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Jobs for Shared Prosperity

Time for Action in the Middle East and North Africa

THE WORLD BANK

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Foreword

A job has always meant more than a salary. As a basic form of social engagement, it can be a critical source of self-fulfillment and self-worth. By that same token, unemployment and underemployment can have a significant psychological as well as economic impact. They can be a source of deep frustration and humiliation. The Arab Spring, and its call for jobs and dignity, made this connection explicit. The revolutions were also a stark lesson in how pervasive unemployment and underemployment can fuel instability. Along with the demand for more political inclusion, young people in particular took to the streets out of frustration with the lack of opportunities to put their skills and talents to productive use. Identifying and lowering the social and economic barriers that have idled large segments of the population continue to be one of the most significant policy challenges in the Middle East and North Africa region.

This report focuses on jobs as the key to understanding the many layers of exclusion that have produced the world's highest youth unemployment rate and left three out of every four working-age women outside the labor force. Each chapter unpacks one of the multiple factors that affect labor markets in the region, ranging from the educational system to government policy and the current governance of the private sector. The main message is that the current regulatory environment, by protecting certain markets and a few privileged insiders, stands in the way of a dynamic private sector and the more and better jobs it could provide. The rules need to change to ease the entry of new firms, supported by better access to credit. This adjustment would increase competition and serve as a vital catalyst for the innovation and investment that ultimately lead to more demand for labor. The current incentives that affect decisions about where to work and when to hire also need to be addressed. This effort would include phasing out the fuel subsidies that encourage investment in machines over the hiring of workers and diminishing the pull of the public sector to allow labor to flow to where it would be most productive. Easing employment regulations, coupled with a strong and well-targeted social safety net to protect the unemployed, would facilitate both hiring and mobility. An educational system more in tune with the needs of the private sector would also be another vital source of growth and jobs, equipping students with the skills and knowledge required by innovative businesses.

These conclusions form the basis of a comprehensive road map for change. The report identifies the specific barriers in the way of inclusive growth and private sector–led job creation and offers a series of policy options for overcoming them. It does not stop there, however. In recognition of the urgency of the situation, and of the difficulty in achieving the necessary consensus to effect change, the report proposes a series of steps to initiate the process. It recommends embracing the new spirit of openness to engage a wide cross-section of society. The goal would be to establish a common understanding of the nature of the problem and a shared commitment to a program for solving it. The report further suggests ways of bolstering the credibility of the reform process with short-term interventions, such as youth-targeted employment programs and investments in essential infrastructure that address immediate needs and produce visible results.

The Arab Spring revealed the true extent of the many challenges the region faces, but it also offered immense opportunities for breaking with the past and adopting a development model that benefits all its citizens. This report offers a formula for seizing those opportunities.

Inger Andersen
Vice President
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Preface

In the aftermath of the Arab Spring, when thousands of young women and men fought for the opportunity to realize their aspirations and potential, the question of jobs continues to be crucial in the Middle East and North Africa region. This report uses jobs as a lens to weave together the complex dynamics of employment creation, skills supply, and the institutional environment of labor markets. Consistent with the framework of the forthcoming *World Development Report 2013: Jobs* (of which this report is the regional companion), this work goes beyond the traditional links between jobs, productivity, and living standards to include an understanding of how jobs matter for individual dignity and expectations—an aspect that was clearly central to the Arab Spring. Just as important, this report complements the economic perspective with an analysis of the political economy equilibrium, with a view to identifying mechanisms that would trigger a reform process.

As such, the report has three objectives:

First, it seeks to provide an in-depth characterization of the dynamics of labor markets in the Middle East and North Africa and to analyze the barriers to the creation of more and better jobs. It does so by taking a cross-sectoral approach and identifying the distortions and incentives that the many actors—firms, governments, workers, students, education, and training systems—currently face, and which ultimately determine the equilibrium in labor markets.

Second, the report proposes a medium-term roadmap of policy options that could promote the robust and inclusive growth needed to tackle the structural employment challenge for the region.

Third, the report aims to inform and open up a platform for debate on jobs among a broad set of stakeholders, with the ultimate goal of contributing to reach a shared view of the employment challenges and the reform path ahead.

This work builds on a large body of existing literature, among which are a number of World Bank publications across various disciplines, including, but not limited to, the regional education flagship, *The Road Not Travelled: Education Reform in the Middle East and North Africa* (World Bank 2008); the regional private sector flagship, *From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa* (World Bank 2009); the regional financial sector flagship, *Financial Access*

and Stability: A Road Map for the Middle East and North Africa (World Bank 2011a); the regional companion report of the World Development Report 2012 on gender, *Opening Doors: Gender Equality in the Middle East and North Africa* (World Bank 2013); the regional reports *Striving for Better Jobs: The Challenge of Informality in the Middle East and North Africa* (Gatti et al. 2012) and "Public Employment Services in the Middle East and North Africa" (Angel-Urdinola, Kuddo, and Semlali 2013); and various Middle East and North Africa Economic Developments and Prospects Reports (such as World Bank 2011b).

Jobs in the Middle East and North Africa are a complex matter. This report captures many, though not all, of the contributing factors. For example, while the report addresses energy and agricultural subsidies, as well as the link between jobs and infrastructure, others issues of relevance for job creation—such as the role played by urbanization in the agglomeration process, or the role of ongoing conflict—are left for future research.

Finally, this report covers all the countries of the Middle East and North Africa region in line with the World Bank definition. However, availability of recent and good-quality data on firms and households and access to information about institutional structures eventually shaped the geographic focus of the report.

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Abbreviations

AKP	Turkish Justice and Development Party
CAPMAS	Central Agency for Public Mobilization Statistics
CEO	chief executive officer
CSO	civil society organization
CWA	collective wage agreement
D-index	dissimilarity index
ECA	Europe and Central Asia
ELMPS	Egypt Labor Market Panel Survey
EPZ	export processing zone
ER	employment rate
ES	Enterprise Surveys
EU	European Union
FDI	foreign direct investment
GCC	Gulf Cooperation Council
GDP	gross domestic product
HBS	Household Budget Survey
ICA	investment climate assessment
ILO-KLM	International Labour Organization–Key Indicators of the Labour Market
IRR	internal rate of return
ISCO	International Standard Classification of Occupations
LAC	Latin America and the Caribbean
LAO	limited access order
LFP	labor force participation
LFPR	labor force participation rate
LFS	Labor Force Survey
LI	labor inspection
LIC	low-income countries
LLL	lifelong learning
LMIS	labor market information systems
LMO	labor market observatory

LMPS	Labor Market Panel Survey
LSMS	Living Standards Measurements Survey
M&E	monitoring and evaluation
MECOVI	Program for the Improvement of Surveys and the Measurement of Living Conditions in Latin America and the Caribbean
MENA	Middle East and North Africa
MFN	most-favored nation
NEET	neither in education, employment, or training
NGO	nongovernmental organization
OAO	open access order
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OOLF	out of the labor force
PAYG	pay as you go
PES	public employment service
PISA	Programme for International Student Assessment
REER	real effective exchange rate
SME	small and medium enterprises
SOEC	single open-ended contract
SSC	Social Security Corporation
SYPE	Survey of Young People in Egypt
TFP	total factor productivity
TIMSS	Trends in International Mathematics and Science Study
TVET	technical and vocational education and training
UA	unemployment assistance
UAE	United Arab Emirates
UI	unemployment insurance
UR	unemployment rate
USAID	U.S. Agency for International Development
VET	vocational education and training
WAP	working-age population

Main Messages

The Middle East and North Africa has a large reservoir of untapped human resources, with the world's highest unemployment rate among youth and the lowest participation of females in the labor force. Desirable jobs, defined as high-paying or formal jobs, are few, and private employment is overwhelmingly of low added value. Overall, the region's labor markets can be characterized as being inefficient, inequitable, and locked in a low-productivity equilibrium. High wage differentials and low mobility of workers to better-quality jobs underscore the fact that human capital is not allocated to its most productive use. The fact that access to desirable jobs depends more on circumstances beyond individual control than on merit leads to an inequitable distribution of employment opportunities. Finally, while some of the most coveted jobs are in the public sector and provide high individual returns, these are not necessarily associated with the highest productivity for society.

MESSAGE 1: *Change the "rules of the game" to create a dynamic private sector that capitalizes on the full range of the region's human capital.*

The slow growth of firms and their limited capacity to generate quality employment are directly linked to the rules governing the business environment. Uneven enforcement of regulations, access to credit on the basis of privilege and connections, and lucrative markets still protected by multiple legal and regulatory barriers have combined to stifle competition. However, an aggressive simplification of business procedures and regulations, making them transparent and easily understood and holding the authorities that administer them accountable, could provide a remedy. Access to credit could be expanded by increasing bank competition, embracing regulatory reforms, and building credit information systems, which would allow banks to lend to more firms and small borrowers. A comprehensive reduction of barriers restricting entry and exit into protected markets would create the incentives to invest and innovate and thereby increase the demand for labor.

MESSAGE 2: *Let skills flow into productive private sector jobs by realigning employment conditions in both the private and the public sector, and by rethinking labor regulation. Lower the barriers holding back women who want to work.*

Strict regulations and a public sector that continues to offer better employment conditions severely limit the flow of skilled labor to the most productive sectors of the economy. While these restrictions protect a minority of existing workers, they have contributed to high rates of informal employment and joblessness, especially among youth and women. These distortions are further exacerbated by energy subsidies that make investment in machinery relatively cheaper than hiring workers. The introduction of unemployment insurance and a well-targeted social safety net would allow governments to ease labor regulations and gradually phase out very costly energy subsidies. Specific policies would be needed to lower the barriers that women who want to work face so as to guarantee a safe working environment and support for the extra domestic burdens that they shoulder.

MESSAGE 3: *Make young people employable by closing information gaps, improving quality and relevance of skills, and partnering with the private sector in training.*

Although young people and families in the Middle East and North Africa invest heavily in education and training, the majority of youth cannot capitalize on such investments and use their skills to best advantage. The quality and relevance of the skills acquired are low, and the importance of merit in gaining a job is limited. Meritocracy in access to education and hiring, the availability of multiple pathways in education, and the provision of second-chance options are key elements for developing a productive workforce. More meritocracy signals market needs more clearly to educational and training systems. By doing so, it creates demand for the "right" skills in the "right" areas and reduces mismatches. Finally, the quality of education and its value in the labor markets need to be assessed regularly through standardized tests and the results fed back as a basis for reform and as a way to empower users.

MESSAGE 4: *Use short-term interventions to respond to immediate needs while building the credibility and consensus for medium-term, game-changing reforms.*

Establishing the right environment for the implementation of reforms requires a broad consensus on the nature of the employment problem and building inclusive constituencies for change. Some of the critical first steps are improving access to data and information, including the full range of social actors in the reform dialogue, and implementing short-term programs that deliver visible results and thereby support the credibility of the process.

Executive Summary

Jobs are crucial for individual well-being. They provide a livelihood and, equally important, a sense of dignity. They are also crucial for collective well-being and economic growth. However, the rules and incentives that govern labor markets in Middle East and North Africa (MENA) countries have led to inefficient and inequitable outcomes, both individually and collectively. Several underlying distortions prevent a more productive use of human capital and have led to a widespread sense of unfairness and exclusion, of which the Arab Spring was a powerful expression.

The MENA region has vast untapped human resources, along with the world's highest unemployment rate among youth and the lowest female participation in the labor force. At the same time, desirable jobs—defined as high-paying jobs or those with social insurance coverage—are few: private employment is overwhelmingly of low value added, and the public sector still provides the majority of formal jobs. High wage differentials, low mobility, and stark and persistent geographic differences in employment outcomes underscore the inefficiency with which labor markets in MENA allocate human capital. Moreover, access to desirable jobs predominantly reflects circumstances such as gender, location at birth, and parental education rather than individual effort. Some of the most coveted jobs, such as those in the public sector, provide high individual returns but do not necessarily provide the highest social productivity, exacerbating these inefficiencies and inequities. Gallup's recent polls show that the overwhelming majority of youth would rather work in the public sector. The incentives that workers face therefore push MENA labor markets into a low-productivity equilibrium: to increase the chances of securing a public sector job, young people choose higher education degrees that are not relevant to the private sector. Those who can afford to, spend time queuing for those public sector jobs with the expectation of relatively high pay for low productivity. In light of the fiscal constraints that countries are facing and the rising share of highly educated individuals, this model of labor market success is unsustainable.

Many barriers contribute to this equilibrium. The process of creative destruction, which led to technological upgrading in fast-growing East Asian and Eastern European economies, is weak in MENA's private sector. A few well-established firms operate under a regime of privilege and modest competition, while young businesses and small and medium enterprises struggle to grow or

gain access to markets. Moreover, energy subsidies distort relative input prices, thereby promoting capital-intensive rather than labor-intensive production. Discretionary enforcement of regulation and constrained access to credit undercut competition and dynamism in the private sector. As a result of these factors, job creation has not been sufficient to keep up—in numbers or in quality—with the demographic pressure from new labor market entrants nor with the expectations of increasingly educated youth.

Existing labor market regulations reinforce the status quo. In some countries, wage floors and rigid employment protection generate incentives for firms to operate informally, which limit their opportunities to grow. Moreover, the employment package offered by the public sector creates important distortions: with generally good salaries, benefits, and job security, it outcompetes the private sector in attracting qualified workers.

With no feedback mechanisms from firms and a legacy of state-led industrialization, the main focus of educational systems continues to be the production of future employees for the public sector. While MENA has the highest percentage of firms in the world complaining of inadequate skills, the incentives for educational and training systems to cultivate relevant skills and competencies are muted. Moreover, a rigid tracking system and restrictive university admission policies promote a logic of selection rather than of quality of education. This result is reflected in MENA's disappointing performance in international assessments such as the Programme for International Student Assessment (PISA) and the Trends in International Mathematics and Science Study (TIMSS) when compared to countries with a similar gross domestic product. When formal skills have less value in hiring than other factors such as personal networks, the distribution of jobs becomes even less equitable.

The Arab Spring and increasing global competition have shown that this fragile equilibrium cannot be sustained any longer—socially or economically. The medium-run policy options for addressing the structural employment challenge in the region are linked by the common thread of breaking privilege to foster inclusive economic and employment growth.

In the private sector, creating a level playing field on which firms can compete and grow and enacting reforms that improve access to credit and remove the current distortions in relative input prices are critical. More moderate employment-protection legislation, accompanied by a system of income support for displaced workers, could promote more dynamic labor markets. A realignment of public sector employment will likely reduce public-private dualism. Finally, pension reform will be needed to address the current fiscal unsustainability of these systems and make the extension of coverage affordable. Producing the skill sets necessary to sustain this new dynamic economy will require better governance, including more systematic measurement of results and increased involvement of the relevant stakeholders.

Most of these policy recommendations are well known and broadly shared. If this is the case, why haven't these reforms come to pass? What could finally trigger the reform process?

MENA countries face a complex legacy. Before the Arab Spring, governments tended to rely on a system of rent sharing among a relative minority, as well as on universal subsidies of basic consumption goods. There were many aspects to this equilibrium: (1) public employment responded to the demand for guaranteed secure jobs by the middle and upper classes; (2) access to credit was concentrated in an extremely small set of well-connected firms; (3) restrictions on the right of association strongly limited the role of civil society organizations; and (4) lack of access to data prevented an informed social dialogue.

The Arab Spring's powerful demand for democracy and voice carries unprecedented opportunities for disrupting this system of privilege and for moving toward a new and more inclusive model of development. However, it also carries challenges: governments are under tremendous pressure to deliver

results rapidly, which might push them toward populist, fiscally costly measures that continue to reinforce current divides. Longtime outsiders might see the current political transformation as the opportunity to finally become the new insiders, thus generating a mere alternation of elites. Moreover, there is evidence that it is difficult for new governments to embrace ambitious reform agendas, something that could be particularly daunting in the midst of the current drop in economic growth and fiscal revenues.

A number of processes, however, could trigger and support the political economy of reform. By investing early in visible and measurable gains, governments in MENA could consolidate their credibility and prepare the ground for game-changing reforms to come. Short-term interventions that can have important, albeit transitory, impacts on jobs include well-evaluated programs to improve youth employability, as well as labor-intensive public works. Implementing reforms to improve access to credit would reduce one of the biggest constraints to growth and job creation for small and medium firms and also endogenously promote a broader private sector constituency for reform. However, without transparent information and a truly inclusive social dialogue, it will be hard for the region to live up to its great potential and to come to a shared view on the merits of reforms. As it has occurred historically in other regions, this process will require investing in data openness and leveraging the new social forces, including a bigger and more representative role for trade unions, employers' associations, and civil society.

And, if not now, when?

Overview

Introduction

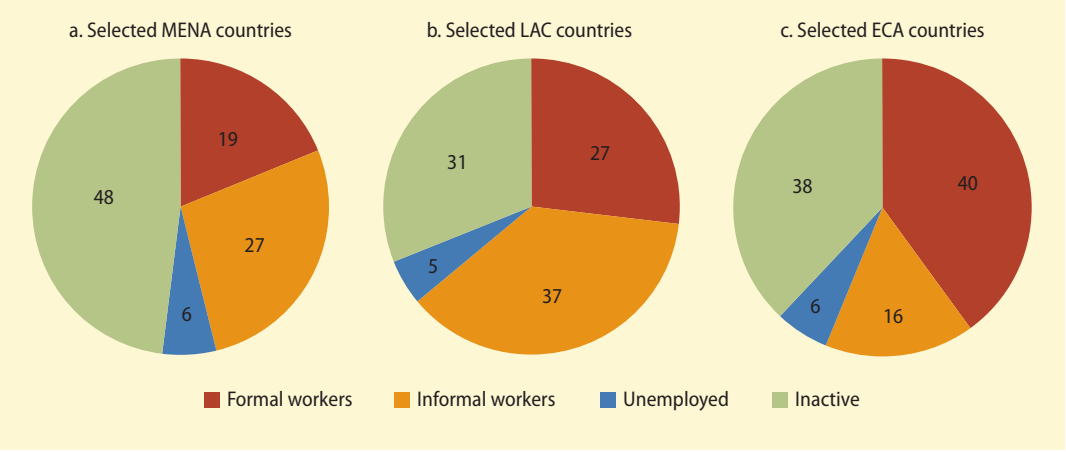
Jobs are crucial for individual well-being. They provide a livelihood and, equally important, a sense of dignity. They are also crucial for collective well-being and economic growth. However, the rules and the incentives that govern labor markets in countries of the Middle East and North Africa (MENA) region have led to inefficient and inequitable outcomes both individually and collectively. In particular, several underlying distortions prevent a more productive use of human capital and have led to a widespread sense of unfairness and exclusion, of which the "Arab Spring" was a powerful expression.

MENA has a large share of untapped human resources. Unemployment and inactivity are more prevalent in MENA than in other middle-income regions like Eastern Europe and Central Asia and Latin America and the Caribbean (figure O.1), as a high proportion of the working-age population, particularly women, is inactive or experiences high unemployment.

Three out of four working-age women do not participate in the labor force and constitute 80–90 percent of MENA's inactive population (see figure O.2). Unemployment is persistently higher than in other regions and overwhelmingly affects youth and women. In some countries, such as the Arab Republic of Egypt and Tunisia (figure O.3), the highly educated are more likely to be unemployed. In most countries however, the majority of the unemployed are still medium- or low-skilled individuals. Among those who are employed, low-quality jobs—those characterized by low pay and productivity, and lack of access to social security—tend to be the majority. The formal private sector—quite likely the most productive segment of the economy—is small, and in no country in MENA for which data are available does the formal private sector employ more than 20 percent of workers. At the same time, public sector employment continues to be large in the Persian Gulf countries and in countries such as Egypt, Iraq, Jordan, and, to a lesser extent, Tunisia, making up between 60 and 80 percent of total formal employment (see figure O.5).

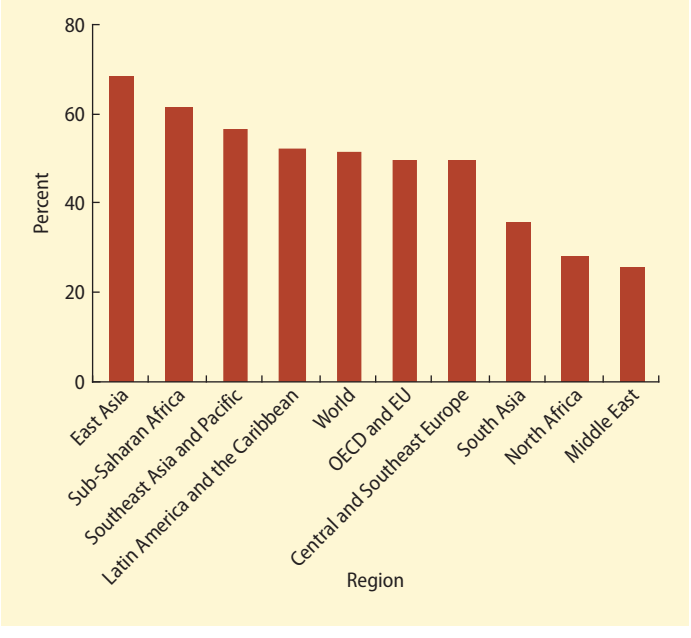
How can one interpret the realities of labor markets in MENA? What are the barriers to creating more and better-quality jobs? What policy options do governments have for addressing these challenges? And, finally, what political-economy processes might facilitate and enable reform? This report tries to answer these questions by

FIGURE O.1 Composition of the working-age population in MENA and two other regions, 2010
percent



Source: Based on the International Labour Organization–Key Indicators of the Labour Market (ILO-KILM) database.
Note: ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa.

FIGURE O.2 Rates of female labor force participation, by region, 2008



Source: ILO–KILM database.
Note: EU = European Union; OECD = Organisation for Economic Co-operation and Development.

looking at the development process through a jobs lens, with a focus on the region's underlying labor demand, the incentives for investing in and generating relevant skills, and the regulatory environment as it affects job creation and quality. It then discusses how these factors have collectively produced the employment challenges in the region and what policy options would be effective in overcoming them.

Labor markets in MENA: Inefficient and inequitable

Since a large share of the population either does not participate in any economic activity or gains little out of it because of the limited availability of high-value-added jobs, the labor markets in the region function at a low-productivity equilibrium. In addition, the allocation of talent is distorted toward the public sector, which has limited productivity in the aggregate but offers highly desirable conditions from the individual standpoint. This equilibrium is both inefficient and inequitable.

Inefficient allocation of human capital

A number of symptoms indicate that labor markets in MENA do not allocate human capital to obtain its highest return: (1) important wage differentials persist across sectors and individuals that are not explained by differences in human capital;

(2) workers' mobility from low-productivity to high-productivity employment is very limited; and (3) geographical differences in labor market outcomes persist.

Wage differentials for similar levels of education

In many MENA countries, returns to education (especially primary and secondary education) are high in the public and formal private sector and very low in the informal sector. Figure O.6 plots the expected wage of an average worker by years of education and employment in the public, formal private, or informal private sector in Egypt and in Jordan. A typical worker in the formal private sector, with no experience and 12–16 years of education (equivalent to completing secondary and tertiary education, respectively), would earn a salary twice to three times that of a worker with similar education in the private informal sector.[1]

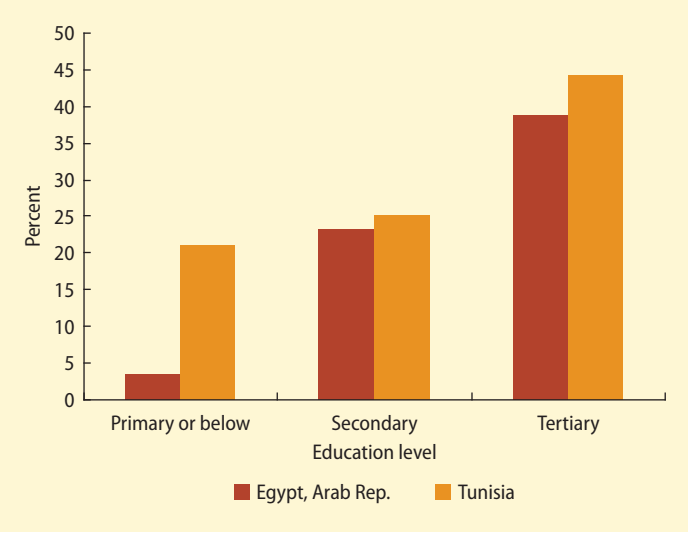
Low mobility across high-pay and low-pay sectors

Low mobility across different kinds of employment, especially toward better-quality jobs, indicates that labor markets do not arbitrage the allocation of human capital effectively across job opportunities. For instance, when data from the Egypt Labor Market Panel Surveys (ELMPSs) are used to track changes in employment status for the same individuals from 1998 to 2006, results indicate high persistence in public sector employment and in formal wage work (see table O.1).

Although mobility is higher among informal wage workers, their chances of moving to better jobs over the eight-year period covered by the surveys are still limited. Similarly, self-reported mobility data from Jordan and Lebanon indicate that job mobility across informal and formal employment is lower in these countries than observed in comparator countries such as Mexico (Gatti et al. 2012).

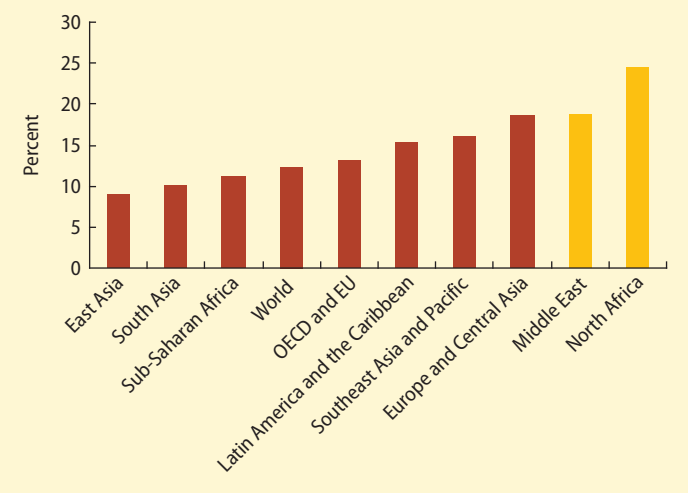
Overall, the evidence points to limited labor reallocation, especially toward more productive jobs. Two factors contribute to this "mobility deficit." First, high-value-added jobs are in limited supply. In addition, strict labor regulation prevents employers from dismissing workers in response to business needs. As a result, few vacancies are likely to open at any point in time, giving incentives to those who obtain jobs early in life to stay

FIGURE O.3 Youth unemployment rates in the Arab Republic of Egypt and Tunisia by education level, ages 15–29, 2010



Source: Based on the Tunisia Labor Force Survey (LFS) 2010 and the Egypt LFS 2010.

FIGURE O.4 Youth unemployment rates by region, ages 15–24, 2008



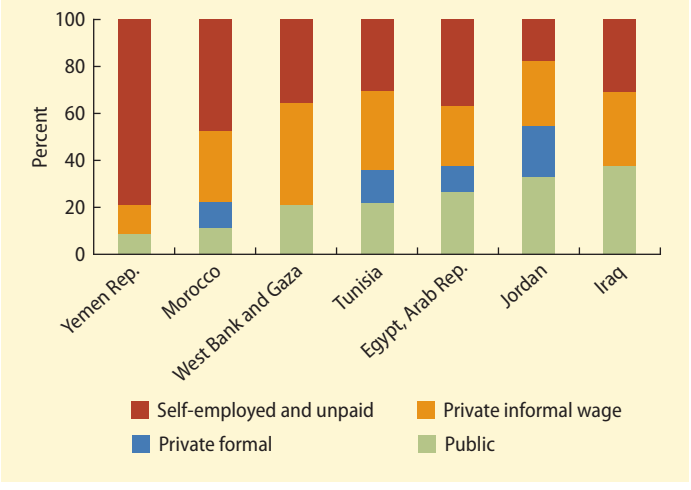
Source: ILO–KILM database.
Note: EU = European Union; OECD = Organisation for Economic Co-operation and Development.

in them for long periods and to those who do not to queue for an opening.

Stark and persistent geographical differences in unemployment rates

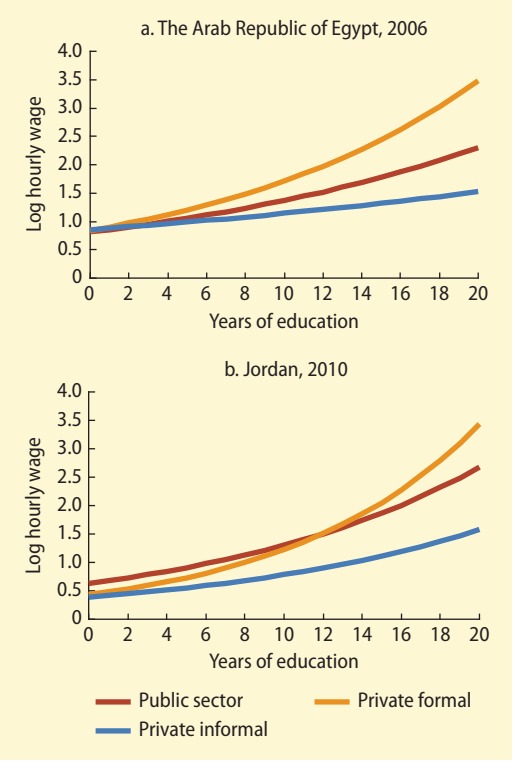
Stark and persistent differences in unemployment rates across geographical areas indicate that geographical mobility has a

FIGURE O.5 Work status of employed individuals in selected MENA economies, 2005–10



Source: Based on the Jordan Labor Market Panel Survey (LMPS) 2010; the Egypt LES 2010; the Tunisia LFS 2010; the Iraq Household Socio-Economic Survey 2006, 2007; the West Bank and Gaza LFS 2009; the United Arab Emirates LFS 2009; the Yemen Household Budget Survey (HBS) 2005–06; and the Morocco Household and Youth Survey (HYS) 2009.

FIGURE O.6 Expected wage by years of education in the Arab Republic of Egypt, 2006, and Jordan, 2010



Source: Based on the Jordan LMPS 2010 and the Egypt Labor Market Panel Surveys (ELMPS) 2006; E(w|Yrs of edu) = exp(C + β_1 Yrs of Edu. + β_2 Experience + β_3 Experience squared).
Note: Estimations based on Mincer model. Sample includes wage earners in urban areas working between 30 and 60 hours per week.

TABLE O.1 Employment transition matrix in the Arab Republic of Egypt, 1998 and 2006

All workers, 1998	Inactive, 2006 (%)	Unemployed, 2006 (%)	Public, 2006 (%)	Formal wage earner, 2006 (%)	Informal wage earner, 2006 (%)	Employer, 2006 (%)	Self-employed, 2006 (%)	Unpaid, 2006 (%)	Total, 2006 (%)	N
Workers with university education										
Public	11	1	87	1	1	0	0	0	100	710
Formal wage earner	5	0	20	65	6	2	2	0	100	86
Informal wage earner	11	4	21	23	26	9	7	0	100	57
Employer	7	2	10	0	2	67	11	2	100	61
Self employed	3	0	0	3	3	41	48	0	100	29
Workers with at most secondary education										
Public	12	0	79	2	2	2	1	0	100	971
Formal wage earner	6	1	7	52	17	9	9	0	100	172
Informal wage earner	6	2	9	9	42	20	11	1	100	598
Employer	7	0	4	2	5	69	12	1	100	297
Self-employed	11	1	5	2	10	27	40	5	100	320

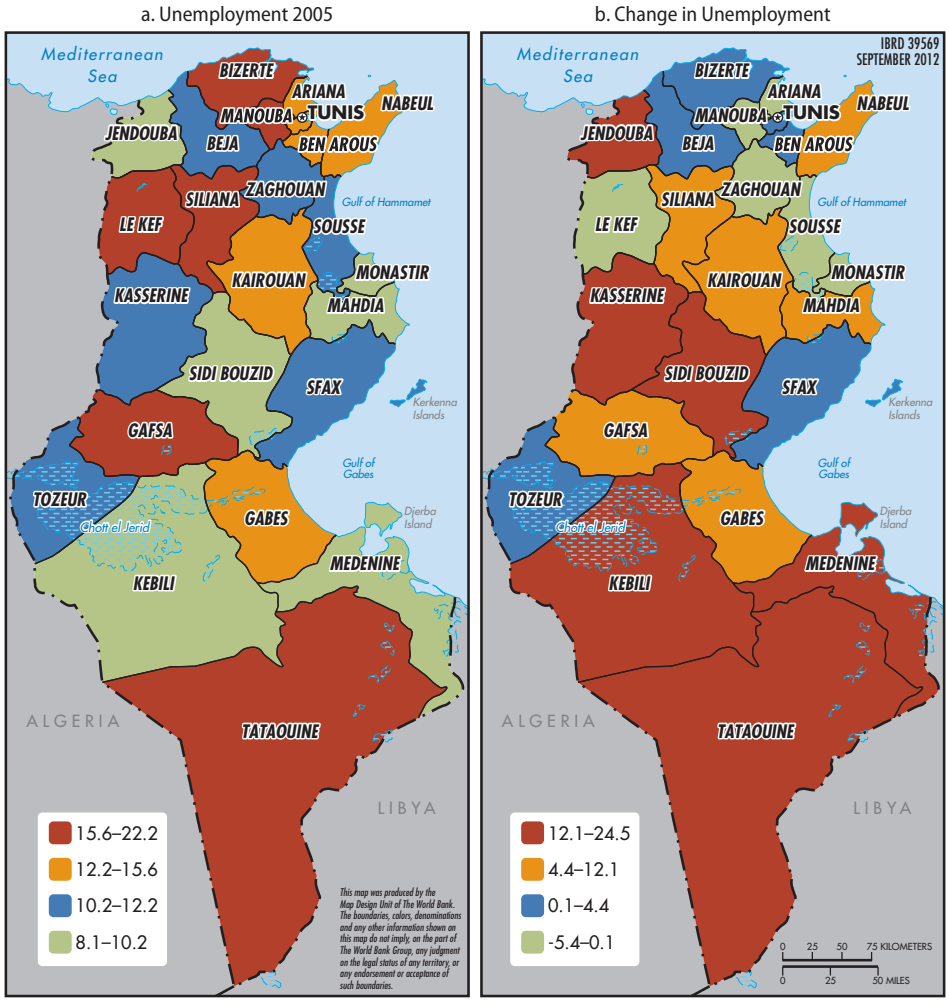
Source: Based on the Egypt ELMPS, various years.
Note: N = number. Sample data are for individuals between 31 and 64 years of age.

limited role in evening out differences in labor market outcomes within a country—another symptom that labor markets are segmented and operate in isolation.[2] This phenomenon is exacerbated when better jobs are concentrated in particular regions (for instance, public sector jobs are often concentrated in the main metropolitan areas). Tunisia, for example, has important variations in labor market outcomes across regions; some of the interior regions bordering Algeria face particularly high unemployment rates (figure O.7a). Some of the regions with highest unemployment rates in 2005 (such as Gafsa and Tataouine) also displayed the highest rates of increasing unemployment between 2005 and 2011, suggesting that the workforce in these regions faces mobility constraints (figure O.7b). In parallel, labor force data for Tunisia indicate that among the lower skilled and female unemployed, the distance to available jobs is among the top reasons for refusing job offers.

Inequitable distribution of job opportunities

Desirable jobs in MENA are jobs that offer either protection and employment stability

FIGURE O.7 **Levels and trends in regional unemployment in Tunisia, 2005–11**
percentage points

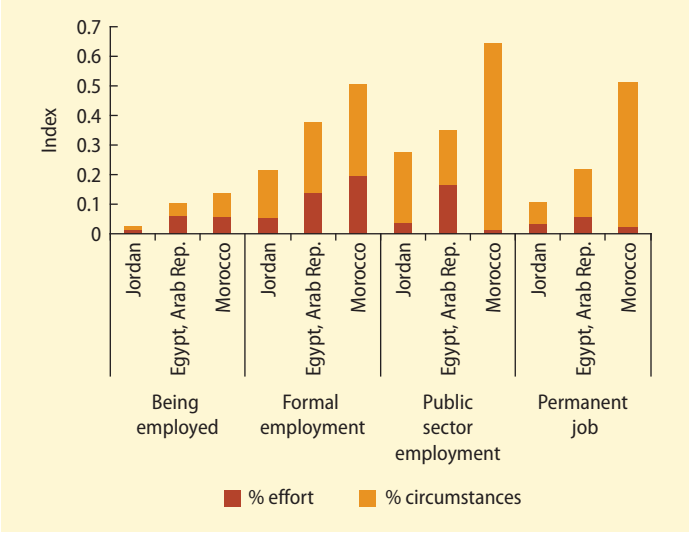


Source: Based on the Tunisia LFS, various years.

or a high income. The evidence suggests that, in many countries, the process through which individuals obtain these jobs often does not reflect effort or merit (as proxied, by education and experience) but instead reflects circumstances over which the individual has little control, such as gender, location, family connections, and parents' education (figure O.8).

Building on the large literature on inequality of opportunity, the dissimilarity index (D-index) offers a synthetic measure of inequality in the distribution of labor market outcomes among groups with different circumstances (see Barros et al. 2008). When used to explain outcomes among youth in Egypt, Jordan, and Morocco, this index indicates that gender plays an overwhelming role in determining the extent of inequality in employment outcomes across individuals. This result is unsurprising, given women's low participation in the labor force and the high rates of unemployment among women who do participate. Among young men, inequality of opportunity in all cases is explained mainly by exogenous circumstances outside the individual's control. Inequality in the outcomes "formal employment" and "public sector employment" (which are correlated) is rather high for all countries (the D-index oscillates between 0.2 and 0.7) but is consistently lowest in Jordan and highest in Morocco (where these jobs are scarcer).

