ALTERNATIVE POLICY SOLUTIONS

BACKGROUND PAPER

Finance: Does It Kill or Create Jobs ?

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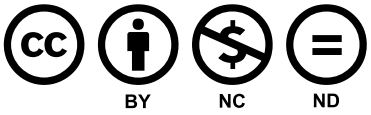

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Alternative Policy Solutions is a non-partisan, public policy research project at The American University in Cairo. Using rigorous, in-depth research and a participatory process of consultations with a diverse range of stakeholders, we propose evidence-based policy solutions to some of the most difficult challenges facing Egypt. Our solutions are innovative, forward-looking and designed to support decision makers' efforts to introduce inclusive public policies.

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1. Introduction: Three Decades, Three Trends

The share of the employed population relative to total population has been declining globally in recent decades. Several reasons have been cited as causes of the decline, including increased labor productivity, austerity, and the financialization of the economy. Even among the employed, an increasing share are grappling with underemployment, precarious work, and stagnant wages. Women are often more vulnerable to such structural changes in the labor market, especially austerity and increasing precarity. Egypt is no exception to this global trend. Without minimizing other factors, this paper will focus on the impact of financialization on job creation in the Egyptian context.

Financialization is a relatively recent concept. It refers to a process whereby financial activities grow in size and influence at the expense of non-financial activities; accordingly, more value in society is captured by financial investments than by work or non-financial investments (see the literature review section below for a more detailed definition of financialization).

In mainstream economics, the increase in financial activity is usually perceived as developmentally desirable, especially because banks mobilize and put otherwise idle savings and deposits into productive use that generates wealth for society (Bonizzi, 2013). However, banks do more than just mobilize and extend idle deposits to productive and wealth generating activities. When the economy is in a state of imbalance (i.e., persistent current account deficit, persistent large budget deficit, currency overvaluation, very high interest, etc.), banks and financial institutions tend to invest in non-productive and extractive activities, namely, funding budget and trade deficits. The impact is therefore twofold: on the level of the economy as a whole, the financial sector can tend to channel capital away from other productive sectors; within the financial sector itself, capital tends to fund deficits in current and consumption expenditure rather than productive activities. This is particularly visible in Global South high-interest contexts. As it stands, Egypt's financial sector is no exception due to long-term structural imbalances in trade and budget, a large rentier economy, and a poorly performing private sector, including the small and medium enterprises (SME) sector (Adly, 2020). This Global South variety of financialization is sometimes referred to as "subordinate financialization".

The Global South high-interest context poses both a challenge and an opportunity. On the one hand, opportunities to benefit from macroeconomic imbalances mean banks have less incentive to provide financial services to the value-adding sectors of the economy. Further, the global nature of financialization means that some of the underlying structural issues need to be addressed on a transnational level, limiting what national governments can achieve on their own. However, in a context of unsaturated markets and potential for growth, there is still more room for investing in productive sectors in the Global South compared to "core" economies, where financialization is a result of capital saturation in their productive sectors (Kalogerakos, 2013).

Although financialization is not always a key concern in mainstream development literature on the Global South, it potentially constitutes an important obstacle to the achievement of development goals, including the Sustainable Development Goals (SDGs). The eighth SDG, for example, promotes "sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all". This SDG's targets include a focus on labor-intensive sectors (target 8.2), productive activities (target 8.3), and the achievement of full and productive employment (target 8.5) (United Nations, n.d.). As will be discussed throughout the paper, increased financialization may—under certain conditions—be antithetical to this focus on the productive economy.

This background paper explores the possible impact on job creation and productive investments of a growing financial sector that is increasingly reliant on fixed-interest investments. It also examines possible measures that could counterbalance the effects of the current dominant regime of high-interest and extractive financialization.

In order to achieve this objective, the paper will start with an overview of the methodology employed and data used in the study. The

subsequent section will identify and address the research gaps in current literature on financialization globally and in Egypt. The following section, examining the link between the financial sector and job creation, discusses the global and national policy context that gave rise to the respective phases of growth and decline in the size of the financial sector, as well as the nature of such growth and decline. This section will also explore whether the association identified between a growing financial sector and lower employment and capital formation is a mere correlation (i.e. coincidence) or a more substantial causal relationship.

Following that, the paper will examine policy measures other countries have implemented to maximize the benefits and minimize the risks of growing financial activities, in order to distribute gains in productivity and the fruits of economic growth more evenly. The paper finally concludes with a list of finance-related measures the government should examine in order to further spur job creation.

2. Data and Methodology

This paper draws on data from various official sources. For the evolution of financial sector size, it uses historical GDP data published by the Egyptian Ministry of Planning (MOP), which breaks down the GDP by economic sector. To measure the size of the financial sector, the contribution of financial intermediaries and insurance companies to GDP from 1990 to 2019 was combined. This indicator acts as a proxy for the income and profits realized by the sector. The bank assets/GDP indicator from the Global Economy database (n.d.) is another widely used proxy for the size of the financial sector. The indicator captures the amount of financial capital that banks hold, thus offering a good picture of the level of capital the sector attracts, compared to the GDP measure, which captures value added by entities registered as financial intermediaries.

For the other two main variables (employment-to-population and capital formation), the World Bank Data database was used, which is based on official statistics. In the case of labor market indicators, the paper uses the ILO modeled estimate, which makes datasets comparable across countries and imputes missing data when needed (ILO, n.d.).

It should be noted that this paper uses employment-to-population indicators rather than unemployment rates because the latter only measures the number of unemployed adults who are capable of and actively searching for work. The labor force, according to this indicator, comprises employed workers and the unemployed population who are able to work and are seeking employment. Unemployment statistics, however, do not capture people who have left the labor force entirely in despair of finding work. In other words, people exiting the labor force contribute to a reduced unemployment rate because they cease to be counted as unemployed, not because they have found employment (Kassab, 2019). In Egypt as elsewhere, employment-to-population ratios decline alongside unemployment rates. The report will therefore rely on the employment-to-population indicator to more accurately capture the level of job creation and employment.

Finally, the paper relies on statistics from the Central Bank of Egypt (CBE) for the time series on domestic credit, which breaks down the financial sector's lending activity to its constituent parts: the government, public business sector, public private sector and household sector. This helped determine how much of the sector's financing activity was directed to capital and current expenditure (see below), which in turn allowed for a distinction between more generative financial activity (wealth and job creating) and extractive financial activity (wealth extracting and job suppressing). For data on taxation and interest payments, the paper relies on national budget statistics published by the Ministry of Finance.

