The Impact of Tax Legislative Disruptions on the Increase of Informal Economic Activities in Egypt

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ABSTRACT
The study examines how legislative instability in tax laws affects the growth of informal economic activities in Egypt. It suggests that unclear or unsustainable tax regulations drive a shift towards the informal sector, fueled by benefits like tax evasion and reduced compliance costs. To encourage voluntary integration, the study proposes measures such as transparent tax laws, awareness campaigns on tax compliance benefits, and simplification of procedures. It advocates for policymakers to prioritize creating an environment conducive to integration over punitive measures. By fostering a fair tax system and addressing underlying factors driving informality, Egypt can boost tax revenue, ensure fairness, and promote sustainable growth. Employing a descriptive-analytical approach, the study analyzes secondary data from official reports, academic literature, and relevant publications. This method allows for a systematic examination of tax legislative disruptions’ impact on informal economic activities. It facilitates understanding the dynamics of tax regulations and their effects on informality by analyzing diverse information sources. This approach ensures reliable insights into the relationship between tax laws and the informal economy in Egypt.

KEYWORDS: Informal economy, Tax legislative, Formal economy, Tax revenues, Systematic taxation.

1. INTRODUCTION
Many countries worldwide grapple with the widespread phenomenon of informal economic activities (Elgin, 2010), which is often referred to as the informal economy (Baklouti & Boujelbene, 2019). In response, some nations continuously and frequently make legislative adjustments to their economic policies to address this issue (Attia et al., 2021). But has this contributed to reducing the prevalence of these activities? Furthermore, the Egyptian economy has faced significant challenges due to the exclusion of these activities from national economic assessments (Kassem, 2009). This omission has resulted in an inaccurate portrayal of the national income (Hamouda & Rashid, 2019), as numerous unreported incomes remain outside the purview of taxation (Mohamed, 2021). Clearly, the study of the growth and expansion of these activities requires careful consideration (Dibeh, 2020).

Due to a severe economic deficit witnessed by the Egyptian economy in recent years (Goel & Potempa, 2020) primarily caused by the increasing public debt (Mohamed, 2020) and the necessity of enhancing state resources to address this issue (Ahmed, 2020), several economic measures have been introduced (Farzanegan & Badreldin, 2020). These measures include decisions such as floating the exchange rate, reducing subsidies, increasing the value-added tax, and expanding the tax base. Currently, expanding the tax base is considered crucial in addressing the economic challenges in Egypt, especially given that it encompasses informal economic activities, which now constitute a significant portion of the overall economy. As a result, the central question of this study revolves around whether legislative disruptions have influenced the growth of informal economic activities. Can the integration of these activities into the formal economy through taxation be seen as a potential solution to address the economic challenges facing Egypt today?

2. METHODOLOGY
The study uses a descriptive-analytical approach to understand how tax legislative disruptions impact informal economic activities in Egypt. This method involves gathering secondary data from official reports, academic literature, and relevant publications to analyze the current situation.
The descriptive-analytical approach was chosen because it allows for a systematic examination of the subject matter. It helps in understanding the dynamics of tax regulations and their effects on informal economic activities by analyzing various sources of information. This approach ensures that the study produces reliable findings and insights into the relationship between tax laws and the informal economy in Egypt.

2.1 Theoretical Framework

Informal economic activities are those intentionally concealed from government authorities (Dell’Anno, 2022), evading legal obligations related to disclosing these activities (Terziev, 2020). Additionally, these activities can inherently be considered in violation of the prevailing legal system in the country (Sillah, 2019; Murunga & Wawire, 2021; Williams, 2023). The study was prompted by two primary considerations:

The first consideration pertains to the escalating proportions of the informal economy and the expanding workforce engaged in informal economic activities. These figures have notably increased year by year.  

Table 1 presents estimations and statistics regarding Egypt’s informal economy, utilizing data sourced from the Egyptian Ministry of Finance (Ministry of Planning and Economic Development, 2023). It is important to clarify that these estimates are mere approximations. Determining the exact size of the informal economy is a challenging task, given that many informal economic activities are either unreported or inadequately measured. Based on Figure 1, we can observe significant changes in Egypt’s informal economy over the past five years. Egypt’s informal economy percentage has increased, constituting approximately 40% of the total Gross Domestic Product (GDP). This means that the informal economy plays a crucial role in the Egyptian economy by providing employment opportunities and contributing to economic growth.