FIGURE O.8 Decomposition of the dissimilarity index by circumstance and effort for men ages 21–34 in the Arab Republic of Egypt, Jordan, and Morocco, 2009 and 2010



Source: Based on Jordan LMPS 2010, Survey of Young People in Egypt (SYPE) 2009, and Morocco HYS 2010.

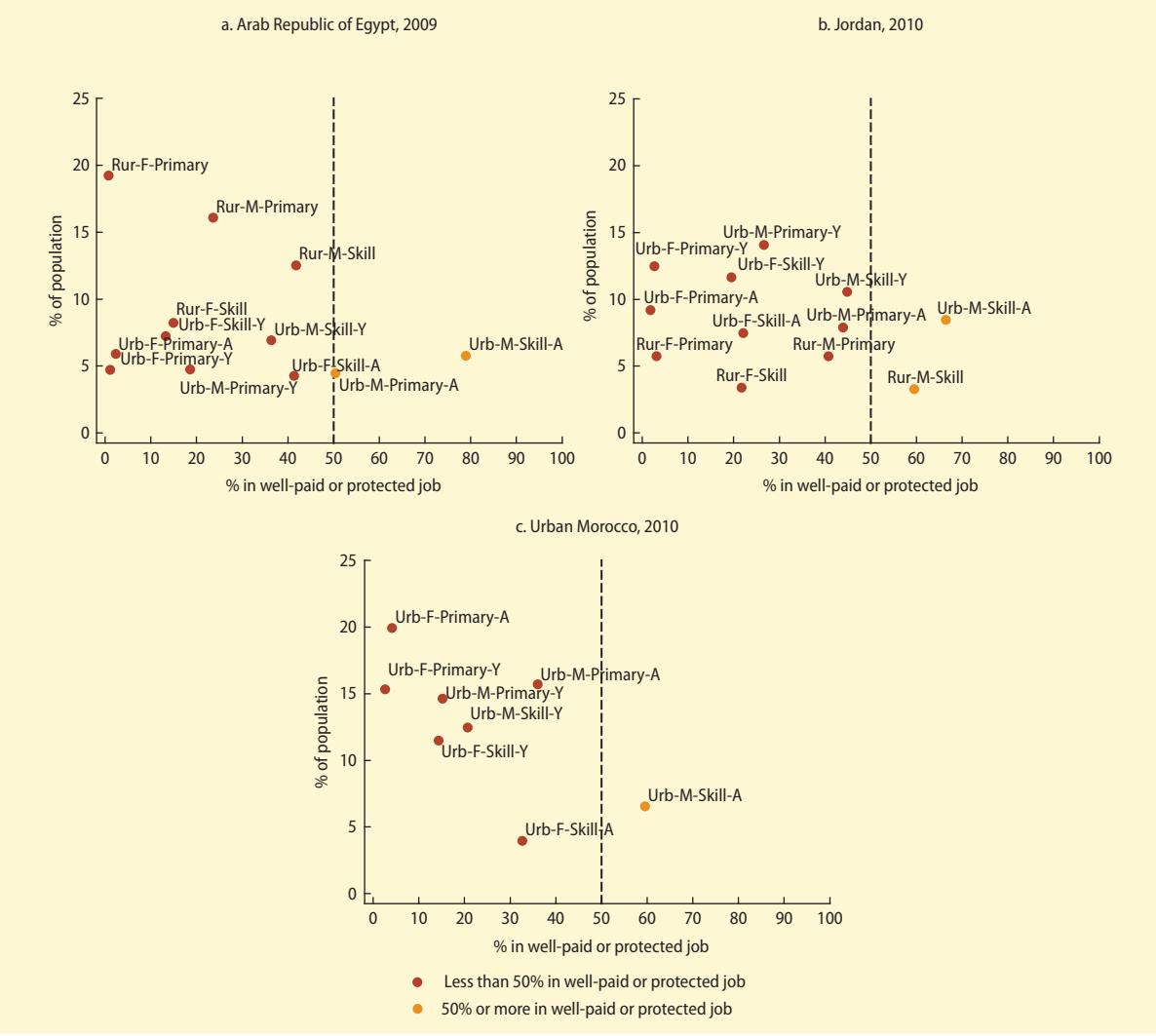
Disproportionate effect of the low-productivity equilibrium on women and youth

Labor markets in MENA seem to offer several paths to what could be understood as "success" in labor markets. Workers can achieve success through a well-protected job (especially in the public sector), through high-paying employment in the private sector, or through high-paying self-employment.[3] However, the inefficiencies laid out earlier affect the chances of achieving a "desirable job" in different ways for different individuals. Figure O.9 maps the extent to which working-age members of different socioeconomic groups hold a high-paying or protected job. Groups are constructed along four main socioeconomic dimensions: gender, location (urban or rural), age (young or prime age), and skills (high or low).

Figure O.9 suggests that the allocation of these desirable but scarce jobs (benefiting 18 percent of the workforce in Morocco and 24 percent in Egypt) is not uniform across the population. In spite of important variations across countries, in general young people, women, and rural, low-skilled workers are markedly less likely to have such a job, while the opposite is true in the case of prime-age men.

An equally important point is that some of the most coveted jobs, such as those in the public sector, provide high returns individually but are not necessarily associated with the highest productivity socially. Data on individual preferences from Gallup show that in some countries the overwhelming majority of the population would rather work in the public sector and that this attitude persists among

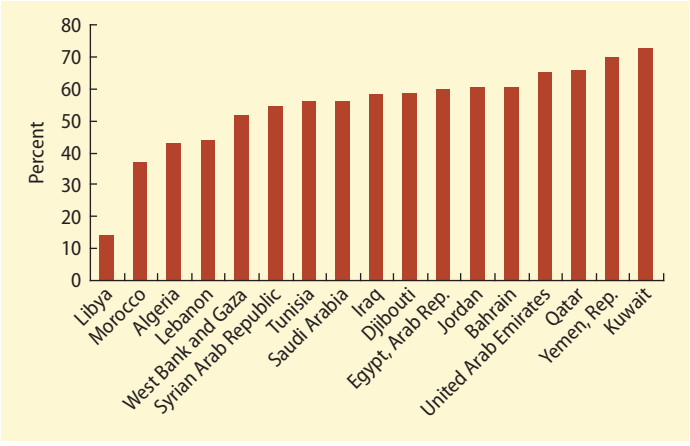
FIGURE O.9 Share of workers with high-paying or protected jobs among the working-age population in the Arab Republic of Egypt, Jordan, and urban Morocco, 2009 and 2010



Sources: Based on Egypt SYPE 2009, Jordan LMPS 2010, and Morocco HYS 2010.
Note: The x-axis represents the share of workers in group J (say, urban-male-skilled-adult) holding desirable jobs, as a percentage of the working-age population; the y-axis represents the share of that group in the working-age population. Group characteristics are abbreviated as follows: Urb: urban; Rur: rural; F: female; M: male; Primary: with primary education or below; Skill: with secondary education or above; A: adult (35–64); Y: youth (15–34). For instance, 79 percent of urban men aged 35–64 with secondary education or above were in well-paid or protected jobs in 2009 Egypt, and they represented 6 percent of the working-age population.

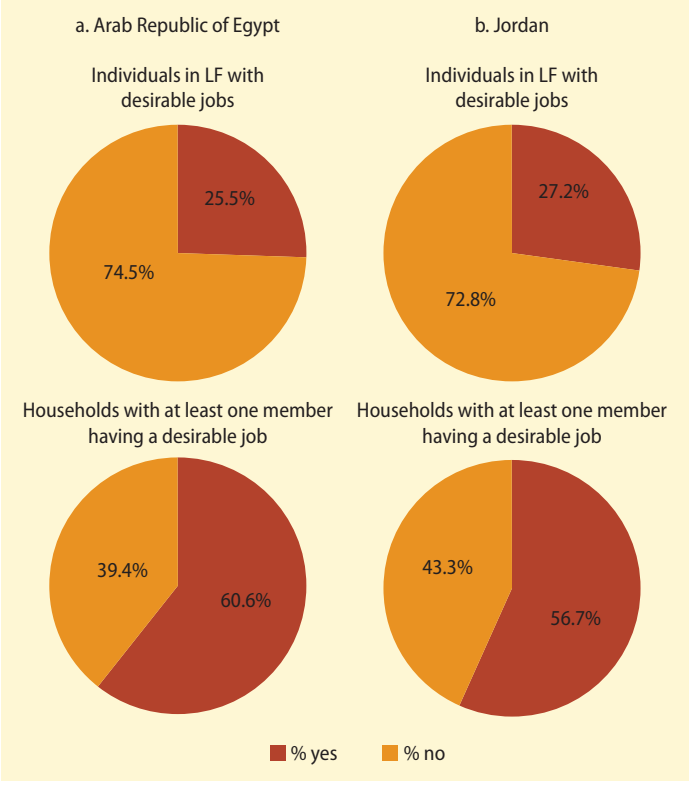
the young generation, in spite of changes in hiring rates in the public sector over time in nonoil countries (see figure O.10). In this way, workers' individual incentives push MENA labor markets to a low-productivity equilibrium: to increase the chances of securing a public sector job, young people choose advanced degrees that are not as relevant to the private sector. Those who can afford it spend time "queuing" with the expectation of relatively high pay for low intrinsic productivity. In light of the fiscal constraints that countries are facing and the rising share of highly educated individuals in the labor market, this model of "success" is unsustainable.

FIGURE O.10 Preference for public sector employment among youth ages 15–34 in selected MENA economies, 2010



Source: Based on Gallup World Poll Survey 2010.
Note: MENA = Middle East and North Africa.

FIGURE O.11 Percentage of individuals and households with desirable jobs in the Arab Republic of Egypt (2009) and Jordan (2010)



Source: Based on the Jordan LMPS 2010 and the Egypt SYPE 2009.
Note: LF = labor force.

A distribution of job opportunities that limits the incentives to change

Although well-paid or protected jobs are few, a large number of households benefit from them because at least one household member is in this condition: for example, about 6 of every 10 households in Egypt and Jordan have at least one individual with a desirable job (figure O.11). With so many people benefiting indirectly from these jobs, the distribution of job opportunities, though unequal, constitutes a political-economy equilibrium that proves hard to alter. This equilibrium is a mixed blessing for the region. On the one hand, it can be considered a (very inefficient) safety net. Even if inequality in labor markets tends to be high, this distribution keeps overall income inequality at a moderate level in MENA countries. On the other hand, the equilibrium sustains relatively high reservation wages (that is, the lowest wage for which an individual is willing to work) among both women and youth in a large section of the population. It explains in part why households can afford to have so many unemployed youth and so many women outside the labor force. Finally, this distribution of job opportunities does not provide the best incentives for individual talent to find productive outlets.

Who are the most affected by the low-productivity equilibrium in labor markets?

Youth, women, and rural, low-skilled workers are the least likely to have a protected or well-paying job. As such, they are overwhelmingly inactive or unemployed or work informally for low pay. Figure O.12 represents the varying degrees of disadvantage or labor market exclusion that underlie these outcomes. For example, some women are inactive because they are not allowed to work (exclusion), while others might decide not to seek work voluntarily (choice).

The following sections explain the specific extent of disadvantage for each of these groups.

Youth

Youth in MENA face a limited number of good employment opportunities compared to the adult population. Depending on their socioeconomic circumstances, young people respond to labor market conditions either by weathering long-term unemployment, if they can afford it; working informally out of need; or becoming discouraged and stopping their job search altogether. Many young women remain inactive because of choice or family pressure.

High joblessness and young people's distance from the labor market

Unemployment is conventionally singled out as overwhelming evidence for a youth disadvantage in the labor market, as it is highest among the young. However, the share of young people neither in employment, education, or training (NEET) better captures the extent to which young people are not participating in the labor market and not building skills to participate in the future.

Figures O.13 and O.14 show that NEET rates in MENA countries are pervasive and that they can be many times higher than unemployment rates, particularly for those with little education. For instance, according to household survey data, in Iraq unemployment among individuals aged 15–24 with a primary school education is 18 percent; perhaps more tellingly, though, 58 percent of individuals in the same reference group are neither in education nor working.

Moreover, for a large portion of out-of-school youth, inactivity is more prevalent than unemployment. While this fact is less surprising with respect to young women, given historical trends in the region, it is worrying that inactivity is more prevalent than unemployment even among male school leavers in many countries, including Egypt, Iraq, Lebanon, and the Republic of Yemen. Much of the inactivity among young men could be due to discouragement, which in turn is indicative of their hopelessness and progressive disengagement from labor markets.

FIGURE O.12 A framework for interpreting the labor market disadvantage

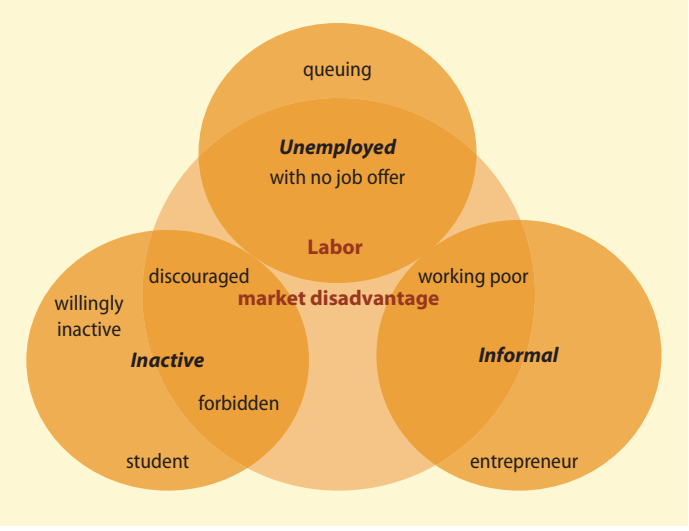
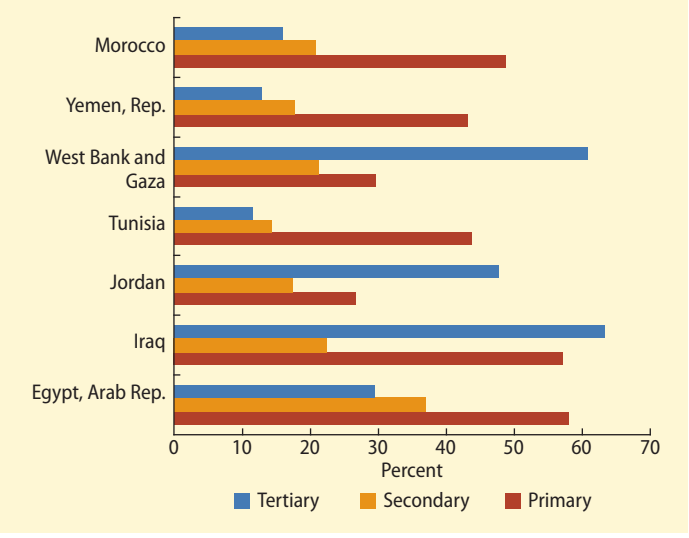


FIGURE O.13 Youth NEET rates in selected MENA economies by education level, individuals ages 15–24, 2008–10

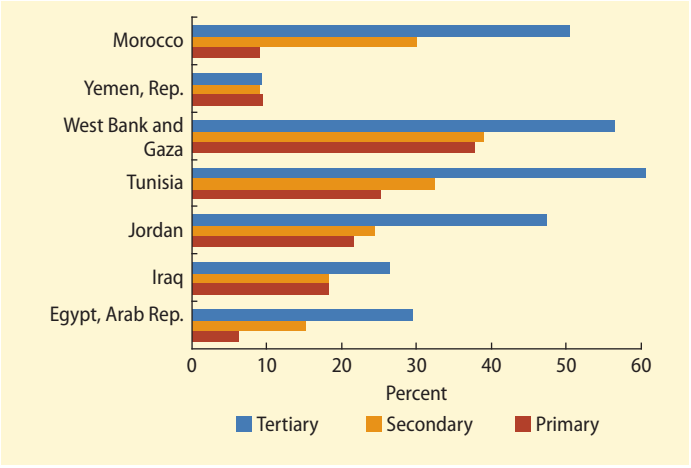


Source: Based on the Republic of Yemen HBS 2005; the West Bank and Gaza LFS 2008; the Tunisia LFS 2010; the Jordan LMPS 2010; the Iraq HSES 2006; the Egypt SYPE 2009; and the Morocco LFS 2009.
Note: MENA = Middle East and North Africa. Data refer to those out of school and out of work (OSOW).

Slow transition to work

High youth joblessness can be interpreted mainly as the result of a slow, incomplete transition from school to work—in other words, an extended period of entry into the labor market for those seeking jobs for the

FIGURE O.14 Unemployment rates in selected MENA economies by education level, individuals ages 15–24, 2005–10



Source: Based on the Republic of Yemen HBS 2005; the West Bank and Gaza LFS 2008; the Tunisia LFS 2010; the Jordan LMPS 2010; the Iraq HSES 2006; the Egypt SYPE 2009; and the Morocco LFS 2009.
Note: MENA = Middle East and North Africa. Data refer to those who are unemployed.

first time. This slow transition results from two concurrent dynamics. The first is the historically sluggish demand for labor in the private sector and falling hiring rates in the public sector in some countries, which together curtail the number of jobs available relative to the number of labor market entrants. The second involves young people's expectations and preferences for seeking a public sector or a highly paid private sector job exclusively.

In most countries in MENA, men with higher-level education make the transition from school to work surprisingly more rapidly than men with secondary education, with the notable exception of Egypt and Tunisia. Hence, even if during the years of transition the more highly educated face higher unemployment, tertiary education represents a relative advantage in the labor market. According to one interpretation of this phenomenon, after completing their studies, those with a tertiary education appear to search for jobs more intensively and to be more selective about which jobs they accept and after some years tend to settle into a job. Less-educated job seekers appear to encounter much greater difficulty in finding any job whatsoever, and even many years after they complete their studies, the prevalence of unemployment decreases only partially for this group. For instance, in the West Bank and Gaza, it takes nine years for 75 percent of secondary-educated males (who no longer study) to enter employment. The transition is much shorter for tertiary-educated men, at three years. In spite of their relatively small size and relatively quicker transition to employment, tertiary educated job-seekers benefit from about half of all active labor market programs across MENA countries, according to a recent survey of public employment services (Angel-Urdinola, Kuddo, and Semlali 2013).

Working for the public sector continues to dominate young people's job preferences. Public employment has become ingrained in society as the main path toward social mobility, even though it is no longer as viable as before. New cohorts of labor market entrants continue to expect jobs resembling those occupied by previous generations. Analysis of the internal rate of return to a government job in Morocco over a worker's lifetime shows that even accounting for the forgone income during unemployment, the current generous conditions for public sector work continue to make queuing for a public job a frustrating but rational strategy for educated job seekers (Bodor, Robalino, and Rutkowski 2008).

Women

Low rates of labor force participation

On average, three out of four women in MENA are outside the labor force, and they constitute the vast majority of the inactive population. Although women's participation in the labor force in the region has increased in the past few decades, that increase has been slow. At the current rate, and given the low starting point, it would take 150 years for MENA countries to reach the current world average for the labor force participation of women (World Bank 2013). Low levels of female labor force participation are explained primarily by the lack of participation among women without tertiary education, who

constitute the vast majority of the working-age female population (figure O.15).

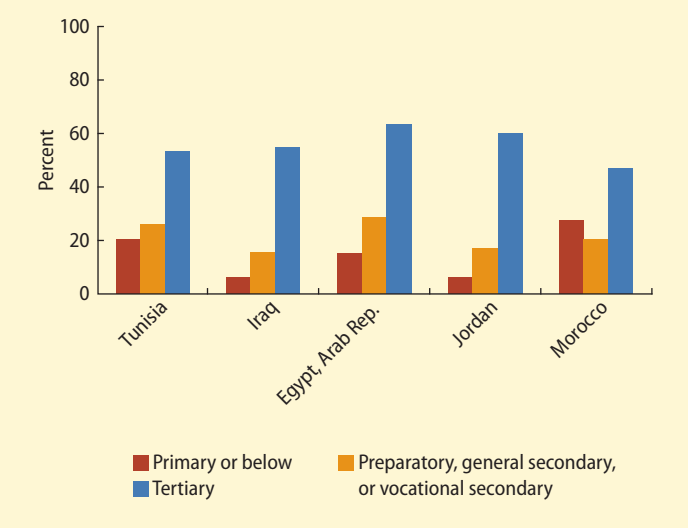
The typical factors that determine an increase in women's labor force participation worldwide, such as a decrease in fertility and improvements in education, also play a role in MENA. However, other factors, such as social norms and the role assigned to women within the family, remain important determinants. For example, evidence from Morocco indicates that women who are allowed to decide alone whether to participate in the labor force are much more likely to participate (figure O.16). The same data also show that, after marriage, women's decision-making power is substantially reduced.

Disadvantages for working women in MENA

As in many other countries, in MENA women who work are often concentrated in specific occupations. Data for 2006 from Egypt, for example, show that most women work in agriculture and education (about 60 percent of all employed women), while most men work in transport, retail, tourism, and manufacturing (which are generally better-paid industries). In Egypt, women work disproportionately in the public sector, which offers employment conditions that are perceived as more suitable for them, particularly in respect to job safety. Overall, 54 percent of female workers in Egypt are estimated to work in civil service jobs, whereas less than 10 percent work in the private formal sector (see also World Bank 2010). Those women for whom public sector jobs are not an option end up working in informal jobs that pay little. Consistent with these patterns, at school women also tend to stream into the humanities and social sciences, while men study science and engineering, which are generally associated with higher wages in private sector jobs (World Bank 2013).

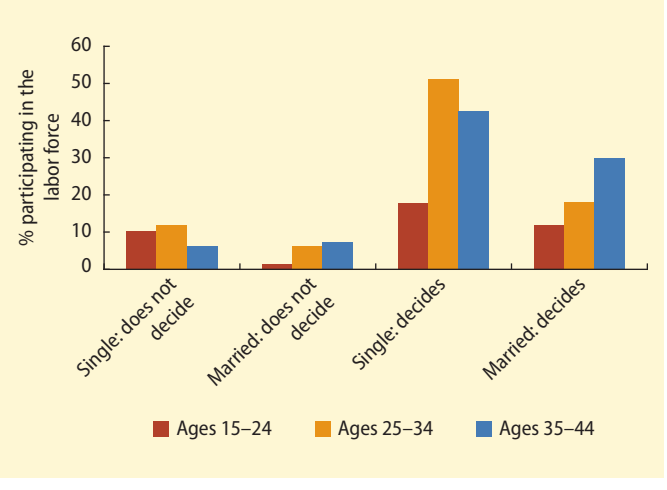
Although in MENA the average employed woman is more educated than the average employed man (World Bank 2013), female workers generally earn lower wages than men, especially in the private sector. However, the estimated gender gap varies significantly from country to country, highlighting the heterogeneity of the phenomenon in the region (figure O.17). Gaps are much wider in private sector jobs

FIGURE O.15 Female participation in the labor force in five MENA countries, by education level, various years, 2005–10



Source: Based on the Tunisia LFS 2010, the Jordan LMPS 2010, the Iraq HSES 2006, the Egypt LFS 2010 and the Morocco LFS 2009.
Note: MENA = Middle East and North Africa.

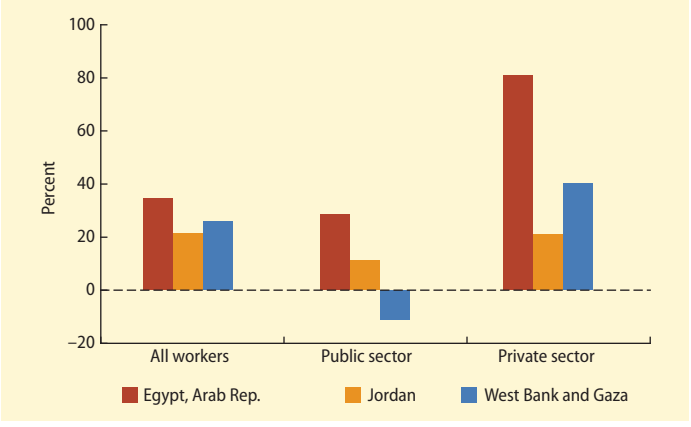
FIGURE O.16 Women's decision-making on whether they can work and labor force participation, by marital status and age, Morocco, 2010



Source: Based on Morocco HYS 2010.

(40–80 percent in the West Bank and Gaza and Egypt) and—as might be expected—smaller in the public sector. In fact, in the West Bank and Gaza's public sector, women actually earn more than men on average, perhaps because only the best female workers self-select for formal public sector jobs.

FIGURE O.17 Male-female wage gap in selected MENA economies, various years, 2006–10

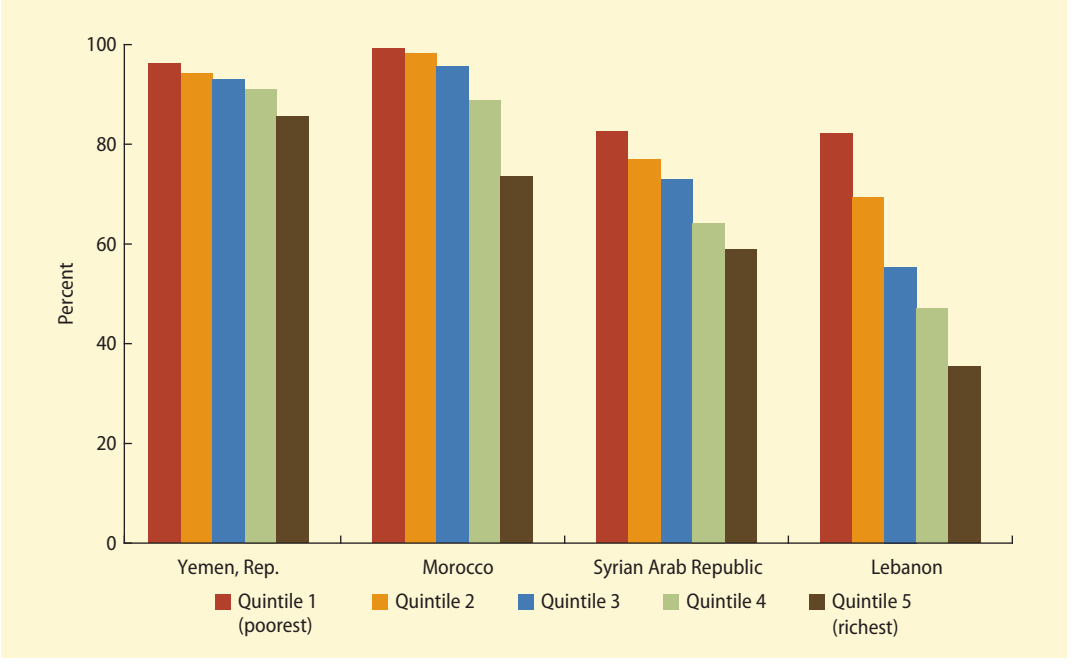


Source: Based on the Egypt LMPS 2006, the Jordan LMPS 2010, and the West Bank and Gaza LFS 2008.
Note: MENA = Middle East and North Africa. The sample is urban workers working between 30 and 60 hours per week.

The working poor

Who are the working poor? Earlier analysis of earnings, benefits, and working conditions has demonstrated that across MENA's labor markets, informal jobs tend to be characterized by low pay and low productivity. Throughout MENA, informality consistently decreases as wealth increases, even though in some countries the phenomenon is widespread enough to affect the wealthier segments of the population as well, such as high-earning entrepreneurs (see Gatti et al. 2012) (figure O.18). Informality is a complex phenomenon; yet one segment of the workforce displays the lowest chance of accessing desirable jobs and the highest chance of being informal and poor unskilled rural workers, defined as those with a primary education or below who live in rural areas.[4]

FIGURE O.18 Informality rate by quintile of per capita consumption in selected MENA countries, 2011



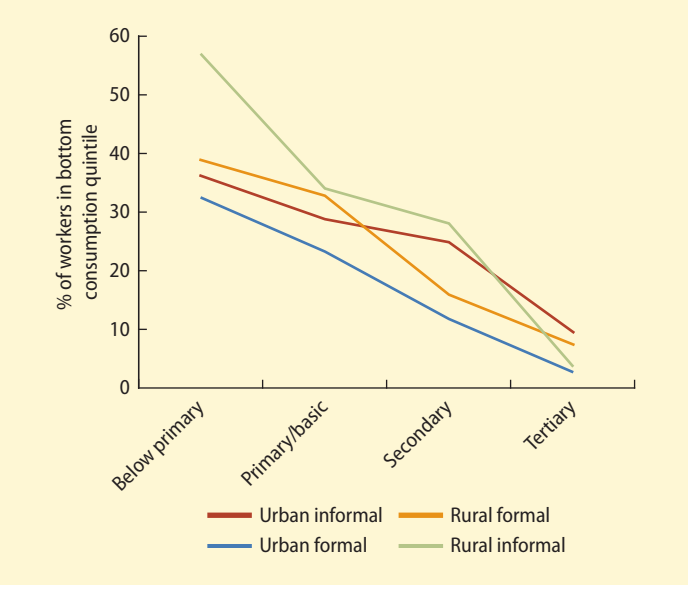
Source: Angel-Urdinola and Tanabe 2012.
Note: MENA = Middle East and North Africa. The consumption aggregate was not available for Morocco for 2010 when this report was completed. Hence, in this figure, data for Morocco are from the 2001 Living Standards Measurements Survey (LSMS).

For instance, among the working population in Jordan, the probability of belonging to the bottom-income quintiles peaks among unskilled rural workers (figure O.19).

According to the definition adopted here, the working poor constitute a considerable share of the working population in many countries in the region, ranging from about 10 percent in Jordan to more than 50 percent in Yemen (figure O.20). The working poor are primarily employed in agriculture. Consistent with the slow structural transformation of the economy in many MENA countries, unskilled rural employment continues to be very prevalent even among young workers.

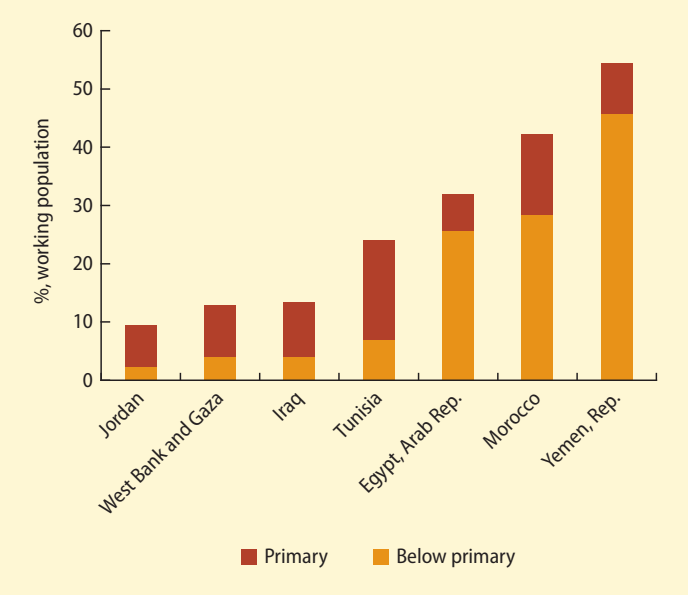
Unskilled rural workers are predominantly nonwage employees. In contrast, the prevalence of nonwage employment tends to be far lower among skilled and urban workers. In nearly all countries, nonwage workers are excluded from social security coverage and are therefore informal. Data indicate that this type of self-employment most often consists of subsistence entrepreneurship. Many of the unskilled self-employed report choosing this type of employment because no other suitable job was available to them.

FIGURE O.19 **Probability of being in a poor household by education and geographic location among the employed population in Jordan, 2006–10**



Source: Based on Jordan's LMPS 2010.

FIGURE O.20 **Education level of unskilled rural workers as a percentage of the working population, 2006–10**



Source: Based on the Jordan LMPS 2010, the West Bank and Gaza LFS 2008, the Iraq HSES 2006, the Tunisia LFS 2010, the Egypt LFS 2010, the Yemen HBS 2006, and the Morocco LFS 2009.

Where are the barriers?

The following sections describe in detail the barriers that prevent the region from moving to a higher-productivity equilibrium. These include the macro- and microeconomic barriers that hinder the generation of more and better-quality jobs; existing labor market regulation that reinforces the status quo; employment conditions in the public sector that distort workers' incentives; training and educational systems that lack incentives to build high-quality, relevant skills; and ineffective labor intermediation systems that further contribute to the lack of a level playing field for qualified candidates.

Is growth a problem?

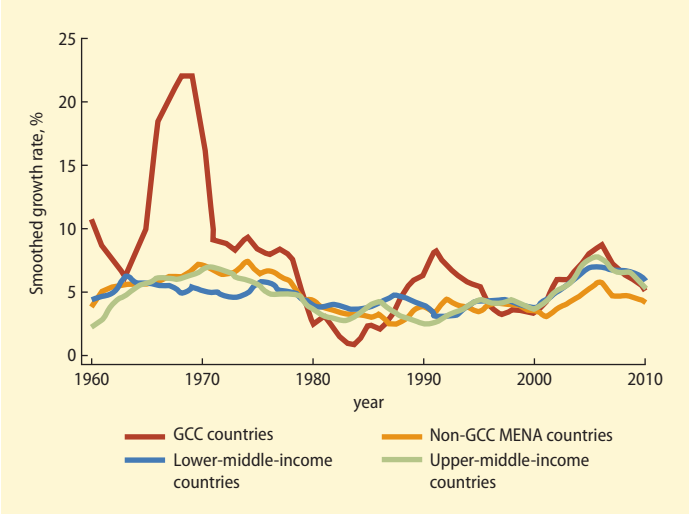
MENA is a region with an extraordinary heterogeneity in socioeconomic characteristics,

TABLE O.2 Heterogeneity in MENA economies

Labor availability	
Labor abundant[a]	
Resource rich[b]	Algeria, Islamic Republic of Iran, Iraq, Syrian Arab Republic, Republic of Yemen
Resource poor	Djibouti, Arab Republic of Egypt, Jordan, Lebanon, Morocco, Tunisia, West Bank and Gaza
Labor importing[c] and resource rich	Bahrain, Kuwait, Libya Oman, Qatar, Saudi Arabia, United Arab Emirates
Population size	
Large[d]	Algeria, Arab Republic of Egypt, Islamic Republic of Iran, Iraq, Morocco, Saudi Arabia
Small	Bahrain, Djibouti, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Tunisia, United Arab Emirates, West Bank and Gaza, Republic of Yemen
Income	
Low income	Djibouti, Republic of Yemen
Lower-middle income	Arab Republic of Egypt, Iraq, Morocco, Syrian Arab Republic, Tunisia
Upper-middle income	Algeria, the Islamic Republic of Iran
High	Kuwait, Oman, Saudi Arabia, United Arab Emirates
Geography or colonial heritage	
Maghreb	Algeria, Libya, Morocco, Tunisia
Mashreq	Arab Republic of Egypt, Iraq, Jordan, Lebanon, Syrian Arab Republic, West Bank and Gaza
Members of the Gulf Cooperation Council	Bahrain, Kuwait, Oman, Qatar, United Arab Emirates

a. Refers to net inflows of workers' remittances.
b. As defined by the World Bank (2004), "resource-rich countries" are those in which extractive industries account for, or are expected to soon account for, more than 50 percent of government revenue.
c. Refers to net outflows of workers' remittances.
d. Population over 20 million.

FIGURE O.21 Five-year moving average of real GDP growth rates in GCC and in Non-GCC MENA countries, 1960–2010



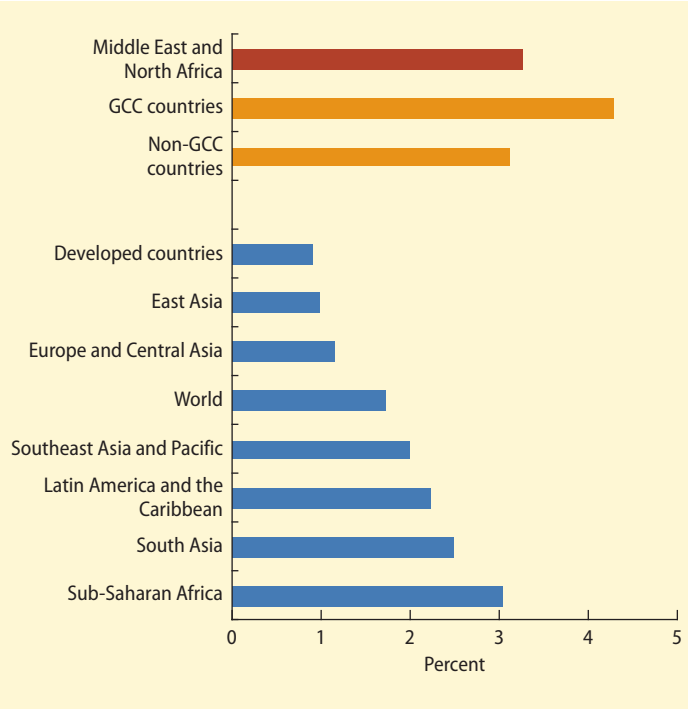
Source: World Development Indicators 2012.
Note: GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

institutional development, and natural resources (table O.2); yet MENA countries share significant trends in economic performance. Following independence in the 1960s and 1970s, most countries experienced solid growth arising from public investments in infrastructure, education, and health which were financed by favorable oil prices.[5] The high growth rates (averaging 7 and 6 percent respectively in the 1960s and 1970s) reflected not only the accelerated accumulation of production factors, but also the increased productivity linked to much-needed investments in physical and human capital. As international oil prices plummeted in the 1980s, however, the foundations of growth in earlier decades collapsed. With eroding macroeconomic balances and growing debt burdens, and despite heavy external assistance (which permitted spending for several more years), investments declined dramatically, and the rate of growth of the physical capital stock almost halved compared to the previous decade.

