The Takeaway
Policy Briefs from the Mosbacher Institute for Trade, Economics, and Public Policy

Broken Link

Egypt's Trade Policy and Local Labor Market Outcomes

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International trade is positively associated with economic growth,[1] falling poverty, and rising living standards. While export-led growth has generated tremendous success in some countries, others that have pursued aggressive trade liberalization with the hopes of increasing wages and employment have been disappointed, raising important questions about the specific links between trade policies and labor market outcomes.

Egypt is a country that seems to have experienced a "broken link" between trade policies and labor market outcomes. Since 2000, Egypt has implemented a range of institutional reforms and signed several key trade agreements. Nonetheless, Egypt continues to struggle with a range of labor market challenges, including stagnant wages, high unemployment, and high informality. There are two possible reasons for this. The first possibility is that Egypt's trade policies, and trade

WHAT'S THE TAKEAWAY?

Trade, especially exports, is strongly linked to rising wages, falling poverty, and economic growth around the world.

Egypt pursued trade agreements, in part to improve labor market outcomes for Egypt's workers, but did not experience the expected improvements in wages and employment.

Egypt's trade agreements are associated with higher exports, suggesting the broken link between Egypt's trade policy and labor market outcomes is not ineffective trade agreements.

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agreements in particular, have not increased trade. The second possibility is that the trade agreements "worked", but the resulting increase in exports did not translate into improved labor market outcomes, such as wages, employment, and reductions in informality. This article is based on my recent co-authored World Bank working paper[2] which aims to evaluate these hypotheses to find the broken link.

Like many developing countries, Egypt implemented several policies designed to foster trade growth. Egypt's maximum tariff rate fell from 110% in the late 1980s to 40% in the early 1990s.[3] In 2003-2004, Egypt again reduced tariffs, simplified the tariff structure and red tape costs, and implemented reforms to improve the business environment. Free trade agreements (FTAs) played a central role in Egypt's trade policies. Agreements with the European Union; Turkey; members of EFTA; and Tunisia, Jordan, and Morocco (the Agadir Agreement) contributed to falling tariffs. Figure 1 shows the change in Egypt's applied weighted mean tariff rate over time, including the sharp drop in the early 2000s, and the unemployment rates for the entire labor force and for young males. While tariffs and unemployment are not necessarily directly related, this figure illustrates that trade liberalization was not followed by falling unemployment.

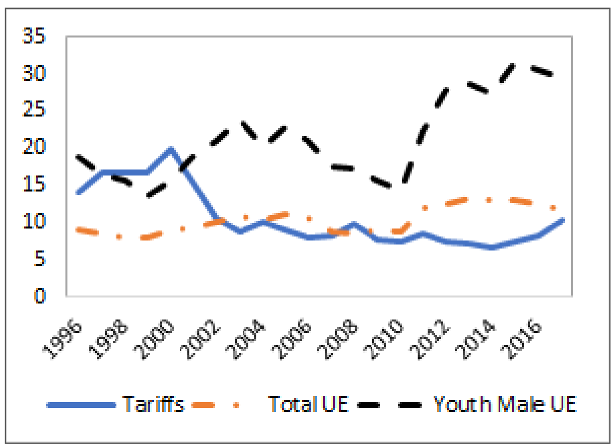
EGYPT'S LABOR MARKET CHALLENGES

When most people think about labor market outcomes that matter for workers, they usually think of informality (often conflated with poor job quality) and real wages. Egypt's informality rates increased from 58% in 2008 to 66.7% in 2017, similar to the estimates for a typical Middle East and North Africa (MENA) country.[4] But there remains significant heterogeneity with respect to gender. Our estimates show that while the informality rate for males has oscillated around 63%, it has risen from 58% in 2009 to almost 65% in 2017 for females. There is also considerable variation in informality rates across Egypt's four regions (Nile Valley and Delta, Eastern Desert, Western Desert, and Sinai Peninsula)—and within them, the 27 governorates. At least two out of every three governorates in Egypt had an informality rate above 50%. We also document a steady increase in average wages between 2009 and 2017, but the changes across and within regions remain uneven.

TWO HYPOTHESES

The coincidence of concerns about trade performance and labor market outcomes

Figure 1: A Broken Link between Trade Liberalization and Labor Markets in Egypt?