The size of the financial sector has witnessed numerous ups and downs during the last three decades in Egypt, even if the overall and long-term trend has been an upward one. The first period, stretching roughly from the early 1990s until the early 2000s, was one of formidable growth. The financial and insurance sectors (hereafter referred to simply as the financial sector) grew from 3.75% of

GDP in 1990 to 6.14% in 2002, while bank assets to GDP grew from 48.5% to 78.32% during the same period. The decade of growth was followed by a period of decline from 2002 until 2011 in which the financial sector's share in GDP fell sharply from 6.14 in 2002 to 3.7 in 2011. The third phase was a phase of stability from 2011 until 2019 during which the financial sector's share of GDP remained almost unchanged at around 4.5% of GDP. However, during the same period, bank assets to GDP grew significantly, from 61.37 in 2011 to 89.26 in 2017 (last available data).

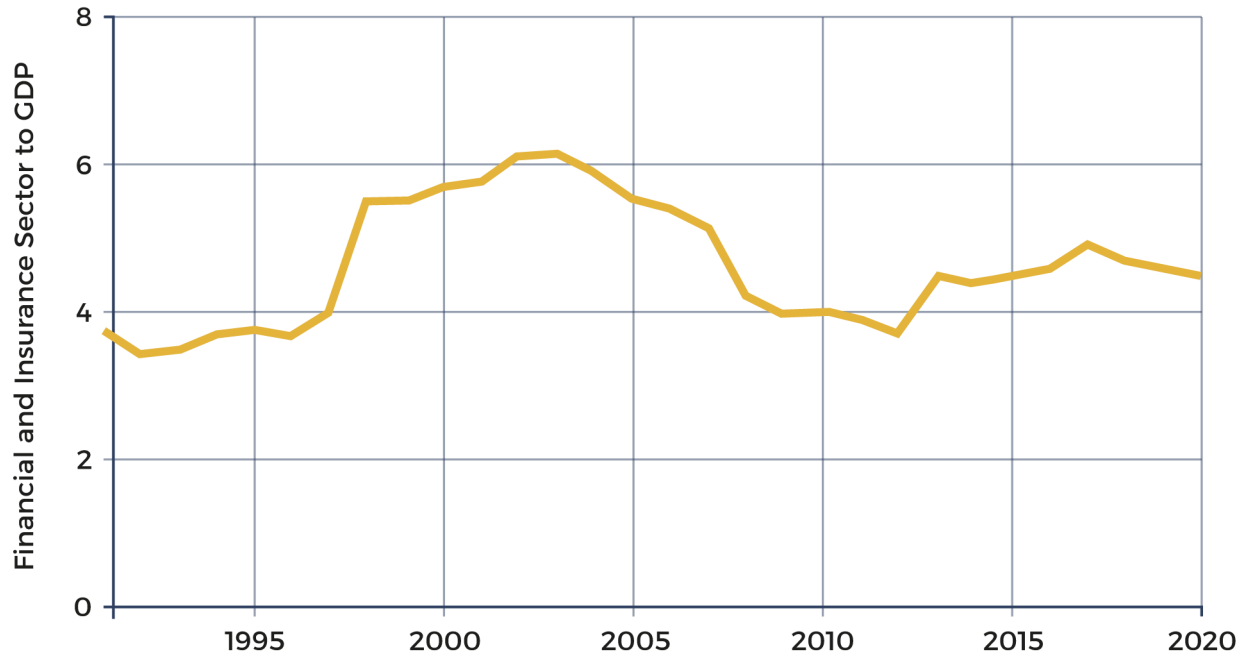
Data generated for the purposes of this paper shows that there is a clear association between growing financial activity on the one hand and lower employment and capital formation on the other. For example, in the first growth period (1990–2002) the size of the financial sector grew by about 66% relative to GDP, which itself grew considerably during the decade (see Figure 1). During the same period, the employment-to-population rate declined from 42.32% in 1991 (earliest available data) to 40.61% in 2002 (see Figure 2) (World Bank, n.d.-c). Capital formation, which measures the level of new investments in the non-financial sector, also declined from 28.9% to 18% of GDP during the same period (World Bank, n.d.-d).

Conversely, during the period of decline (2002–2011) the size of the financial sector fell again to the 1990 level of 3.7% of GDP. During the same period, the employment-to-population ratio increased from 40.61% to 43%, also very similar to the early 1990s ratio. Capital formation levels at the start and end of the period remained stable.

During the last period (2012–2019), the size of the financial sector hovered around 4.5% of GDP, while the employment-to-population ratio dropped from 43% to 40.47% and capital formation was also stable around 17%, which is significantly lower than the average for the region and other middle-income countries like Egypt. This suggests that lower employment rates might have other long-term structural causes, such as austerity and increased productivity. Additionally, banking assets to GDP increased significantly during the period indicating, as discussed above, growth in the sector, although it is not reflected in GDP figures. This could be explained by the relatively low return of the additional stock of bank assets.

