income inequality and social exclusion by improving the welfare of individuals and households, especially those who are vulnerable and marginalized. Informal economy integration is thus a key strategy for poverty reduction and inclusive development.
2. **Providing low-income individuals with economic opportunities:** This sector is considered an important source for providing economic opportunities for the poor, vulnerable, and marginalized communities. It can contribute to improving their income and enhancing their economic prospects.
3. **Achieving sustainable economic development:** Equitable distribution of wealth and opportunities promotes sustainable economic growth that harmonizes the economic, social, and environmental aspects.
4. **Strengthening financial inclusion:** The integration of the informal economy can facilitate the provision of financial services to the unbanked segments, enabling them to access credit, savings, and enhance their financial resource management. Furthermore, when economic activities are formalized and organized, individuals from marginalized groups gain access to financial services, banking institutions, and credit facilities, thereby augmenting their prospects for economic development and elevating their living standards.
5. **Promoting transparency and fighting corruption:** The integration of the informal economy has the potential to enhance transparency by reducing corruption risks. Additionally, it can facilitate effective monitoring and regulation of economic activities, while promoting the exchange of information among stakeholders.
6. **Strengthening the right to access to justice:** The integration of the informal economy into the formal economy enhances the right of individuals to access justice and legal remedies. Such integration establishes organized and regulated economic activities, whereby individuals adversely affected by disputes or violations may resort to judicial authorities for the enforcement of their rights and the attainment of appropriate relief.
7. **Enhancing work environment:** The integration has the potential to improve the work environment and promote the provision of safe and healthy working conditions. By adhering to labor standards and ensuring social and health protection for workers, it contributes to boosting the quality of life as well as reducing risks and preventing exploitation.
8. **Bolstering the right to education and training:** The integration of the informal economy holds the potential to enhance individuals' right to education and training, thereby promoting their access to knowledge, skills, and learning opportunities. This can empower individuals, particularly those engaged in informal work, to acquire the necessary competencies and qualifications, leading to improved employment prospects, economic growth, and sustainable development.
9. **Fostering societal development:** In the pursuit of sustainable development and the enhancement of economic and social sustainability, it is crucial for inclusive participation in economic growth and equitable distribution of benefits. This approach fosters the promotion of sustainable development and the attainment of a harmonious balance between economic and social dimensions.

10. **Promoting the rights of migrant workers:** Typically, migrant workers in the informal sector are vulnerable to exploitation and discrimination. However, by promoting their integration into the formal economy, it is possible to provide them with legal protection and ensure their rights to equality, social protection, and healthcare.

Obstacles and Challenges

The obstacles facing the integration of the informal sector in the formal economy:

The integration of informal activities into formal sector is a complex and interrelated process that is influenced a number of factors, including the follows:

- The laws implemented by the government, which have a direct or indirect impact on this process, are designed on the basis of incentivization. Employers are required to be included in government registers to avail themselves of the benefits offered by these laws, thereby fostering the expansion of their business operations.
- The reluctance of informal business owners to transition into the formal sector, where they would be subject to legal obligations towards their employees under labor laws, as well as complying with government procedures and regulations.
- The limited capacity of relevant government entities at the directorate and department levels in the provinces impedes the optimal implementation of new measures. The official authorities should prioritize the simplification, streamlining and harmonization of government procedures.
- The lack of awareness among a significant portion of the target groups, particularly workers, farmers, artisans, and owners of small workshops, regarding their social and insurance rights, their obligations and business registration requirements, hampers the comprehensiveness and effectiveness of the formal transition process.
- The reluctance of small entity owners to engage with banks, driven by erroneous religious beliefs or lack of confidence in electronic financial transactions, highlights the genuine need for effective and systematic communication to enhance awareness among all targeted segments about their rights and obligations, as well as how to engage and respond to initiatives aimed at providing them with social security and protection.
- The significance of education as a powerful and sustainable tool is paramount. Enhancing investment opportunities in the educational pathway and raising the quality of education, in general, contribute to reducing the likelihood of individuals engaging in the informal sector. In particular, educational curricula, including vocational education, should encompass modules on labor laws and the rights and protections they afford to workers across all productive and service sectors. Students should acquire the requisite skills and knowledge to embark on formal endeavors, fully cognizant of the mandatory governmental procedures and binding laws applicable to both employers and workers.