As the government-led development model became increasingly unsustainable in the late 1980s, a number of countries (including Morocco, Tunisia, and, soon after, Jordan) embarked on programs of macroeconomic stabilization and policy

reform, followed in the 1990s by the Gulf Cooperation Council (GCC). Reforms varied markedly in timing and intensity, but all included reducing subsidies and public spending, liberalizing trade, encouraging exports and investment, and strengthening the institutional foundations of a market-led economy. These structural reforms allowed the region to catch up on several fronts. Export growth increased. A shift away from procyclical fiscal policy and from a government-led growth model also helped reduce macro imbalances, particularly in Gulf countries. As a result, average real gross domestic product (GDP) growth rose from 3.6 percent a year between 1996 and 1999 to around 5 percent between 2000 and 2008 (figure O.21). These changes were associated with increases in total factor productivity and labor force participation, with a limited role for physical and human capital accumulation compared to the past.[6] In particular, changes in total factor productivity became the main driver of growth in the early reformers such as Jordan, Morocco, and Tunisia.

FIGURE O.22 Total annual employment growth in selected regions of the world, 1998–2008



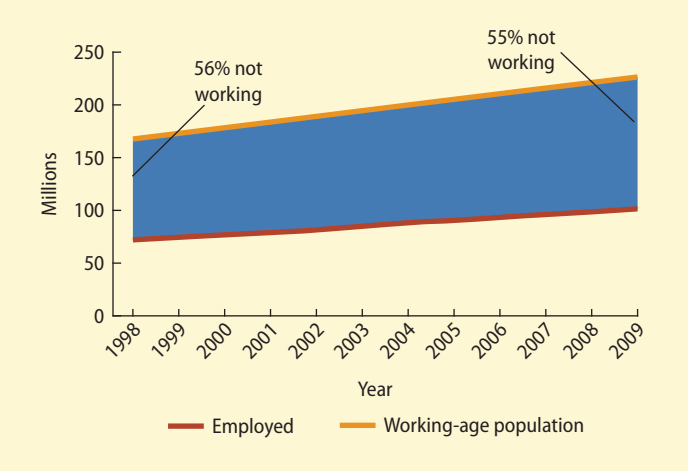
Source: ILO–KILM database.
Note: GCC = Gulf Cooperation Council.

Disappointing employment outcomes

Despite the recent extended stretch of solid growth in the past decade (which has, however, slowed since the 2008 crisis), employment outcomes in the region continue to be of concern on two main fronts:

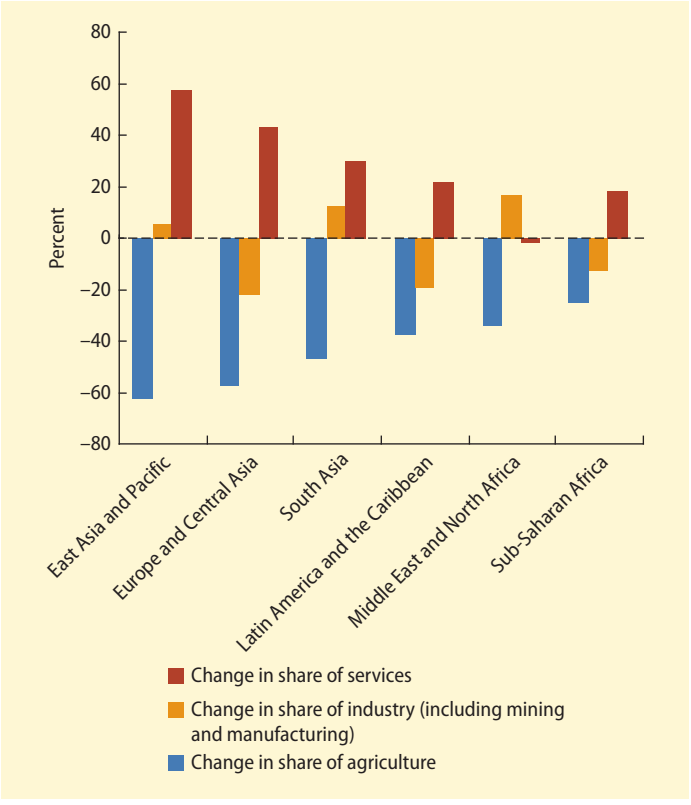
- *In the past decade, the number of jobs created, while quite responsive to the level of growth, was not sufficient to absorb the increasing number of new entrants into the labor market.* Employment grew—and at a higher rate than in other regions of the world (figure O.22)[7]—but so did the working-age population (figure O.23), as most MENA countries are experiencing a "youth bulge."
- *Jobs were created in relatively low-value-added sectors, and public employment continued to account for a substantial share, especially in Gulf countries.* This phenomenon reflects the slow pace at which structural transformation has

FIGURE O.23 Growth in employed and working-age population in non-GCC MENA countries, 1998–2009



Source: Based on the ILO's EAPEP (Economically Active Population, Estimates and Projections) database.
Note: GCC - Gulf Cooperation; MENA - Middle East and North Africa.

FIGURE O.24 Changes in the composition of GDP in selected world regions, 1980–83 and 2007–10



Source: Diop, Marotta, and deMelo, forthcoming.
Note: GDP = gross domestic product.

occurred in MENA (although results vary across countries) with respect to economies elsewhere in the world. Manufacturing contributes little to both value added and employment growth (figures O.24 and O.25). Instead, low-value-added sectors, such as construction, have driven most of the employment creation in the past decade. At the same time, agriculture continues to play a relatively large role in contrast to comparator countries that instead saw labor shift from agriculture into services. As discussed in the recent MENA *Economic Development and Prospects* report (World Bank 2011b), natural resources remain a major growth engine in the typical MENA country. While extractive industries are generally associated with high value added, they are capital intensive and generate little employment directly. At the same time, however, oil revenues have been instrumental in increasing employment by financing the creation of more public sector jobs.

An unfinished reform agenda

Many argue that the slow structural transformation in the region is the result of an unfinished reform agenda. Sound fiscal and monetary policies—prerequisites for sustained economic performance—are still to be implemented in MENA, as is a level playing field that would allow the private sector to play a pivotal role in achieving structural change. A number of specific factors inhibit the needed changes:

- *MENA's real exchange rate volatility*, which is the highest in the world. A volatile real effective exchange rate reduces the incentive to invest in nonresource-tradable sectors by increasing uncertainty. In turn, it reduces development prospects in more dynamic sectors of the economy, which are not capital intensive and have a higher potential for creating employment.[8]
- *Procyclical and discretionary fiscal policies*, which rely on costly universal energy and food subsidies and result in a lack of high, sustained investment.
- *A failure to establish rule-based modes of interaction with the private sector,* which has limited the incentives for the private sector to grow and generate jobs.

As a result, while the private sector plays a larger role in MENA today than before, it is far from being a strong engine of growth. For instance, the contribution of private investment to growth is among the lowest in the world (figure O.26). Except for some of the resource-poor countries (oil importers in the Maghreb), where the ratio of private investment has actually increased owing to a substantial increase in foreign direct investment, the composition of investment

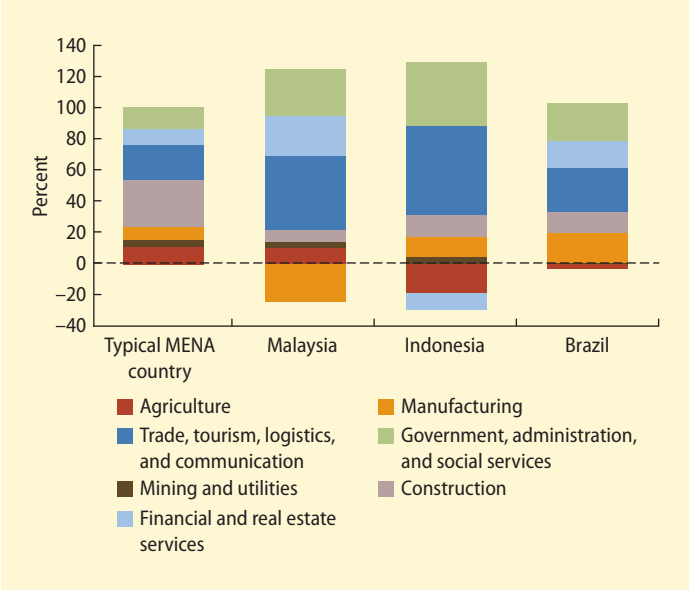
still favors public investment in most of the resource-rich countries. Most private investment directed to the region has been biased toward either capital-intensive or low-skill, labor-intensive sectors (such as oil, construction, and tourism) rather than toward more dynamic, employment-creating sectors like financial services and manufacturing (figure O.27).

This evidence suggests that while GDP growth was solid and some employment was created, an understanding of the quality of growth, and more specifically of the dynamics of the private sector, is necessary for identifying the determinants of the region's underperformance in employment outcomes.

The private sector: A dynamic based on privilege

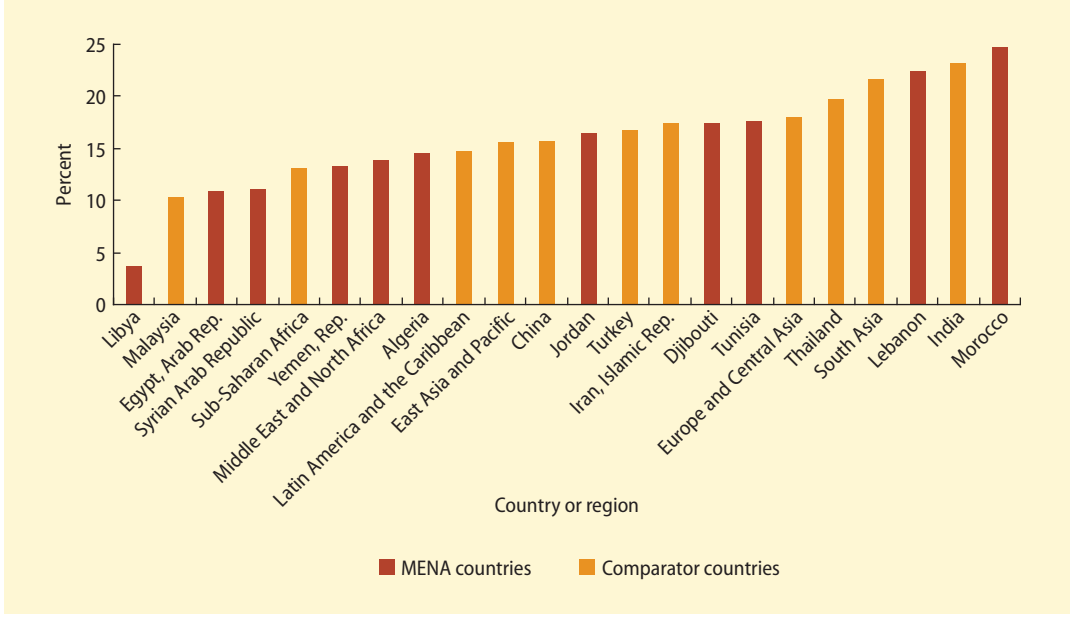
The private sector in MENA displays little dynamism: it has one of the world's highest average firm age, the highest average age

FIGURE O.25 Sectoral contribution to annual employment growth in a typical MENA country and other selected countries, average 2000s



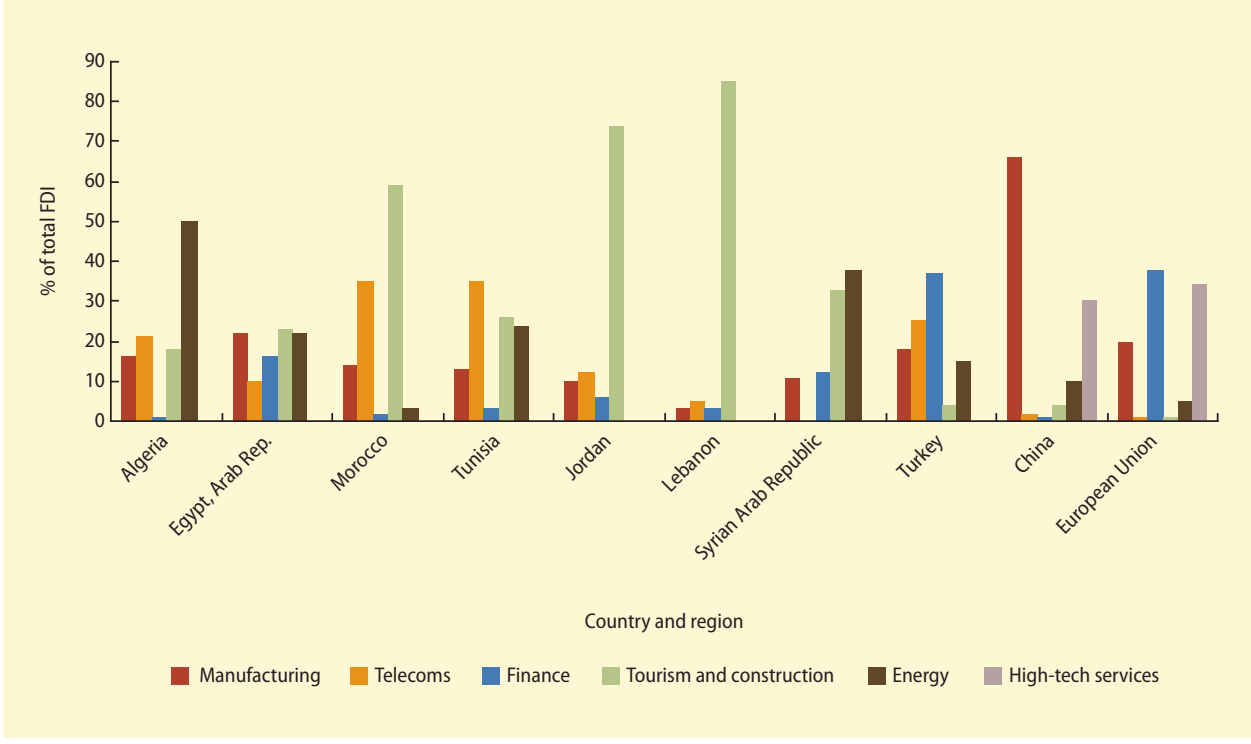
Source: World Bank 2011b.
Note: MENA = Middle East and North Africa.

FIGURE O.26 Private sector gross fixed-capital formation as a percentage of GDP in selected countries, average 2004–09



Source: World Development Indicators 2004–09.
Note: GDP = gross domestic product. MENA = Middle East and North Africa.

FIGURE O.27 **Structure of foreign direct investment in selected MENA countries and the EU, 2000–07**



Source: United Nations Conference on Trade and Development, World Development Indicators 2000–07.
Note: EU = European Union; MENA = Middle East and North Africa.

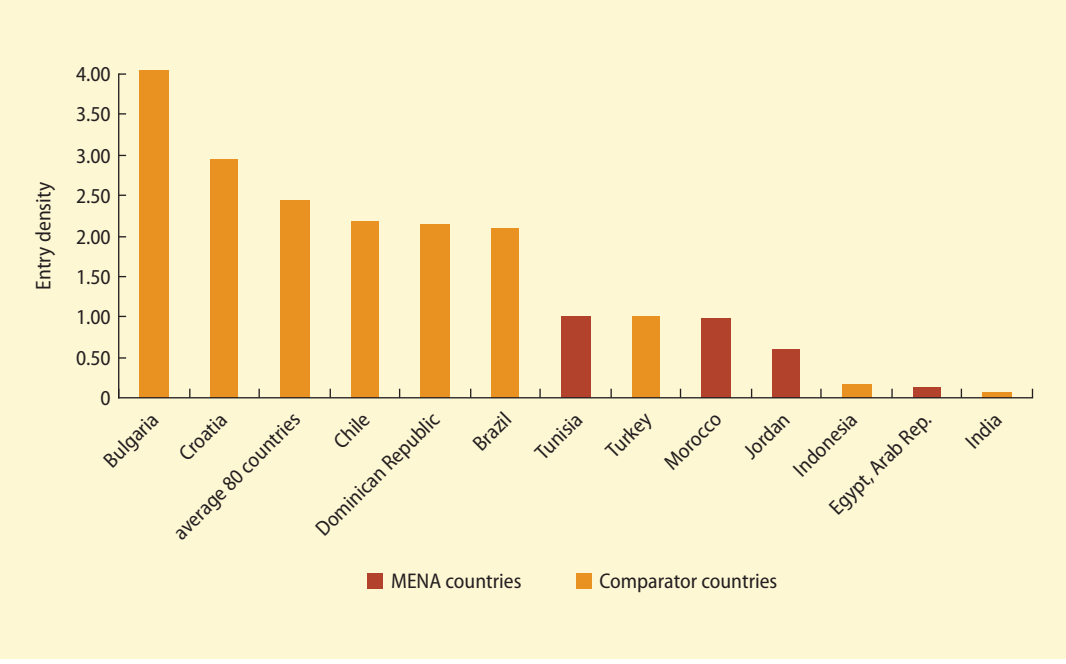
of its chief executive officers, and one of the lowest firm densities in the world (see World Bank 2009; Klapper and Love 2010) (figure O.28). Recent evidence from firm censuses in Morocco and Tunisia shows that even when firms enter the market, they stay small and do not grow. For example, a comparison of representative firm trajectories in Brazil and Jordan indicates that while firms start out larger in Jordan, they grow more slowly over time than in Brazil. Over a 10-year period, for example, a firm in Brazil becomes about twice as large as one in Jordan (figure O.29). Overall, the process of creative destruction—that is, the birth of innovative firms and the exit of unproductive firms that characterize regions with higher and sustained growth such as East Asia—is substantially attenuated in MENA.

Lack of a level playing field

The lack of a level playing field inhibits the employment growth of firms. Firms' slow growth and limited capacity to generate employment are linked to the quality of the business environment. A comparative analysis of the characteristics of business environments worldwide shows that while MENA countries have made important advances in reforming, they still rank consistently low on two key dimensions: the enforcement of regulations and access to credit.

Legal and regulatory ambiguity expands the scope for discretion in public agencies, and reforms designed with little transparency or consultation compound the unpredictability of the investment environment. Firms in MENA complain bitterly about inconsistent and unpredictable policy implementation,

FIGURE O.28 Average firm entry density for selected emerging economies, 2004–09

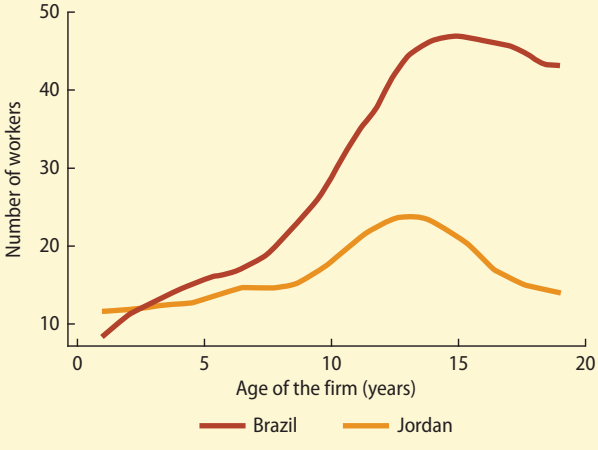


Source: Klapper and Love 2010.
Note: Entry density measures the number of newly registered limited liability firms per 1,000 working-age people (those between ages 15 and 64). Average 80 countries represents the average entry density in the 80 developing countries for which data are available.

and data reveal a high variation across firms in the enforcement of regulations. By raising entry costs, the unpredictable implementation of policies reduces competition, reinforces a status quo characterized by limited dynamism, skews firms' incentives toward rent-seeking activities, lowers turnover, and diminishes the probability of innovation (World Bank 2011b).

On the other hand, firms in MENA—small and large—have the second-lowest access to credit in the world, surpassing only Sub-Saharan Africa. Probably as a consequence, MENA's banks have highly concentrated portfolios focused on large enterprises. For example, non-GCC MENA countries have the highest ratio of top 20 loan exposures to total equity.[9] Both discretionary implementation of regulation and limited access to inputs are particularly constraining for young enterprises, which have been shown to create the

FIGURE O.29 Relation between firm size and age in Brazil (2009) and Jordan (2006)



Source: Based on Enterprise surveys in Jordan (2006) and Brazil (2009); private domestic firms only.

majority of jobs. With limited competition, incumbent firms enjoy privileges and face little or no pressure to innovate and create new avenues for growth.

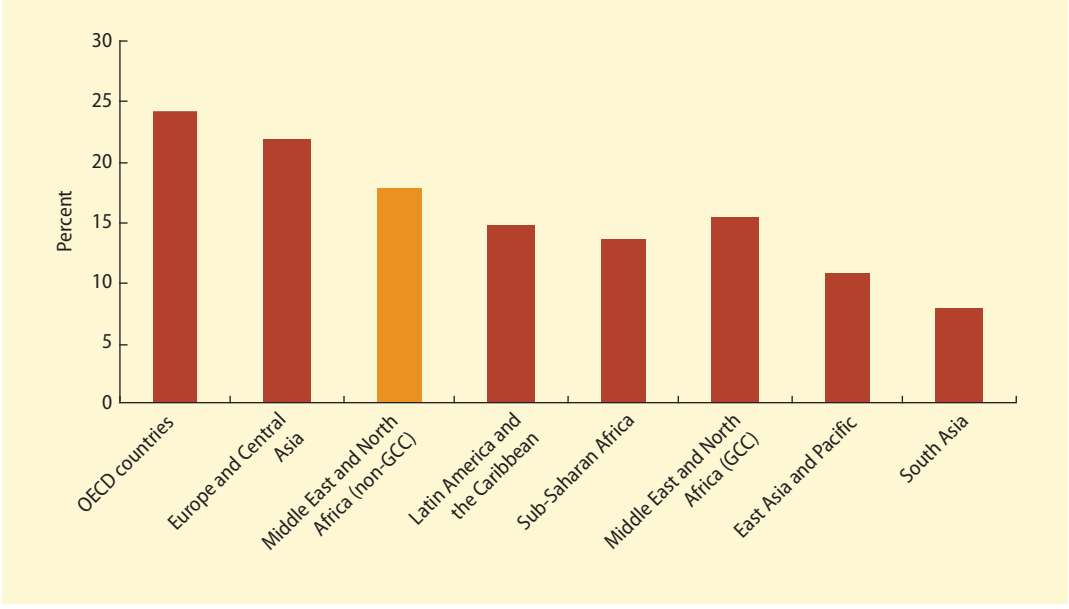
Effects of distorted input prices

In MENA, input prices are distorted and create an antilabor bias. Energy subsidies, which are common and substantive in the region, increase the relative cost of labor in relation to the cost of energy and thereby limit labor demand. For instance, in 2007 Egypt's energy-intensive industries consumed more than 80 percent of the country's fuel oil and 28 percent of the diesel oil, which together receive 50 percent of the total energy subsidies (Abouleinein, El-Laithy, and Kheir-El-Din 2009). In fact, many MENA countries figure among those with the highest energy content per unit of GDP in the world. Fuel subsidies are doubly disadvantageous: they not only repress demand for labor in the short run, but also suppress incentives to innovate, thereby impeding productivity growth, which is the crucial determinant of long-run labor demand. They tend to disproportionately benefit older and publicly owned firms, which in turn are likely to use more outdated technologies and consequently more energy.

A regulatory environment that reinforces the status quo in the labor market

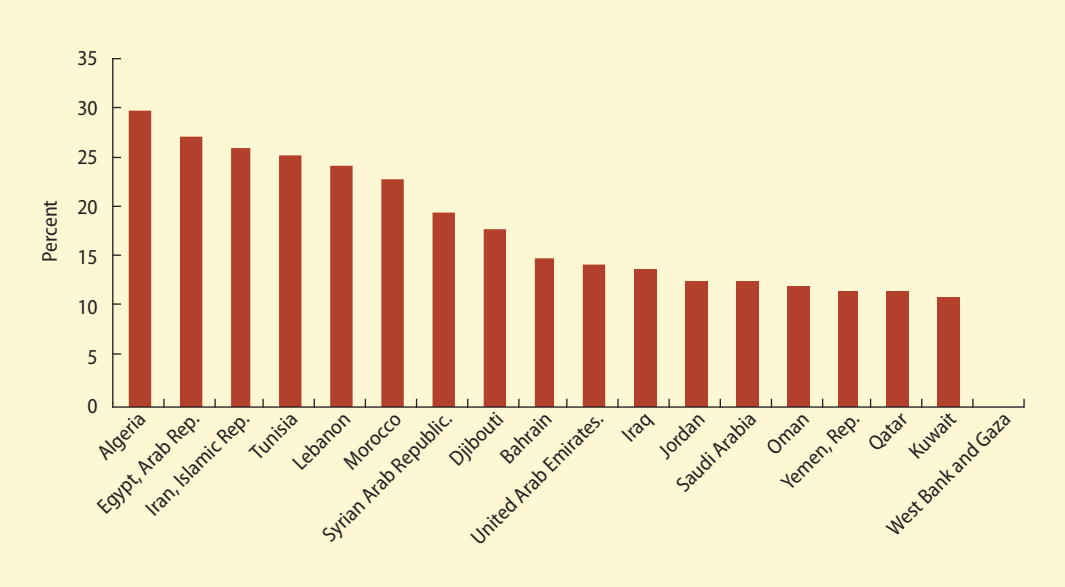
Labor regulation in MENA is quite heterogeneous—it is more restrictive in Maghreb countries and more flexible in GCC countries—but all labor markets in the region contend with a relatively heavy public sector. The design of social insurance systems also influences the dynamics of labor markets: very generous, costly pension systems cover a small minority of workers, while the lack

FIGURE O.30 Labor taxes and contributions as a percentage of base salary in world regions, 2011



Source: IFC and World Bank 2011.
Note: GCC = Gulf Cooperation Council; OECD = Organisation for Economic Cooperation and Development.

FIGURE O.31 **Labor taxes and contributions as a percentage of base salary in MENA economies, 2011**



Source: IFC and World Bank 2011.
Note: MENA = Middle East and North Africa.

of well-functioning unemployment insurance and poverty-targeted social safety nets makes job losses extremely costly for the majority.

Effects of rigid employment protection on labor mobility

In some countries, important wage rigidities contribute to unemployment, queuing, and informality. In Tunisia, for example, collective wage agreements work by levels, reflecting employees' education and competencies. These agreements assume that a university education is needed for the highest levels. Wage floors are then set accordingly, often above what workers with less than a university degree, who would still be qualified for those jobs, are paid on the market.

As a result, the salary differences are quite remarkable in most sectors, and unemployment is likely at each of these levels whenever the mandated wage exceeds the actual productivity of the workers that are available to fill the position.

The level of labor taxes can affect many decisions of firms and workers—including whether to operate informally, whether to open vacancies, or whether to accept job offers—and further exacerbates wage floors.

MENA countries, especially those outside the Gulf, have relatively high labor taxes and social contributions, ranking only after countries in the Organisation for Economic Co-operation and Development (OECD) and Eastern Europe, where, however, social insurance and public services have much higher coverage and scope on average than in MENA (figures O.30 and O.31).

In addition to wages, contract duration (temporary, fixed term, or open ended), working hours, and dismissal procedures (including severance pay) define the employment relationship. In the past decade, a number of countries (Egypt and Morocco, for example) reformed their labor codes; in Egypt, this reform resulted in substantially more flexible hiring procedures. Indeed, with the exception of Algeria and Djibouti, fixed-term contracts for permanent tasks are now allowed in all

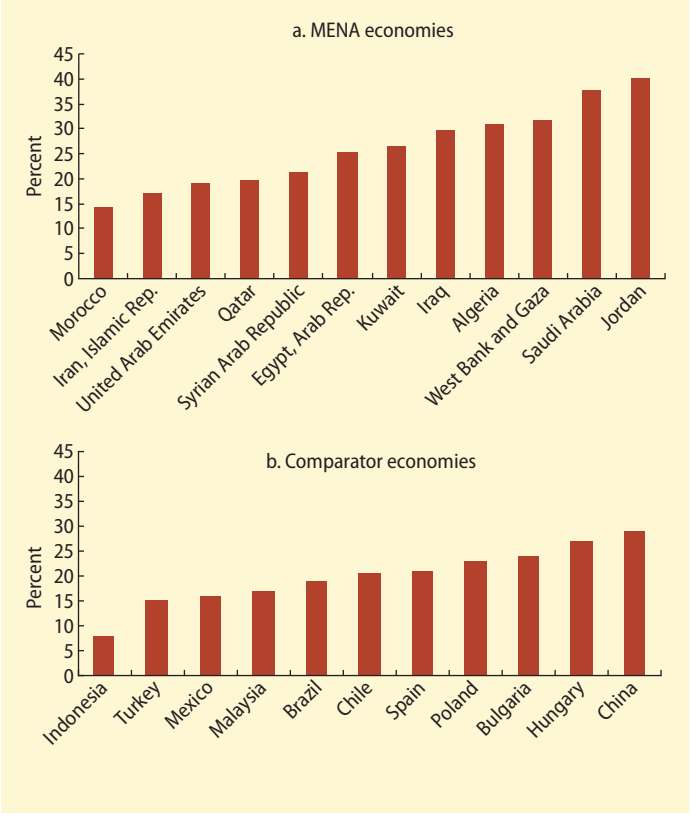
countries. Dismissal (from the formal sector), however, remains more difficult in MENA than in any other region of the world. Most MENA countries (all but most Gulf countries, Lebanon, and Morocco) require the employer to notify a third party (such as a government agency) for the dismissal of just one worker, and severance pay is particularly high in Egypt.

Important role of the public sector

The public sector has traditionally played an important role in the region, employing anywhere between 14 and 40 percent of all workers (figure O.32). Employment conditions in the public sector (job safety, access to social security, higher wages, and generally low pressure to be productive, among others) compete with and may even crowd out employment conditions in the private sector. Generous public employment conditions provide a de facto reservation wage, if not a wage floor, especially for those with higher education, thus making the public sector the implicit rule setter for the labor markets in the region.

In addition to advantageous wages and benefits, extremely low risk of dismissal, and relatively low demands for productivity, "double dipping" is a possibility. For example, evidence indicates that in Egypt one-quarter of the personnel in public health facilities is absent on an average day (Grun, Etter, and Jillson 2010). As a result of all these factors, the overall employment package continues to determine the preference of job seekers, including youth, for working in the public sector.

FIGURE O.32 Average employment shares in the public sector in MENA and selected comparator economies, averages 2000s



Source: Laborsta 2012.
Note: MENA = Middle East and North Africa.

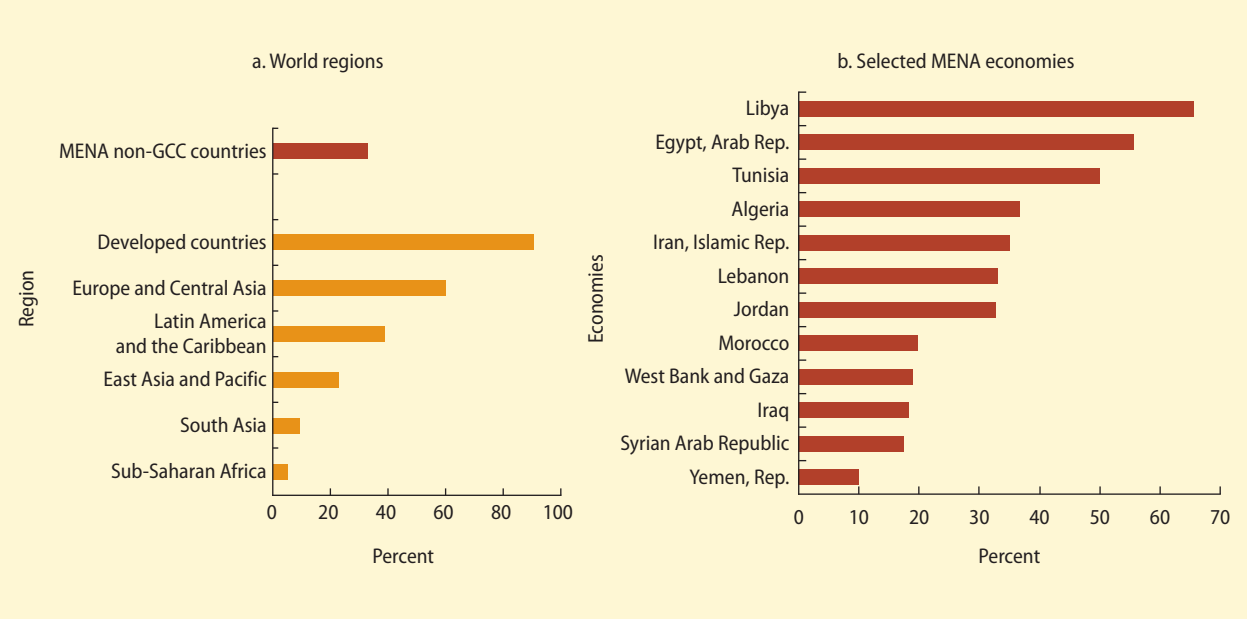
Effects of generous social insurance systems

The design of pension systems constitutes a further barrier to mobility in labor markets in the region. Pension systems in MENA are relatively new, having recently evolved from covering only civil servants (figure O.33). Their coverage is still limited, leaving about 60 percent of the labor force without protection against old-age risk.

Notwithstanding the fact that pension systems in MENA notionally have a favorable ratio of contributors to retirees, they are increasingly unsustainable financially. In part, the generosity of benefits drives the imbalance between contributions and liabilities of the system. Internal-rate-of-return computations indicate returns between 6 and 17 percent, significantly higher than those of other investment instruments. With such high returns, workers would want to participate in pension systems if they could. This indirect evidence suggests that in many cases lack of participation in social insurance is due to exclusion rather than to opting out.

With a large share of the private sector engaged in low-value-added production,

FIGURE O.33 **Percentage of labor force contributing to social security in MENA and other regions, 2000–07**



Source: Gatti et al. 2012. Data on social security contributions in GCC countries are available only for Bahrain, 2007 (20 percent), and Qatar, 2008 (4.4 percent) (Pallares-Miralles, Romero, and Whitehouse 2012).
Note: GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

social security contributions often become unaffordable for firms, resulting, in the aggregate, in a limited contributory base for pension systems (thus further increasing pension liabilities) and making public sector jobs all the more desirable.

Overall, by segmenting the market into a small set of protected insiders and large pools of outsiders who have little or no protection and security, the relatively rigid wage structure, overall high social security contributions and strict dismissal constrain the development of a healthy, dynamic labor market.

Skill gaps and asymmetric information in job search

In economies where (1) the private sector has limited dynamism, (2) the public sector offers attractive employment conditions, and (3) relatively rigid labor regulations maintain labor market divides, the incentives to cultivate relevant skills can be distorted. In particular, in moving from school to work, youth in MENA need to make a successful "double transition." First, they need to obtain skills, competencies, and credentials of sufficient quality to become employable; second, they need to position themselves in a labor market characterized by poor signaling and substantial segmentation.

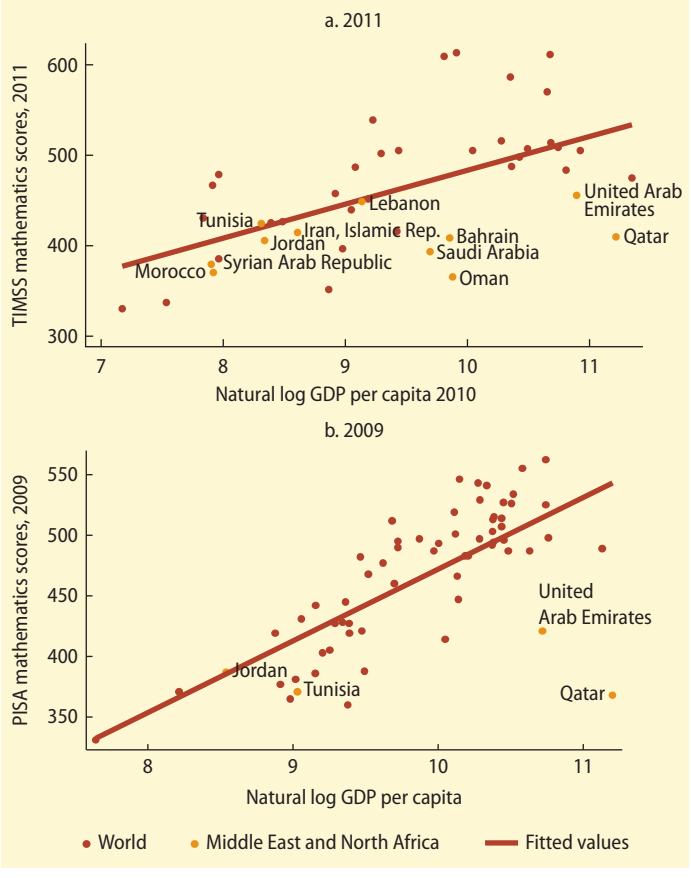
Challenge of becoming employable

Over the past decades, MENA countries have significantly expanded access to education, with substantial growth in enrollment in secondary and tertiary education (see World Bank 2008). However, employability—defined as the capital of skills, competencies, academic certificates, and professional qualifications, as well as the capacity to function in a job—remains a challenge in the region.