Table 1: Percentage of the informal economy by years of schooling

<table>
<thead>
<tr>
<th>Years</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of Employment in the Informal Economy (Million People)</td>
<td>22</td>
<td>23</td>
<td>24</td>
<td>25</td>
<td>26</td>
</tr>
<tr>
<td>Size of Employment in the Formal Economy (Million People)</td>
<td>25</td>
<td>16</td>
<td>17</td>
<td>18</td>
<td>14</td>
</tr>
<tr>
<td>Informal Economy (Percentage of Total)</td>
<td>35%</td>
<td>37%</td>
<td>39%</td>
<td>41%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Table 1 illustrates the employment rate in Egypt’s informal and formal economies from 2019 to 2023. In 2019, there were 22 million people employed in the informal economy compared to 25 million in the formal economy. By 2023, the number of individuals working in the informal economy increased to 26 million, while it decreased to 14 million in the formal economy. Regarding the percentage of the informal economy as a proportion of the total, it rose from 35% in 2019 to 41% in 2022, then declined to 40% in 2023; we can see that in Figure 2.

Additionally, it is noteworthy that there are numerous tax laws in Egypt that have been in place since 1939, with many amendments and the introduction of new taxes over the years. Some examples of these tax laws include (Ministry of Finance Arab Republic of Egypt, n.d.) Income Tax Law No. 91 of 2005 and its amendments (amended by Law No. 97 of 2018, Law No. 158 of 2018, and Law No. 26 of 2020 (Ministry of Finance Arab Republic of Egypt, n.d.)), Value Added Tax (VAT) Law No. 67 of 2016 and its amendments (amended by Law No. 83 of 2017 and Law No. 13 of 2020), Unified Tax Procedures Law No. 206 of 2020 (Ministry of Finance Arab Republic of Egypt, n.d.). These tax laws reflect the evolving tax landscape in Egypt, with various amendments and regulations aimed at managing taxation in the country.

In analyzing the percentages of the informal economy from 2019 to 2023 in tandem with the successive tax laws, a discernible exacerbation of the issue emerges. Consequently, it can be argued that as taxes and fees imposed by the public sector increase, the cost of operating within the formal sector rises substantially (Salah et al., 2020; Goel & Palempa, 2020; Masca & Chis, 2023). This, in turn, makes it challenging for small
and medium-sized enterprises (SMEs) to thrive, leading workers to opt for employment in the informal sector to avoid tax obligations (Bouriche & Bennini, 2020). Furthermore, the continuous changes in tax legislation often result in complexity and ambiguity (Sami, 2020). This complexity makes it difficult for both businesses and workers to comprehend their tax responsibilities (Berdiye & Schneider, 2020), thereby incentivizing them to operate in the informal sector to evade taxation (Torgler & Schneider, 2009). Recognizing the critical role of taxation systems in encouraging the transition from the informal to the formal economy (Blackburn & Capasso, 2012). Egypt has introduced a range of tax incentives, including simplified tax procedures, incentives for businesses formalizing their operations, and initiatives aimed at promoting tax education and awareness among businesses and workers. These measures are intended to address the challenges associated with the informal economy and encourage greater participation in the formal sector.

Law No. 152 of 2020 regarding the Small and Micro Enterprises Development Law, which emphasized their exemption from certain types of taxes when they apply for regularization, as tax revenues constitute a vital source for the government (Hassan & Schneider, 2016) to fund its social obligations and services to citizens (sharpness & Faisal, 2014) individuals provide these services in return for fulfilling (Deef & Al-fawaerh, 2021) their civic duty of paying taxes. However, the informal sector can present an opportunity for emerging economies to achieve economic growth by integrating it into the formal sector (Roy, 1992; Frey & Schneider, 2000). This integration can be facilitated through incentives, with one of the most important being the legislative stability of taxation (Baklouti & Boujelbene, 2019). It may also involve tax reductions or even complete exemptions for specified durations determined by the regulatory system. Failure to implement such measures can result in negative consequences, primarily an increase in tax evasion rates.

3. RESULTS AND DISCUSSION

3.1 Tax Law Instability: Fueling Informal Economies

Legislative instability in tax laws contributes to a reduction in tax collection and an increase in informal economic activity. When tax legislative instability escalates and tax laws become unclear or unsustainable in Egypt, individuals and small to medium-sized businesses may find advantages in turning to the informal economy to evade excessive tax obligations (Feder & Scharfstein, 1988). This can result in an expansion of activities within the informal sector (Uhl, 2013).

