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Between Costly Formality and Legal Informality: Egypt's Social Insurance Design Woes

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In a nutshell

- *Social insurance (SI) coverage rates have plummeted across the board in Egypt. In 2021, around a third of total employment (36%) were covered, and only a fifth (20%) of private sector employment.*
- *Although the current (SI) design includes irregular workers, they are not obligated to participate and are technically excluded from the scheme because the required documentation to enroll is difficult to attain for this group. This renders their informality permissible under existing law.*
- *The drop in access to social insurance was most pronounced among regular wage workers, who are required to be covered by law. Our analysis shows that such a drop was punctuated by an increasing cost of contributions due to increases in the minimum insurable wage.*
- *The changes in the real minimum insurable wage every year since 2016 has been a major driver of falling coverage rates among regular wage workers. The scheme became much more expensive for workers in the first and second quintiles, but also the effect is spreading to other quintiles over time.*

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Introduction

Over the past two decades, and even when Egypt exhibited positive annual growth rates, access to contributory social insurance (SI) coverage among workers continued to fall. Access to jobs with SI coverage declined steadily in Egypt from 42% of total employment in 2009 to 36% in 2021. Furthermore, while access to social insurance has been particularly low in the private sector, compared to the public sector (Assaad & Barsoum, 2019), it became even lower over time, reaching 20% of private sector employment in 2021, down from 24% in 2009. A key dimension of lack of access to SI is that it is also common among the non-poor, with Lopez-Acevedo et al. (2023, p. 244) showing that workers who are not poor but are informally employed constitute 40% of workers in Egypt. What are key institutional elements in the scheme design that can lead to such wide and increasing coverage gap? This is the main question that we discuss in this policy brief based on Selwaness & Barsoum (Forthcoming). We argue that the increase in cost for regular wage workers, and the legal informality along with the exclusion of irregular wage workers, and own-account workers are key to understand the low and dropping SI coverage in Egypt.

Three Reasons Why We Should Worry About Si Coverage Gaps

- First, coverage gaps mean that a broad range of workers (and their households) are vulnerable across their lifecycle, such as at times of sickness, disability, job loss/unemployment, maternity and old age.
- Second, maintaining the stream of social insurance contributions from the working-age population is pivotal to the financial sustainability of the system.
- Third, The youth of today, constituting 40% of the population in Egypt, will represent a huge "elderly" bulge in the coming 30 years (Assaad, 2022). Their increasing lack of social insurance coverage now will pose a serious problem both in terms of old-age poverty in the future and increased fiscal pressures on the government budget to provide social transfers.

What Are the Contributing Factors for This Increasing Coverage Gap?

Although the Law 148/2019 created a unified framework for SI, the scheme has different routes of enrolment based on a combination of employment status, regularity of the job, formal registration of business, and occupation. For each of these routes, we examine whether the lack of coverage is due to legal informality, or due to the trade-offs between costs and benefits.

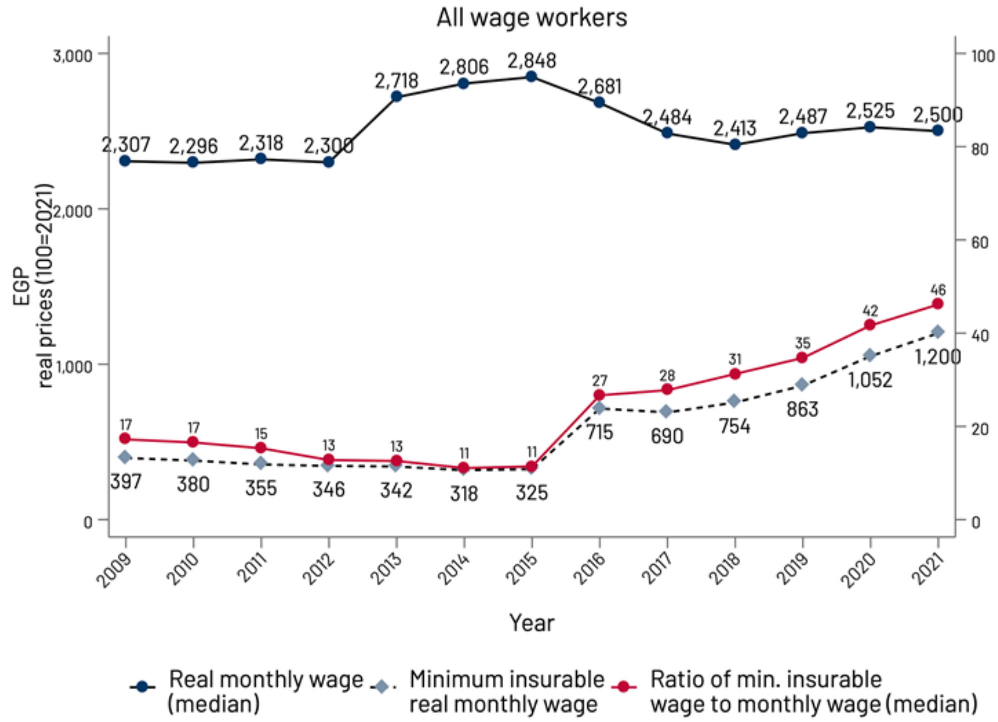
Costly formality for regular wage workers