The quality of learning in MENA as measured by international standardized tests, for example, is still below the level expected given MENA countries' per capita income (figure O.34). At the same time, evidence points to pervasive mismatches of skills. Compared to firms elsewhere in the world, more firms in MENA contend that inadequate labor force skills, both technical and soft, impede growth (figures O.35 and O.36).[10]

Three key factors rooted in the incentives prevalent in MENA's training and educational systems contribute to these outcomes: (1) a logic of selection rather than learning; (2) poor links between the educational system and the private sector; and (3) the perception that the public sector is still the main client of the educational system.

FIGURE O.34 Quality of education as measured by TIMSS and PISA, 2011 and 2009



Source: TIMSS and IMF World Economic Outlook (database), January 2013 update.
Note: For panel a, the GDP per capita of year 2010 is an IMF estimate, not final figures, for Botswana, Chile, Georgia, Ghana, Honduras, Lebanon, Oman, South Africa, the United Arab Emirates, and the United Kingdom. GDP = gross domestic product; MENA = Middle East and North Africa; PISA = Programme for International Student Assessment; TIMSS = Trends in International Mathematics and Science Study.

A prevailing logic of selection

A "logic of selection"—manifested in rigid tracking in secondary education and high-stakes examinations—dominates educational systems instead of a "logic of learning." An ample literature shows that early tracking and streaming[11] can have negative consequences for subsequent education and labor market outcomes, particularly for pupils from lower socioeconomic backgrounds who tend to perform less well in early selection (Ireson, Hallam, and Hurley 2005; OECD-PISA 2006; Jakubowski et al. 2010). In particular, one disadvantage of highly stratified systems is that transitioning from a lower to a higher track is difficult and thus not common. In educational systems in MENA, tracking happens relatively early in pupils' lives, which substantially limits transition pathways and viable second chances. For example, in Egypt, only 5 percent of graduates from technical secondary schools transitioned into postsecondary vocational education in 2008–09, down from 8 percent in 2003–04. The low quality of the training provided by the technical and vocational education and training (TVET) system reinforces the low perceived status of technical training and exacerbates the effects of tracking. As such, this type of system perpetuates and reinforces exclusion from labor market opportunities and segmentations.

Private sector links with the educational and training sector

When the private sector and the educational and training sector operate in isolation, information and signaling failures occur on both sides, resulting in skill gaps and mismatches (IFC and ISDB 2011; World Bank 2008). In MENA, educational and training systems lack the information to respond to the needs of the private sector, whereas the private sector lacks the capacity or the interest in playing its role in a demand-driven

skill development system. This miscommunication is a particular concern for the TVET system, in which employers have a crucial role in ensuring that skills acquired through that system are relevant for the labor market.

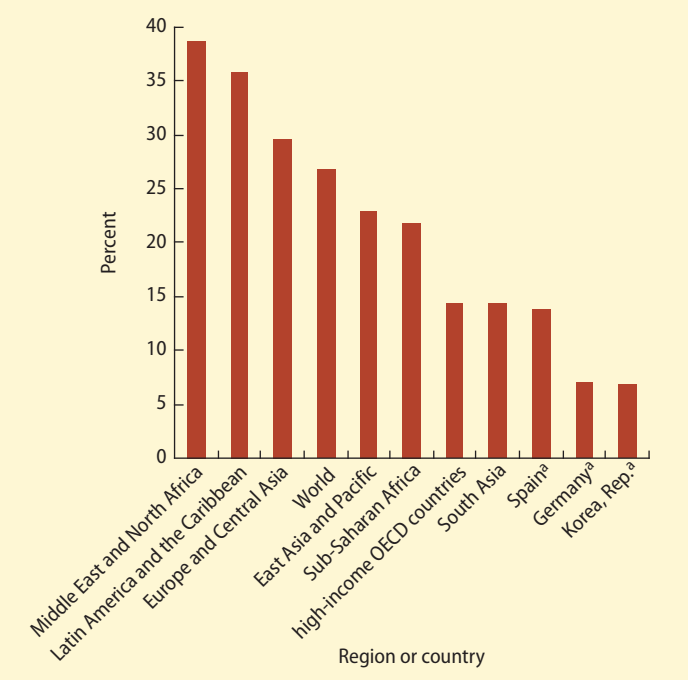
Perception of the public sector as the main client of education and training

The public sector continues to be the main client of educational and training systems and thus the main shaper of students' choices and expectations. Some countries have already undergone structural adjustment (Morocco, for example), and others have considerably slowed public sector hiring (Egypt). Even so, the fact that governments continue to play an important role in providing jobs in MENA and that public sector jobs (although more scarce) are still the most coveted by youth distorts incentives for skill formation. Students strive to attain degrees that fit with public employment, but those degrees are increasingly irrelevant to the private sector, leaving graduates without the skills demanded by the market. In Tunisia, for example, about half of university graduates opted to study the humanities and social sciences, curricula favored for entering the public sector (figure O.37). A recent tracer study in Tunisia found that almost 50 percent of graduates in the humanities and law had still not found a job 3.5 years after graduation, while more than 80 percent of medical school graduates had found a job by that time (Ministry of Employment and Professional Insertion of Youth and World Bank 2009).

A meritocracy deficit in the labor market?

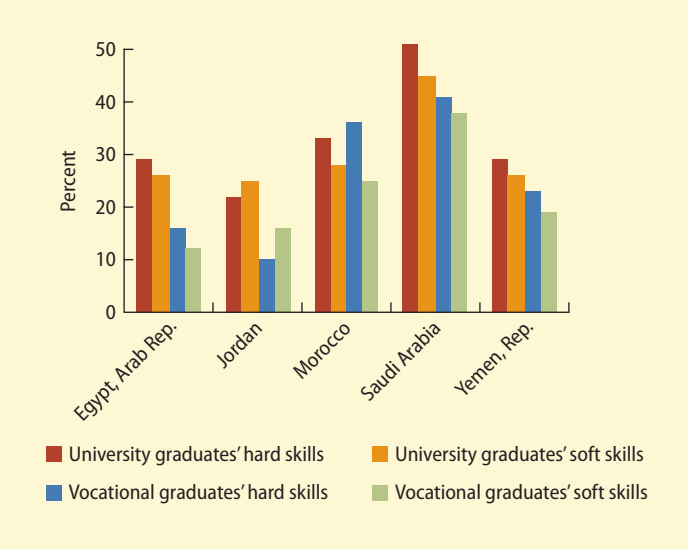
The increasing demand for transparency and equality of opportunity in accessing jobs heightens the importance of merit and clear rules for job seeking and hiring. Young people and their families have high expectations for the future, they invest heavily in education and skills, and they expect these investments to pay off eventually. Yet from what students, graduates,

FIGURE O.35 Share of firms identifying inadequately educated workforce as a major constraint to growth, by region and selected countries, 2005–11



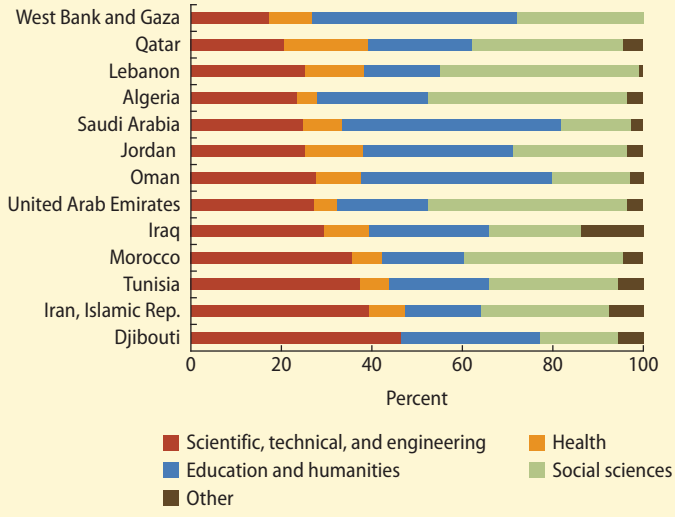
Source: Investment Climate Assessment (ICA) Enterprise Surveys (global dataset) 2012.
Note: OECD = Organisation for Economic Cooperation and Development.
a. 2005.

FIGURE O.36 Mismatches in hard and soft skills of newly hired graduates in selected MENA countries, 2010



Source: IFC and ISDB 2011.
Note: MENA = Middle East and North Africa. Numbers show the percentage of human resource managers agreeing that graduates hired in the past year have the appropriate skills.

FIGURE O.37 Distribution of university graduates by field of study in MENA economies, 2004–10



Sources: Edstats (database); Tunisian data from L'enseignement supérieur en chiffres, Année universitaire 2010–2011; Bureau des Etudes, de la Planification et de la Programmation.
Note: MENA = Middle East and North Africa. Data from Tunisia refer to students enrolled during the academic year 2010–11.

and employers in MENA countries report, it is clear that educational credentials are widely perceived to play a minor role in employers' hiring decisions. For example, while in Egypt, Tunisia, and, to a lesser extent, Syria, young people identify the lack of good jobs as the main constraint to being hired, a substantial share of youth in MENA thinks that jobs are given to connected people (figure O.38).

When formal degrees have limited signaling value, other factors (such as trust and personal connections) can dominate job search and hiring decisions. Since individual ability is unobservable, informal networks can be efficient in resolving the information asymmetries in labor markets. Anywhere between 40 percent (in Yemen) and 80 percent (in Lebanon) of private sector employees in countries with available data report having found their job through friends or relatives. However, since informal networks usually develop within limited socioeconomic strata, they can affect the distribution of job opportunities, putting those from less affluent families at a disadvantage.

Professional services can help firms tap a large pool of talent and find the best matches in skills and competencies for any given vacancy; yet firms in MENA make limited use of such recruitment practices. Indeed, non-GCC countries score the lowest compared to other regions in the meritocracy of hiring (see figure O.39). In contrast, GCC countries score extremely high, probably because of the large recruitment of expatriate workers.

The prevalence of informal job-matching methods is consistent with a number of explanations. Small or family-owned firms—which are the norm in the region's private sector—might have little or no incentive to invest in searching wide pools of talent. The structure of product markets (little competitive pressure) or the pervasiveness of arbitrary rule enforcement, which makes other qualities such as trust more relevant, could also dictate this choice.[12] Although improvements in competition and transparency are likely to increase incentives to find better matches, the infrastructure and regulation that could increase information flows are also lacking.

Limited role of formal labor intermediation

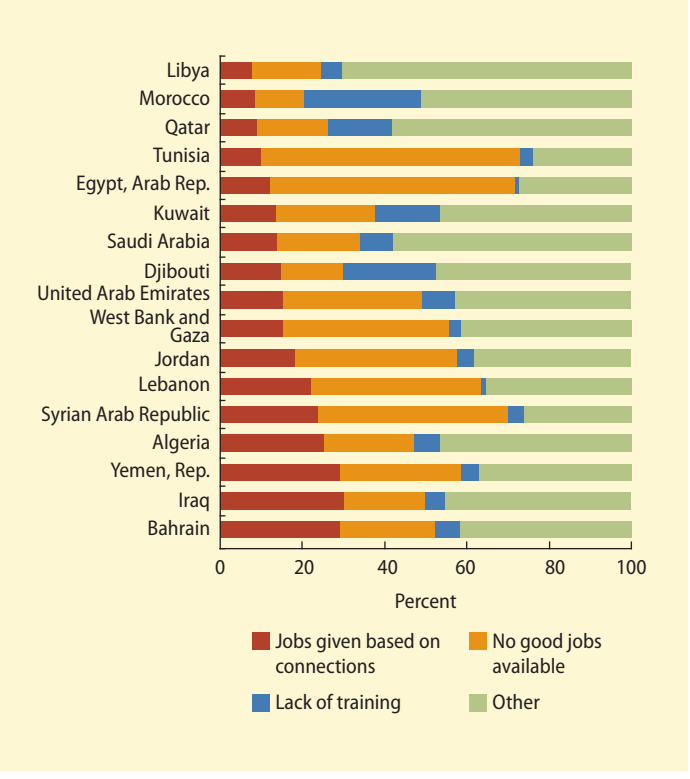
The widespread use of informal networks is a sign of information asymmetry and of signaling failure. Information asymmetries in labor markets can be overcome to some extent through intermediation services, and public and private employment agencies can play an important role in job matching. For employers, these agencies facilitate contacts with job seekers and even provide assistance with screening and selection. In non-GCC MENA countries, public intermediation services are still relatively new and underdeveloped. Most display low capacity and efficiency, with public employment service workers carrying excessive caseloads and adopting a generally passive approach to job matching.

What policy options?

The employment challenge in MENA is structural. The previous sections underscored how the rules that govern the distribution of growth dividends—including limited competition in the private sector and restrictive regulation of labor markets—have also limited economic growth and employment creation.

To move MENA toward a higher-productivity equilibrium with more and better-quality jobs (figure O.40), a medium-term agenda is needed to shift the current equilibrium along two dimensions: a more efficient and fluid allocation of resources and a more equitable access to opportunities. Realigning incentives for firms to invest and grow will be essential to unlocking the potential of the private sector. At the same time, a rebalancing of employment protection regulation and incentives in the public sector will be needed to promote a more dynamic labor market and to capture the benefits of growth in greater job creation more fully. Finally, better governance will be needed to equip educational and training systems to respond to the new signals coming from the labor market.

FIGURE O.38 Perceptions of youth in selected MENA economies of the constraints to getting a job, 2009



Source: Based on Gallup World Poll Survey 2009.
Note: MENA = Middle East and North Africa.

Aligning incentives to invest, innovate, and generate employment

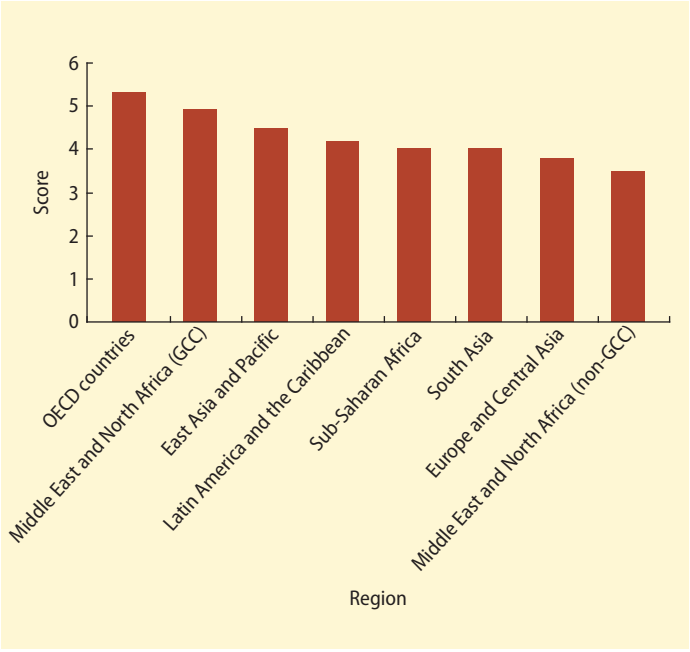
With burdensome business regulations and discretionary enforcement, poor access to credit, and subsidies that distort energy prices, the private sector—particularly the high-productivity segment—is suboptimally small and lacks the incentives to diversify, innovate, and invest. These constraints can be addressed, among other ways, by lifting barriers to competition, making access to production inputs more equitable, and promoting a culture of entrepreneurship that encourages experimentation and learning.

Removing distortions that repress labor demand

Reducing the cost of labor relative to other factors of production (such as capital and material inputs) is likely to stimulate job creation. Since tax and subsidy schemes in MENA place labor at a disadvantage, reducing labor taxes or reducing subsidies on other factors of production should create more employment opportunities and, in the medium term, accelerate growth through better allocative efficiency and innovation. These actions would free fiscal resources to further stimulate job creation.

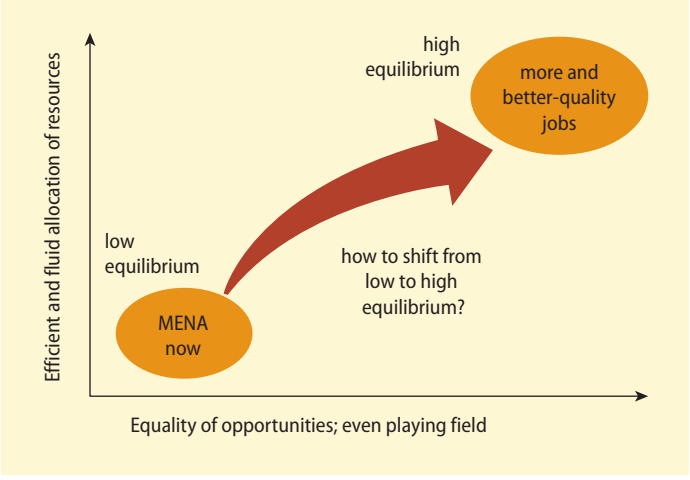
The current subsidy system favors energy-intensive production processes that rely on outdated technology. Ensuring that firms internalize the true cost of energy would enhance competitive pressure and stimulate the adoption of more advanced, energy-efficient modes of production. Such a reform would level the playing field for small and medium enterprises and private sector firms, given that their competitors (large and public

FIGURE O.39 World scores on proxies of meritocracy in hiring, 2011



Source: Based on Executive Opinion Survey.
Note: GCC - Gulf Cooperation Council; OECD - Organisation for Economic Co-operation and Development. See World Economic Forum (2011, 75) for a detailed description of the Global Executive Survey. Most questions in the survey ask respondents to evaluate, on a scale of 1 to 7, one particular aspect of their operating environment. One represents the worst possible situation; seven represents the best.

FIGURE O.40 Toward more and better-quality jobs in MENA



firms) currently benefit disproportionately from energy subsidies.

Without a doubt, the removal of subsidies would have political and economic repercussions. To create the political support to enact and sustain reform, governments must compensate the losers adequately and credibly and sustain their transition to more energy-efficient production. Another option for simultaneously increasing employment and fiscal space would be to reexamine agricultural subsidies. For example, removing wheat subsidies (which account for a large share of agricultural subsidies in MENA) could have important impacts on agricultural employment. Wheat production is relatively capital intensive, unlike the production of other crops, such as olives, which require more labor. In lieu of providing wheat subsidies, governments could finance investments to increase agricultural productivity. The removal of energy and agricultural subsidies could have especially powerful effects in labor-abundant countries such as Egypt and Syria.

Enabling firms to compete and invest

Reduce the costs of entry, exit, and adjustment

Creating more jobs requires existing firms to expand, new firms to start operations, and, paradoxically, the destruction of unproductive firms that use inputs inefficiently. All of these developments become more feasible when competitive pressure is unleashed and contestability is enhanced. Most MENA countries, particularly those with burdensome business environments, have considerable scope for adapting business regulations to encourage firm entry and facilitate the exit of unproductive firms (through more efficient and rapid bankruptcy procedures, for example). In addition, access to many markets remains restricted. For instance, the legal or accounting professions in Morocco and Tunisia are subject to licensing processes that are not clearly spelled out and leave room for discretion.

Create a level playing field

The case for regulatory reform is especially pronounced in countries where discretionary enforcement of regulation has been used more as a vehicle for rent distribution. Institutional reforms that improve the accountability of the public administration can foster a consistent implementation of rules and regulations and may include several elements. First, transferring responsibilities and decision making to lower tiers of the public bureaucracy while making (lower-tier) civil servants accountable to a broader base could enhance accountability and reduce the scope for opportunistic behavior. Second, it is important to increase the capacity of the lower ranks of the bureaucracy. Third, restructuring recruitment and promotion schemes in public administrations based on merit or commitment to a development strategy instead of regional and sectarian considerations would progressively reduce incentives for rent seeking.

In parallel, empowering antitrust agencies could also effectively bolster competitiveness. Recently established authorities on competition would benefit from clear-cut legal autonomy from the executive branch, which currently approves decisions on competition cases while presiding over the very public enterprises that often maintain monopolistic positions.

Promote trade to relax demand constraints

Opening up economies to trade can also enhance competition, especially if coupled with an improvement in the investment climate. Increased openness could pay a double dividend, because tapping into the global demand pool would be an effective way of complementing domestic demand, which is manifestly insufficient. It would also spur productivity growth both by serving as a disciplining device for inefficient firms and by allowing firms to capitalize on knowledge spillovers.

Expand access to credit to help firms grow and invest

Another precondition for the efficient functioning of markets is fair and equitable access to credit. The limited development of the financial sector reflects a stark absence of legislation, probably owing to insufficient interest among incumbent institutions in widening access to credit. A new set of policies focused on strengthening financial infrastructure, increasing bank competition, and developing nonbank financing (such as venture capital) would not only improve access to finance in the MENA region, but also lay the foundation for more sustainable economic growth.[13]

Rebalancing the social contract to promote more dynamic labor markets

How can countries in MENA foster labor markets that give all groups an equal chance, enable the labor force to move toward the most productive sectors, and eventually support a dynamic private sector? This question is not unique to MENA, as many other economies, including advanced ones, are grappling with similar issues. While the answer must be country specific, striking a productive balance between flexibility and the protection of workers will be key to promoting inclusive and dynamic labor markets. Attaining this balance will involve decisions about the minimum wage, wage agreements, and public sector wage scales. It will also involve decisions about the regulation of contracts, including hiring and dismissal procedures and working hours in both the private and the public sectors. Finally, it will involve decisions about the characteristics of social insurance systems.

To achieve inclusiveness, move toward a higher-productivity equilibrium, and foster a more equitable distribution of opportunities in labor markets, these decisions need to rest on a broad-based consensus that involves the whole citizenry. In this sense, not only the regulatory framework around labor markets but also the social dialogue needs to be rebalanced, so that those who have been traditionally outside the decision-making process—informal

workers, youth, the unemployed, and women—can participate in a bargaining that, through wage and rule setting, affects them directly. Several specific measures could improve the design of social insurance and labor regulation in MENA:

- *Wages*. Algeria, Tunisia, and, to a lesser extent, Jordan have relatively well-organized, traditional social partners (trade unions, employers, parliaments, and the government), but they do not yet include representation of new social partners (civil society organizations, youth, women, the unemployed, and informal workers). Opening up the dialogue on collective wage agreements might result in a more inclusive wage-setting process.
- *Contract provisions and worker protection*. Most countries in the region would benefit from reviewing their employment legislation and instituting more moderate worker protection (especially for dismissal, which includes a rethinking of the strong divides between fixed-term and open-ended contracts), combined with better income security through provision of effective unemployment insurance.
- *Unemployment insurance*. In labor markets with less rigid and less costly dismissal regulations, appropriately designed unemployment insurance schemes can provide adequate protection to workers. With the gradual disappearance of lifelong jobs and an increasing need for job mobility, income protection for workers in transition between jobs will be increasingly important. Only a few countries in the region have unemployment insurance systems (Algeria, Bahrain, Egypt, the Islamic Republic of Iran, and Kuwait). However, even the systems that are in place are underused owing to a lack of public awareness, restrictive eligibility conditions, the difficulty of and the stigma attached to documenting a "just-cause" firing decision, and low overall layoff risks among covered open-ended contract employees. Emerging examples of newly designed unemployment insurance systems include the Jordanian Unemployment Insurance Savings Accounts: such accounts reduce work disincentives by allowing recipients to keep their own unused unemployment contributions and offer the possibility of extending coverage to informal sector workers.
- *Pensions*. Many countries will need to redesign their pensions systems. Parametric reforms or shifts to defined contribution systems could prevent pension debt from spiraling up. At the same time, social partners are increasingly demanding greater coverage, something that could substantially close the divide between system insiders and outsiders. Sequencing will be very important to success, as reforms to improve the sustainability of current systems will need to be enacted before coverage can be extended.
- *The role of the public sector*. It is unlikely that countries such as Egypt, Jordan, or Syria will inject much dynamism in labor markets or promote incentives to create better jobs without a reform of civil service employment. Most countries will need to review the risks and returns offered by the employment package in the public sector by revisiting career and performance incentives, accountability mechanisms, and wage and job security.
- *Barriers to women's participation in labor markets*. Explicit attention is needed to reduce the barriers to female labor market participation and assist those women who wish to enter the labor force. Policies that could help include ensuring that women can travel to work safely and that the workplace itself is safe; increasing the supply of and access to affordable care for children; reforming and improving parental leave policies without reducing incentives to hire women (such policies also have several positive externalities); increasing women's capacity to start and run their own businesses and obtain credit;[14] and revising

laws that still limit women's access to productive assets.[15]

Realigning incentives for skills that matter

In a region that generates far too few jobs, and far too few high-quality jobs, and where merit influences the allocation of jobs to only a limited extent, the educational and training systems receive scrambled signals that do not emphasize skill acquisition as the route to employment. Instead, the signal is to acquire the "right" degree from the "right" university and then queue for a public sector job. The results are little pressure to change traditional patterns of pedagogy (which maintain high selectivity and rigid tracking), a declining TVET system, and eventually a system with relatively poor outcomes at the end of the compulsory schooling cycle.

The key to increasing productivity and restoring a sense of dignity and agency among MENA's young people is for educational and training systems to become more accountable to people, more responsive to the private sector, and more capable of promoting labor markets that value and recognize individual skills and competencies in a transparent, merit-based manner. If those goals are met, the incentives of students and educational systems will be reoriented toward the acquisition and provision of more relevant skills, provided that competition in the private sector becomes stronger, a level playing field is created between public and private employment, and labor markets in general are revitalized. At the same time, a number of institutional features can affect the ability of educational and training systems to productively capture and respond to these changes.

Closing stakeholders' information and knowledge gaps

More access to education and training is not enough to realign incentives to teach and acquire the most relevant skills. To know which skills are required, and where, the large information and knowledge gaps related to learning outcomes and the supply of and demand for skills must be closed. This effort entails monitoring and evaluating the quality of education and, at the same time, reforming assessment and certification systems. Addressing knowledge and information failures, including through counseling throughout secondary school, will allow employers to better communicate what they require from the educational system, schools, and educators to improve quality and to better assess and certify learning, and families and students to make better decisions and form realistic expectations about the transition from education to work. Overall, more systematic, accurate, and publicly available information on what is accomplished by education and training will lead to more solid accountability of all institutions and actors involved.

Value learning and problem solving

The ultimate challenge for education in the 21st century is a paradoxical one: to design a race where everybody can win and where everyone has multiple ways to win. International experience shows that this goal can be achieved by making educational and training systems, particularly those at the secondary and TVET level, more inclusive, more directed toward learning, and less directed toward selecting and exclusively rewarding the academically able while leaving the rest behind. The priority is to prevent students from dropping out and to identify alternative training itineraries so that everyone can acquire relevant skills for a successful school-to-work transition.

Empower the private sector and realign incentives for public sector hiring

Making employability count through a renewed partnership between educational and training systems and the private sector will help align incentives. A new and more effective public-private partnership

framework in education and skill development should help create a common language and incentives for addressing the signaling failures from both sides.

Improve efficiency through active labor market policies

A better balance between publicly funded and private intermediation services will likely improve job search processes and lead to better matches between labor demand and supply. Some countries may also need to adopt legislation to enable and regulate private intermediation services. Most countries will need active labor market programs (that is, programs aimed at improving beneficiaries' employment prospects or earnings capacity) for those who falter in the transition from education to work and for serving the workers who are most difficult to place or most in need of improving their skills. Although active labor market programs currently serve urban areas and the unemployed (some of whom can afford to be unemployed) almost exclusively, they will need to reach out to rural areas and informal workers. To increase effectiveness, services must also be rationalized and focused on case management. Finally, in all countries, better measurement and tracking of effectiveness—for example, of the insertion rate (that is, the proportion of program beneficiaries who find employment)—and feedback mechanisms from beneficiaries and the private sector will contribute to improved performance.

The political economy of inclusion

The analysis so far has shown that breaking the cycle of privilege and lifting the barriers to more and higher-quality employment will involve a complex set of reforms. Yet the question of jobs in MENA is not new, and many of the "technical" recommendations discussed so far are well known. If this is the case, why have these reforms not been enacted before? Conversely, what could finally trigger the needed reform process? And what strategies can help countries face the post–Arab Spring challenges in the short term?

A complex historical legacy

Historically, the social contract in many countries in the region anchored the support of often autocratic, long-lived regimes to a system of rent sharing among minority coalitions. In this system, elites benefited from rents derived from their leading positions in organizations that controlled certain sectors of the economy or from rich natural resources. To maintain their dominant position, elites used different strategies to limit access to these rents, including discretionary application of regulation and significant labor market rigidities. For example, the lack of access to credit limited the entry of new firms and increased privileges for incumbent firms.

At the same time, elites constrained the ability of other social groups to challenge their dominant position by restricting the right of association, press freedom, the role of civil society organizations, and access to data and information. In many countries, this combination resulted in narrow-based social dialogue that limited accountability to the majority of the population. This system reinforced divides both within the private sector (where a few privileged firms thrive while many struggle to survive and fail to grow) and within labor markets (where only a minority of insiders enjoys gainful employment).

The stability of this equilibrium relied also on elites' ability to share these rents selectively through subsidies and public employment. For example, public employment has been actively used as an instrument for guaranteeing secure jobs for middle- and upper-class university graduates and subsidies for ensuring a minimum standard of living for the whole population. However, such heavy interventionism in the economy and in labor markets has muted incentives for the private sector to grow, innovate, and generate high-quality jobs.

Looking ahead in post–Arab Spring MENA

The powerful demand for democracy and voice of the Arab Spring carry unprecedented opportunities to move toward a more inclusive development model. Engendering true change in the rules of the game will be challenging, however. Governments are under tremendous pressure to deliver results rapidly, which might lead to populist, fiscally costly measures that continue to reinforce existing privileges. Long-time outsiders might see the current political changes as their opportunity to finally become insiders, which would merely imply an alternation of elites. Moreover, evidence indicates that it is especially difficult for new democracies to credibly commit to policies with broad-based benefits at the expense of highly organized small interest groups, something that can be even more daunting amid the current drop in growth and fiscal revenues.

Yet the Arab Spring is testimony to a powerful demand for change, one that has toppled decades-old autocratic regimes. It is, however, important to accompany the progressive forces that are working to disrupt the status quo with measures that facilitate transitioning to a new equilibrium—that is, measures that build credibility for the new governments and mitigate the future cost of reforms. Given the pressure that governments receive to repeat "more of the same," it is important that these transitory measures be compatible with the new midterm agenda of reform.

The following sections explore three complementary approaches that would allow governments to respond to short-term challenges while preparing the ground for more structural, medium-term reforms. First, improving access to data and information and allowing for public expression would enable governments to inform the people about the necessity of reform and to improve the common understanding of key issues. Second, leveraging the dialogue with newly emerging social forces could change the nature of the policy dialogue from a narrow base to a more inclusive process. Finally, governments could concentrate on generating early gains that both respond to immediate concerns and are compatible with a medium-term agenda of inclusive growth. Figure O.41 summarizes the links among enabling conditions that disrupt the low-productivity equilibrium, potential short-term actions, and reform objectives.

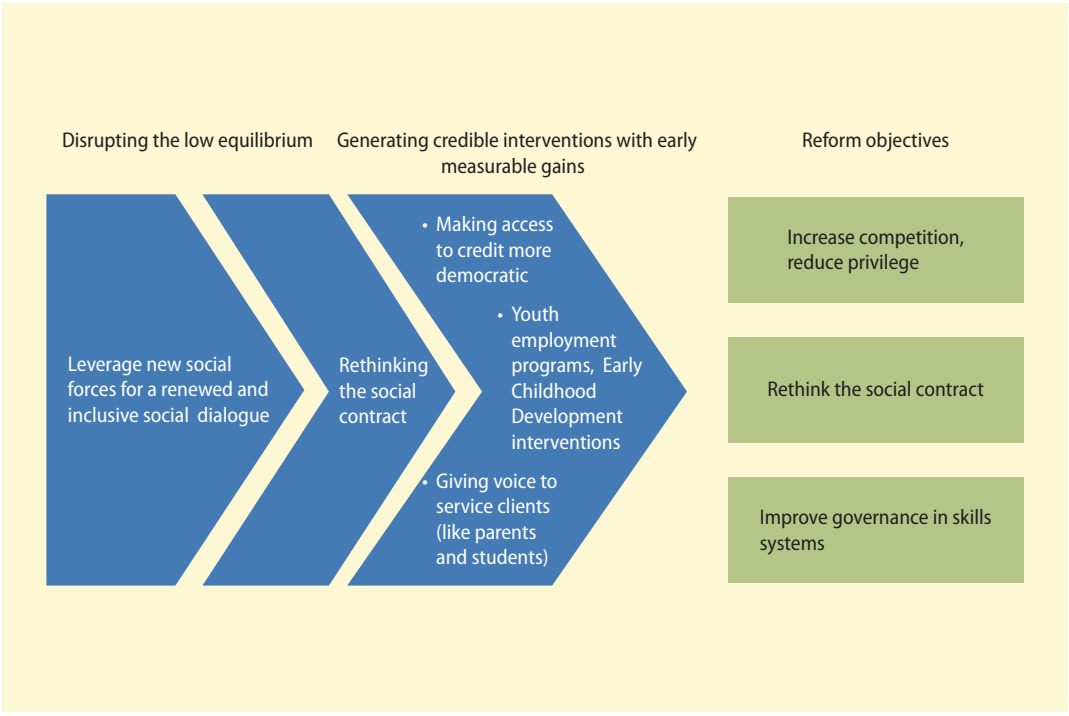
Leveraging new political forces for an inclusive dialogue

A new political landscape continues to shape the region, affecting the roles of both traditional social partners (trade unions and employers, for example) and new social partners (civil society organizations representing outsiders such as youth and women, the unemployed, and informal enterprises). An inclusive social dialogue that gives these new partners a voice can help build a shared view of labor market challenges and consensus around reforms that are beneficial to all. Such reforms include a minimum wage that protects workers without harming the job entry chances of others; collective wage agreements that balance inequality concerns with the entry chances of inexperienced youth; the establishment of the features of a social insurance system that can progressively cover the entire workforce; or the improvement of governance in educational and training institutions.

Improving data openness

Access to data and information is crucial for accountability, transparency, and effective citizen participation in policy formulation. How should governments open up access to data? First, they can eliminate legal barriers that prevent the public from accessing anonymized microdata.[16] A number of countries in Latin America and Eastern Europe have made important strides in this area; in MENA, countries such as Tunisia are providing a leading example that things can change. Second, building a critical mass of expertise in and outside of statistical agencies will allow for consistent use of data for policy making and will support the creation of a shared view of policy priorities. In other countries, institutions such as labor market

FIGURE O.41 Linking short-term measures to medium-term objectives



observatories have contributed productively to developing this type of expertise.

Generating early measurable gains

Governments in MENA are now operating in a fluid and complex political landscape. Investing in early measurable results will help consolidate their credibility and build the terrain for the game-changing reforms to come. Examples of these interventions follow:

- *Targeted programs to improve opportunities and employability of young people.* Instead of creating more permanent civil service jobs in response to popular pressure, rigorously evaluated publicly funded youth and "cash for work" programs can contribute to employment creation in the short run and promote skills building as a bridge to future employment, when designed according to international best practices.
- *Early childhood development interventions to facilitate female participation in to the labor force.* A developed industry for child care education could directly create a large number of jobs among women, while also allowing many more parents (young mothers) to be economically active. In addition, international evidence (MIT 2005) suggests that high-quality early childhood education and care help prepare young children to succeed in school and eventually in life.
- *Filling important infrastructure gaps for direct and indirect job creation.* Investment in infrastructure could be a natural "early gains" measure for creating jobs in MENA. Depending on design, this intervention can have high labor content and play a strategic role in connecting people to markets.
- *Reform credit regulations to benefit credit-starved small firms.* Evidence suggests that in the short run, increased access to finance, including microfinance, can foster new business growth and

especially investment growth among the credit-starved firms. This reform would require the political will to increase competition between banks, allow new entries, and reduce state ownership of financial institutions. While the immediate gains in job creation might not be large, improving access to credit could provide an important signal of the government's commitment to fostering a more open and inclusive business environment. By improving the conditions of firm entry, access to credit could also endogenously expand the constituency for change and reform in the private sector.

- *Produce tangible signs of improved social services to citizens*. The demand for greater inclusion can also be satisfied by helping citizens monitor the delivery of local services and in this way improve service providers' performance (Reinikka and Svensson 2004). For instance, in education, countries in other regions are providing greater autonomy to schools and encouraging stronger local scrutiny from parents through the empowerment of parents' councils. Publication of data on performance and resource flows and the use of scorecards that allow citizens to evaluate delivery are additional methods of increasing accountability.

Conclusion: Time for action in the Middle East and North Africa

With their natural resource wealth, young and increasingly well-educated populations, and strategic location near mature markets, countries in the Middle East and North Africa have tremendous potential. However, the great promise these countries hold has yet to be realized.