Figure 1

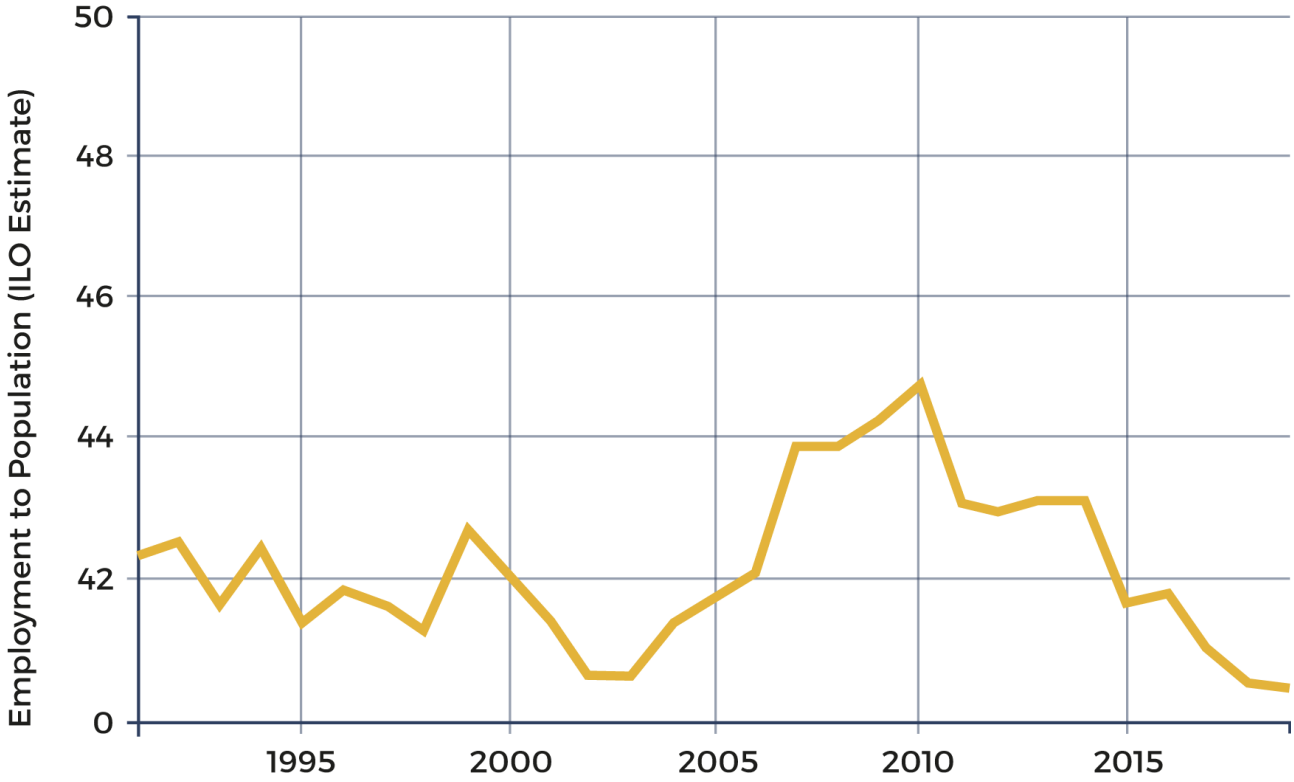
Financial and insurance sector to GDP from 1990 to 2020



Source: Author's calculations based on GDP figures from the Egyptian MOP

Figure 2

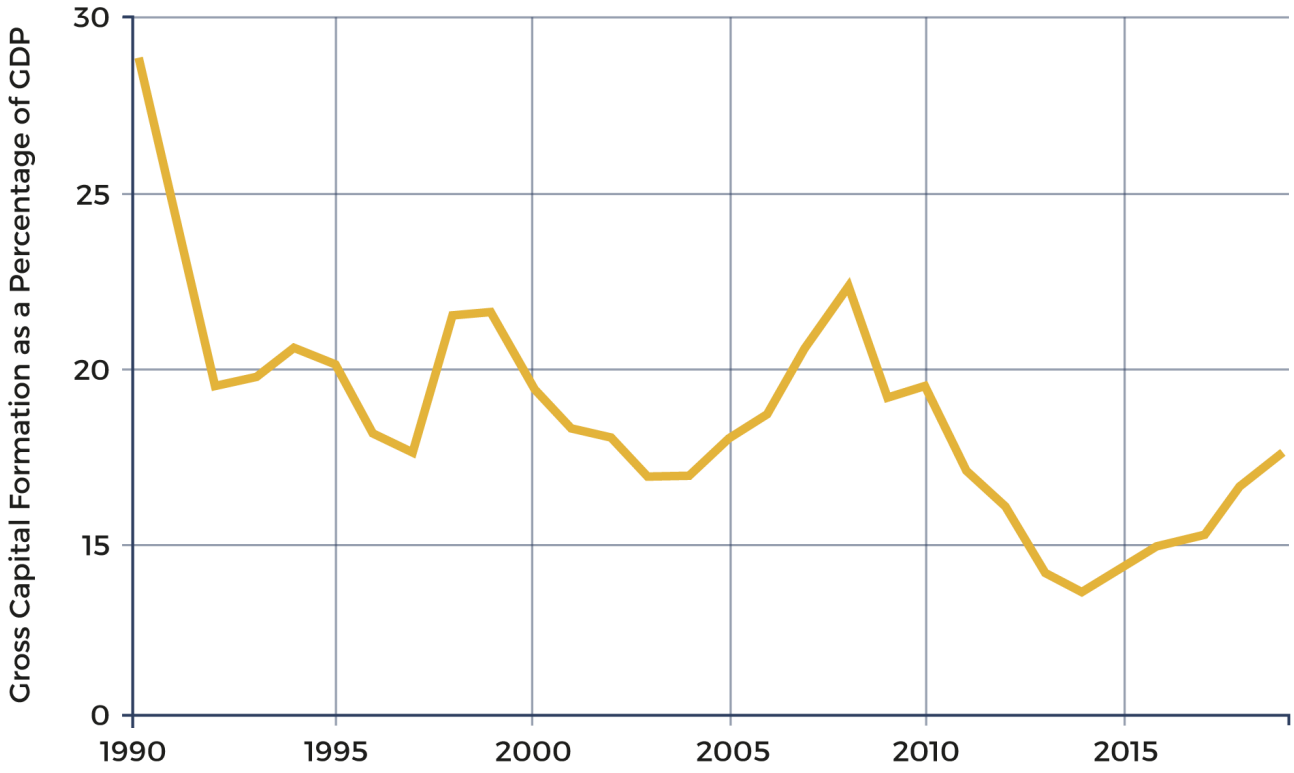
Employment to population ratio in Egypt from 1991 to 2019



Source: World Bank (n.d.-c).

Figure 3

Gross capital formation in Egypt as a percentage of GDP from 1990 to 2019



Source: World Bank (n.d.-d).

It should be noted that while some data for 2020 is already available, it was excluded from the dataset and analysis to ensure that the exceptional circumstances of the Covid-19 global pandemic did not distort the findings.

These datasets provide a sufficiently accurate picture of the evolution of the financial sector both in terms of size and type of investment. It does, however, come with a number of caveats. As will be discussed below, one aspect of financialization is the increased financial activity of non-financial entities. Unfortunately, neither indicator used here captures this likely growing phenomenon because they only capture the added value and financial assets of financial corporations. For example, if a manufacturing company makes profits through trade in financial securities, it will be recorded in the GDP as added value of the manufacturing sector, and it will not be captured by the bank assets/GDP indicator. This means that the contribution of the financial sector to GDP is likely to be substantially underestimated. This underestimation is confirmed by looking at the finance-related profits of listed companies: these constituted 11.2% of profits of both financial and non-financial firms in 2005, 27.9% of profits in 2009, and 69.4% of total profits in 2015 (Hanieh, 2016).