Conclusion

Developing a strategy to integrate the informal economy into the formal system of the Egyptian economy is recognized as an important and necessary step, requiring bold action to address various structural challenges. This strategy encompasses several key components. Firstly, it emphasizes

the establishment of a comprehensive and reliable database that encompasses all informal productive activities, underscoring the role of the Central Agency for Public Mobilization and Statistics (CAPMAS) in designing a program aimed at improving the relevant statistics and create an integrated database on the informal economy in Egypt. Secondly, it highlights the need to identify the relevant stakeholders responsible for addressing the informal economy, determining the entity entrusted with its management, and formulating the requisite legislation, policies, and procedures to effectively fulfill its mandate. Furthermore, the strategy emphasizes the importance of offering substantial incentives to encourage informal economy participants to transition into formal state institutions. Additionally, it underscores the significance of advancing the digitalization of the economy, moving from paper-based documentation to electronic platforms and databases. Lastly, the strategy underscores the ongoing efforts to enhance financial inclusion and raise citizens' awareness about the advantages and benefits of engaging with both banking and non-banking financial institutions.

It is imperative to ensure the presence of institutional entities that facilitate the inclusion of service providers and individuals engaged in informal activities. The application of principles of governance, transparency, accountability, and oversight is crucial in order to maximize the positive outcomes and mitigate the negative aspects associated with the informal economy. Furthermore, it is important to strengthen the role of regulatory bodies and conduct intensive awareness campaigns aimed at disseminating knowledge among stakeholders and small investors in this sector regarding the advantages and benefits of transitioning to the formal economy¹.

The report highlights a weak inverse relationship between the shadow economy and economic growth in Egypt. We can succinctly summarize a series of recommendations that would assist the incorporation of the informal economy into the formal sector, a matter of utmost significance that demands attention from all relevant entities. Despite its substantial scale, the informal sector fails to fulfill any financial obligations towards the state, thereby posing a threat to the formal sectors. Consequently, it is imperative to devise non-conventional solutions to encourage the informal sector's lawful integration and engagement with the formal sector.

Recommendations

1. Allocating an enabling environment for enterprise registration by simplifying procedures, including licensing requirements and other related processes. Moreover, providing assistance, loans, and cost reduction measures for the informal sector from governmental authorities, recognizing its vital role in fostering internal labor mobility and contributing to local development.
2. Pursuing suitable amendments and holistic reforms of the law, in light of the obsolescence of many laws in relation to the prevailing conditions. The advent of digital commerce has become a tangible reality, thereby outpacing the legislative process. Therefore, the enforcement of economic laws is weak and cannot keep up with the fast and changing situation.

¹ Dr. Fakhry El-Feky, The Informal Economy between Integration and Incorporation, published on the website of the Cabinet's Information and Decision Support Center (IDSC) on September 29, 2021. You can find the publication at the following link: (idsc.gov.eg).

3. Conducting extensive awareness programs to inform the public and small investors about the benefits of formalizing their economic activities, such as easier access to licenses, banking services, e-banking culture, and lower cash transactions.
4. Promoting engagement in the formal sector by offering financial incentives and credit facilities to individuals aspiring to engage in legitimate economic activities.
5. Implementing robust tax system reforms and expediting solutions to effectively tackle the regulatory and tax collection challenges. This proactive approach will facilitate the integration of the informal economy.
6. Regulatory and administrative authorities (e.g., insurance, tax, health, labor, etc.) need to adopt a flexible approach that does not discourage or deter workers from formalizing their activities.
7. Leveraging the informal sector and its industrial output to enhance the national productive capacity and welfare outcomes for all market agents.
8. Allocating low-cost spaces for informal workers and vendors to reduce externalities from occupying public roads and sidewalks, while imposing regulatory standards and oversight by the ministry of industry and consolidating enforcement agencies.
9. Support the creation of unions or cooperative associations for workers in the informal sector to ensure social solidarity, as well as launching social protection schemes.
10. Encouraging the informal sector to engage with and benefit from the services that both banking and non-banking financial institutions provide, by boosting financial inclusion rates.