A comparative analysis of the region's employment dynamics suggests that the development model adopted by many countries in MENA has failed to deliver enough good quality jobs. Demographics and global economic transformations more than ever make a dynamic private sector the indispensable factor for sustained job creation. This report has shown in detail how the incentives for formal private sector job creation, productivity growth in firms, skills formation, and the efficient allocation of resources and human talent are stifled in MENA. Not only has this curbed the dynamism of the economy, but has also produced inequitable outcomes that have been especially detrimental to women, young people, and the poor. The public sector and the state have a vital enabling role to play, but this is a very different role from that seen in the majority of the region's countries at present.

Part of the underperformance in MENA is grounded in the complex political economy of the region, which also explains the inability of countries to embrace the reforms that could really change their development trajectory. The Arab Spring disrupted the political equilibrium in the region and many countries are undergoing important and complex transitions. This presents a unique opportunity to break the system of privileges and move toward a new and more inclusive model of development. However, the new governments will need to walk the fine line between responding to political pressure of different groups and building ownership for reform.

Many structural reforms will be needed to unburden countries from the legacies of the past and promote job creation. These include creating a level-playing field among firms, establishing a fair *de facto* investment climate, extending access to credit, rebalancing employment conditions between the private and the public sector, improving governance in education and training systems, and removing energy subsidies while protecting the poor and vulnerable.

The time for action is now. Global experience has shown that it is possible to produce tangible improvements in the lives of citizens in the short run without resorting to populist policies that might be harmful to the economy in the longer run. Improved social service delivery, short-term employment and skills development program with well-designed temporary interventions for youth and the poor, and well-functioning

social safety nets are but a few of the policies that can deliver early, visible and measurable results. They can help new governments gain credibility, while a more open dialogue with the population, strengthened by open access to public data and information, builds consensus for the needed, longer-term structural reforms.

And if not now, when?

Notes

1. The expected wage is predicted based on a simple Mincerian regression. Interestingly, wage differentials persisted even when the direct measure of ability was accounted for (in Lebanon and Syria, where available data made this possible).
2. For a discussion on agglomeration, see World Bank (2010).
3. *Protected* is defined as having social security, and *high-paying* is defined either as yielding a wage above two-thirds of the wage distribution or as self-employed and belonging to a household in the top two income quintiles.
4. This definition leaves out pockets of the working poor in urban areas, but the prevalence of poverty is not as correlated with being low-skilled in urban areas as it is in rural areas.
5. The growth strategy during these decades was financed mainly by high oil revenues in resource-rich countries and by workers' remittances and public borrowing in the resource-poor countries.
6. Changes in the drivers of growth, and particularly in total factor productivity growth rates, conceal stark differences between sectors within the same country, which warrant a more detailed country-level analysis to better identify and determine the impact of this change.
7. See also discussion in Gatti et al. (2012).
8. As analyzed in Diop, Marotta, and deMelo (forthcoming).
9. World Bank (2011, fig. 4.8, 103).
10. Soft skills include teamwork, leadership, and problem solving.
11. Tracking and streaming are alternative denominations of similar practices of the ability grouping of students. While tracking usually refers to totally different study programs for different groups of students of the same age (for instance, vocational and educational training programs in upper secondary education versus general ones), streaming refers to ability grouping in selected curriculum areas or subjects.
12. The use of informal networks for hiring is less prevalent among firms with foreign or mixed ownership. In Tunisia, for example, 34 percent of employees with a university degree working in private firms with Tunisian ownership report having found their job through friends or relatives compared with 24 percent in firms with foreign or mixed ownership (based on a Graduate Tracer Survey of the graduation cohort of 2004).
13. World Bank (2011a).
14. See World Bank (2010).
15. World Bank (2011b) discusses these issues in depth.
16. *Microdata* is information at the level of individual respondents. *Anonymized* means that it is not possible for the data user to track the information back to individuals, that is, to identify the identity of individuals in the data.

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Labor Markets in the Middle East and North Africa: A Low-Productivity Equilibrium

PART 1

And I say that life is indeed darkness save when there is urge,

And all urge is blind save when there is knowledge,

And all knowledge is vain save when there is work,

And all work is empty save when there is love;

And when you work with love you bind yourself to yourself, and to one another, and to God.

— Khalil Gibran, *The Prophet*

The first part of this book lays the foundations for the analysis of the process of job creation and job allocation in the Middle East and North Africa (MENA). Chapter 1 presents the main characteristics of labor markets in MENA and then analyzes systematically the extent to which its mechanics favor economic development and a productive allocation of the available human resources. It lays out the evidence that labor markets are both inefficient and inequitable and that they operate at a low-productivity equilibrium. Three groups are most likely to be negatively affected by this low-productivity equilibrium: women, youth, and unskilled workers in rural areas.

Chapter 2 examines the specific situation of each of these three groups more closely and identifies some of the constraints to fulfilling their potential in the labor market. It analyzes the specific barriers that women face in entering into productive employment, the different dimensions of labor market disadvantage among young people, and the main factors associated with working poverty.

Inefficient and Inequitable Labor Markets: A Low-Productivity Equilibrium

1

Main findings

- MENA has a large share of untapped human resources that is not participating in economic activities. Most workers are employed in low-value-added sectors, and well-remunerated jobs in the private sector have hardly increased over time.
- The most qualified workers desire working in the public sector, which is under little pressure to be productive and whose expansion is costly for society at large.
- Low mobility and large unexplained wage gaps across sectors indicate that labor markets are inefficient in allocating human talent and function at a "low productivity equilibrium."
- Attaining a desirable job is largely due to "unearned" circumstances, such as gender and parental characteristics, because labor markets do not allocate opportunities equitably.
- A large share of households agglomerates around one member who has access to a well-paid or protected job. This factor constitutes a de facto safety net that makes reforms much more difficult politically.

Labor markets in MENA: Key facts

High and persistent rates of joblessness and low-productivity informal employment, together with a formal sector dominated by public employment, suggest that the Middle East and North Africa (MENA) is not putting human capital to its best use. Multiple barriers prevent individuals either from participating in the labor force or from obtaining a job with the productivity and pay that correspond to their human capital and effort—especially if such jobs are scarce.

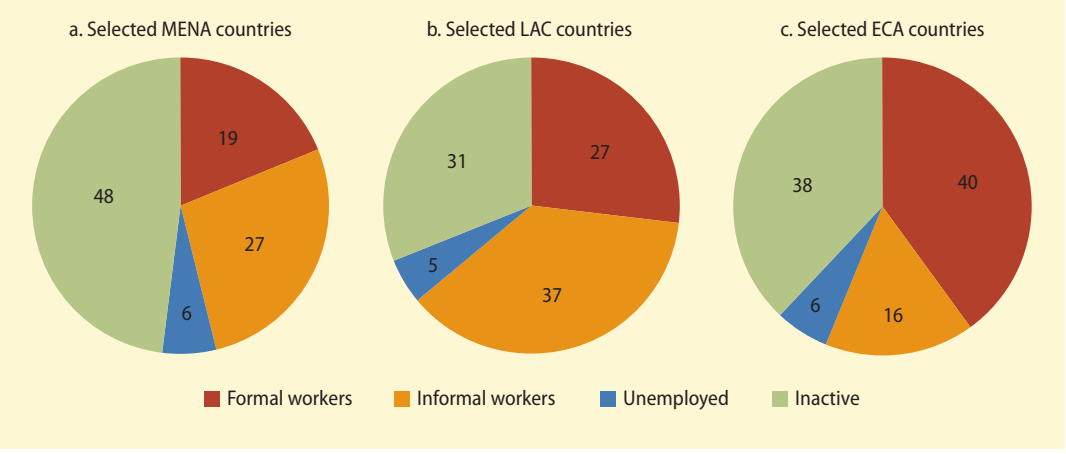
High rates of joblessness

MENA has extensive untapped human resources: that is, many willing and able people are not participating in economic activity. When compared to joblessness (defined as the sum of the unemployed and the inactive) in other middle-income regions, such as Latin America and the Caribbean (LAC) and Europe and Central Asia (ECA), joblessness in MENA is relatively high: 54 of every 100 individuals between the ages of 15 and 64 in MENA do not participate in the labor force. A notable feature is that the inactive

working-age population is much higher in MENA than in LAC and ECA (at 48 percent versus 31 and 38 percent, respectively) (figure 1.1). Also, of these regions, MENA has the lowest share of the working-age population with a formal job (19 percent, versus 27 percent in LAC and 40 percent in ECA).

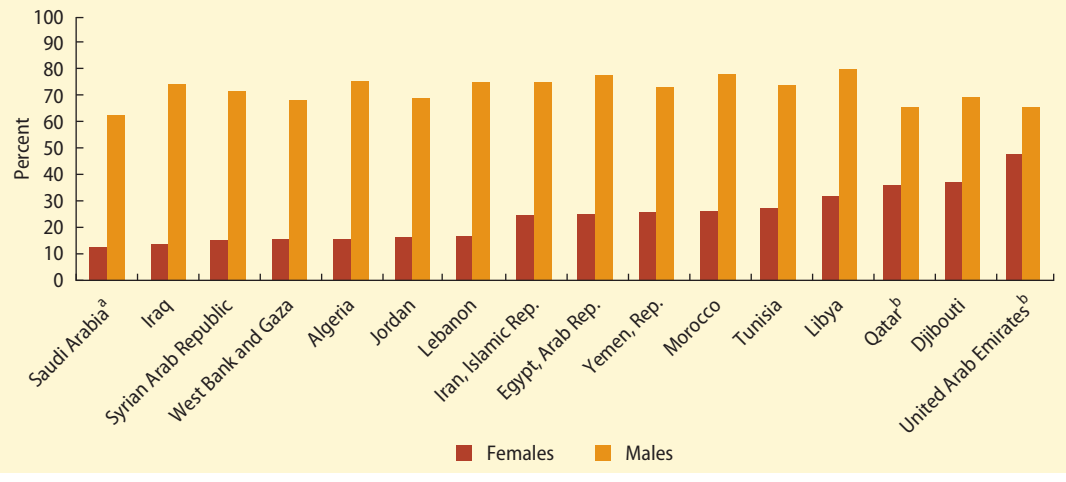
High rates of inactivity in MENA are largely explained by women's low participation in the labor force, which can be as low as 15 percent in many countries, compared to the world average of 60 percent in 2005–10 (see figure 1.2). In past decades, women in the region have participated very little in the labor force, especially married women with children. An increasing number of women want to work, but they face a series of constraints (beyond their own preferences)

FIGURE 1.1 Composition of the working-age population in the Middle East and North Africa, Latin America and the Caribbean, and Eastern Europe and Central Asia, 2010
percent



Source: Based on the International Labour Organization's Key Indicators of the Labour Market (ILO-KILM) database.
Note: ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa.

FIGURE 1.2 Labor force participation rates of the working-age population in selected economies in MENA, by gender, 2009–10



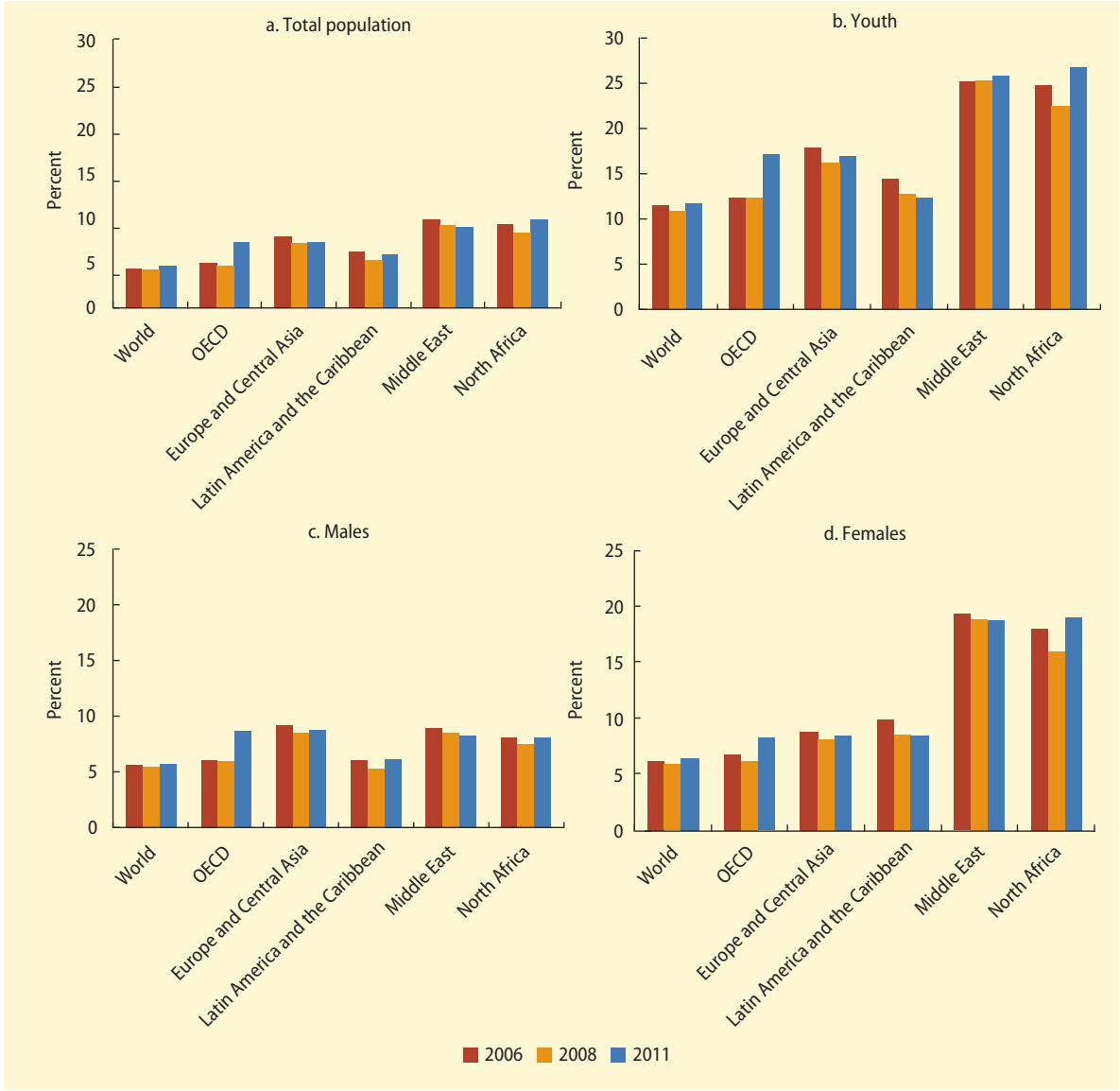
Source: Based on ILO-KILM 2012, Kuwait's 2009 Annual Statistical Abstract, Oman's Labor Statistics 2009, Saudi Arabia's 2009 Saudi Manpower Survey, and the United Arab Emirates' Labor Force Survey (LFS) 2009. See the appendix for more information on some of these surveys.
a. Refers to national, nonimmigrant population.
b. Includes immigrant population.

that make it hard for them to find acceptable forms of employment. Unemployment rates for women in MENA are considerably higher than unemployment rates for men. In some localities, and for certain types of academic degrees, more than half of female graduates with a tertiary education remain unemployed after a year of job search. Women also face difficulties finding employment in the informal sector, whether as employees or as entrepreneurs. These constraints are discussed in detail in chapter 2.

High and persistent unemployment

Unemployment in MENA is persistently higher than in other regions and is overwhelmingly a youth phenomenon (see figure 1.3a, b, c, and d). Nearly all the unemployed are young, not only because

FIGURE 1.3 **Unemployment rates in various world regions, by age group and gender, 2006–11**

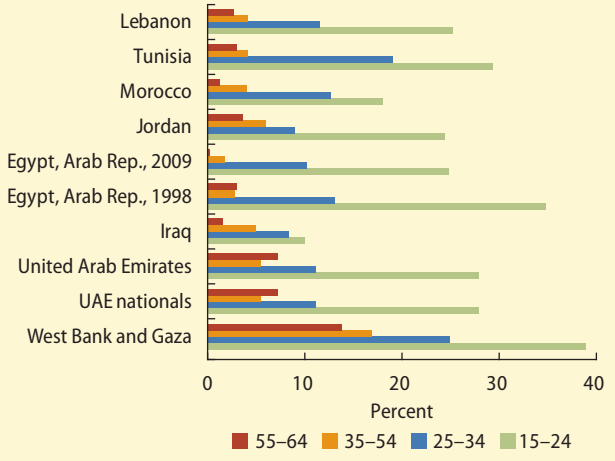


Source: Based on ILO-KILM 2012.
Note: Youth refers to those ages 15–24. OECD = Organisation for Economic Co-operation and Development.

unemployment is far more prevalent among the young (as shown for instance in figure 1.4) but also because of the demographic weight of this age group within the working-age population (see also the discussion on demographics in chapter 3). In addition, unemployment among women, currently well above that of men, represents the absolute highest regional unemployment rate in the world (see figure 1.3c and d).

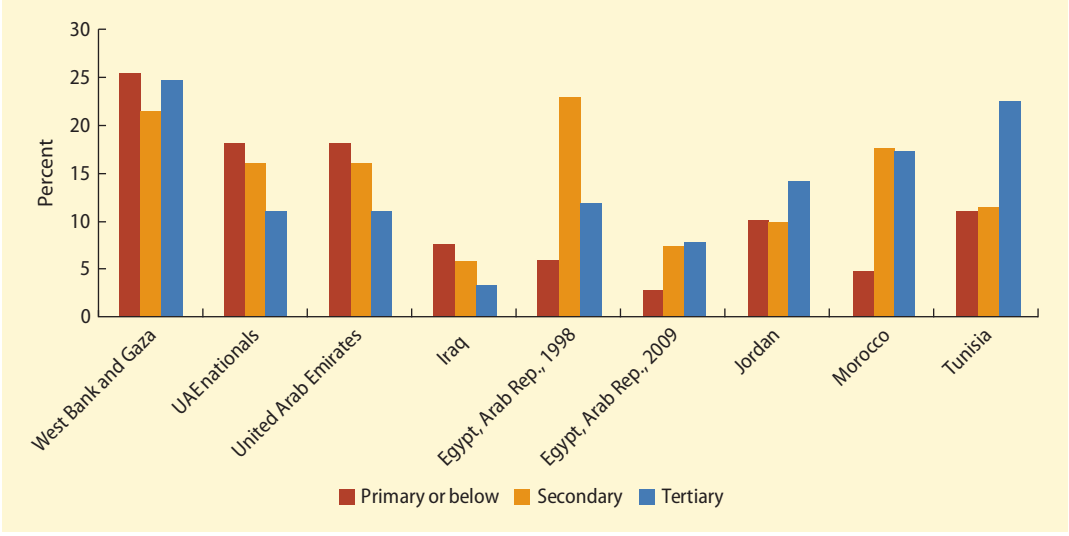
The educational profile of the unemployed is heterogeneous in the region. In the Arab Republic of Egypt, Jordan, and Tunisia, unemployment rates are very high among the better educated, particularly among women. However, in economies like some of the Gulf States, Iraq, and the West Bank and Gaza, unemployment rates tend to be higher among the low-skilled population (see figure 1.5). In Morocco, unemployment of the tertiary-educated population fell in recent years to the level of those with a secondary education, while in Egypt, the opposite occurred between 1998 and 2006. Within the stock of the unemployed (as distinguished from unemployment rates), the majority in all countries in the region are low-skilled workers who attained at most a secondary education (figure 1.6).

FIGURE 1.4 Unemployment rates in MENA, by age, 1998–2010



Source: Based on the Arab Republic of Egypt's Labor Market Panel Survey (LMPS) 1998 and the Survey of Young People in Egypt (SYPE) 2009, Iraq's Household Socioeconomic Survey (HSES) 2006, Jordan's LMPS 2010, Lebanon's Employer-Employee Survey 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the West Bank and Gaza's LFS 2008, and the United Arab Emirates' LFS 2009. See the appendix for more information on these surveys.
Note: MENA = Middle East and North Africa; UAE = United Arab Emirates.

FIGURE 1.5 Unemployment rates by education in selected economies in MENA, 1998–2010



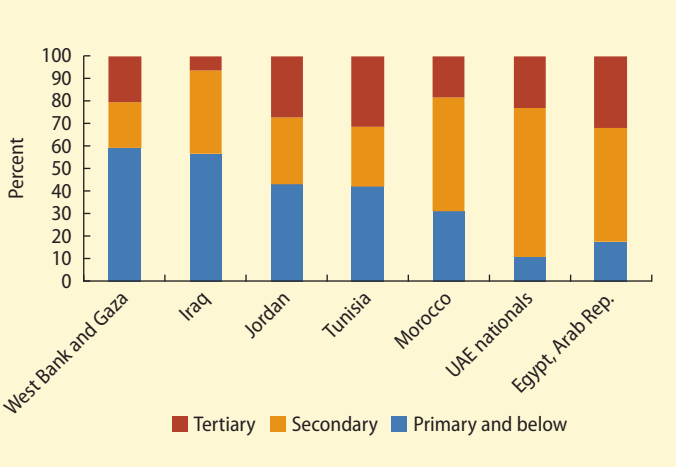
Source: Based on the Arab Republic of Egypt's LMPS 1998 and SYPE 2009, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the United Arab Emirates' LFS 2009, and the West Bank and Gaza's LFS 2008. See the appendix for more information on these surveys.
Note: The unemployment definition varies by survey type. MENA = Middle East and North Africa; UAE = United Arab Emirates.

High informality

Informal employment in MENA is prevalent and associated with low-productivity and low-quality jobs. A typical country in MENA produces about one-third of its gross domestic product (GDP) and employs 67 percent of its labor force informally. As a result, more than two-thirds of all workers in the region may not have access to health insurance or may not be contributing to a pension system (two common proxies for informality). From a fiscal perspective, about one-third of total economic output in the region remains undeclared, with considerable implications for government revenue. The difference between the share of the labor force engaged in informal employment and the share of GDP produced informally (as captured by the Schneider index) is larger in MENA, for example, than in Latin America (figure 1.7). Although there are many caveats to these comparisons, this evidence suggests that informal jobs in MENA are, on average, associated with lower productivity than in other regions at comparable levels of development. This interpretation is supported by evidence on earnings, showing that informal workers systematically earn less than formal workers in MENA (Gatti et al. 2012; see also figure 1.7).

The prevalence of informality varies substantially across countries in the region. Their heterogeneity—in size, role of the public sector, availability of resources and labor, economic development, and productive and demographic structure—influences the size of the informal economy. Informality is higher in countries such as Morocco and the Republic of Yemen, where the share of agricultural employment relative to total employment is high, and lower in Egypt and Jordan, where the public sector accounts for 30–35 percent of overall employment (Elbadawi and Loayza 2008).[1] A country's productive structure is also an important driver of informality: energy-rich countries (such as the Islamic Republic of Iran and the Syrian Arab Republic) tend to have high informal employment (about 80 percent) but have rather low informal output as a share of GDP (about 20 percent, as measured by the Schneider index; see figure 1.8). This gap likely indicates that a small formal workforce in the capital-intensive energy sector produces most of the output of these countries, while the majority of the informal workforce is engaged in low-productivity jobs.

FIGURE 1.6 Percentage of the unemployed by education in selected economies in MENA, 2006–10

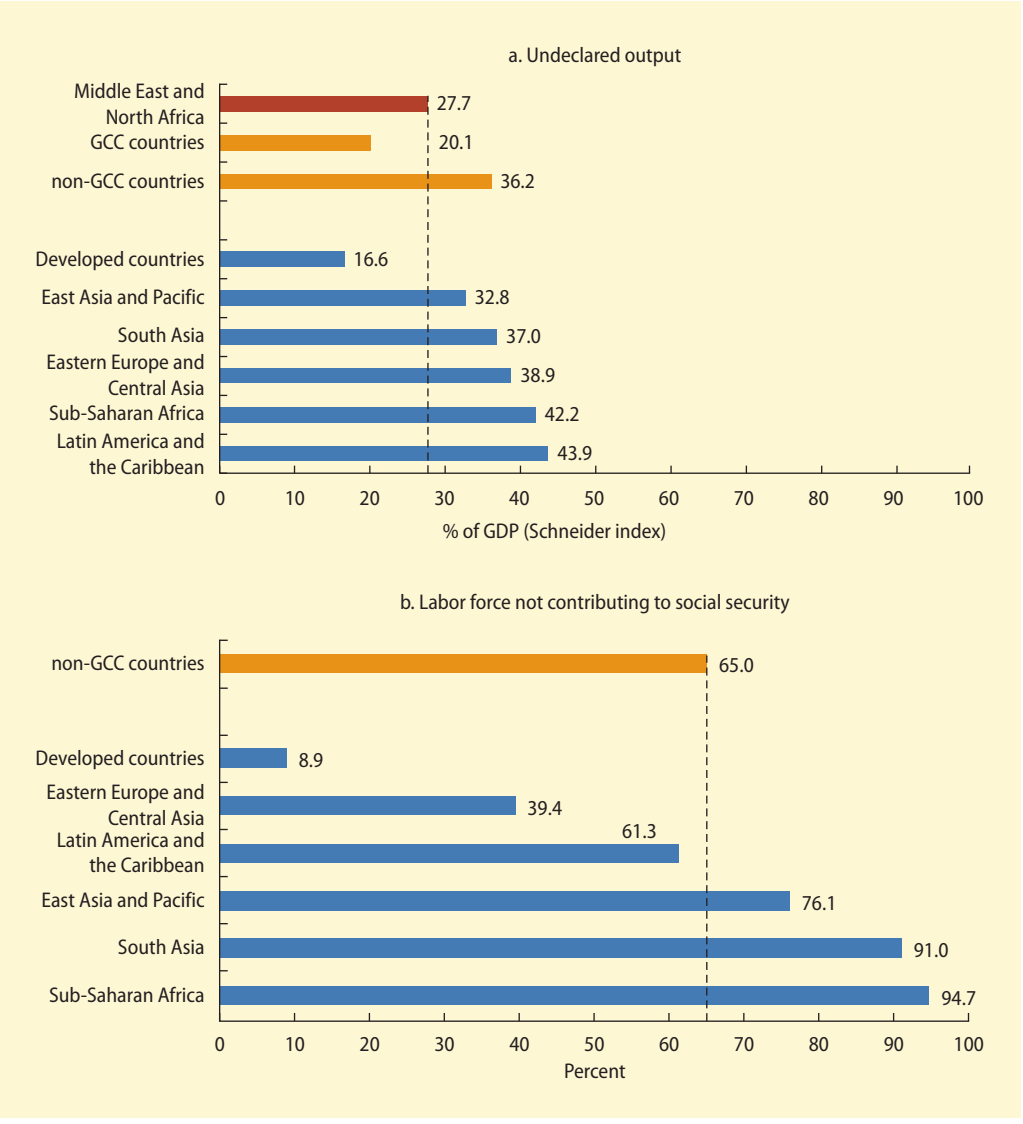


Source: Based on the Arab Republic of Egypt's SYPE 2009, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the United Arab Emirates' LFS 2009, and the West Bank and Gaza's LFS 2008. See the appendix for more information on these surveys.
Note: The unemployment definition varies by survey type. MENA = Middle East and North Africa; UAE = United Arab Emirates.

Widespread subsistence self-employment and limited entrepreneurship among the highly skilled

The magnitude and qualitative features of entrepreneurship (comprising here both self-employed and employers) in MENA are different from those in other regions in the world. About one-third of the workers in MENA are nonwage workers (figure 1.9), a share that varies across countries according to their per capita income and the importance of agriculture in the economy. Globally, the share of wage workers (nonentrepreneurs) across countries tends to increase with the level of income (Gindling and Newhouse 2012), reflecting

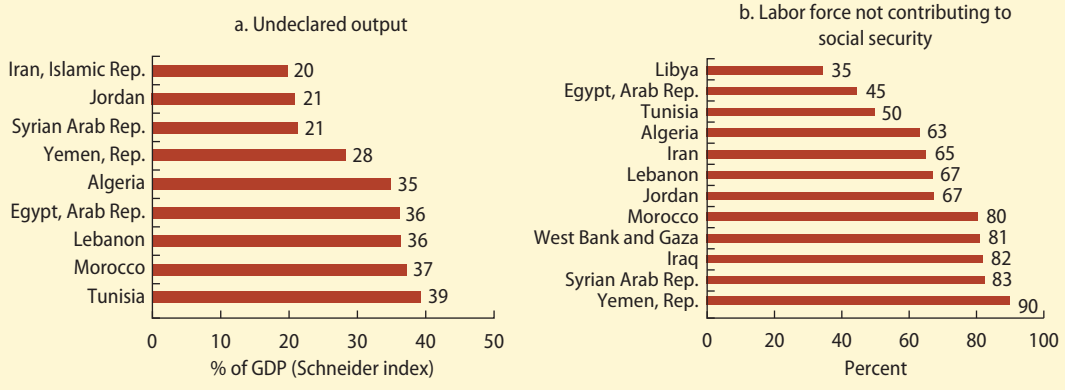
FIGURE 1.7 **Informality in MENA and other regions, 2001–07**



Source: Gatti et al. 2012.
Note: The periods covered are the average of 2000–07 for pension scheme and 2001–04 for Schneider index, respectively. GCC = Gulf Cooperation Council.

the structural transformation (that is, the movement of workers out of agriculture into wage work) of the countries as well as how the size distribution of firms evolves with development. In this respect, MENA countries are atypical, as they have a lower share of wage workers than middle-income regions such as ECA and LAC, denoting the prevalence of employment in relatively small firms. The educational distribution of workers also suggests that MENA has a large number of poorly educated subsistence entrepreneurs and a small number of highly educated firm owners. Globally, employers tend to be more educated than self-employed and wage employees (Gindling and Newhouse 2012), but not in MENA. Across all countries considered,

FIGURE 1.8 **Informality rates for selected non-GCC economies in MENA, 2000–07**



Source: Gatti et al. 2012.
Note: Time periods are as follows: Schneider index (1.8a), average 2001–04; not contributing to social security, average 2000–07. MENA = Middle East and North Africa; GCC = Gulf Cooperation Council; GDP = gross domestic product.

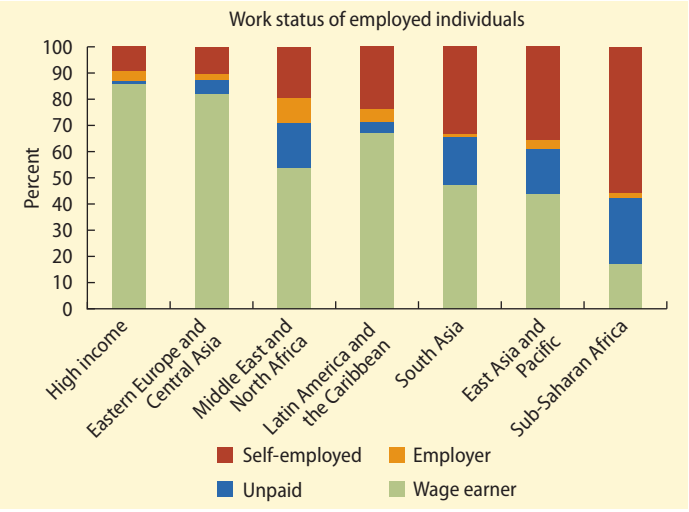
fewer employers than wage employees have a tertiary education (see figure 1.10), reflecting the role played by the public sector in absorbing high-skilled individuals.

High-productivity entrepreneurs are few, as measured by household welfare. Figure 1.11 shows the distribution of employed males by work status and by quintile of their household wealth or consumption in Egypt, Jordan, and Morocco.[2] About half of informal wage workers live in poor or near-poor households, while entrepreneurs are distributed more evenly across quintiles. Formal wage workers are the most likely to be in the top income quintiles. A more detailed disaggregation would show that the employers are those most likely to be in higher-income quintiles—they are the most successful of entrepreneurs—while the self-employed are relatively more likely to be poor, but less so than informal wage workers. Another fact that makes MENA countries stand out is the gender predominance among entrepreneurs, the majority of whom are men.

Dominance of public employment in the formal sector

Labor markets in many MENA countries are still influenced by the legacy of a large public sector, which accounts for about 29 percent of overall employment in the region. In countries like Egypt, for example, growth in the civil service was the result of a social contract in the 1970s and 1980s, whereby the government effectively offered employment guarantees to university graduates and to graduates of vocational secondary schools and training institutes (World Bank 2004). As a

FIGURE 1.9 **Distribution of work status across regions, 1999–2008**

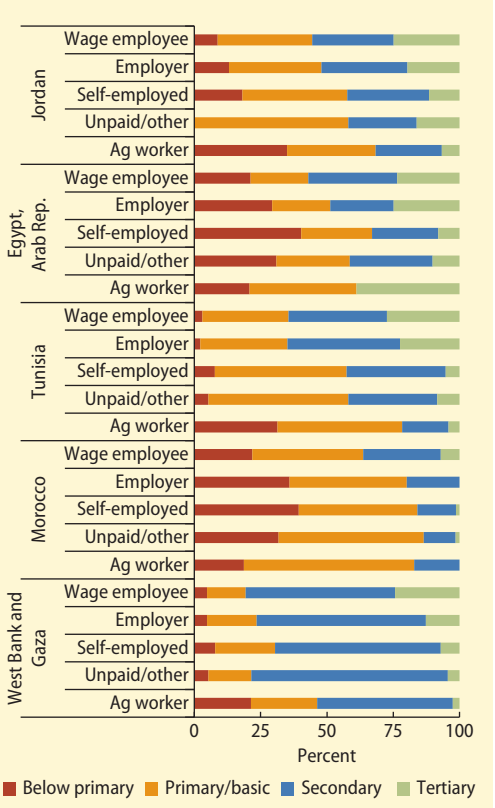


Source: Gindling and Newhouse 2012, based on the International Income Distribution Database (I2D2) (World Bank 2012) (repository of household surveys).

consequence of that inheritance, the civil service in many MENA countries is larger than in other countries with similar income levels and economic structure (Elbadawi and Loayza 2008).

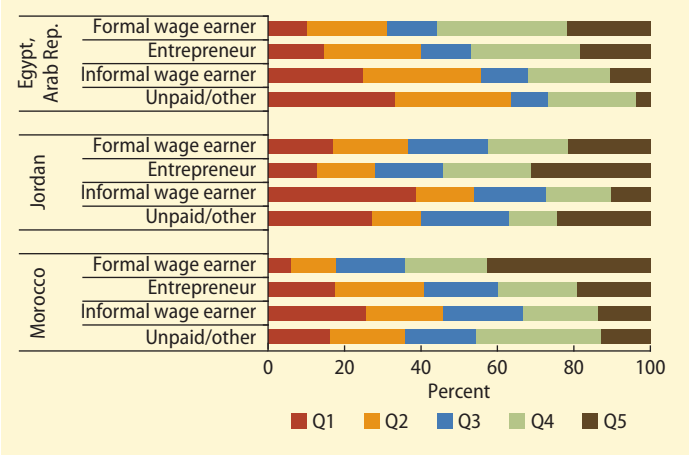
Despite the fact that employment growth in the public sector has slowed dramatically in recent years, government and public enterprises in most countries still account for more than 60 percent of all formal sector employment, while the formal private sector (generally the most productive in the economy) is rather small (figure 1.12). Employment in the formal private sector is almost nonexistent in Iraq and the Republic of Yemen and below 10 percent of total employment in Egypt and Morocco, while it is somewhat larger in Jordan and Tunisia. As seen earlier, this situation reflects a number of factors, including the structure of a country's production, the large size of the public sector (which effectively competes for resources and talent with the private formal sector), and the design of pension systems (which in Iraq and the Republic of Yemen do not extend to the private sector) (see also the discussion in chapters 4 and 5).

FIGURE 1.10 Distribution of employment status by educational attainment in selected economies in MENA, 2008–10



Source: Based on the Arab Republic of Egypt's SYPE 2009, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, and the West Bank and Gaza's LFS 2008.
Note: ag = agricultural; MENA = Middle East and North Africa.

FIGURE 1.11 Work status of employed males in the Arab Republic of Egypt, Jordan, and Morocco by household per capita wealth and consumption quintile, 2009–10



Sources: The Arab Republic of Egypt's SYPE 2009, Jordan's LMPS 2010, and Morocco's LFS 2009.
Note: Q = quintile.

MENA labor markets: Inefficient and inequitable

Labor markets in MENA can be characterized as both inefficient and inequitable. They are inefficient because human capital is not allocated where it could get a higher return (that is, so that the highest output can be achieved with the available inputs). And they are inequitable because desirable labor outcomes, such as getting access to a protected or well-paid job, are determined by circumstances (like gender and parental education) that do not necessarily depend on individual effort. The inefficient and inequitable nature of labor markets in the region

has created a deep sense of exclusion among young people.

Symptoms of inefficiency

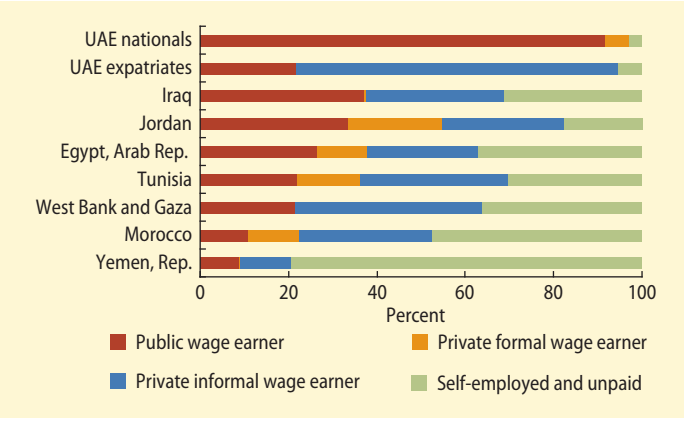
Three main symptoms of inefficiency prevail in MENA's labor markets: (1) wage differentials across sectors and individuals are not explained by differences in human capital endowments; (2) mobility of workers from low-productivity to high-productivity employment is low; and (3) geographical differentials in labor market outcomes are large and persistent.