Source: Author's elaboration using data from https://www.macrotrends.net/countries/EGY/egypt/tariff-rates'>Egypt Tariff Rates 1995-2021 and World Bank Development Indicators.

suggests that trade policy did not generate the kinds of labor-market gains that had been observed in other countries and that had been hoped for in Egypt. The goal of our research is to locate the broken link: either trade policy did not increase exports or the exports did not translate into improved wages and employment.

To evaluate the first hypothesis, we rely on the gravity model of international trade. Trade flows between two countries are modeled as functions of the size (Gross Domestic Product) of each country, the distance between them, and trade costs. Trade costs might include a wide range of variables, including bilateral, multilateral, and regional trade agreement provisions, such as tariffs. Comparing the change in trade from a particular trade agreement, while controlling for other variables often found in gravity models, is one heuristic way to estimate either the effectiveness of trade agreements that a country signs, or, alternatively, the relative importance of policies and trade costs that are not included in an agreement.

In our paper, we compare the effects of Egypt's trade agreements on Egypt's trade with the global "average" effect of trade agreements using the gravity model. Given the persistent concerns about Egypt's trade, our results are somewhat surprising. We find that "average" trade agreements increase trade by about 25%, but Egypt gets a much larger, nearly double, increase in exports from its trade agreements. These results suggest that Egypt's trade policies seem to be quite effective at increasing Egypt's exports.

EXPORTS AND LABOR MARKET OUTCOMES

Informality rates in Egypt have been relatively stubborn, with an upward trend since 2009. Consistent with this, we do not find any relationship between informality rates and trade. Specifically, when formally estimating the relationship between regional exports and informality, no statistically significant relationship emerges. We considered the relationship based on changes over different time frames ranging from 1 year to 8 years and consistently find no significant relationship between local exports and local informality rates.

In terms of wages, we did not find that exports are associated with higher wages. On the contrary, the results show that specific regions that are more exposed to trade experience a decrease in average real wages relative to less exposed sub-districts in the short run. This negative effect, however, dissipates over time. This holds for both males and females, although for women it is not statistically significant. One interesting exception emerged when focusing on specific industries. Workers in textiles and apparel, which makes up 7% of Egypt's export basket, experienced a sustained increase in average wages after the first period, although not statistically significant.

LOOKING AHEAD

Rising exports have lifted millions from poverty around the world, but for some reason the link between exports and workers seems to be broken in Egypt. Looking ahead, future research is needed in three important areas to gain more insight into the relationship between greater exports and local labor market outcomes.

First, the team is working with firm-level data to identify firm-level effects and short-run industry-specific effects. It is likely that Egypt is exporting more to countries with the same income than to wealthier ones. This matters because the most technologically demanding goods come from wealthier countries, which would push firms to upgrade. Second, our paper currently uses the rise in exports of final goods, but Egypt's imports are more than double the value of its exports. Future work should distinguish between imports of parts and imports of final goods. Third, firm- and industry-specific effects might not spill over to otherwise identical workers—even in the same industry, region, or country. Similarly, workers with the same age, education, and occupation might earn different amounts based on their gender or industry-specific or firm-specific experience. Thus, it is important to sort out not only the different kinds of trade links to wages, but also which dimensions of earnings would be affected in each case.

Exports have contributed to rising incomes and falling poverty around the world. While trade agreements are associated with more exports for Egypt in particular, the rising exports have not translated into better outcomes for workers. Finding the broken link between trade and better labor market outcomes is a policy priority and a critical area for future research.

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Notes:

[1] Frankel, J.A. & Romer, D.H.(1999). Does trade cause growth? American Economic Review, 89(3), 379-399.

[2] Robertson, R., Vergara Bahena, M.A., Kokas, D., & Lopez-Acevedo, G. (2021). International trade and labor markets: Evidence from the Arab Republic of Egypt. *Policy Research Working Paper, No. 9668.* World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35629

[3] Zaki, C.& Hendy, R. (2013). Assessing the effects of trade liberalization on wage inequalities in Egypt: A microsimulation analysis. *The International Trade Journal. 27*(1), 63-104 . DOI: 10.1080/08853908.2012.702538

[4] For more on comparing informality rates within MENA countries see Atamanov, A., Tandon, S.A., Lopez-Acevedo, G., & Vergara Bahena, M.A. (2020). Measuring monetary poverty in the Middle East and North Africa (MENA) Region: Data gaps and different options to address them. *Policy Research Working Paper, No. 9259*. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/33843

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