3. Literature Review

There has been an explosion of literature on financialization in recent decades, especially since the 2008 global financial crisis. Increasing global inequality and a deep economic crisis are often linked to the growing and shifting role of finance, prompting many scholars and commentators to examine the impact of a growing/changing financial sector and activity on economic performance in general as well as on the particular issues of growth, inequality, and job creation.

Bezemer and Hudson (2016), for example, wrote about how finance is a key barrier to the productive economy as it attracts funds away from it. For Gerald Epstein (2019) financialization is "the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international levels".

Despite the extensive literature, there has been considerably less attention devoted to financialization in the contexts of low- and middle-income countries. Bonizzi (2013) argues that financialization in "advanced" Anglo-American economies is based on the appreciation of financial asset prices (e.g., stocks and bonds), whereas in "developing countries," financialization often occurs through the increase in interest income since high inflation and the need to encourage capital inflows and discourage outflows pushed Global South governments to adopt high interest rates. This so-called "subordinate financialization" refers to a situation in which "financial capital can secure profits and take them out of the country safely, while industrial capital pays the penalty of low competitiveness" (Lapavistas & Kadri, 2018). Bonizzi also argues that the combined availability of high-return/short-term financial investments has led to a reduction in productive investments in many developing countries.

Adam Hanieh (2016) argues that a major limitation in the study of financialization is "that the vast majority of academic work on financialization has concentrated on the core capitalist countries—particularly the US, UK and Japan (and to a lesser degree, France and Germany)". According to Hanieh, work beyond these economies has been restricted to a handful of countries, notably, Brazil, South Korea and Turkey, and has largely focused on how these countries are inserted into global financial flows, rather than mapping the specificities of their own domestic financial markets. He adds that Arab countries have been almost completely absent from the debates on financialization.

Only Adam Hanieh has written about financialization in Egypt and the MENA region, but his focus is mostly on the scalar and spatial dimension of GCC accumulation and spillovers through the mediation of banks and financial institutions. As such, this policy paper attempts to shed light on the socioeconomic impacts of the growing financialization of economic activities in Egypt in particular, but also in Global South economic contexts more generally.

4. The Link Between the Financial Sector and Growing Unemployment

The financial sector witnessed formidable growth in the 1990s, largely attributable to the dramatic expansion of Egypt's stock market as a result of Law 95/1992 on capital markets, which led to the listing of over 600 stocks in the Cairo and Alexandria Stock Exchange in 1992 (Otaify, 2016). The growth in this period can also be explained by the shift in banking activity from lending to investments associated with the stock market, as well as the emergence of investment banks and brokerage companies. This transformation of non-interest bank profits was observed in many countries around the world during the same period (Bonizzi, 2013).

The subsequent decline may be partially explained by the two major financial crashes in the first decade of the millennium, the dotcom bubble of 2002 and the global financial crisis of 2008. Additionally, 26% of listed companies were delisted from the Egyptian stock exchange in 2002 due to new listing regulations, which might have also placed downward pressure on the financial sector's size (Otaify, 2016). During the same period, bank assets to GDP also fell from 78.32% to 61.37%. In addition to being a turbulent decade for financial investments, this was a decade of high GDP growth rates in Egypt. The indicators of financial sector size are both relative to GDP, which means that the decline in absolute size was less acute.

As for the last "stable" decade, since the contribution to GDP is largely determined by return on investment while the bank assets to GDP indicator is determined by the value of assets regardless of their return and profitability, the disparity between the stable relative size of returns and the growing size of assets is likely explained by the financial sector's shift to investment in low-risk/low-return financial assets, namely, sovereign debt.

On the employment front, the crisis of employment is everywhere a structural rather than cyclical crisis, caused by two distinct, yet related, factors: 1) the growing financialization of the economy due to a crisis of profit and saturation in traditional sectors (Kalogerakos, 2013); and 2) advances in labor-saving technologies restricting the creation of new jobs. For example, the global employment-to-population ratio declined from 62.4% in 1991 to 54.8% in 2020. This was exacerbated by the Covid-19 pandemic but the ratio was already at 57.5% in 2019 (World Bank, n.d.-a). Another indicator of the structural dimension of the employment crisis is the doubling of labor productivity from 1991 to 2019 (World Bank, n.d.-b). Simply put, this means that the same amount of goods and services need on average half the amount of labor to produce compared to 1991.

Egypt is no exception in this respect. Employment-to-population ratios have declined over the past three decades while GDP per person employed has also almost doubled in the same period (World Bank, n.d.-b). However, policy prescriptions for economic recovery following crisis or slowdown are almost always polarized between countercyclical (i.e., stimulus) or procyclical (i.e., austerity) measures, indicating that economic policy is dictated by a belief in the cyclical nature of the employment crises across the political and ideological spectrum, from the fiscally conservative, procyclical advocate to the "progressive", countercyclical evangelist. This polarization precludes effective policy discussions that acknowledge the structural causes of the crisis.

But what is the role of the financial sector in this crisis? There are strong indicators that the association between lower employment and the growth of the financial sector is more than just a coincidence. The first indicator is the low labor intensity of financial investments. In fact, the financial sector is one of the least labor-intensive sectors in Egypt. For every 1% of GDP contributed by the financial sector in 2017, there were 42,000 employees. In manufacturing, in contrast, there were 160,000 workers for every 1% of GDP whereas in agriculture the number was even higher at 224,000.[1] This means that when the financial sector grows at the expense of other sectors, it will not make up for the jobs lost in those sectors, especially when it attracts capital that would have

1 Author's calculation based on the 2017 CAPMAS Annual Bulletin of Labor Force Survey (Central Authority of Public Mobilization and Statistics, 2018) and the GDP data broken down by economic sector published by the MOP (n.d.).

been otherwise invested in more labor-intensive activities; this impact can be further aggravated when the financial sector itself invests in activities that do not create sufficient jobs.

Financial investments' ability to attract capital away from job-creating activities is more acute in high-interest Global South contexts. Capital and investment are diverted away from the increased risk in more traditional sectors such as manufacturing and agriculture and toward lucrative and safe investments in sovereign debt. Rowthorn (1995) argues that declining profitability and heightened risks in the real economy leads to lower capital formation and hence lower employment.