Wage differentials unexplained by differences in human capital endowments

Neoclassical economic theory states that in unified and efficient labor markets, firms create vacancies according to their productive needs and workers compete to fill these vacancies according to their human capital endowments. In such labor markets, variations in the wages and conditions of different workers arise from individual differences in their human capital (skills, experience, or formal education) or preferences. Symptoms of inefficiency exist when differences in compensation and other employment conditions originate on the demand side rather than being explained by individual workers' productivity. Often such inefficiency is characterized by the existence of a sector (or sectors) that rewards human capital better than others or in cases where labor market institutions (such as a minimum wage) oblige employers to pay wages above productivity.

Figure 1.13 plots the expected wage rate of an average worker (not including the effect of experience) according to his or her years of education by applying the exponential function to the coefficients obtained from the Mincer model.[3] Results indicate that returns to education (and especially of primary and secondary education) are higher in the public and formal private sector and very low in the informal sector. For instance, a typical formal worker in Egypt and Jordan with no experience but with 12–16 years of education (equivalent to complete secondary and tertiary education, respectively) would earn wages that are twice to three times larger than those earned by an informal worker who also has 12–16 years of education. This result indicates that wage differentials across sectors are not necessarily explained by differences in human capital.

FIGURE 1.12 Employment composition by sector in selected economies in MENA, 2005–10

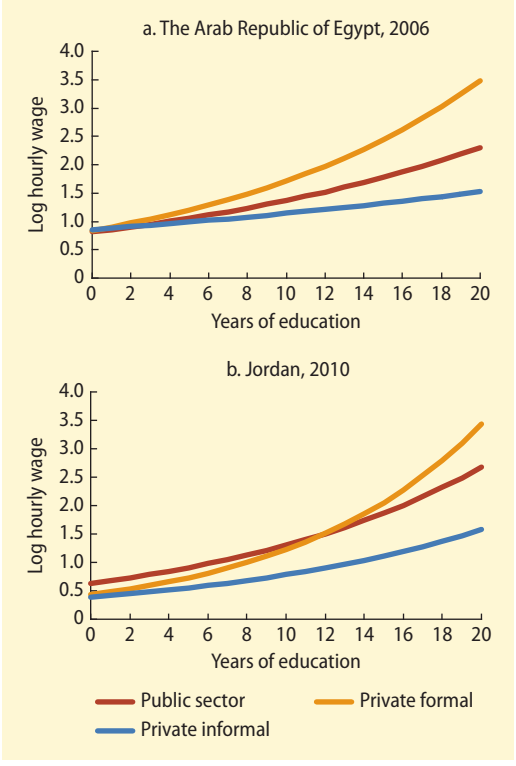


Source: Based on the Arab Republic of Egypt's LFS 2010, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the United Arab Emirates' LFS 2009, the West Bank and Gaza's LFS 2008, and the Republic of Yemen's Household Budget Survey (HBS) 2005. See the appendix for more information on these surveys.
Note: Formal employment, defined through affiliation with social security, is not available among private sector firms in the West Bank and Gaza and for migrant workers in the United Arab Emirates. MENA = Middle East and North Africa; UAE = United Arab Emirates.

While higher returns to human capital in the formal sector are not uncommon in developing economies (for instance, see World Bank 2009, for a discussion of Turkey), what is unique to MENA is that returns to human capital in the informal sector (on average) are strikingly low.

Finally, as expected, the formal private sector pays higher wages to individuals who have attained higher levels of education, which probably reflects higher productivity in this sector. It is worth mentioning, however, that in many countries, public sector jobs are still preferred over private formal jobs, because, first, private formal jobs are scarce and, second, public sector jobs might require less effort, have better nonmonetary benefits, and are more secure (as discussed in detail in chapter 5). Only about one-third of all youth with a tertiary education finds public sector

FIGURE 1.13 Expected wage by years of education in the Arab Republic of Egypt, 2006, and Jordan, 2010



Source: Based on the Arab Republic of Egypt's LMPS 2006 and Jordan's LMPS 2010. See the appendix for more information on these surveys.
Note: E(w|Yrs of edu) = exp(C + β1 Yrs of Edu. + β2 Experience + β3 Experience squared). Estimations based on Mincer model. Sample includes wage earners in urban areas working between 30 and 60 hours per week.

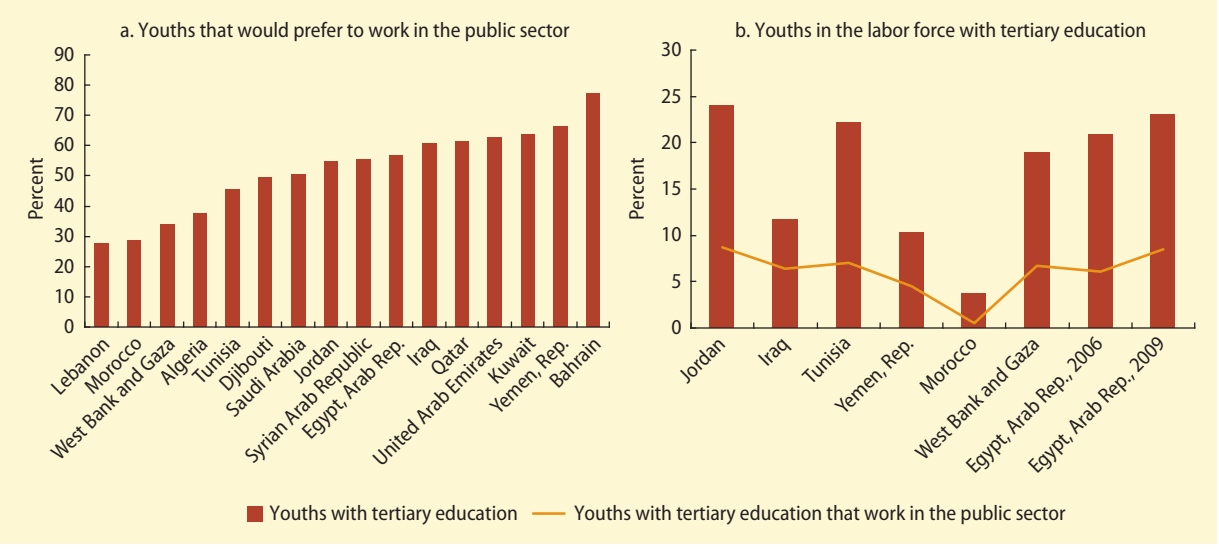
employment (see figure 1.14b); yet data from Gallup indicate that in most countries in the region, the majority of young people (50–60 percent in most cases) prefer to work in the public sector (figure 1.14a). The implications for labor market efficiency are important: the most talented young individuals prefer to work in the public sector, which provides less value added to the economy than the high-productivity private sector.

Important wage differentials that are not fully explained by differences in human capital or industry also persist among men and women. Employment among women in MENA is likely to reflect important self-selection patterns. That is, the few women who choose to participate in the labor force (generally those with higher levels of education) tend to select themselves into public sector and services sector employment. As indicated in table 1.1, a significant share of employed women work in the public sector (from 40 percent in Tunisia to 77 percent in Iraq) and in the services sector (from 16 percent in Iraq to 25 percent in Jordan). Because working women are on average more educated than their male counterparts, one would not especially expect to see a gender wage differential in the public sector. In the private sector, women may self-select into lower-paying service industries (as occurs in many countries), which could partly explain the wage differentials seen between men and women.

For instance, estimates for Egypt in 2006 indicate that the majority of women in the private sector work in the agricultural and personal service sectors (about 60 percent of all employed women), while most men work in transport, retail, tourism, and manufacturing (which are generally better-paid industries) (see World Bank 2010). Even after controlling for self-selection into particular sectors and industries, however, results from Egypt and Jordan indicate that women earn lower wages than their male counterparts, net of education and experience, even in the public sector (figure 1.15). These gaps can be attributed to discrimination (which in theory is inefficient, but firms may be able to afford these practices) or to other unobservable factors, such as ability and effort.[4] At the same time, results from Egypt and Jordan differ significantly, which indicates that wage differentials between men and women are likely to vary greatly across countries in the region. In Jordan, wage gaps are rather low (varying between 10 and 12 percent in the public and private sectors), whereas in Egypt, they are much larger (ranging from 19 percent in the public sector to 77 percent in the private informal sector).

Finally, wage differentials also exist between migrant and nonmigrant populations and are also not explained by differences in human capital endowments. Labor market outcomes differ greatly between national and foreign workers, particularly in the Gulf countries. As a result of these countries' liberal de

FIGURE 1.14 Preference for and attainment of public sector employment among youths ages 15–34 in selected economies in MENA, 2005–10



Source: Based on the Arab Republic of Egypt's SYPE 2009 and LMPS 2006, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the West Bank and Gaza's LFS 2008, the Republic of Yemen's HBS 2005, and the Gallup World Poll Survey 2010. See the appendix for more information on these surveys.
Note: MENA = Middle East and North Africa.

TABLE 1.1 Composition of urban employment by industry in the Arab Republic of Egypt, Iraq, Jordan, and Tunisia, 2006–10
percent

	Jordan		Egypt, Arab Rep.		Iraq		Tunisia	
	Women	Men	Women	Men	Women	Men	Women	Men
Primary	3.63	3.20	6.07	4.71	1.04	3.47	2.81	6.63
Secondary	11.28	23.82	11.38	29.43	5.77	29.95	35.23	34.63
Tertiary	24.72	44.58	24.10	41.48	16.13	38.95	21.68	35.94
Public administration	60.37	28.40	58.45	24.38	77.07	27.62	40.28	22.80

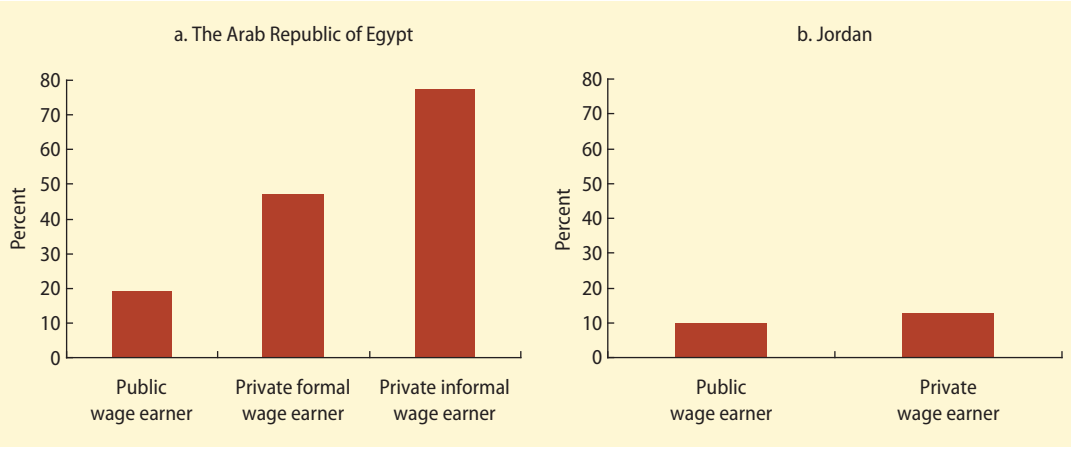
Source: Based on the Arab Republic of Egypt's SYPE 2009, Iraq's HSES 2006, Jordan's LMPS 2010, and Tunisia's LFS 2010.
Note: Primary sector (agriculture); secondary sector (manufacturing and construction); tertiary sector (wholesale, transport, services); and public administration and social services (including education and health).

facto immigration policies, the abundant supply of low-wage foreign labor has depressed the immigrants' wages, pushing them to the bottom of the wage scale. Taking the example of the United Arab Emirates, results from the World Bank (2011) suggest that wage differentials persist after controlling for education and skills and indicate that nationals earn wages that are two to three times higher than those of migrants. As one might expect, these gaps are even greater for low-skilled workers (figure 1.16). (Chapter 5 will explain this issue in greater detail.)

Limited labor market mobility into high value-added jobs

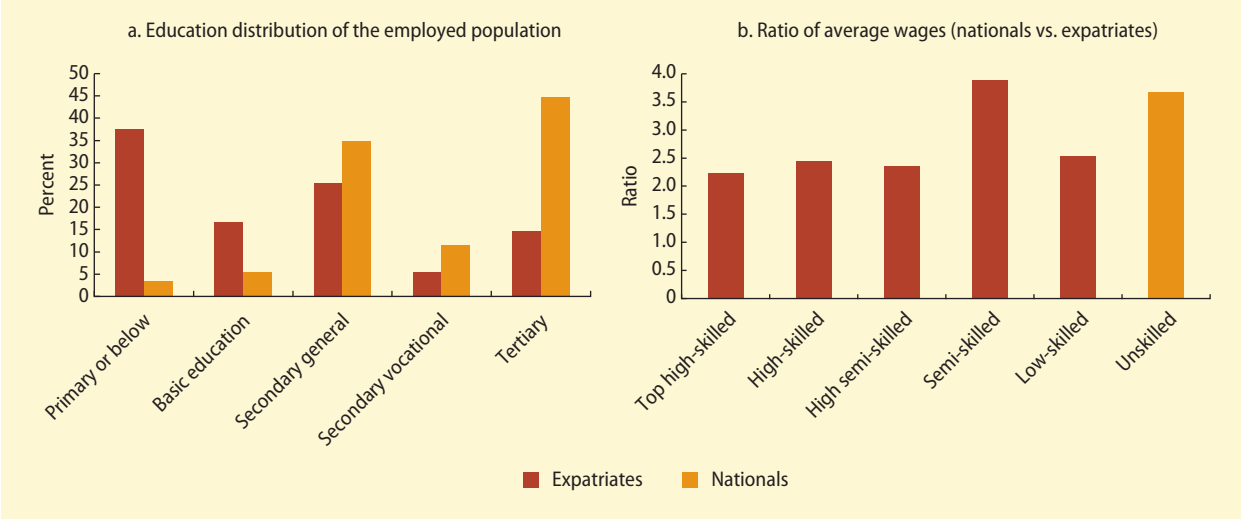
Low mobility of human capital into high-productivity sectors and out of low-productivity sectors is also a symptom of labor market inefficiency. In this context, a desirable social and economic outcome would be one in which workers move out of sectors with low value added (the informal sector) and low pay (the public sector) and into sectors with high value added and high pay (the formal private sector). Panel data and retrospective questions from

FIGURE 1.15 Male-female wage differentials by sector in the Arab Republic of Egypt and Jordan, 2006 and 2010



Source: Based on the Arab Republic of Egypt's LMPS 2006 and Jordan's LMPS 2010.
Note: Data are net of education, experience, and industry. The selection sample includes wage earners in urban areas working between 30 and 60 hours per week.

FIGURE 1.16 Education and wage differentials among migrants and nationals in the United Arab Emirates, 2011



Source: World Bank 2011.
Note: Skill levels here are defined on the basis of different one-digit International Standard Classification of Occupations (ISCO) job categories, in which the highest ISCO classification reflects the highest skill level.

Egypt, Jordan, and Lebanon allow for measurement of the extent of mobility in the labor market.

In the case of Egypt (table 1.2), most workers employed in the public sector in 1998 (79 percent among unskilled workers and 87 percent among skilled workers) continued to work in the public sector in 2006, and the majority of those who left the public sector became inactive, probably due to retirement. Only a minority (1–2 percent) of all workers in the public sector in 1998 moved to the formal private sector. In contrast, movement into the public sector was substantial: a significant share (about 20 percent) of all high-skilled workers in the

TABLE 1.2 **Employment transition matrix in the Arab Republic of Egypt, 1998 and 2006**

All workers, 1998	Inactive, 2006 (%)	Unemployed, 2006 (%)	Public, 2006 (%)	Formal wage earner, 2006 (%)	Informal wage earner, 2006 (%)	Employer, 2006 (%)	Self-employed, 2006 (%)	Unpaid, 2006 (%)	Total, 2006 (%)	*N*
Workers with tertiary education										
Public wage earner	11	1	87	1	1	0	0	0	100	710
Formal wage earner	5	0	20	65	6	2	2	0	100	86
Informal wage earner	11	4	21	23	26	9	7	0	100	57
Employer	7	2	10	0	2	67	11	2	100	61
Self-employed	3	0	0	3	3	41	48	0	100	29
Workers with at most secondary education										
Public wage earner	12	0	79	2	2	2	1	0	100	971
Formal wage earner	6	1	7	52	17	9	9	0	100	172
Informal wage earner	6	2	9	9	42	20	11	1	100	598
Employer	7	0	4	2	5	69	12	1	100	297
Self-employed	11	1	5	2	10	27	40	5	100	320

Source: Based on the Arab Republic of Egypt's LMPS, various years.
Note: The highlighted text measures the share of workers whose employment status did not change between 1998 and 2006; for example, 87 percent of workers with tertiary education who were public employees in 1998 were still public employees in 2006. *N* = number. Sample data are for individuals between 31 and 64 years of age.

formal private sector in 1998 held public sector jobs in 2006.

With regard to informal workers, data for Egypt (table 1.2) show that their mobility prospects are associated with their educational level. Among workers with a tertiary education, working as a wage earner in the informal sector is a transitional path to formal employment, while informal wage earners without a university education have quite limited mobility into higher-value-added jobs. Indeed, 42 percent of informal wage earners without a university diploma in 1998 still had a similar employment status in 2006 (against only 26 percent among the highly skilled), while 31 percent had become employers or self-employed (probably still in the informal sector).

To a large extent, employment transitions in Jordan between 1999 and 2010 (table 1.3) mirror patterns observed in the data from Egypt. Mobility out of the public sector (other than to become inactive or retired) is limited, and low-skilled workers have little mobility out of informal (presumably low-productivity) activities. As in Egypt, in Jordan a sizable share of high-skilled workers uses the informal sector as a bridge to formal employment (mainly in the public sector).

Lebanon's case is somewhat different from the previous two, among other reasons because the available data show short-term mobility patterns (see table 1.4). Because of the short time span, even small differences in probabilities indicate important mobility differences over longer periods. Table 1.4 shows that in Lebanon, hardly any worker who is in informal wage work or is self-employed has a chance to move into a formal wage job, as was the case in Egypt, signaling that mobility into higher-value-added wage positions is constrained. However, the nonwage sector in Lebanon appears to be particularly open to entry and is attractive on many levels: self-employment is a very important avenue into the labor market for unemployed and inactive individuals (relative to other work status), and even many formal wage workers move to

TABLE 1.3 Employment transition matrix in Jordan, 1999 and 2010

All workers, 1999	Inactive, 2010 (%)	Unemployed, 2010 (%)	Public, 2010 (%)	Formal wage earner, 2010 (%)	Informal wage earner, 2010 (%)	Employer, 2010 (%)	Self-employed, 2010 (%)	Unpaid, 2010 (%)	Total, 2010 (%)	*N*
Workers with tertiary education										
Public wage earner	15	4	68	5	3	1	4	0	100	262
Formal wage earner	13	7	14	57	4	5	0	1	100	117
Informal wage earner	16	3	18	14	33	7	9	0	100	110
Employer	15	6	0	0	0	73	7	0	100	40
Self-employed	8	3	14	4	5	27	40	0	100	35
Workers with at most secondary education										
Public wage earner	24	4	55	5	4	2	6	0	100	977
Formal wage earner	22	4	7	54	6	4	2	0	100	380
Informal wage earner	12	5	7	11	44	9	11	0	100	888
Employer	10	6	3	0	3	64	13	0	100	185
Self-employed	15	8	5	4	9	6	52	0	100	292

Source: Based on Jordan's LMPS 2010, with retrospective data.
Note: The shaded text measures the share of workers whose employment status did not change between 1999 and 2010; that is, 68 percent of workers with tertiary education who were public employees in 1999 were still public employees in 2010. *N* = number. The sample consists of individuals between 33 and 64 years of age.

TABLE 1.4 Monthly employment transitions of the working-age population in Lebanon, 2010
percent

Current month → next month	Self-employed	Formal employees	Informal employees	Employee unknown	Unemployed	Inactive	Total
Self-employed	99.96	0.00	0.00	0.03	0.01	0.00	100
Formal employees	3.13	94.06	0.32	1.94	0.43	0.11	100
Informal employees	3.02	0.19	93.69	1.89	0.91	0.30	100
Employee—unknown	0.17	0.00	0.06	99.72	0.06	0.00	100
Unemployed	6.19	0.26	2.01	0.00	91.54	0.00	100
Inactive	4.50	0.35	1.04	0.25	0.69	93.18	100
Total	83.70	1.74	4.97	3.72	2.15	3.72	100

Source: World Bank 2013, using Lebanon's Employer-Employee Survey 2011. See the appendix for more information on this survey.
Note: This table should be read as follows: for example, 99.96 percent of respondents who were self-employed during one month were self-employed the following month.

self-employment. The quality of these jobs is very heterogeneous, and the high persistence of self-employment could be a combination of preference and lack of better alternatives (as discussed in chapter 2).

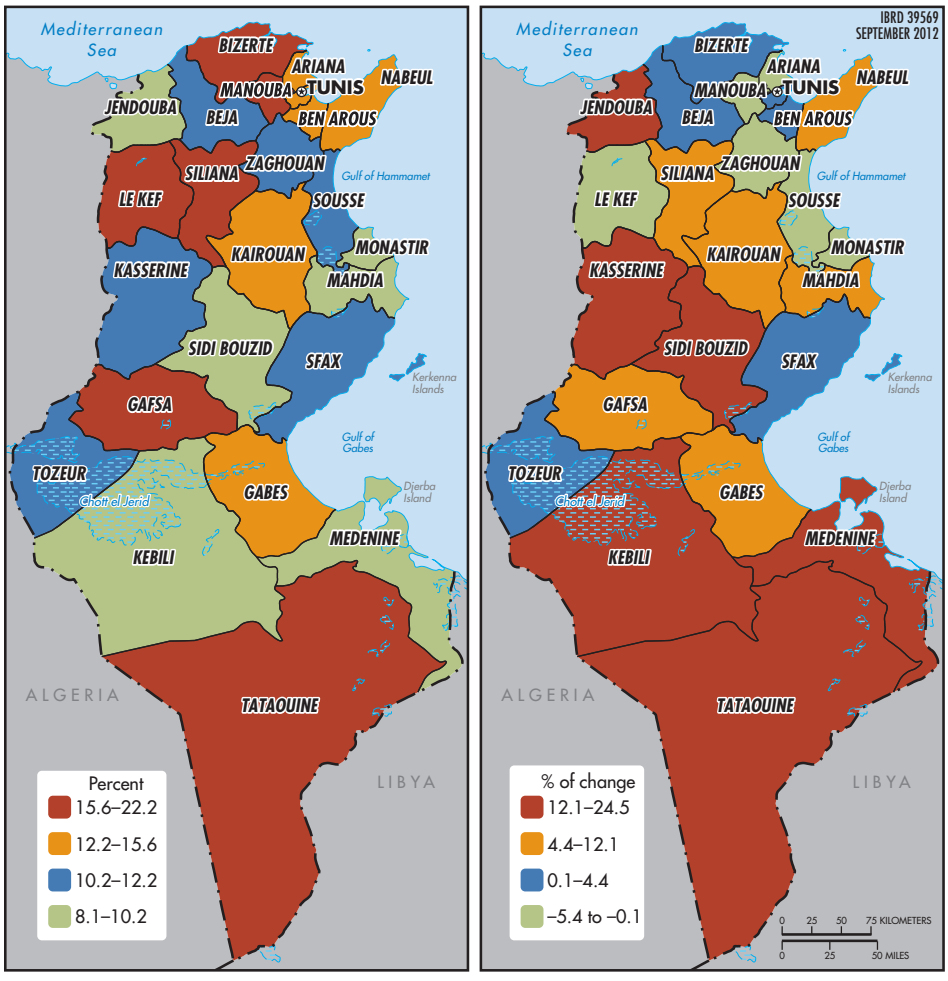
Geographical disparities

Another symptom of inefficient allocation of resources in labor markets is the marked geographical variation in labor market outcomes that persists over time. In mobile markets, workers tend to migrate to regions where employment opportunities are better. Yet important factors such as the cost of housing, poorly developed rental markets, skill mismatches, and limited mobility of women may prevent individuals from migrating from one region to another to obtain a better job (see Grunwald et al. 2009).

Data for Tunisia indicate that some of the regions with the highest unemployment rates in 2005 (such as Gafsa and Tataouine) also experienced the highest increase in unemployment rates between 2005 and 2011. This suggests that mobility constraints prevent workers from taking advantage of employment opportunities in other regions (figure 1.17). Labor force data for Tunisia show that among the lower-skilled and

FIGURE 1.17 **Levels and trends in regional unemployment in Tunisia, 2005–11**

a. Unemployment, 2005 b. Change in unemployment



Source: Based on Tunisia's LFS, various years.

female unemployed, the distance to available jobs was among the top reasons for refusing job offers (see chapter 2).

Symptoms of inequity in the labor market

This section highlights how an individual's access to desirable jobs—defined as jobs that offer either protection (notably social insurance) or high pay—is not necessarily transparent or determined by his or her own effort or merit. Indeed, to a large extent, labor market outcomes for individuals in many MENA countries depend more on external circumstances beyond their control and their individual efforts. This is measured here using the approach developed by John Roemer (1998) to capture the extent to which opportunities are equally distributed in the labor market.

Inequality of opportunities is measured by the dissimilarity index (D-index), which indicates how equitably outcomes are distributed among groups with different "life circumstances," such as gender, race, family background, and place of birth, which may affect their capacity to gain advantages but do not depend on individual effort or merit (see Barros et al. 2009; also Bourguignon

et al. 2007). Box 1.1 explains in detail the index construction.

The index can be interpreted as the share of the "outcome" that needs to be reallocated among the groups with different life circumstances to ensure equality of opportunities. It ranges between 0 and 1, with higher values suggesting higher inequality (see box 1.1). For instance, a D-index equivalent to 0.3 for the outcome variable "having formal employment" would suggest that 30 percent of all individuals having formal employment are disproportionately represented in one or more circumstance group; thus, to achieve equal opportunities across different circumstance groups, one would need to reallocate 30 percent of formal jobs.

The present analysis includes data from Egypt, Jordan, and Morocco for individuals between 21 and 34 years old. The exogenous circumstances considered in the analysis include the person's gender, his or her location (urban or rural), the wealth quintile of his or her household, and the level of education of his or her mother and father. To control for individual effort, the analysis includes educational attainment and age (as a proxy for years of working experience). It is worth noting that ability and effort are largely unobservable, and thus the analysis is likely to underestimate the effect of individual effort on outcome inequality. Since this framework requires the identification of advantages or outcomes deemed to be favorable, the results

BOX 1.1 The dissimilarity index

In Roemer's framework (Roemer 1998), social fairness exists when an individual's efforts prevail over his or her circumstances in determining the main outcomes that define his or her life. In some cases, to achieve social fairness, government interventions might be required to alleviate the "additional" burden that these circumstances impose on a certain group of people, to delink desirable outcomes from privileged backgrounds, and provide everyone realistic possibilities of success. The Dissimilarity Index is used to capture the extent to which opportunities are distributed equally in society.

The first step in constructing the index is to identify a dichotomous variable that captures the outcomes deemed to be socially desirable, such as having more income, more human capital, or high-quality high-paying employment.

The second step is to identify a set of variables that captures individual circumstances and individual efforts. As described in Bourguignon et al. (2007), circumstances are factors that are out of the individual's control, such as gender, race, family background, and place of birth, but that may affect their capacity to gain advantages. Effort, however, can be affected by individual choice. The following basic steps are used to calculate the dissimilarity index (D):

1. Estimate a separable logistic model on whether individual i had access to a given basic good or service as a function of his or her circumstances. From the estimation of this logistic regression, we will obtain coefficient estimates.
2. Given these coefficient estimates, determine for each individual in the sample the predicted probability of access to the basic good or service in consideration, p_i, based on the predicted relationship, $\hat{\beta}_k$,and a vector of their circumstances x_{ki}:

$$\hat{p}_i = \frac{Exp(\hat{\beta}_0 + \sum_{k=1}^{m} x_{ki}\hat{\beta}_k)}{1 + Exp(\hat{\beta}_0 + \sum_{k=1}^{m} x_{ki}\hat{\beta}_k)}.$$

3. Compute the overall coverage rate C (where $w_i = 1/n$ or some sampling weights):

$$C = \sum_{1}^{n} w_i \hat{p}_i.$$

4. Compute the dissimilarity index (D):

$$\hat{D} = \frac{1}{2C} \sum_{i=1}^{n} W_i |\hat{p}_i - C|.$$

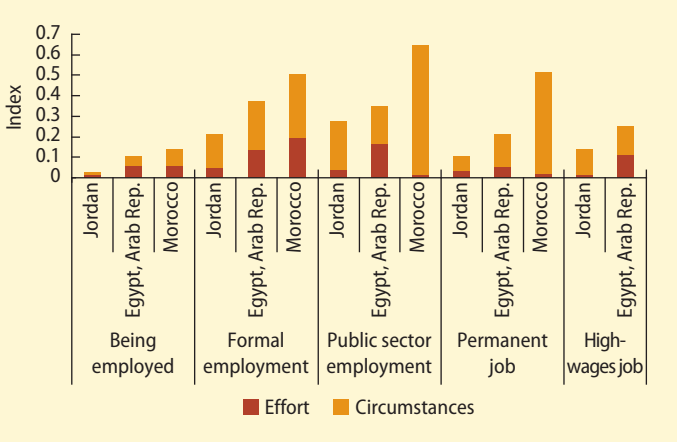
The index has several advantages: it is easy to calculate, allows progress to be monitored over time, and is particularly useful for comparing inequality of opportunities across different countries and sectors of the population. Another advantage of the index is that it can be easily decomposed so that the contribution of all circumstances to the dissimilarity index adds up to 100 percent (see Hoyos and Narayan 2011).

look mainly at employment outcomes that are desirable (in this case, formal employment or public employment and having a permanent or high-paying job).

Results for young men and women are presented in figures 1.18 and 1.19. In nearly all cases, 60 to 75 percent of the D-index is explained by circumstances outside an individual's control. Results for men indicate that the D-index is generally higher for all selected outcomes in Morocco, suggesting that the inequality of opportunities plays a higher role in explaining youth employment outcomes in that country compared to Egypt or Jordan. Inequality in the outcomes "formal employment" and "public sector employment" (which are somewhat correlated) is rather high for all countries (the D-index swings between 0.2 and 0.7) but is consistently lowest in Jordan and highest in Morocco. The inequality in the outcome "having a permanent job" seems low in Egypt (D-index at 0.1) and rather high in Morocco (D-index at 0.5) and is also explained mainly by circumstances rather than effort. Finally, data from Egypt and Jordan indicate that the inequality of "holding a high-wage job" is moderate (the D-index oscillates between 0.1 and 0.2) and is explained mainly by circumstances in Egypt (and to lower extent in Jordan).

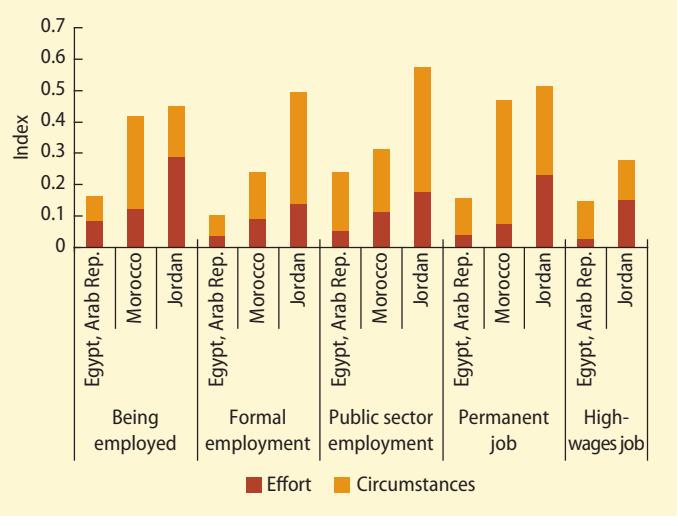
Results for female youth, on the other hand, suggest that the unequal distribution of opportunities is higher in Jordan and Morocco than in Egypt. In addition, it is interesting to see that in most cases the weight of circumstances is consistently lower among women than among men. This result is true, for instance, in Jordan, where most inequality in access to public and permanent employment among men is explained by circumstances, whereas for women a significant share is explained by effort. This result probably reflects self-selection: because few women enter the labor force—and they are more educated than men who enter the labor force—their background (family income and socioeconomic situation) tends to be more homogeneous and is thus less likely to explain differences in employment outcomes.

FIGURE 1.18 Decomposition of the dissimilarity index by circumstance and effort for men ages 21–34 in the Arab Republic of Egypt, Jordan, and Morocco, 2009 and 2010



Source: Based on the Arab Republic of Egypt's SYPE 2009, Jordan's LMPS 2010, and Morocco's Household and Youth Survey (HYS) 2010. See the appendix for more information on these surveys.
Note: Morocco's HYS 2010 does not contain wages, which is why there are no D-index values for "high wages jobs."

FIGURE 1.19 Decomposition of the dissimilarity index by circumstance and effort for women ages 21–34 in the Arab Republic of Egypt, Jordan, and Morocco, 2009 and 2010



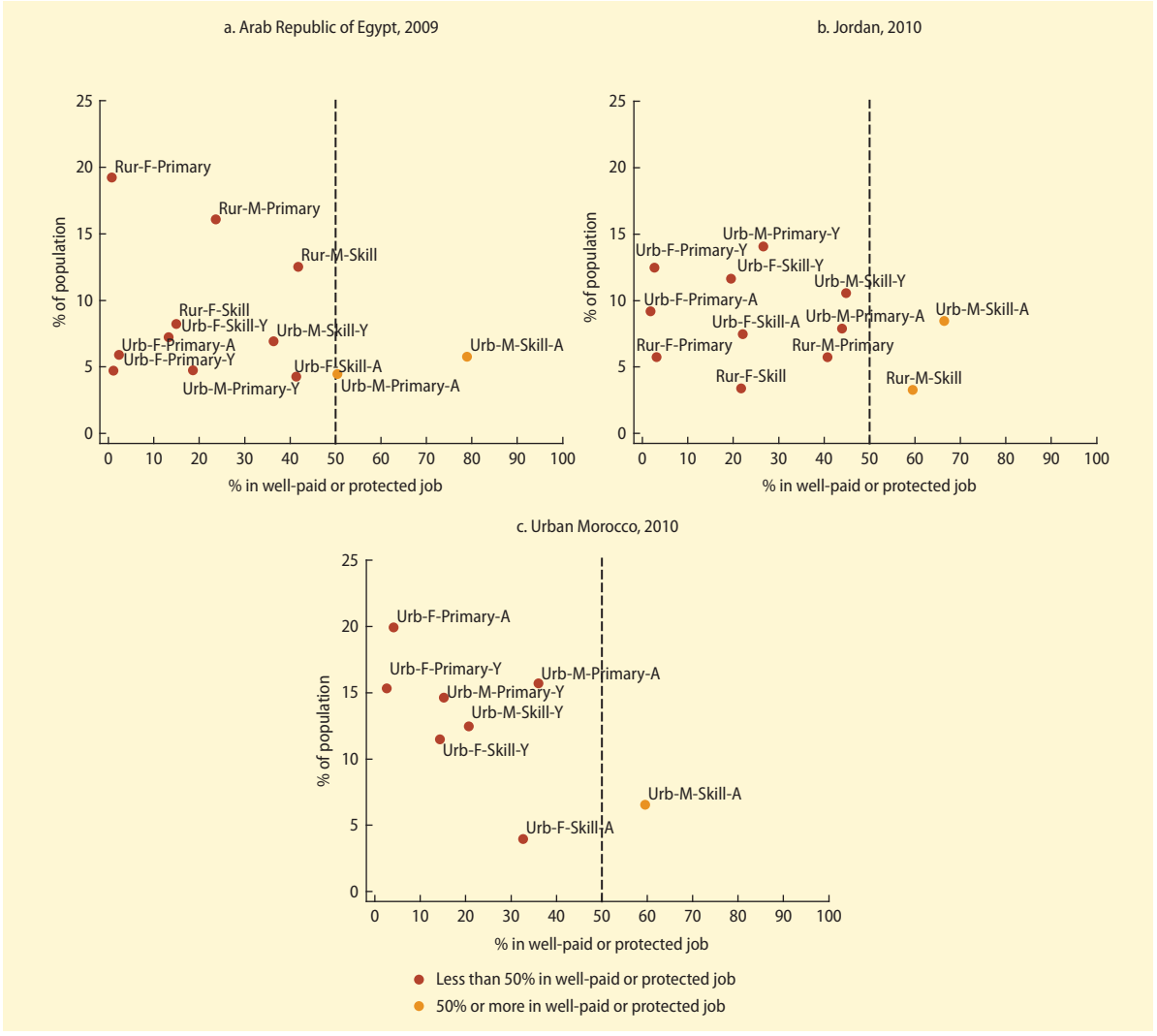
Source: Based on the Arab Republic of Egypt's SYPE 2009, Jordan's LMPS 2010, and Morocco's HYS 2010.
Note: Morocco's HYS 2010 does not contain wages, which is why there are no D-index values for "high-wages jobs."