A rise in corruption within tax enforcement (Sultana et al., 2022), caused by legislative instability, may lead citizens and businesses to shift towards the informal sector to avoid bribery or reduce costs associated with tax compliance. Consequently, this could further boost the size of informal sector activities (Schneider & Enste, 2000). If citizens do not perceive the tax system as equitable and believe that tax burdens are unfairly distributed, it may drive them toward the informal sector, where some of these burdens can be evaded (Zanati & Abadir, 2022).

In conclusion, legislative instability in tax laws can have substantial implications on tax revenue collection and the prevalence of informal economic activities, potentially leading to adverse consequences for the formal economy (Mulunda, 2022).

The first result of section 3.1, namely, Tax Law Instability: Fueling Informal Economies, underscores the significant impact of legislative instability on the tax landscape in Egypt; the findings highlight that as tax laws become uncertain or unsustainable, individuals and businesses may opt for the informal sector to escape high tax burdens. This shift not only reduces tax collection but also leads to the expansion of informal economic activities.

Moreover, the connection between legislative instability and corruption within tax enforcement is noteworthy. The rise in corruption incentivizes actors to engage in informal economic activities to circumvent bribery and reduce overall compliance costs. This, in turn, contributes to the growth of the informal sector.

Additionally, the perception of tax inequity emerges as a critical factor. When citizens believe that the tax system is unfair, they may be inclined to participate in the informal economy to avoid what they perceive as unjust tax burdens. This dynamic further emphasizes the interplay between legal frameworks, public perception, and the formal-informal economic divide.

In conclusion, addressing legislative instability is pivotal for fostering tax compliance and reducing the prevalence of informal economic activities. A stable and transparent tax environment is essential for promoting equity, discouraging corruption, and supporting the formal economy in Egypt.

3.2 Tax Regulation Fluctuations: Driving Informal Economies in Egypt

The findings indicate that fluctuations in tax regulations have a detrimental impact (Krafitt et al., 2020) on informal economic activities (Ali, 2017) in Egypt. (Figure 1) demonstrates a consistent increase in employment within the informal sector, corresponding to the escalation of the informal economy as a percentage of the total, rising from 35% in 2019 to 41% in 2022. This positive correlation suggests that instability in tax regulations can drive economic activities towards the informal sector (Lopez-Martin, 2019).
If the costs associated with tax compliance in the formal sector are excessively high, individuals and businesses may perceive working in the informal sector as more financially attractive. The informal economy can provide individuals and businesses with the opportunity to evade or significantly reduce fees and taxes. In conclusion, the volatility of tax regulations can lead to negative consequences for the extent of informal economic activities in Egypt, driven by factors like regulatory opacity and the financial allure of the informal sector.

The second result section 3.2, namely, Tax Regulation Fluctuations: Driving Informal Economies in Egypt highlights the adverse effects of fluctuating tax regulations on the informal economy in Egypt. High costs related to tax compliance in the formal sector may act as a catalyst, pushing individuals and businesses towards the informal sector, where financial burdens are perceived to be lower.

Furthermore, the informal economy provides an avenue for individuals and businesses to circumvent or substantially decrease fees and taxes. The allure of financial benefits in the informal sector becomes more pronounced when tax regulations are unpredictable and subject to frequent changes.

In conclusion, the volatility of tax regulations plays a pivotal role in shaping the landscape of informal economic activities. Regulatory opacity and the financial advantages offered by the informal sector contribute to the expansion of informal economic activities in Egypt. Addressing these issues and promoting stable tax regulations can be crucial in curbing the growth of the informal economy and encouraging participation in the formal sector.

3.3 Towards Formalizing Informal Economies: Key Considerations for Tax Integration in Egypt
The integration of these informal activities into the formal economy (Tonuchi & Idowu, 2020) through taxation is deemed a crucial step toward enhancing tax revenue collection and achieving tax (Bennihi & Schneider, 2021) fairness in Egypt. Nonetheless, there are several factors that need to be considered (Abdel Ghafer, 2021).

3.3.1 Designing a Fair and Incentivizing Tax System
If the goal of the tax system is to promote compliance in the informal sector, it must be fair, reasonable, and financially motivating. Unfair or burdensome tax assumptions may hinder participation in the formal economy (Amoh & Adafula, 2019).