Moreover, Egyptian financial intermediaries have traditionally been overly prudent in dealing with the private sector, especially SMEs, which they often perceive as high risk (El-Said et al., 2013). This tendency is exacerbated when government debt emerges as a safe alternative. Figure 4 and Table 1 show how the share of bank credit extended to the private sector shrinks significantly in favor of government financing when the financing needs of the government increase. But even within the private sector, Egyptian banks preferred lending to private-sector firms connected to the state because they were seen to be implicitly supported by the state against failure (Diwan & Schiffbauer, 2018).

Official CBE data shows that in 2000, domestic credit had indeed mostly gone to the private sector and was supporting capital expenditure more than current expenditure, but this did not last long. At the time, domestic credit had a capital-current ratio of 70-30. This ratio was completely mirrored by 2020 when it became 30-70 (see Table 1). A breakdown of domestic credit extended by banks demonstrates that current financing constituted 90% of loans to the government, as well as all credit extended to the household sector. The reason only 90% of lending to the government is counted as current financing is because about 90% of government expenditure on average is current, while the remaining 10% is capital expenditure. Capital financing, on the other hand, included all lending to the private sector and the public business sector and 10% of all credit extended to the government. While this calculation is not without limitations, it gives a general idea of the tremendous shift in financing behavior in the last two decades away from non-government to government financing.

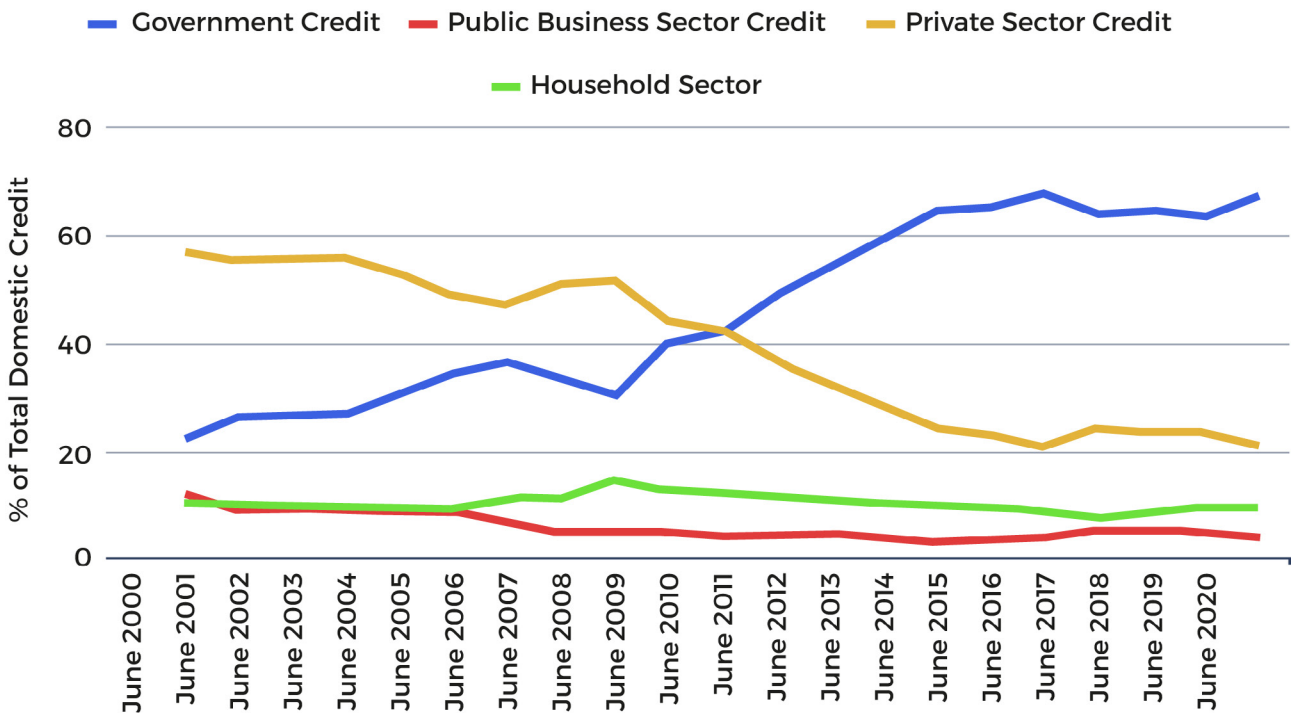
A look at interest expenditure helps make more sense of the nature of this shift. The government's expenditure on interest rates increased from about 18% of total expenditure in 2006 to 33% in 2020, reaching about 9% of GDP.[2] The fact that interest payments constitute double the financial sector's contribution to GDP indicates that a large chunk of these interest payments are collected by non-financial actors and foreign investors.

Although Egypt's high interest rate makes its financialization analogous to other experiences in the Global South, the Egyptian situation was peculiar in that Egyptian banks were the only ones in the region that witnessed a significant decline in banks' non-interest income between 1998 and 2013. This further indicates a movement toward investment in sovereign debt and away from non-interest income (i.e., fees and commissions). Egyptian banks' non-interest income was about 57% between 1998 and 2001, then dropped to 29% between 2010 and 2013 (Hanieh, 2016).

2 Based on data gathered by the author from different national budgets issued by the Ministry of Finance.

Figure 4

Breakdown of total domestic credit by sector in Egypt from 2000 to 2020



Source: Author's calculation from the CBE's Statistical Monthly Bulletins (see reference list for a list of specific issues)

Table 1

Capital and current credit as a percentage of total domestic credit from 2000 to 2020

Year	Capital credit of total domestic credit (%)	Current credit of total domestic credit (%)
2000	70.07	29.93
2001	67.14	32.86
2002	66.90	33.10
2003	67.01	32.99
2004	64.29	35.71
2005	60.33	39.67
2006	57.04	42.96
2007	58.51	41.49
2008	58.85	41.15
2009	52.48	47.52
2010	50.17	49.83
2011	44.80	55.20
2012	40.96	59.04
2013	36.70	63.30
2014	33.18	66.82

2015	32.38	67.62
2016	31.01	68.99
2017	35.07	64.93
2018	34.20	65.80
2019	33.48	66.52
2020	30.72	69.28

Source: Author's calculation from the CBE's Statistical Monthly Bulletins (see reference list for a list of specific issues)

5. Limiting the Harmful Effects of Subordinate Financialization on Job Creation

This section will outline the options for limiting the harmful effects of subordinate financialization on job creation. They are roughly divided into three main categories. The first are policy options for the tax treatment of financial profits, which aim not only at increasing tax revenues but also at making extractive financial investments less attractive relative to job-creating financial and non-financial investments. The second set of policy options concern monetary and financial regulation policies to limit the harmful effects of subordinate financialization. However, before delving into policy options, the paper will examine a third option, looking at how a Global South economy that has been traditionally home to one of the highest interest rates in the world managed to escape the trap of financialization or at least minimize its harmful impact with a set of short-term countercyclical interventions. The positive potential of short-term cyclical intervention should not, however, lead to a dismissal of the structural nature of the employment crisis and the need to consider long-term structural changes to offer more sustainable solutions to the long-term trends discussed in this paper.