MENA labor markets: A low-productivity equilibrium

MENA's economies offer several paths to "success" in the labor market: a well-protected job (especially in the public sector), a well-paid job in the private sector, or high-earning self-employment.[5] The distortions of the labor market laid out in the previous discussion do not affect all individuals in the same way. The chances of attaining a "desirable job" may vary across socioeconomic groups and lead to the inequitable labor market outcomes that we have observed.

To quantify this distribution, figure 1.20 maps the extent to which different

FIGURE 1.20 Share of workers with high-paying or protected jobs among the working-age population in the Arab Republic of Egypt, Jordan, and urban Morocco, 2009 and 2010



Source: Based on the Arab Republic of Egypt's SYPE 2009, Jordan's LMPS 2010, and Morocco's HYS 2010.
Note: The x-axis represents the share of workers in group J (say, urban-male-skilled-adult) holding desirable jobs, as a percentage of the working-age population; the y-axis represents the share of that group in the working-age population. Group characteristics are abbreviated as follows: Urb = urban; Rur = rural; F = female; M = male; Primary = primary education or below; Skill = secondary education or above; A = adult (35–64); Y = youth (15–34). For instance, 79 percent of urban men ages 35–64 with secondary education or above were in well-paid or protected jobs in 2009 Egypt, and they represented 6 percent of the working-age population.

socioeconomic groups in the working-age population of Egypt, Jordan, and Morocco hold high-paying or protected jobs. Groups are constructed along clusters combining four dichotomous dimensions: gender, urban or rural location, young or prime age, and high versus low skilled.

The figures suggest that while the allocation of "desirable jobs" is not uniform across the population and displays important variations across countries, young people, women, and rural, low-skilled workers in general are less likely to have such a job. In contrast, prime-age men are most likely to have a desirable job. The reasons for this outcome are specific to each group and will be examined in chapter 2.

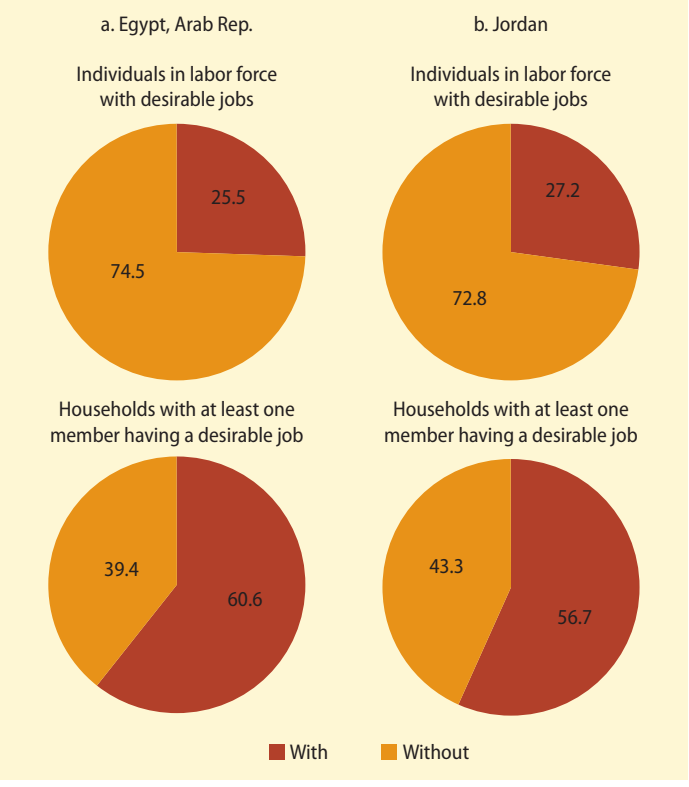
Using the same definition, only a minority of the labor force has access to desirable jobs (from 27 percent in Jordan to 26 percent in Egypt; see figure 1.21), but, interestingly, the fact that male adult breadwinners are those who benefit most from this situation ensures that the benefits from these scarce jobs accrue to a large number of households through cohabitation patterns. It is also important to point out that many of these coveted jobs, while desirable from an individual standpoint, may actually be suboptimal for society. In MENA countries, most of these "desirable" jobs are in the public sector, which is characterized by weak governance and low intrinsic productivity.

This equilibrium is a mixed blessing for the region. On the positive side, it keeps inequality as a whole moderate in MENA countries and can be considered as offering a safety net, given that about 6 of every 10 households in Egypt and Jordan have at least one individual with a desirable job (figure 1.21). The drawback is that it sustains relatively high reservation wages among both women and youth in a large section of the population,[6] which is also reflected in high unemployment rates. The specific determinants of this behavior among young people and women will be explored in detail in chapter 2.

In sum, the evidence shows that the inefficient use of human capital, along with workers' individual incentives, move MENA labor markets into a low-productivity equilibrium. To increase the chances of securing a public sector job, young people choose higher education degrees that are not relevant to the private sector; then those who can afford to wait spend time queuing for a public sector job, with the expectation of relatively high pay for low intrinsic productivity. Many women who have made important investments in human capital choose not to participate in the labor market at all. Given the fiscal constraints that countries are facing and the rising share of highly educated people in the population, this model of labor market success is unsustainable.

FIGURE 1.21 Percentage of individuals and households with "desirable" jobs in the Arab Republic of Egypt and Jordan, 2009 and 2010

percent



Sources: The Arab Republic of Egypt's SYPE 2009; and based on Jordan's LMPS 2010.

Notes

1. Given the weight of the public sector in overall formal employment, changes in the size of the public sector are likely to affect overall informality trends, especially considering that growth in private formal employment remains limited and has been insufficient to offset the recent downsizing of the public sector in many countries (Rodman 2007).
2. This imperfect measure is used to compare workers across work status, in absence of earnings data for the self-employed.
3. Because of the likely presence of omitted variables, the estimates of the Mincer regression are probably biased. In particular, if (unobservable) ability is positively correlated with formality, this coefficient is likely biased upward. Gatti et al. (2012) use direct measures of individuals' cognitive and noncognitive ability for Lebanon and Syria in the attempt to reduce these concerns. Their results show that, even after controlling for these variables, wage gaps between the formal and the informal sectors persist and that the size of the coefficient remains largely unchanged.
4. Sample includes wage earners in urban areas working between 30 and 60 hours per week. Wage gaps were assessed through a simple Mincer regression controlling for years of education and experience. The model includes a Heckman correction for selection into different industries. Statistical analyses based on those nonrandomly selected samples can lead to erroneous conclusions. The Heckman correction, a two-step statistical approach, offers a means of correcting for nonrandomly selected samples.
5. *Protected* is defined as having social security; *well paid* is defined as yielding either a wage above two-thirds of the wage distribution or as being self-employed and residing in a household in the top two income quintiles.
6. This term is used in labor economics to define the lowest wage rate at which a worker would be willing to accept a particular kind of job.

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Women, Youth, and the Working Poor

2

Main findings

- Progress in female participation in the labor force has been slow in MENA, particularly among the less educated.
- Youth unemployment rates underestimate the extent of youth labor market disadvantage in MENA, because of high rates of discouragement among the lower educated and among young women.
- Many factors such as limited decision making, an imperfect legal framework, and lack of enforcement of norms that protect women's safety keep many women willing to work out of the labor force.
- Lower-educated youth on average experience a longer transition to work than the higher educated.
- Reservation wages above market wages and preferences for public sector jobs partially explain high unemployment rates, especially among better educated youth and educated women.
- Working in poverty is most common among low-skilled rural workers. These workers represent 10 percent to 50 percent of the working population in the region; they tend to be informal and subsistence entrepreneurs.

Women

Female labor force participation in MENA

The achievements of the countries in the Middle East and North Africa (MENA) in many areas of women's well-being compare favorably with those of other regions. Indicators such as female education, fertility, and life expectancy show that MENA's progress in those areas in recent decades has been substantial. Where MENA falls considerably short is on indicators of women's economic participation (World Bank 2003). At 25.4 percent in the Middle East and 28.1 percent in North Africa, women's labor force participation (LFP) is lower than the 2008 world average of 51.6 percent.

Over the past two decades, women's labor force participation has risen in many MENA countries (table 2.1), and in most countries

TABLE 2.1 Percentage increase in female labor force participation in selected economies in MENA by age group, 1990–2010
percent

Economy	All (ages 15–64)	Ages 25–34	Ages 35–54
Jordan	71.6	78.0	48.0
West Bank and Gaza	52.5	72.4	44.1
Lebanon	37.0	55.3	45.0
Iraq	32.2	13.3	65.9
Tunisia	24.4	55.7	51.1
Morocco	–2.6	7.1	12.7
Egypt, Arab Rep.	–9.3	–18.7	9.7
Syrian Arab Republic	–27.9	–17.2	0.6

Source: Based on International Labour Organization–Key Indicators of the Labour Market (ILO-KILM) database.
Note: MENA = Middle East and North Africa.

the highest increase occurred among the age group of younger women who have likely completed their education (25–34), whose participation rates are much higher than those of older women (35–64).

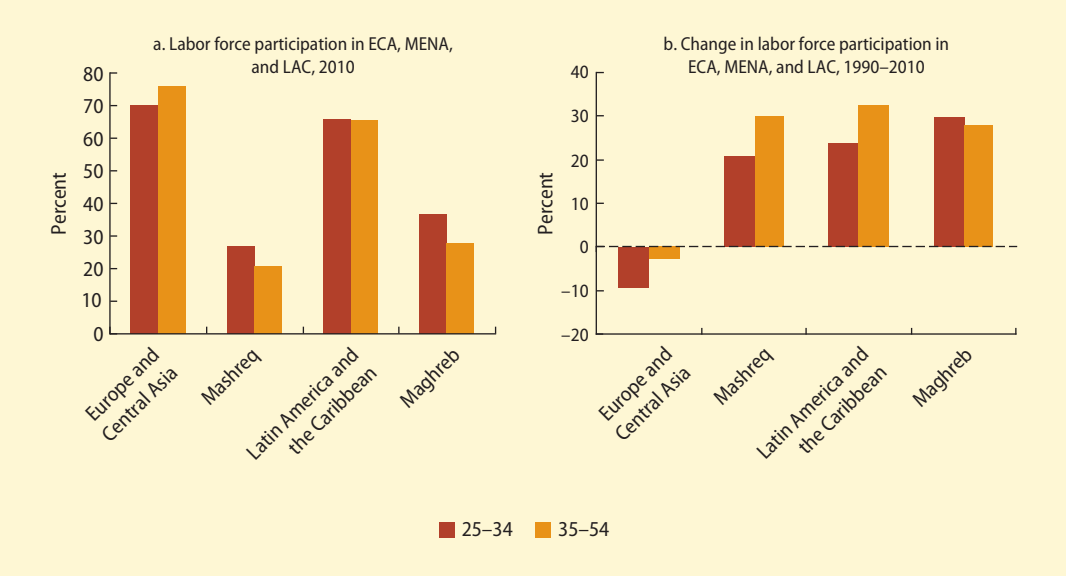
Despite this progress, rates of female participation in the labor force in MENA are not necessarily catching up with international levels. Figure 2.1 depicts rates in MENA in year 2010 (figure 2.1a) and their evolution compared to Europe and Central Asia (ECA) and Latin America and the Caribbean (LAC) (figure 2.1b). Results indicate that female LFP rates in MENA have risen at the same speed as in LAC and only slightly faster than in ECA. If rates continue to rise at this pace, it will take the region 150 years to attain the current world average (World Bank 2013).

Why is female labor force participation important?

Higher rates of female LFP are instrumental to generating economic growth and reducing poverty. International experience indicates that greater economic equality between women and men is associated with poverty reduction, higher gross domestic product (GDP), and better governance (Bardhan and Klasen 2000; World Bank 2012b). Recent studies indicate that many economies in MENA have lower female LFP rates than those expected given the education and demographic structure of the population. If female LFP in these countries were to rise to the level predicted by women's age and educational structure, household earnings could increase by up to 25 percent (World Bank 2003). These effects occur because female employment brings extra income to the household, decreases women's dependence on their spouses and other family members, and increases their intrahousehold decision-making power. At the same time, important externalities are linked to women's economic empowerment. The literature has found that working women generally are more involved than nonworking women in making the right decisions about their children's education, nutrition, and health (Angel-Urdinola and Wodon 2010).

It is important to emphasize that this chapter does not advocate for increasing female participation at all costs. Rather, it explores the constraints faced by women who would like to participate in the labor force. This analysis is particularly important because many women in the region want to work. Younger and more educated women have positive views about the suitability of engaging in paid work and exhibit a stronger desire to join the labor market.

FIGURE 2.1 **Female participation in the labor force in three world regions by age, 1990–2010**



Source: Based on the ILO-KILM.
Note: Calculation based on averages. *Mashreq* refers to the Arab Republic of Egypt, Iraq, Jordan, Lebanon, the Syrian Arab Republic, and the West Bank and Gaza. *Maghreb* countries included are Morocco and Tunisia. ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa.

Box 2.1 reflects some of these views and aspirations.

Women's labor market outcomes beyond participation

Unemployment

As illustrated in figure 2.2, unemployment rates are much higher among women than among men in almost all countries in the region (reaching up to 50 percent in some countries). In most of the developing world, women's unemployment rates are higher than men's. Nevertheless, the gap between female and male unemployment rates is particularly wide in MENA and has doubled over the past 25 years (World Bank 2013). High female unemployment rates can be explained largely by the fact that women, especially university graduates who are single, are willing to search for employment (and can afford doing so for longer periods) to obtain a return on their investments in education. Less educated women, in contrast, generally look for jobs in the informal economy. Simple profiles of female unemployment for a selected group of countries in MENA confirm that female unemployment is generally higher among younger women, single women, and more educated women (table 2.2). Young, educated women often queue for public sector employment, as the private (often informal) sector offers conditions that are below their reservation wages[1] or quality (see Assaad 2006; Frankel 2010; Keddie 2007; World Bank 2013).

Skill mismatches also explain why unemployment is disproportionately higher among women. In MENA, the type of technical skills acquired by men and women differ considerably (figure 2.3). Women are much more likely to specialize in the humanities or education—degrees that are required for many public sector jobs but not highly valued by the private sector—while

BOX 2.1 Women in MENA want to work

"If I could use my time differently, I would trade free time in the afternoon to study to become literate or to learn a craft or work skill." *Female, urban Yemen*

"The main characteristic of a strong woman is to be confident and participate. A strong woman can lead and create an economic project." *Female, urban Yemen*

"I want to work, it is very important in my life. I cannot stay home watching television." *Female, rural Morocco*

"Women want to work even when married; we want to have the financial independence because men cannot be trusted." *Female, peri-urban Morocco*

"Palestinian women have a long history of high education and of working; a woman can work and is often even expected to work (but there are no jobs at the moment). She can combine motherhood and work." *Female, West Bank*

"We have ambitions and we would like to start our own projects; we want to succeed by ourselves, not counting on the government or seeking help from associations." *Female, peri-urban Morocco*

"I want to start a business; I am ambitious and creative and would love to lead something of my own. I have no training though which might be a problem." *Young female, urban Egypt*

"I want to be an entrepreneur; I want to do a master's degree and then open a private project with my friend." *Young female, Gaza*

"Most of us [women] want to work but a problem is commuting between home and work at night." *Female, rural Morocco*

Source: The quotations in this section draw on multiple sources. As part of the background work for this report, focus groups were carried out in March 2011 in the West Bank and Gaza (Brodmann et al. 2012). Other focus groups and interviews were conducted as background work for La Cava et al. (2012a, 2012b).

FIGURE 2.2 Unemployment rates by gender in selected economies in MENA, 2006–10

Source: Based on ILO-KILM 2012 for Algeria, Iraq, Lebanon, the Syrian Arab Republic, the West Bank and Gaza, and the Republic of Yemen and on the Arab Republic of Egypt's Labor Market Panel Survey (LMPS) 2006, Jordan's LMPS 2010, Morocco's Labor Force Survey (LFS) 2009, and Tunisia's LFS 2010. See the appendix for more information on these surveys.
Note: MENA = Middle East and North Africa.

more men tend to study science and engineering (World Bank 2013). Differences in technical skills between men and women lead to occupational segregation, hindering women's ability to find suitable employment in the private sector.

Wage gaps

Although the average employed woman is more educated than the average employed man (World Bank 2013), data on wages from the Arab Republic of Egypt, Jordan, and the West Bank and Gaza indicate that—net of

age, education, and experience—a gender wage gap exists in favor of male workers.[2] While the magnitude of the gender wage gap appears to be highly heterogeneous across the region (figure 2.4), it is generally much larger in the private sector (reaching up to 40–80 percent in Egypt and the West Bank and Gaza). Likely explanations for the gender wage gap in the private sector include occupational segregation (women work disproportionately in low-paying sectors) and discrimination (see discussion in chapter 1 and World Bank 2013).

As one might expect, gender wage gaps are lower in the public sector where there are more concerns about equity and less tolerance of discrimination. In fact, in the public sector of the West Bank and Gaza, women actually earn more than men on average, possibly because the best female workers self-select into public sector jobs.

What determines women's low participation in the labor force?

Economic factors

One body of literature claims that economic reasons account for the low levels of female participation in the labor force: women's employment decisions are based on the quality of available opportunities, including market wages. According to this argument, women would enter the labor market if their market wage were above their reservation wage (see Rauch and Kostyshak 2009; World Bank 2013), corresponding to the value of their household chores and caretaking.

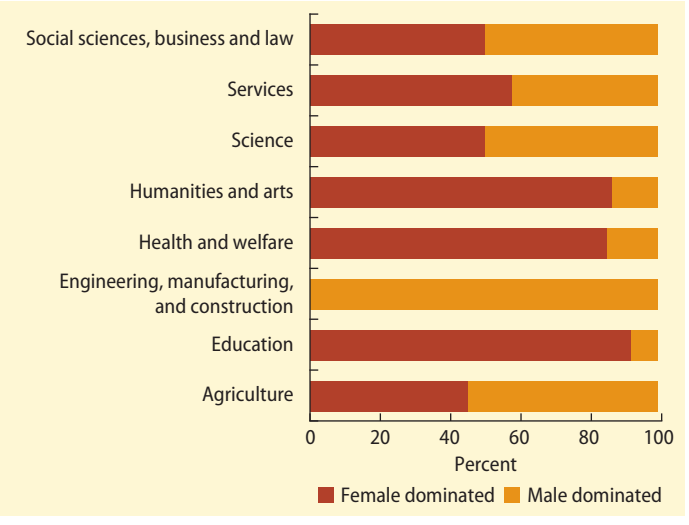
Consistent with this explanation, a number of studies have pointed out that low levels of female LFP in MENA are explained mainly by very low participation rates among women without tertiary education, who still constitute the largest share of the working-age population (Paterno, Gabrielli, and D'Addato 2008; Chamlou, Muzi, and Ahmed 2010). In fact, while LFP rates among educated women in MENA are comparable to those in more developed economies (at approximately 60 percent),

TABLE 2.2 Basic unemployment profile of women ages 15–64 for the Arab Republic of Egypt, Jordan, Morocco, and Tunisia, 2009–10

	Tunisia	Egypt, Arab Rep.	Jordan	Morocco
Strata				
All	19.1	21.6	19.7	9.73
Urban	19.6	23.2	17.1	19.93
Rural	17.9	20.3	30.8	1.75
Age groups				
15–24	32.7	44.2	42.9	16.21
25–34	26.1	29.4	18.9	15.51
35–64	5.2	3.1	6.4	33.48
Marital status				
Married	8.5	15.4	14.2	2.13
Not married	28.5	32.5	24.9	17.49
Education level				
Primary or below	12.9	1.8	13.0	2.92
Preparatory/ secondary, general/ secondary, vocational	15.5	34.9	19.9	24.80
Tertiary	32.0	29.1	22.5	23.44

Source: Based on the Arab Republic of Egypt's Survey of Young People in Egypt (SYPE) 2009, Jordan's LMPS 2010, Morocco's LFS 2009, and Tunisia's LFS 2010. See the appendix for more information on these surveys.

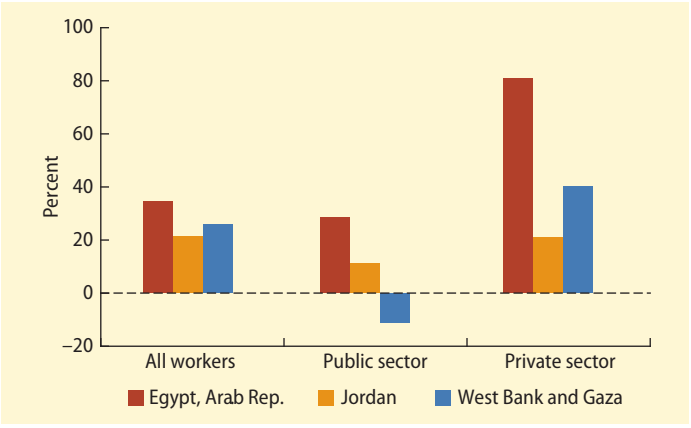
FIGURE 2.3 Educational specializations in countries in MENA, 2010



Source: World Bank 2011.
Note: MENA = Middle East and North Africa.

LFP rates are very low for all other educational groups (figure 2.5). Women without university education, especially in urban areas, can obtain only jobs that offer low wages, require long and hard hours, and

FIGURE 2.4 Male-female wage gap in selected economies in MENA, various years, 2006–10



Source: Based on the Arab Republic of Egypt's LMPS 2006, Jordan's LMPS 2010, and the West Bank and Gaza's LFS 2008. See the appendix for more information on these surveys.
Note: The sample is urban workers working between 30 and 60 hours per week. MENA = Middle East and North Africa.

provide no social security. Indeed, in countries like Egypt and in urban Morocco, about 70 percent of all unskilled women hold jobs in the informal sector.[3]

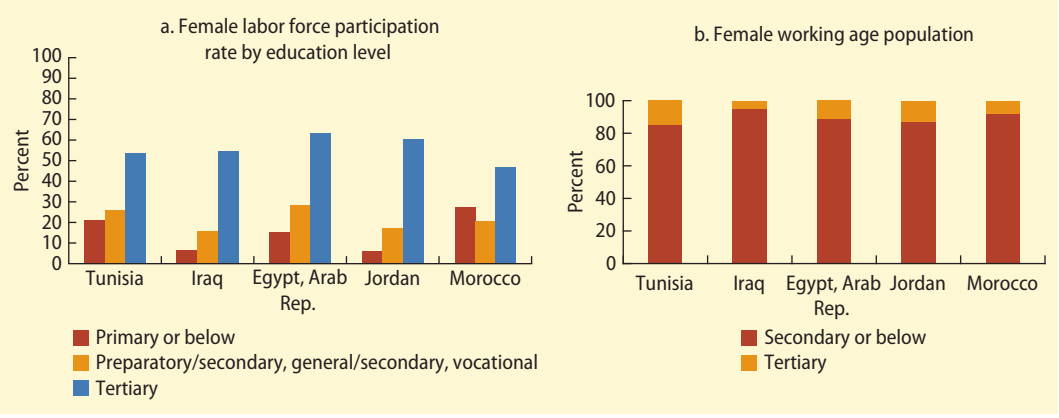
While the expected market wages for most women remain low, the structure of households in MENA contributes to keeping reservation wages high. In the particular case of oil-producing countries, reservation wages are high, thanks to a wide array of subsidies. In the case of middle-income countries like Egypt and Jordan (as discussed in chapter 1), the majority of households have at least one individual (generally a prime-age male) in a protected or well-paid job. That job serves as a safety net for the whole family and contributes to keeping reservation wages high. Other economic factors, such as urbanization and the business cycle, affect female employment. For instance, Paterno, Gabrielli, and D'Addato (2008) show that female participation is generally higher in urban areas, because women have opportunities to access wage work in the service and industry sectors (for a review of the literature, see Assaad 2006; Clancy-Smith 1999; Frankel 2010; Keddie 2007; Moghadam 1998; Rodary 2007; Ross 2008; and World Bank 2013).

Beyond high reservation wages, employment quality is also a major determinant of female participation in the labor force. Safety concerns about the workplace, for instance, limit women's employment options relative to men's. Safety issues make women reluctant to travel or live alone to access employment. These limitations disproportionately affect women in remote, rural, or less prosperous areas. As a young woman in rural Yemen notes, "Distance does not play a role in finding a job for men, because they can travel if they want. It does play a role for a woman" (World Bank 2013). Also, as a woman in rural Yemen observes, "even if we wanted to we cannot work because not all these jobs are suitable for women's nature, nor does it suit customs and traditions" (World Bank 2013).

Harassment in the workplace also remains a serious problem in some countries. In their report on the major challenges related to youth employment in Egypt, Assaad and Barsoum (2007) illustrate how fears of workplace harassment discourage many women from joining the labor force, especially in smaller workplaces and in less traditional jobs. Only four countries in the region (Algeria, Iraq, Morocco, and Tunisia) have legislation that deems sexual harassment in the workplace a criminal act and allows women to prosecute claims in court. These legal provisions are a good start, but implementation remains a challenge. Legal systems may not be strong enough to create an effective deterrent against crimes, and many women are reluctant to report harassment.

As a result, women tend to prefer public sector jobs as they are more conducive to family life, often offering flexible work hours, leave, and job security. Such jobs may also be perceived as safer than private sector jobs. Indeed, qualitative research from Upper Egypt indicates that for many women, government jobs are the only "acceptable" form of employment (World Bank 2011). As discussed in chapter 1, however, the demand for public sector jobs far outstrips supply. The comments of a woman

FIGURE 2.5 Female participation in the labor force in selected countries in MENA by educational attainments, 2006–10



Source: Based on the Arab Republic of Egypt's LFS 2010, Iraq's Household Socioeconomic Survey (HSES) 2006, Jordan's LMPS 2010, Morocco's LFS 2009, and Tunisia's LFS 2010. See the appendix for more information on these surveys.
Note: Rates and composition are given as a percentage of the working-age population. MENA = Middle East and North Africa.

participating in a focus group in Morocco illustrate the point: "Many female graduates only want public jobs. They refuse to look for other options and need to change this mentality since the government's capacity to recruit is limited."

Finally, women usually have smaller professional networks than men and are less active job seekers. Families generally call upon their *wasta* (or social connections) to help their male relatives find employment (Furstenberg and Kaplan 2004). Data from the 2009 Survey of Young People in Egypt show that men and women use very different approaches to finding employment (table 2.3). Women were disproportionately likely to enter lotteries for public sector jobs and to register in labor offices, while men were more likely to actively respond to advertisements, contact employers directly, and ask friends or relatives for advice or help.

Social factors

Social factors are also a fundamental determinant of female employment in the region (see Bourqia 2010; Offenhauer 2005; Moghadam 2004; Rachik 2006; World Bank 2013; Youssef 1972). Some studies mention religion and culture as determinants of low female labor force participation in Muslim countries (see Keddie 2007; Rauch and Kostyshak 2009; Rodary 2007); yet evidence seems to identify other social factors as equally important determinants. Indeed, for most women in the region, "family reasons" are a main explanation for inactivity (table 2.4). The share of women claiming that they are inactive due to family reasons ranges from 85 percent in urban Morocco to 96 percent in Egypt. Of course, some of this information may leave out important nuances in women's choices, preferences, and constraints. Most surveys in the region do not explicitly ask inactive women whether they would be willing to work. An exception was the Morocco Household and Youth Survey (La Cava et al. 2012a), in which young women reported the lack of parental or spousal permission as the main reason that they did not want or did not expect to work (figure 2.6).

Nevertheless, a woman's path to success and self-realization in MENA is not necessarily associated with participation in the labor force. Results from the World Values Survey suggest that women in the MENA

TABLE 2.3 Job search methods used by young people in the Arab Republic of Egypt, 2009
percent

Method	Men	Women
Entered government job lottery competition	9.7	29.3
Sent job application	26.3	24.8
Inquired at work location	20.7	8.8
Applied to a job advertised in newspapers	13.1	5.7
Asked friends or relatives for help	40.4	22.1
Contacted employer	17.6	3.9
Registered at a government or labor office	9.7	21.1
Used a regular phone	47.2	24.5
Used a mobile phone	44.0	19.7

Source: The Arab Republic of Egypt's SYPE 2009. See the appendix for more information on this survey.
Note: This table shows major job search methods or those in which there are significant gender differences.

TABLE 2.4 Reasons for being out of the labor force among working-age individuals in the Arab Republic of Egypt, Iraq, urban Morocco, and Tunisia, 2006–10
percent

	Women (ages 15–64)			
	Egypt, Arab Rep.	Iraq	Tunisia	Urban Morocco
Family reasons[a]	96.1	94.0	91.1	85.5
Old age/retired	1.2	0.3	—	8.4
Illness/disability	1.2	1.3	4.7	3.7
Other	1.5	4.4	4.2	2.4
	Prime age males (ages 35–54)			
	Tunisia	Egypt, Arab Rep.	Urban Morocco	Iraq
Illness/disability	91.8	26.4	24.1	8.8
Old age/retired	—	63.2	67.1	39.6
Family reasons	4.7	2.2	5.6	0.8
Other	3.6	8.1	3.2	50.8
	Young males (ages 15–34)			
	Urban Morocco	Tunisia	Egypt, Arab Rep.	Iraq
Illness/disability	51.4	34.4	12.9	8.0
Family reasons	30.7	7.0	12.3	1.2
Other	17.9	58.5	74.8	90.8

Source: Based on the Arab Republic of Egypt's LMPS 2006, Iraq's HSES 2006, Morocco's Household and Youth Survey (HYS) 2010, and Tunisia's LFS 2010. See the appendix for more information on these surveys.
Note: Data apply to those who have left school. — = not available.
a. "Family reasons" groups answers such as pregnancy, taking care of children, and housewife.

region are more likely than women in other parts of the world to view the role of full-time domestic work as favorably as that of working for pay (World Bank 2013). A young female from rural Morocco observes, "In our modern society, girls and boys face the same difficulties because we need to work and help the family. But boys are more pressed because he is the man and he needs to find a job to support the family.…A girl can always marry" (World Bank 2011). Traditional norms see men as the primary breadwinners in the family unit. While many families may support a woman's desire to work, her work is not seen as mandatory. On the contrary, a man's identity is strongly linked to his role in the labor market, and unemployment is more stigmatized for men than for women. For this reason, women can rely on other family members (parents, husbands) and wait for a suitable job. Results from the World Values Survey also indicate that a majority of MENA women agreed with the statement that "when jobs are scarce, men should be given priority over women."

The following excerpt from a mixed focus group in Morocco illustrates two aspects of the ongoing cultural transition of women's role in the labor market:

> *Female participant:* Girls are completely different. They are more responsible than boys. And many girls are engaged or married before the high school diploma. So the unemployment is not really a big problem. Because she will stay home [and] take care of husband and kids. Only the youth from rich …[families] can work outside and have high positions.
>
> *Female participant:* In my case, I hate to be unemployed. I feel excluded, all my friends are busy and I stay home watching TV and doing home duties. I feel like I am already an old woman. (La Cava et al. 2012a)

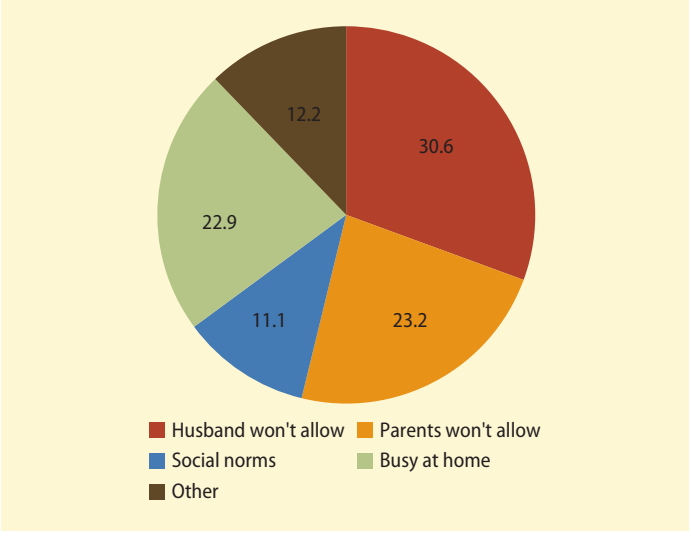
Marriage may also limit some women's ability to make their own choices about

whether to work. Women who still live at home with their parents may enjoy greater freedom to work than women who are married. Another explanation could include the social preference for the male as the main or sole provider for a couple or family (Paterno, Gabrielli, and D'Addato 2008).

Figure 2.7 illustrates the important effect of marital status on female employment. With the exception of Egypt, single women are noticeably more likely to participate in the labor force than married women. While it is not uncommon to see a negative effect of marriage on female employment, this effect is much stronger in MENA than in other regions (see Jaumotte 2003). Similarly, a greater number of infants in the household will likely reduce women's participation. A female in urban Morocco explains the phenomenon in the following way: "The majority of girls say that their objective for finding a job is to be able to buy better clothes so that she eventually will find a good husband. Once she has found a husband she will mostly quit her job" (World Bank 2013). One common expectation is that women will leave the workforce upon marriage and will have only brief careers. Results from surveys conducted in Amman, Cairo, and Sana'a (see Chamlou, Muzi, and Ahmed 2010) confirm these results. The authors find a significant negative association between being married

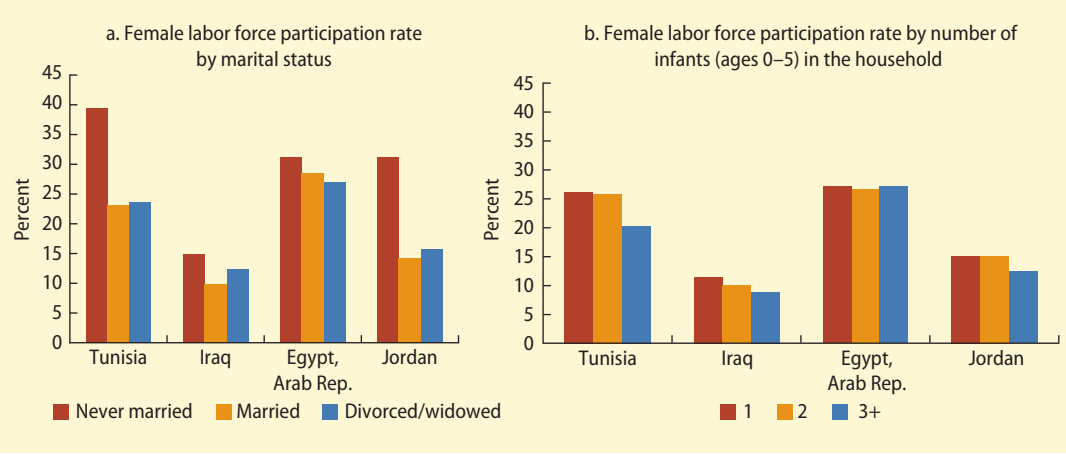
FIGURE 2.6 Main reason given by females ages 15–29 in Morocco for not wanting to work, 2010

percent



Source: La Cava et al. 2012a, using Morocco's HYS 2010.

FIGURE 2.7 Female participation in the labor force, by marital status and number of infants in the household, in the Arab Republic of Egypt, Iraq, Jordan, and Tunisia, 2006–10



Source: Based on the Arab Republic of Egypt's LMPS 2006, Iraq's HSES 2006, Jordan's LMPS 2010, and Tunisia's LFS 2010. See the appendix for more information on these surveys.

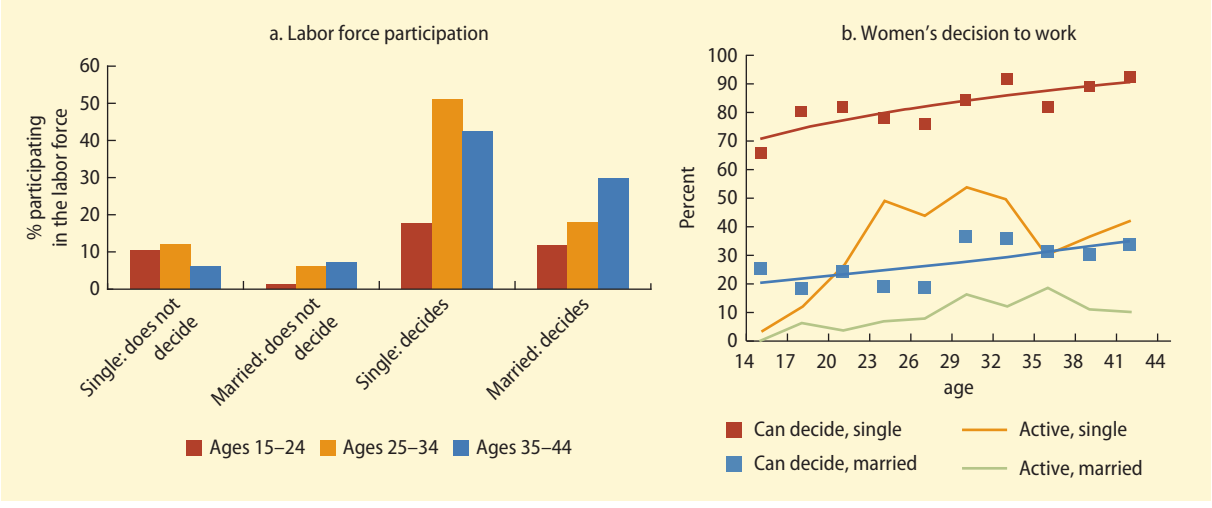
and having children and female participation in the labor force, highlighting that the "marriage factor" is much stronger than the "children factor."