Workers in regular jobs, i.e., being in 'continuous' employment relationship for at least six months should be registered into the SI system through their employers. For this group, social insurance participation is obligatory, and the employer is penalized for non-conforming.[1] Therefore, the lack of coverage (if any) for these workers is illegal and reflects the discretion of their employers not to enroll their regular employees, whether based on a mutual agreement with the workers or not. According to nationally representative microdata from the Labor Force Survey (LFS), the share of regular wage work expanded from 24% in 2009 to 34% of total employment in Egypt in 2021, i.e., increasing with 10 percentage point (p.p.). Much of this increase was regular jobs with no coverage. Despite their mandatory and de jure coverage, participation into the system is weak. By 2021, 21% of total employment is regular uncovered work, up from 11% in 2009.

Our analysis of the legal framework shows that consecutive increases to the minimum insurable wage made the scheme less affordable (to workers and their employers) over time. The ratio of the minimum insurable wage to the median monthly wage declined from 17% in 2009 to 11% in 2015, before sharply increasing to 27% in 2016 and continued to increase until reaching 48% in 2021. This means that in 2021 almost half of wage workers in the private sector received a monthly wage that is below the minimum insurable wage. This is because some workers' wages did not rise as quickly as the rise in this minimum bound. Enrollment in the scheme became more expensive, and thus much lower,

[1] Under the new law, the penalty that employers must pay in case of not registering workers in social insurance increased to reach a minimum of EGP 30,000 and a maximum of EGP 100,000 and may potentially lead to jail (article 165). This is relative to a penalty of EGP 1 per worker with a maximum of EGP 500 in the old law.

Figure 1. The evolution of the minimum insurable wage, the median monthly wage and the median ratio of insurable wage to monthly wage



Source: LFS 2009-2021.

for workers in the first and second wage quintiles, relative to workers in higher wage quintiles. By 2021, the insurable wage was double the monthly wage for half of workers in the first wage quintile and equal to the monthly wage for workers in the second wage quintile.

Moreover, not every participating wage worker is eligible for benefit entitlements. In case of reaching retirement age, or in cases of disability or survivorship, the worker is eligible for a retirement (or survivor) pension only if they contributed for at least 10 years (120 months). Otherwise, workers need to accumulate 20 years of contributions to receive a pension. In case of contributing less than the required duration of contributions, there is no retirement pension, but rather an end of service compensation that is calculated at 15% of the annual income for each year of contributions.

Therefore, the system favors those who contribute at a young age and manage to accumulate as many years as possible, which is no longer adapted to many of Egypt's labour market realities. For instance, women are one of the most penalized groups because they often drop out from the labour market at marriage (Assaad et al., 2022), i.e., not completing the minimum vesting period. In anticipation of their early withdrawal from the labour market, employers are not willing to enroll their female workers in the scheme, since they perceive contributing for those workers who are potentially not eligible for a social insurance pension as too costly. Also, workers (again mostly women) with late entry to the labour market, above age 50, are disadvantaged. Also, given the rise of new entrants who start in jobs with no social insurance coverage, and given the low chances to transition to formal jobs once starting in informal ones (Krafft & Hannafi, Forthcoming; Selwaness & Ehab, 2022), the scheme is becoming exclusive to a select group in the labour market.