The case of Brazil

When Brazil shifted toward neoliberalism and the commitment to monetary stability in the early 1990s, financial investments were primarily encouraged by very high interest rates. Bonizzi (2013) argues that the resulting expansion of public debt marked the internal financialization of the country and a redistribution of income from the middle class to financial capital.

The Central Bank of Brazil, which has traditionally been the guarantor of one of the highest real interest rates in the world, decided in 2009 to reduce the policy interest rate from 13.75% to 8.75%. The consequences of the cut seemed to bear out the oft-made claim that the country's high real interest rates were a key obstacle to economic development (Segura-Ubiergo, 2012): interest rate reduction along with increased government spending led to GDP growth of 7.6% in 2009 while inflation stood at 5.1% (Filho & de Paula, 2015). Reflecting the well-established inverse relationship between employment and interest rate (Feldmann, 2013), Brazil's unemployment rate fell in the wake of the global financial crisis from 8.52% in 2009 to 7.73% in 2010, and then to 6.92% in 2011 (World Bank, n.d.-e). Even the employment-to-population ratio remained stable at around 60% for a few years before and after the reduction in interest rate (World Bank, n.d.-f).

Egypt can perhaps learn a few lessons from the Brazilian government's response to the global financial crisis, which allowed it to emerge with minimal loss. Barbosa (2010) explained that contrary to the Latin American debt crises of the 1980s and its procyclical response in the 1990s, the Brazilian authorities in 2009 adopted a sequence of monetary and fiscal countercyclical actions to stop the international crisis from harming the Brazilian financial system. According to Barbosa, these actions helped the government absorb the worst of the crisis without any major disruption in the banking system, and an economic recovery was already evident in the second quarter of 2009; not only did unemployment not shoot up as feared, but real wages continued to grow, and consumer and business confidence was quickly restored (Barbosa, 2010).

The measures taken were a mix of monetary, fiscal, and regulatory actions. Monetary measures included a reduction in the reserve requirements by the Central Bank of Brazil and a substantial cut in the country's base interest rate. Fiscally, the treasury offered interest-rate subsidies for Brazil's two largest commercial banks and enacted a number of temporary reductions in federal indirect taxes on a selection of capital, consumer, and durable goods amounting to about 0.3% of GDP. Finally, the government required its own state-owned commercial banks to increase their lending to the private and SME sector during the crisis.

Barbosa argues that a number of preconditions for such policies were already in place. Firstly, countercyclical policies were supported by existing mechanisms of social protection that allowed the government to easily reach the most affected/vulnerable socioeconomic groups, who happened to also be the consuming classes and therefore the boosters of aggregate demand. The expansion and increased depth of social protection programs like Takaful and Karama could therefore similarly improve the Egyptian government's countercyclical interventions considerably.

Barbosa also argues that the economic approach of the administration at the time facilitated the countercyclical policy because the government authorities did not lose too much time debating the ideological implications of each policy initiative. Therefore, a rejection of austerity policies as a way out of crisis is a necessary precondition for the effective enactment of countercyclical policies.

5.1 Ending the preferential tax treatment of financial profits

Financial profits in Egypt are taxed at much lower rates than other forms of profit and income. Tax rates differ significantly depending on the type of security (e.g., shares, bonds, etc.), income (e.g., dividends, capital gains, etc.), and nationality. In general, they are subject to lower tax rates than non-financial income, whether wage income or non-financial profits (see Tables 2 and 3). A single rate for all types of income would have the advantage of lowering administrative and accounting costs, increasing clarity and certainty, simplifying the tax system, and most importantly, reducing the diversion of capital away from productive and job-creating activities by ending financial investments' preferential tax treatment.

Some steps in the right direction have been taken in recent years. For example, as of 2021 treasury bill profits were no longer exempt from income tax and were subject to a withholding tax of 20% (Hassan, 2021). Stock-trading profits are now subject to a 10% tax starting in 2022, albeit still far from the general non-financial income tax rates (see Tables 3 and 4).

Table 2

Tax rates for corporate financial income disaggregated by type of security

	Listed		Non-listed	
	Resident	*Non-Resident*	*Resident*	*Non-Resident*
Dividends	5%	5%	10%	%10
Stock dividends	0%	0%	0%	%0
Stock trading	10%	0%	22.5%	%22.5
Treasury bills and bonds	20%			
Non-financial income	22.5%			

Table 3

Tax rates for individuals' financial income disaggregated by type of security

	Listed		Non-listed	
	Resident	*Non-Resident*	*Resident*	*Non-Resident*
Dividends	5%	0%	10%	0%
Stock dividends	0%	0%	0%	0%
Stock trading	10%	0%	25%	25%
Treasury bills and bonds	20%			
Non-financial income	25%			

Source: Law 91/2005 on income tax (Manshurat Qanuniya, n.d.) & PwC (2021).

Such light taxation has three main effects: first, it puts a strain on the collection of corporate tax, affecting public resource mobilization; second, it intensifies capital diversion to financial activities; and third, it has an indirect and long-term effect on payroll tax and value-added tax (VAT) due to the possible negative impact on employment and consequently mass consumption, affecting resource mobilization even further. In other words, if there are fewer jobs available (especially in the formal sector), then payroll tax revenues will decline. Further, if fewer jobs place downward pressure on aggregate demand, this will eventually translate into downward pressure on VAT revenues as well.