3.3.2 Educational Efforts and Awareness Campaigns
Efforts should be directed toward educating individuals and raising awareness about the importance of tax compliance, emphasizing its impact on economic development and the provision of public services (Kaloane & Bodhlyera, 2022). Informed individuals are more likely to willingly transition to the formal sector (Al-Najjar, 2019).

3.3.3 Incentivizing and Simplifying Tax Laws
Tax laws should be motivating and easy to understand. The more complex the regulations, the more likely activities will persist in the informal sector. Simplification can facilitate the transition to the formal economy (Elshamy, 2014).

3.3.4 Addressing Root Causes and Establishing Incentives
Solutions should be developed to address the root causes that drive individuals and businesses towards the informal sector (Estevão & Penela, 2022). Establishing secure incentives ensures sustainability. The goal should not only be the transition from the informal to the formal sector with high taxes and penalties, as this approach may deter integration into the formal economy (Moaaz & Mansour, 2023).

The third result section 3.3, namely, Towards Formalizing Informal Economies: Key Considerations for Tax Integration in Egypt emphasizes the importance of integrating informal activities into the formal economy through taxes to enhance tax revenue collection and achieve tax fairness in Egypt (Mohamed & Osman, 2023). However, achieving this goal requires serious consideration of several factors (Tawakol, 2023).

a. Fair Tax System: Designing a tax system is crucial. It should not only encourage compliance but also be perceived as fair and reasonable to avoid discouraging participation.

b. Educational Efforts: Education about the benefits of tax compliance is essential. Awareness campaigns can highlight the positive impact on economic development and public services, encouraging a sense of responsibility.

c. Simplification of Tax Laws: Complex tax laws may act as a barrier to transition. Simplifying regulations can contribute to easing the shift to the formal economy.

d. Addressing Root Causes: Understanding and addressing the root causes of working in the informal sector are necessary. Implementing solutions that provide secure incentives for transitioning to the formal sector is more sustainable than relying on punitive measures, In conclusion, a comprehensive approach combining fair tax policies, educational efforts, simplified regulations, and addressing root causes is essential for the successful integration of informal activities into the formal economy in Egypt.

4. CONCLUSION
The study underscores the substantial impact of legislative instability in tax laws on the proliferation of informal economic activities in Egypt. It reveals that
unclear or unsustainable tax regulations contribute to a migration towards the informal sector, driven by benefits such as tax evasion, reduced compliance costs, and avoidance of corruption within tax enforcement mechanisms.

Moreover, the findings emphasize the necessity for strategic interventions to integrate informal activities into the formal economy through equitable and incentivizing tax systems. Crucial considerations include the development of transparent and fair tax laws, dissemination of awareness regarding the advantages of tax compliance, simplification of procedures, and addressing the underlying factors compelling individuals and businesses toward the informal sector.

Policymakers are urged to concentrate on fostering an environment that promotes voluntary integration rather than relying solely on punitive measures. By establishing a fair and transparent tax system and addressing the root causes driving informal economic activities, Egypt can facilitate a smoother transition towards formalization while enhancing economic stability and sustainability.

Considering these findings, the following recommendations and potential policy interventions are proposed for Egypt:

a. **Tax Reform and Clarity**: Implement comprehensive tax reforms aimed at clarifying and simplifying tax laws to reduce ambiguity and uncertainty, thereby encouraging compliance among taxpayers.

b. **Awareness Campaigns**: Launch extensive awareness campaigns to educate individuals and businesses about the benefits of formalization, including access to financial services, legal protections, and opportunities for growth and expansion.

c. **Capacity Building**: Invest in capacity-building initiatives to enhance the administrative capabilities of tax authorities, enabling them to enforce tax laws and combat tax evasion and avoidance effectively.

d. **Incentive Structures**: Introduce incentive structures such as tax breaks, subsidies, and financial assistance programs to incentivize informal businesses to transition into the formal economy.

e. **Collaborative Approach**: Foster collaboration between government agencies, civil society organizations, and the private sector to develop holistic solutions addressing the multifaceted challenges associated with informal economic activities.

By implementing these recommendations and adopting a proactive approach towards formalization, Egypt can unlock the full potential of its economy, promote inclusive growth, and mitigate the adverse effects of informal economic activities on fiscal sustainability and economic development.

**REFERENCES**