Another issue is that employers might enroll some of their workers but not all, for fear of increased taxation. Taxation authority, a different agency than the social insurance one, estimates specific production levels (and earned revenues) with each additional worker registered in social insurance. This is despite the fact of employers might be reporting their revenues and taxes in a legal and perhaps accurate way.

Legal informality for irregular wage workers

The second group is irregular workers, for which the new Law 148/2019 (article 4) classify into nine categories (See Barsoum and Selwaness 2019). They have the option to register themselves in the social insurance scheme, which suggest that their informality is legal.

However, irregular wage workers are technically excluded from the system because the required documentation to enroll in the scheme is a very serious hurdle. This documentation includes a national identity (ID) card that shows that the worker's occupation is one of those nine included in the law. This is hard to achieve for two reasons: First, the authority issuing identification cards requires a proof of such occupation which is difficult to obtain for many of the irregular jobs. Second, there could be a stigma associated with some types of work (e.g., domestic work) means that in most cases domestic workers would abstain from identifying themselves as such in their national identity cards. Another required documentation is an employment history from the civil register, which is likely not feasible given the nature of irregular jobs.

Also, the law does not mention that there is a penalty in case these workers did not enroll in the scheme. This means that their enrollment is practically on a voluntary basis, and hence their informality is legal. Furthermore, some categories are totally excluded such as domestic workers inside private households, or 'gig' and digital platform workers. Construction, fishery and transportation workers who do not work for an employer are also considered as irregular workers, and subject to these enrolment rules.

The mix of legal informality and costly formality of own-account workers

The third type of workers are self-employed and employers. Enrollment in the system is mandatory for either syndicated professionals from 15 high-skilled occupations or employers of registered businesses. An employer with social insurance coverage is thus equivalent to a formal business unit. The pension law for own-account workers (replaced by law 149 of 2019) is meant to cover a select few self-employed workers from the educated, artists and the owners of formal businesses and large landowners.

This means formality of business units is a driver for the coverage of its owners (and consequently their employees). The design of the scheme for employers and self-employed also suffers two key challenges. First, while the main benefits of the scheme (that costs 21% of reported income monthly) for this group of workers are disability, old age and survivorship pensions, there is no health insurance component in the scheme, which represents an important disadvantage for employers. Second, there are 16 brackets of income listed on the law, from which employers and self-employed choose as their insurable income. However, those who reach age 55 cannot change their insurable income and must remain contributing using this income till reaching age 65. This results in very low pensions at age 65, since the pension is calculated based on this last income bracket at age 55 whose real value has eroded over time. Like wage workers, the minimum insurable income for employers increased substantially in 2016. Although there is not enough information on the detailed change in the brackets of income, it is expected that all brackets of income increased proportionally to the minimum insurable income.

The cost of the system for owners especially of micro and small firms, and whose workers may receive lower wages or have lower productivities is substantially large. For example, in case of fishermen who work for an employer on a sail or motor, employers must pay yearly contributions of 15% multiplied by the number of fishermen working on the boat multiplied by 12 (months) and have a permit. In addition, those employers can enroll themselves in the system for a contribution rate of 21% of the income category they choose.

The Missing Link: What Can Increase Coverage?

The policy implications of this analysis are three-fold:

1. The spirit of the law shows a commitment to include informal workers, however, cumbersome and unattainable requirements for system enrollment and eligibility need to be simplified for the self-employed and unpaid family workers in unregistered enterprises or un-syndicated occupations.
2. Second, the cost of the scheme, through important for the financial viability of the system, leads to the loss of contributions from a significant proportion of workers. As a pay-as-you-go financed system, the exclusion of this group negatively affects the financial viability of the system. It is obviously the case that the increases stipulated since 2016 have had a negative effect on system coverage, particularly given the pressures of the economic situation. It is, therefore, recommended to lower the minimum insurable wage in order to allow for a wider outreach.
3. Third, optional additional payments, already stipulated in the law, need to be duly advertised to prospective contributors. These recommendations are in line with

Holzmann and Hinz's (2005) argument for a multi-pillar system design. Specifically, there is need for a mandated publicly managed defined benefit system that would include the poorest segments of the workforce; along with a voluntary retirement savings scheme that is flexible and responsive to the economic situation (Holzmann & Hinz, 2005).

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