Other than statutory tax rates, the financial sector is typically well-positioned to pay lower effective tax rates using various tax avoidance techniques due to the liquid nature of its investments, not to mention its role in assisting other sectors pay lower effective rates as enablers and intermediaries. For example, Oxfam research found that in 2015 the 20 biggest European banks made EUR4.9 billion in financial profits in Luxembourg, a low-tax jurisdiction for trade in European bonds. This amount is more than the profits of British, Swedish, and German banks combined. The research also found that European banks paid zero taxes on EUR383 million in profits made in tax havens in 2015 (Aubry & Dauphin, 2017). There is also sufficient reason to believe that similar dynamics are in play in Egypt, where it has been revealed once again that most commercial and investment banks have extensive tax haven operations.[3]

To limit tax avoidance by financial intermediaries, Egypt should be quick to sign international agreements aimed at combating tax avoidance, as well as critically engage more deeply with emerging

3 For an example of financial intermediaries as enablers in Egypt see al-Wakea, 2016, and as enablers and avoiders see Diab, 2016.

anti-tax avoidance global regimes to encourage the effective participation of low- and middle-income countries.

The main international agreement aimed at combating tax avoidance is based on the Common Reporting Standard (CRS), which is the main global standard for the collection, reporting, and exchange of financial account information on foreign tax residents. Devised by the OECD in the last decade to increase tax transparency and limit endemic tax avoidance practices that marred the global financial system in recent decades, the regime requires countries and tax authorities to exchange information about non-resident financial accounts, obtained annually from their financial institutions automatically, with the countries to which the account holders belong. This reduces the possibility of tax evasion by hiding assets abroad.

Egypt's engagement should be two-fold. It needs to participate actively in global efforts to combat tax avoidance, but at the same time it should mobilize against the current loopholes in the system that makes it biased against low- and middle-income countries. A study published by the Financial Transparency Coalition (n.d.) says that the CRS in practice excludes the lowest-income countries that are most affected by tax avoidance and asset hiding practices, and simultaneously the most in need of money due to their economic vulnerability. A loophole in the system allows the participating countries to choose the countries with which they will exchange information, which means, according to the report, that politically and economically weaker countries are usually excluded. The report says that none of the 31 low-income countries in the world receive any tax information about their citizens from abroad and only 21 out of 109 middle-income countries (19%) receive information. As for higher income countries, 55 out of 78 (70%) receive tax information on their citizens from other countries.

Although Egypt is a signatory to the Global Forum on Transparency and Exchange of Information for Tax Purposes, which aims at enhancing financial and banking transparency through the exchange of financial information of individuals and entities for tax purposes, it has not yet signed the CRS. Egypt has also not entered any bilateral exchange relationships since it has become a member of the Global Forum (OECD, n.d.).

Egypt should therefore play a more active role in ending the tax information regime's bias against Global South countries. As briefly mentioned above, the factors responsible for such imbalance can be summed up as follows: 1) the high administrative cost of collecting and exchanging such information, which acts as a barrier to low-income countries; 2) the principle of reciprocity, which dictates that recipient countries cannot receive tax information about their citizens and entities from another jurisdiction unless they reciprocate and send the counterpart jurisdiction financial information about their citizens; and 3) the ability of countries to pick and choose which jurisdictions they exchange information with on the pretext of concerns about the protection of personal data, which excludes many of the low-income countries.

Another option to limit potential tax manipulation in financial activities is to broaden the application of country-by-country reporting (CbCR) to include financial institutions that have offshore operations. CbCR obliges companies to report the profits of all entities associated with them in every country, allowing the tax authorities to assess whether the company is involved in profit shifting and tax avoidance. Research shows that the effective tax rate of financial institutions and banks that are subject to CbCR reporting is 2.5% higher than those that are not subject to the standard (Overesch & Wolff, 2021). As it stands, CbCR only applies to multinational enterprises (MNEs) with annual consolidated group revenue of EUR750 million (EGP15 billion) or more (Egyptian Tax Authority, n.d.). This threshold is too high, especially in Global South contexts, and will exclude about 90% of multinational enterprises (MNEs) from the reporting standard (OECD, 2020a), including some of the largest commercial and investment banks. The threshold for reporting should therefore match the economic context and reality of each country. The OECD itself admits that the current revenue threshold discriminates "against developing countries, where smaller MNEs can be responsible for larger shares of economic activity—and for larger shares of tax risk" (OECD, 2020b).

In fact, Egypt is among the few countries to impose a lower threshold for MNEs whose parent entities are tax residents in Egypt, setting the threshold at EGP3 billion instead of USD750 million (Egyptian Tax Authority, n.d.). However, this should be further

lowered for financial institutions since finance is a field that does not require the same high level of revenue to cheaply establish offshore shell companies for tax avoidance purposes.

5.2 Alternatives to high-interest monetary policy

Improving public resource mobilization will help tilt the balance toward job-creating finance because it will lead to less borrowing at high interest rates from capital markets, which should control the capital markets' overreliance on investment in government debt and encourage them to finance capital investments instead. As discussed above, the most mainstream way to control currency exchange rate in countries with structural imbalances is to promote a high-interest monetary regime. This approach, however, enriches bankers and financial investors (many of whom are foreign) on the backs of taxpaying citizens and low- and middle-income groups, as was the case in Brazil. It has also been found that countries that respond to inflation by raising real interest rates are more likely to experience employment contractions, with significantly higher costs for women's employment (Braunstein & Heintz, 2008).

While it is true that Egypt has lowered its interest rates since the momentous spike following the 2016 economic reform program, in April 2021 it still had the world's highest real interest rate (Magdy, 2021). The CBE should therefore lower real interest rates further and use a mix of non-interest fiscal and monetary measures inspired by the Brazilian experience to manage excessive inflation and "cool down" the economy in an equitable manner and only when necessary. These measures can include the sale of foreign currency on the spot market as well as the temporary manipulation of indirect taxes on consumer, capital, and durable goods.

5.3 Financial sector and capital market regulation

Having a wealth of state-owned banks, Egypt is well-positioned to craft a development-oriented lending policy akin to the Brazilian example discussed above. Indeed, in a very positive step, the CBE, as part of its SME financing initiative, used its leverage to instruct private and public banks to dedicate 20% of their debt portfolio to concessional financing to SMEs at 5% interest. However, available evidence suggests that banks did not comply and SMEs continue to face extreme difficulties in accessing finance; at best it is unclear whether banks have met this requirement (Amer & Selwaness, 2021). The only measure put in place at the moment to ensure bank compliance with the condition is exempting SMEs from banks' reserve requirements. To complement this incentive-based rather than penalty-based approach, the CBE should enact a credit guarantee scheme to lower the risk of SME financing by providing partial guarantees in cases of default.

When they are able to access finance, small-scale borrowers have to deal with predatory microcredit firms that charge up to 45% interest on their loans (Seif Eldin, 2021). Egyptian law also does not allow for the establishment of cooperative banks, which offer long-term maturity at a low interest rate to SME borrowers, reducing the extractive and regressive nature of high-interest credit regimes.

Cooperative banking played and still plays a significant developmental and poverty reduction role in Global South and Global North settings alike. The establishment of well-managed cooperative banks could also play a role in mobilizing the resources of low- and middle- income citizens by providing them with investment opportunities, both access to finance for small-scale borrowers and financial investment for small-scale depositors (Alternative Policy Solutions, 2019). A 2018 study on poverty alleviation through cooperative banking in India shows that in three Indian states financial inclusion through cooperative banks played a significant role in poverty reduction (Lal, 2018).

The study highlights that access to basic financial services such as savings, loans, insurance, and credit through cooperative banking has generated a positive impact on the lives of the poor. The positive impact was, however, limited for a variety of reasons, including a less than optimal presence in rural areas. Moreover, the loans were not low-cost and small enough, and know-your-client rules were too strict, placing administrative barriers on those who were already outside the system. Lack of knowledge about the banking products also limited

the success of cooperative banking as a poverty alleviation mechanism in the three Indian states. Despite such limitations, the study asserts that "cooperative banks have been playing an imperative role in the socio-economic development of the country by making available institutional credit at reasonable cost, particularly in the rural areas".

6. Preliminary Financial Regulation Measures

As discussed above, counterbalancing the impact of "subordinate" financial activity on employment and job-creating investment requires a broad mix of policies ranging from fiscal and monetary to legal and regulatory. To turn these measures into concrete policy, the government must conduct and engage with independent research detailing the impact of major macroeconomic monetary shifts on job creation and investments in the real economy.

In this section, some potential measures will be outlined. While they need further examination, they have the potential to yield fast yet lasting results, as well as start a much-needed structural shift to limit the negative effects of extractive "subordinate financialization". These measures mostly address the Central Bank of Egypt as the setter of monetary policy, and the Ministry of Finance as the setter of fiscal policy in separate sections below.

The employment crisis is multifaceted and structural, and hence cannot be reduced to a modification of financial policy on the national level. Given the scope of this paper, the policy measures in this section will be mostly limited to the regulation of financial markets. However, as discussed throughout the paper, there is a near inevitable secular evolution toward less employment due to improvements in labor-saving technologies. The exploration of non-work-based streams of income is therefore necessary, though it is beyond the immediate scope of this paper.

6.1 Fiscal measures

The Ministry of Finance should consider how to streamline different financial income tax rates to be on a par with non-financial income tax rates, preferably by subjecting financial income to the general income tax rate. In doing so, it should also ensure that speculative short-term investments are taxed at higher rates to promote long-term investments in job-creating activities. When preferential tax treatment is granted, it should be limited so as not to create a complex tax system, and it should prioritize sustainable and job-creating activities with a general socially favorable outcome. The ministry should also consider using budgetary savings from lower debt servicing costs to finance temporary reductions in VAT when necessary, and to design and support interest-subsidy policies directed at the SME sector especially when it is unable to reduce real base interest rates due to out-of-hand global macroeconomic conditions.

6.2 Financial market regulation and monetary policy

Both the Ministry of Finance and the CBE should explore ways to use widely available investment and saving certificates offered by public banks and post-office savings accounts to mobilize the savings of low- and middle-income groups and offer a larger number of financial investment opportunities with minimal institutional and capital barriers. This should ensure a more even distribution of financial profits derived from fixed-interest investments. They should also consider establishing cooperative banks. As it stands now, the law only allows for the establishment of banks as joint stock companies with a high capital barrier of EGP5 billion.[4] Cooperative banks would not only provide alternatives to the high-cost credit provided by microcredit firms, but also serve to mobilize the resources and savings of low- and middle-income households and individuals.

The CBE should consider lowering the real policy interest rate and adopting other measures to control

4 Article 64 of Law 194/2020 on the Central Bank of Egypt and the banking sector.

inflation when necessary, such as open market operations, including sales of foreign exchange on the spot market. Furthermore, to ensure that 20% of banks' loan portfolios is indeed directed toward SMEs, the CBE should explore the use of public commercial banks to enact similar policies to provide concessional loans to job-creating activities. It could also incentivize banks further to meet such a requirement by enacting a credit guarantee scheme to lower the risk of SME lending by providing partial guarantees to SMEs in cases of default.

At the international level, the government should further join Global South efforts to make the tax information exchange regime more balanced. This can be done either by introducing a period of non-reciprocity in the exchange of tax information until low- and middle-income countries develop the necessary administrative and infrastructural capabilities that would allow them to reciprocate information with other jurisdictions or by limiting the ability of single jurisdictions to pick and choose other jurisdictions to exchange financial information with, to avoid the current situation where most exchanges of financial information happen between and among high-income countries. Other measures it should consider include joining the CRS and entering into as many bilateral and multilateral financial information exchange agreements as possible. The government should also broaden the application of CbCR by lowering the threshold for financial institutions with offshore operations below the current annual revenue threshold of EGP3 billion.

7. Conclusion

Increased financial activity is due to the appeal of financial investments as an investment avenue characterized by low taxation, low risk, minimal effort, and high profitability relative to productive and job-creating economic activities. This trend is not peculiar to Egypt and is global in scope. However, high interest rates unique to the Global South context aggravate the adverse social impact of financialization and the extractive nature of its activities.

A lack of effective policy intervention will simply allow the continuation of already existing harmful trends that have marred national and global economies over the last few decades. Further growth of extractive finance in a high-interest rate environment can be expected to sustain and exacerbate income and wealth inequality and create downward pressure on job creation. The impact on wealth generation, as expressed by low capital formation, will also deepen the increasing unavailability of decent jobs, which have already become scarcer due to productivity gains resulting from improvements in labor-saving technologies. As a result, economic growth will become further decoupled from job creation and wage increases—a phenomenon that has characterized the age of neoliberal hegemony and its failed promise of spontaneous trickle-down economic growth and productivity gains.

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