Data from Morocco make it possible to identify women's decision-making patterns in relation to employment. Figure 2.8a plots the share of women (ages 15–45) who claim that they can determine their own employment status by age and marital status. After marriage, only a minority of women (about 15 percent) can make their own work-related decisions. Husbands or other family members make decisions about work for the remaining 85 percent. For single women, the pattern is somewhat different: not only are they more likely to make decisions on the own, but their decision-making power increases rapidly with age. Interestingly, even for married women without children, decision-making power remains weak, suggesting that the marriage effect is stronger than the children effect.[4]

Figure 2.8b suggests that when women are allowed to decide by themselves on their labor market status, they tend to participate more in the labor force. First, we estimated the probability that a woman will "work" based on whether or not she makes her own decisions about her work status. The difference between these two probabilities is used as a proxy of the "extra" likelihood that a woman will work because she can make her own decisions. Our findings indicate that, all things equal, if women can make their own decisions, they are between 10 and 15 percentage points more likely to work. Results hold for both single and married women. Nevertheless, female decision-making patterns are likely to vary across countries in MENA and thus these results from Morocco should not be generalized.

Finally, cross-country evidence suggests that the female role model at home largely determines a woman's decision to participate in the labor force. Data from Egypt, Iraq, Jordan, urban Morocco, and Tunisia all point to an important association between female employment and the employment status of the female role model in the household (proxied by the household head's spouse). Women who belong to households where the spouse of the male household head is employed are highly likely to be active (they exhibit

FIGURE 2.8 **Women's decision making and labor force participation by marital status and age in Morocco, 2010**



Source: Based on Morocco's HYS 2010. See the appendix for more information on this survey.

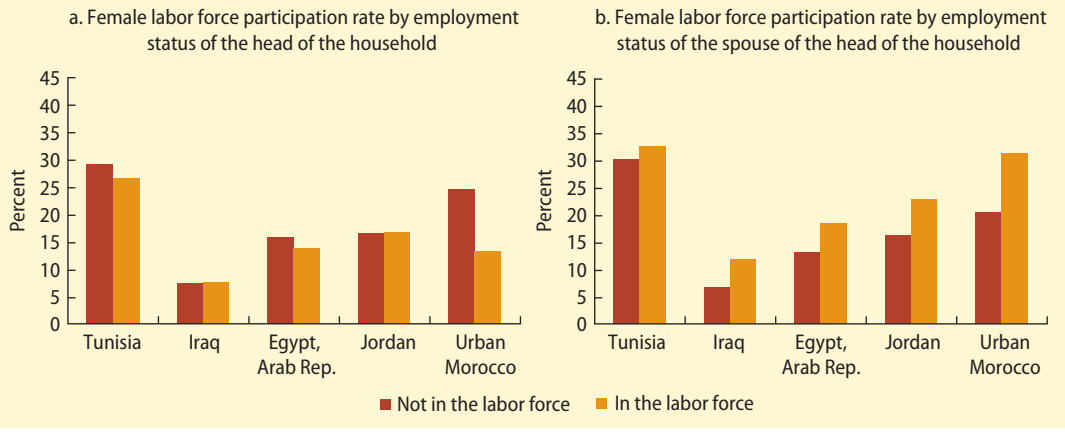
participation rates between 18 and 31 percent), whereas women who live with female role models who are not in the labor market will generally remain out of the labor force, too (in all countries but Tunisia) (figure 2.9). This finding is consistent with that of Fernández, Fogli, and Olivetti (2004), who show that the working behavior of a man's mother has a large and significant impact on the likelihood that his wife works. Farré and Vella (2007) also find that a woman's attitudes toward female employment have a statistically significant effect on how her children perceive women engaged in work and in turn influence female labor market decisions.

Legal and institutional factors

Finally, some laws and regulations also discourage or prevent women from having access to the labor market:

- *Laws guaranteeing highly protective maternity leaves and child care benefits impose extra costs on firms that hire women.* All countries in the MENA region provide for some form of maternity leave, and some also have provisions for child care.[5] Although designed to enable women to return to the workplace after childbirth, these policies have the unintended consequence of raising the cost of hiring women. First, firms are often required to pay for part or all of a woman's maternity leave, and firms must also hold a position open for her until she returns to work. By raising the cost of employing women relative to men, these laws may discourage firms from hiring women. Jordan recently amended its social insurance law to address this problem; maternity benefits are now be provided by social security, funded by a payroll tax on both male and female employees. Second, firms in some countries are required to pay maternity benefits only when they employ more than a certain number of female workers. This law can have the perverse incentive of discouraging a firm from hiring additional women employees in order to remain below the threshold.
- *Laws restrict women from working at night and limit the industries in which they can work.* Of 113 countries surveyed by the Economist Intelligence Unit, 11 had restrictions on female employment in jobs that were considered "against women's

FIGURE 2.9 Female participation in the labor force, by employment status of the household head and spouse, in the Arab Republic of Egypt, Iraq, Jordan, urban Morocco, and Tunisia, 2006–10



Source: Based on the Arab Republic of Egypt's LMPS 2006, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's HYS 2010, and Tunisia's LFS 2010. See the appendix for more information on these surveys.

morals" (UN Women 2011). Many of these countries are in the MENA region. Egypt, Kuwait, Morocco, Saudi Arabia, Syria, the United Arab Emirates, and the Republic of Yemen all have restrictions on work that may be "morally harmful" or affect women's social standing. Some countries also restrict female employment during night shifts. Such restrictions are intended to protect women, but in industries like accommodation and restaurants they greatly curtail women's job opportunities.

- *Guardianship laws limit women's employment options.* Some countries in MENA require women to obtain a male guardian's express permission to accept a job; incorporate a business; apply for a passport, driver's license, or loan; travel; or even leave the house (table 2.5). Even if permission can be obtained easily in most cases, the process limits women's freedom of movement and autonomy and makes it more difficult for them to work effectively, look for work, or carry on a business. As a woman in urban Yemen notes: "If a woman wants to start a business without her husband's approval it would be very difficult" (World Bank 2012b).
- *Women have limited ownership rights to household capital.* The most common property ownership arrangement in the region is the *separate property regime*, whereby a woman owns only the personal assets that she brings to, or acquires during, the marriage. This arrangement typically excludes land and housing, which are purchased and owned by men. If women do not have ownership rights over these fixed family assets, they are limited in the extent to which they can borrow for their own enterprises. Some countries now provide the option of a "community property regime" under which all property acquired during the course of the marriage is jointly owned.[6] However, this regime is normally only optional, and women may be reluctant to request it at the time of marriage.

Even where laws have been reformed or introduced to level the playing field for women, implementation is often selective or absent. The majority of countries in the MENA region have laws against

TABLE 2.5 Summary of legal restrictions on women in selected economies in MENA, 2012

	Unmarried women	Married women
Women are not able to do the following in the same way as men:		
Apply for a passport	Saudi Arabia	Egypt, Arab Rep.; Iran, Islamic Rep.; Jordan; Kuwait; Oman; Saudi Arabia; United Arab Emirates; Yemen, Rep.
Travel internationally	Saudi Arabia	Iran, Islamic Rep.; Saudi Arabia; Syrian Arab Republic
Travel domestically		Iran, Islamic Rep.; Saudi Arabia; Yemen, Rep.
Get a job or pursue a trade	Kuwait, Oman	Iran, Islamic Rep.; Jordan; Oman; United Arab Emirates
Sign a contract	✓	✓
Register a business	✓	✓
Open a bank account	✓	✓
Women must obey their husbands	n.a.	Egypt, Arab Rep.; Jordan; Lebanon; Saudi Arabia; Syrian Arab Republic; United Arab Emirates; West Bank and Gaza; Yemen, Rep.
The constitution:		
Bans gender discrimination	Algeria, Oman, West Bank and Gaza	
Guarantees gender equality	Algeria; Egypt, Arab Rep.; Iran, Islamic Rep.; Jordan; Kuwait; Lebanon; Morocco; Oman; Syrian Arab Republic; Tunisia; United Arab Emirates; West Bank and Gaza; Yemen, Rep.	

Source: Women, Business and the Law Database 2012 (http://wbl.worldbank.org).
Note: n.a. = not applicable; MENA = Middle East and North Africa; ✓ = Permitted in all MENA countries.

discrimination in the workplace and guarantees of equal pay for equal work. But without enforcement, these laws are powerless to protect women. Entrenched social prejudices about women's abilities, the safety of the workplace, and so on may continue to deter women from taking jobs in the private sector (or their family from allowing them to do so). Only visible enforcement of these protections will change attitudes.

Youth

The previous chapter showed that unemployment, out-of-school inactivity, and informality tend to affect young people disproportionately. This chapter analyzes these states, taking into account the evidence on individual preferences and constraints, and shows that for the large majority of young people in MENA, working informally or being out of work is not the result of choice but of lack of alternatives that are either better in a strict economic sense or socially acceptable.

The analytical approach adopted in this section acknowledges that each outcome could be the result of a process of selection or rather of outright exclusion (see figure 2.10). For instance, some youth may choose to work in the informal sector to become a successful entrepreneur, while others may be constrained in their ability to join wage employment.

NEET rates best define young people's labor market disadvantage

Unemployment is conventionally singled out as evidence of youth disadvantage in the labor market. However, the share of youth neither in education, employment, nor training (NEET) is now considered a more accurate measure of labor market disadvantage, because it simultaneously captures the extent to which young people are neither participating in the labor market nor building skills for participating in the future.[7] Unemployment rates, for instance, are sensitive to participation in the labor force and could disguise involuntary inactivity. Figure 2.11a shows that NEET rates in MENA countries are pervasive (figure 2.11a) and that they can be much higher than unemployment rates (see figure 2.11b), particularly for those with little education. For instance, while the unemployment rate among youth with primary education (ages 15–24) in Egypt and Iraq is 6 and 18 percent, respectively, 58 and 57 percent in the same reference group are NEET.

FIGURE 2.10 Framework for interpreting the labor market disadvantage

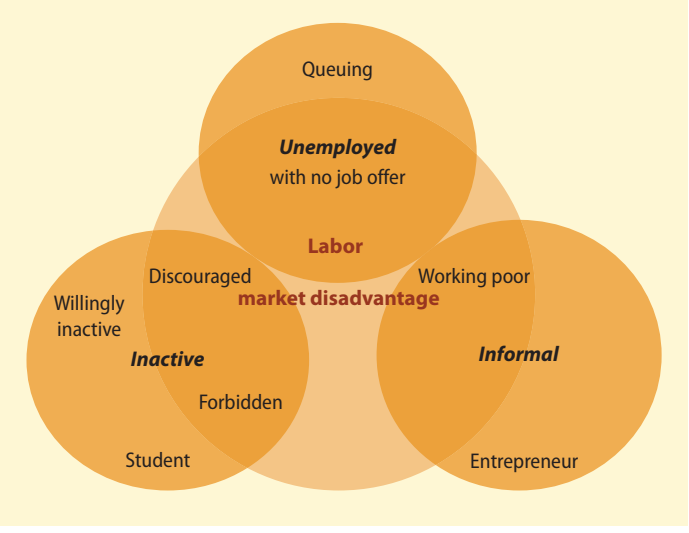
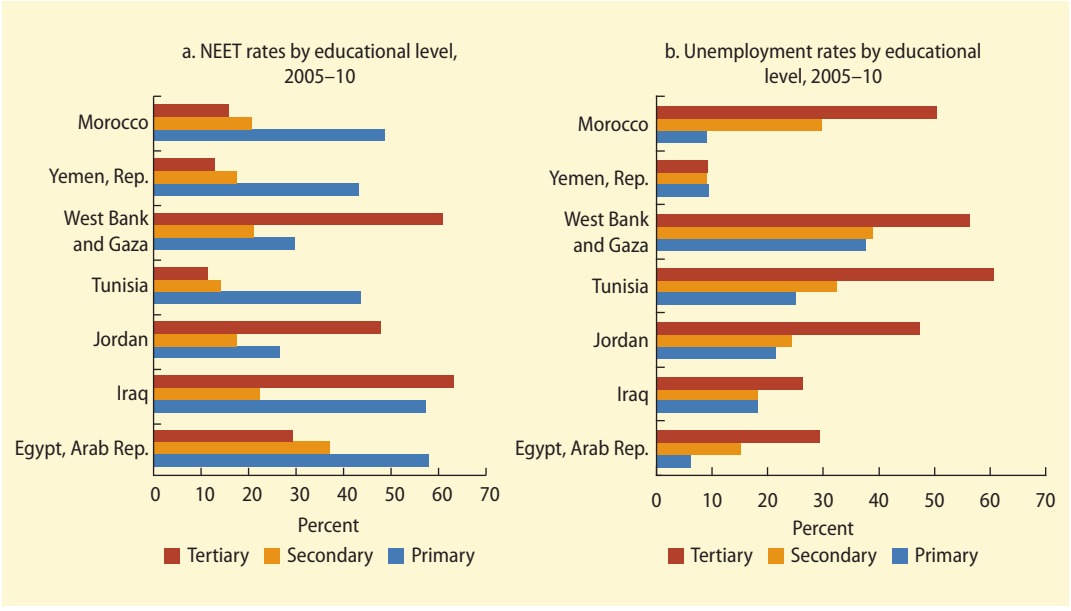


Figure 2.12 shows that within this large group of NEET youth, those out of the labor force are more than those in unemployment. While this fact is not surprising for young women—given historical trends in the region—it is also a prevailing pattern among out-of-school young males in many countries, including Egypt, Iraq, Lebanon, and the Republic of Yemen.

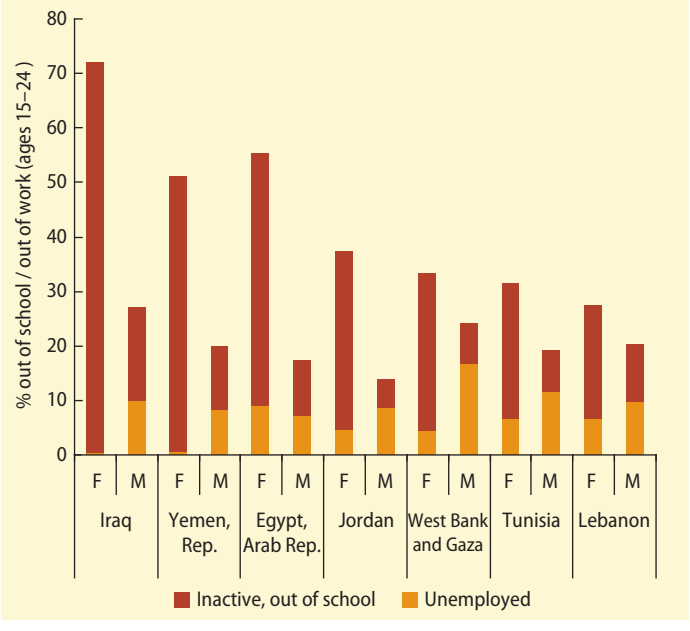
According to available evidence, much of the inactivity among youth who are not in school is not voluntary. Results from a recent Youth Survey in Morocco showed that about 60 percent of all inactive young men and about 23 percent of all inactive young women were actually discouraged

FIGURE 2.11 NEET and unemployment rates in selected economies in MENA for individuals ages 15–24



Source: Based on the Arab Republic of Egypt's SYPE 2009, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the West Bank and Gaza's LFS 2008, and the Republic of Yemen's Household Budget Survey (HBS) 2005.
Note: NEET = neither in education, employment, nor training; MENA = Middle East and North Africa.

FIGURE 2.12 Labor market status of NEET youth in selected economies in MENA, by gender, 2005–10



Source: Based on the Arab Republic of Egypt's LMPS 2006, Iraq's HSES 2006, Jordan's LMPS 2010, Lebanon's Employer-Employee Survey 2010, Tunisia's LFS 2010, the West Bank and Gaza's LFS 2008, and the Republic of Yemen's HBS 2005. See the appendix for more information on these surveys.
Note: NEET = neither in education, employment, nor training; MENA = Middle East and North Africa; F = females; M = males.

workers (La Cava et al. 2012a). Similarly, the survey on youth in Upper Egypt shows a high rate of discouragement among inactive youth (La Cava et al. 2012b). Although the additional detrimental effects of joblessness in MENA are not covered in detail in this report, it is important to highlight them; they include delays in marriage; increase in risky behaviors, such as substance abuse for young men and prostitution for young women; greater exposure to violence, including political violence; and unsafe migration (Assaad and Barsoum 2007; Boudarbat and Ajbilou 2007; Kabbani and Kamel 2007; Silver 2007; World Bank 2007, 2012a, 2012b).

A slow school-to-work transition

High NEET rates among youth are mainly the result of a slow and incomplete transition from school to work. A proxy measure of the duration of the transition from school into employment in absence of cross-country data on individual work histories is given by the age in which a youth cohort

has achieved a set employment rate (like 75 percent or 90 percent),[8] minus the presumed age of completing education. Such a measure for MENA countries shows that the transition to work is long overall, and relatively longer for youth with secondary education than for those with higher education. For instance, in West Bank and Gaza, secondary male graduates achieved only a 75 percent insertion rate nine years after graduation from secondary school compared to three years for university graduates (see figure 2.13).

During the years of transition, unemployment seems to be more pervasive among the more highly educated individuals, while inactivity is higher for the less-educated ones. One explanation is that after completing their studies, those with a tertiary education appear to be searching for jobs more intensely and to be choosier in the jobs they accept. But after some years, they have the ability to settle with a job. In contrast, job seekers with lower education appear to have a much harder time finding a job, and the prevalence of unemployment decreases only partially even many years after they have completed their studies.

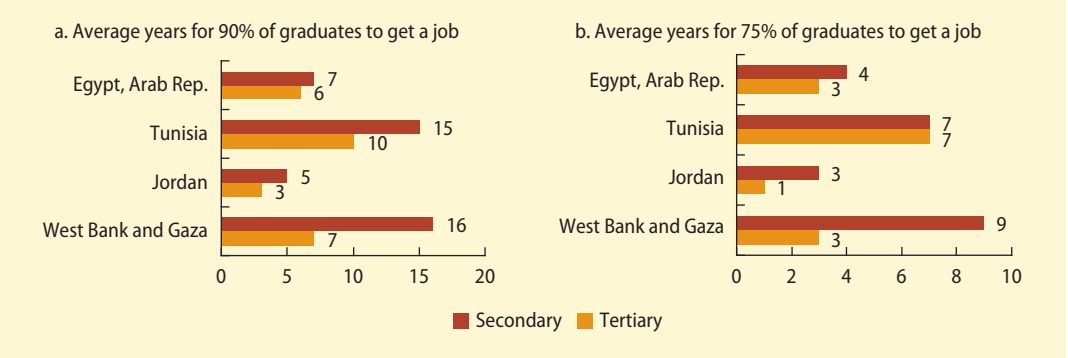
Wage and job quality expectations

High unemployment rates—and their differentials by educational attainment—seem to result from dynamics on both the labor supply and the labor demand side. On the demand side, historically sluggish demand for labor in the private sector and falling hiring rates in the public sector have curtailed the number of jobs available relative to the number of labor market entrants. On the supply side, a subset of the youth population may be exclusively seeking a public sector or a highly paid private sector job.

Relatively high unemployment rates among more highly educated youth are probably the result of their greater ability to afford unemployment: they can wait for the appropriate job, compared to the less educated. As a first indication of this fact, the ratio of the unemployment rates of individuals with tertiary education to those with secondary education is above 1 for youth in many economies (see table 2.6), suggesting that unemployment is higher among the more highly educated. However, among adults, the ratio is below 1. This finding may be a signal that labor markets are not systematically biased against tertiary-educated workers and that a subset of the young higher educated may actually prefer unemployment to some of the jobs available.

In addition, a recent Gallup survey shows that in 2009 in most countries in the region (even in a context of job scarcity)

FIGURE 2.13 Gap between school and work for young men in the Arab Republic of Egypt, Jordan, Tunisia, and the West Bank and Gaza, 2006–10



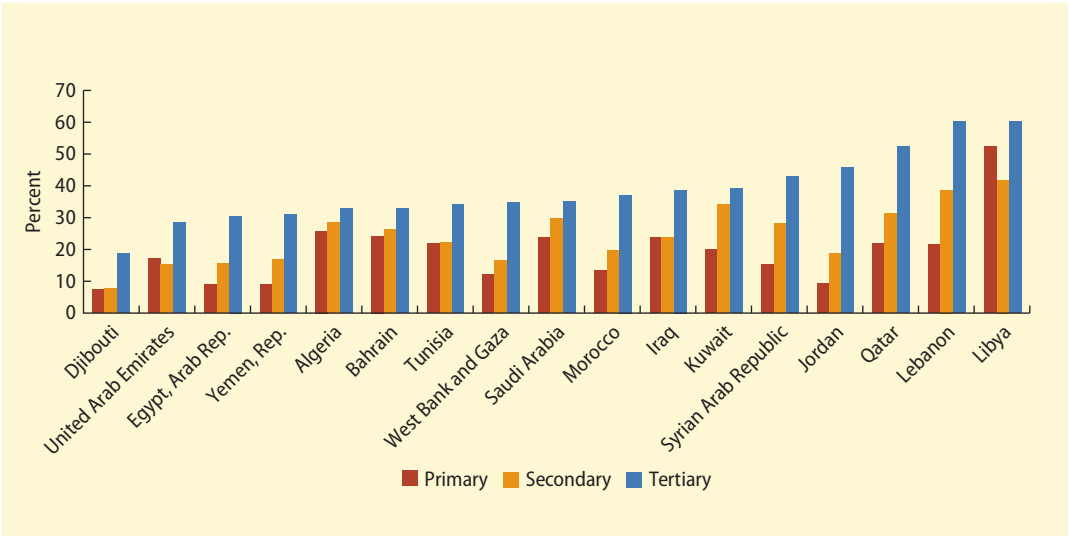
Source: Based on the Arab Republic of Egypt's LMPS 2006, Jordan's LMPS 2010, Tunisia's LFS 2010, and the West Bank and Gaza's LFS 2008. See the appendix for more information on these surveys.

TABLE 2.6 Ratio of unemployment rates of tertiary educated and secondary educated in several economies in MENA, 2005–10

	Iraq	West Bank and Gaza	Yemen, Rep.	Egypt, Arab Rep.	Morocco	Jordan	Tunisia
Adults	0.62	0.44	0.56	0.61	0.86	0.78	0.91
Young	0.92	1.19	1.21	1.34	1.40	1.54	1.77

Source: Based on the Arab Republic of Egypt's SYPE 2009, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's HYS 2010, Tunisia's LFS 2010, West Bank and Gaza's LFS 2008, and the Republic of Yemen's HBS 2005. See the appendix for more information on these surveys.
Note: MENA = Middle East and North Africa.

FIGURE 2.14 Prevalence of refusing a job in selected economies in MENA, by educational level, 2009



Source: Based on Gallup World Poll. See the appendix for more information on the poll.
Note: The polling question was, Have you ever refused a job? MENA = Middle East and North Africa.

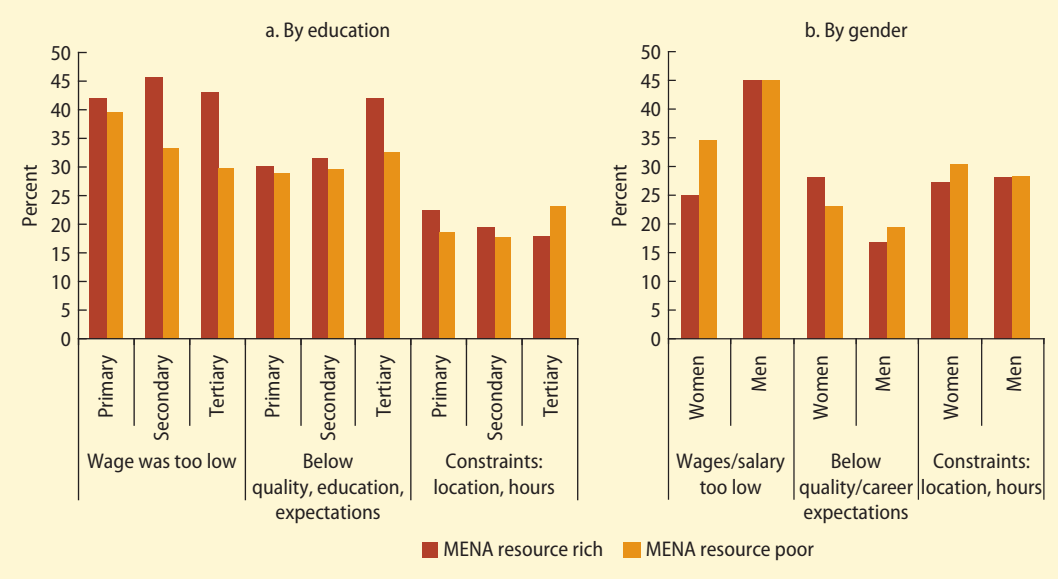
more than a third of individuals with tertiary education reported refusing a job offer (figure 2.14), and these rates increase uniformly with educational achievement. Among those who refused a job, concerns with low wages play an important role for all educational categories; however, concerns with job quality and the sector in which the job is increase with the level of education (figure 2.15).

Detailed data on unemployed Tunisian youth (see appendix for LFS 2010) indicate that refusals for inadequate pay are particularly an issue for males with primary education, who probably receive the lowest wage offers among job seekers. However, the top reason that young unemployed women reported for refusing a job offer is the location of the job, which is evidence of how mobility constraints continue to undermine opportunities for women. Finally, for the higher educated, finding work with appropriate qualifications increases in importance relative to other groups of unemployed, but salary continues to prevail over quality as a main concern for refusing a job.

In sum, both the reservation wage and the nonpecuniary attributes that make a job valuable increase in importance with education.

Figure 2.16 shows that the minimum salary at which young Moroccans would accept work increases with the level of education,

FIGURE 2.15 Reason for refusing a job in resource-rich and resource-poor economies in MENA, by education and gender, 2010

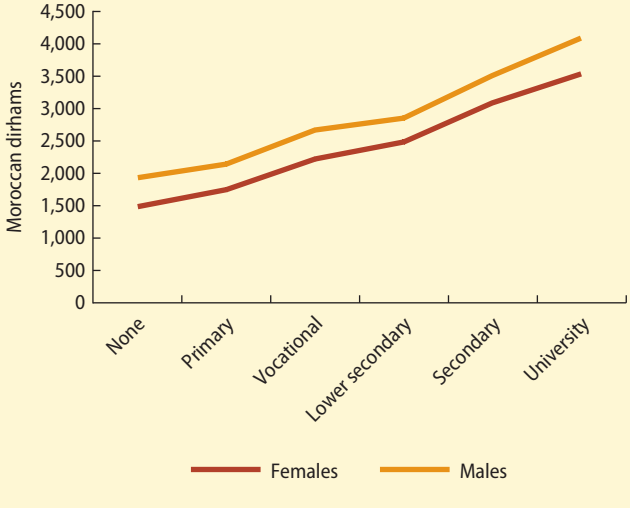


Source: Based on Gallup World Poll.
Note: MENA resource rich = Algeria, Bahrain, Iraq, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates. MENA resource poor = Djibouti, the Arab Republic of Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia, the West Bank and Gaza, and the Republic of Yemen. MENA = Middle East and North Africa.

even after controlling for household wealth, location, and marital status. Men tend to report higher reservation wages than women. Focus group research (La Cava et al. 2012a) has shown the strong differences in the meaning of work for young men and young women (men feel compelled to be breadwinners, for example), which can explain the systematic differentials between men and women in wages expectation.

A second observation is that across educational groups, young people on average continue to expect higher wages than those observed in the market. Young women with less than a high-school diploma have the widest gap between actual earning potential and reservation wages, with a ratio of 1.6 (see figure 2.17).[9] Although returns to education do not seem to increase until an individual reaches the high-school level, young women with basic education tend to have higher wage expectations than women without

FIGURE 2.16 Average self-reported reservation wages for males and females ages 15–29 in Morocco, by educational level, 2010



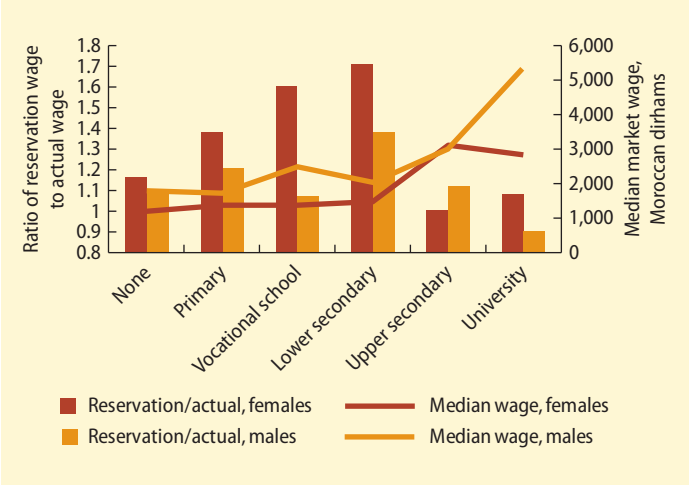
Source: Based on Morocco's HYS 2010. The figure reports the predicted self-reported reservation wage among youth ages 15–29 willing to work, controlling for household wealth, location, and marital status.

education and generally above what the market would offer them.

The prevalence of high reservation wages has much to do with how perceptions of public sector employment have shaped wage and employment preferences among educated labor market entrants. World Bank (2004) provides a comprehensive account of the public employment policy followed by MENA governments over the past decades. Until the early 1990s, governments guaranteed public sector employment to their most educated population, driving up education rates but pushing public budgets to the limit. Following structural adjustment, the guaranteed employment policy was revoked, and public jobs were subjected to hiring freezes. Figure 2.18 shows that this adjustment occurred largely at the expense of new entrants. In Egypt in 2006, a relatively larger share of prime-age males (above age 40) held formal sector jobs compared to young people. Given the limited mobility across the formal and informal sectors, it would appear that formal employment has become relatively less frequent among the current youth generation than it was for past generations.

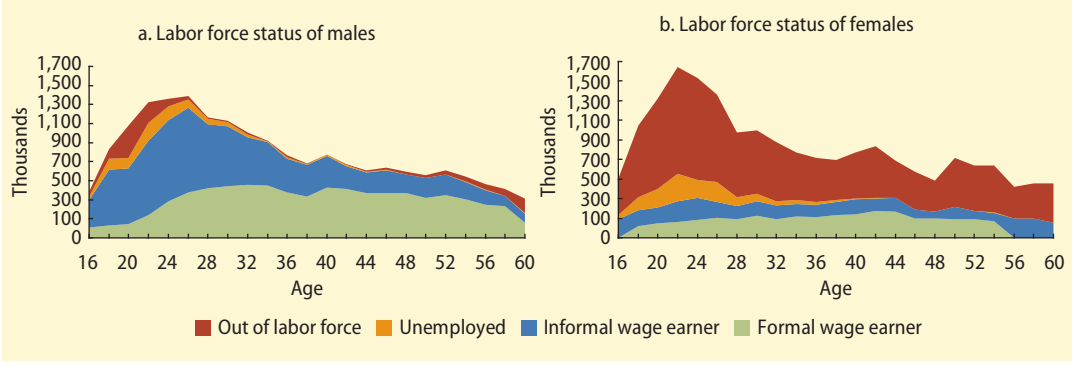
The current generous conditions of public employment make queuing for a public job a rational, although frustrating, strategy for educated job seekers.[10] However, there are indications that young people's perceptions of public sector jobs are starting to shift at last, especially in countries with sustained reductions in public sector hiring. Assaad, Binzei, and Gadallah (2010) note that in Egypt the now-permanent reduction in prospects for attaining a public job is translating into shorter unemployment rates among more highly educated groups. Similarly, opinion surveys suggests that in almost all countries the preference

FIGURE 2.17 Relation of reservation wages to actual wages by gender, males and females ages 15–29 in Morocco, 2010



Source: Based on Morocco's HYS 2010.

FIGURE 2.18 Male and female age cohorts by labor force status in the Arab Republic of Egypt, 2006



Source: Based on the Arab Republic of Egypt's LMPS 2006.

for private jobs, while low, is greater among young people than among their parents, especially in resource-poor countries (see figure 2.19).

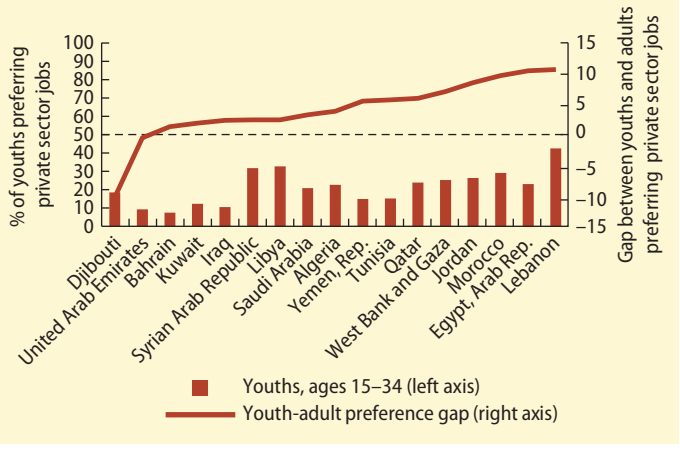
The Working Poor

Mostly rural, low-skilled, and informal

A significant share of MENA's workers live in poverty. Poverty is obviously present among different social and geographic groups; yet in countries where recent measures of consumption and poverty are available, the data suggest that in MENA working poverty peaks among rural workers with primary education or less (figure 2.20). Clearly this definition leaves out pockets of working poverty in urban areas. There, however, poverty is less correlated with low skills than it is in rural areas, because urban areas have considerable numbers of low-skilled workers who are not poor.

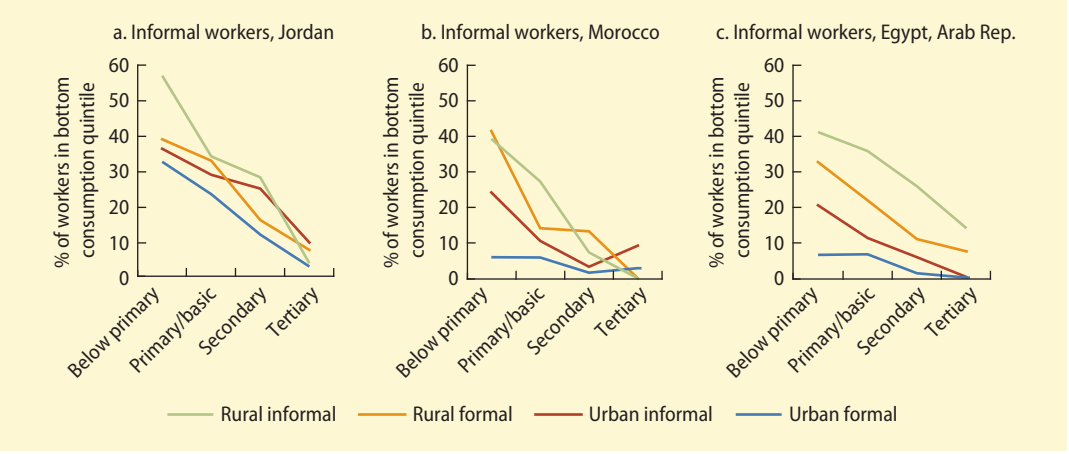
Taken together, the rural low-skilled population constitutes much of the working population in many countries in the region, ranging from about 10 percent in Jordan to more than 35 percent in Morocco (see figure 2.21). Surprisingly, in several countries unskilled rural employment is more prevalent among youth than among adults. For instance, about 50 percent of employed youth in Morocco and 34 percent of employed youth in Tunisia are rural

FIGURE 2.19 Percentage of youth ages 15–34 that prefer private sector jobs and gap between youth and adult preferences for private sector employment in selected economies in MENA, 2010



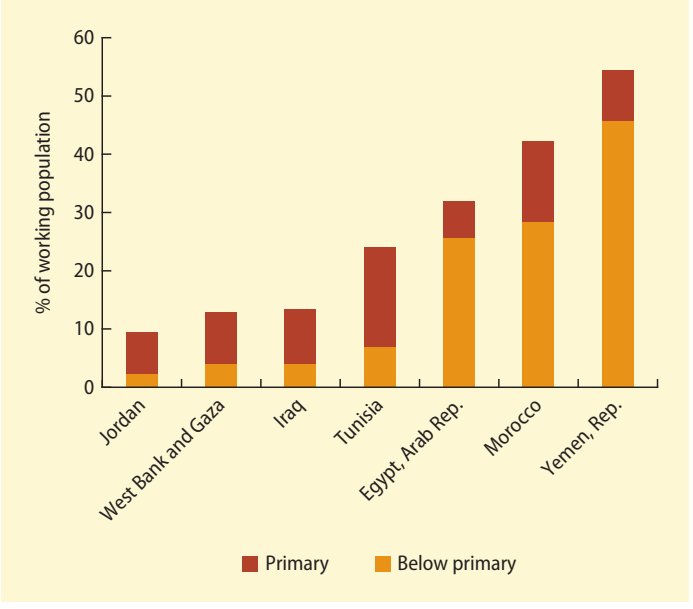
Source: Based on Gallup World Poll.
Note: MENA = Middle East and North Africa.

FIGURE 2.20 Share of workers in the Arab Republic of Egypt, Jordan, and Morocco who live in poor households, by urban or rural location, 2009–10



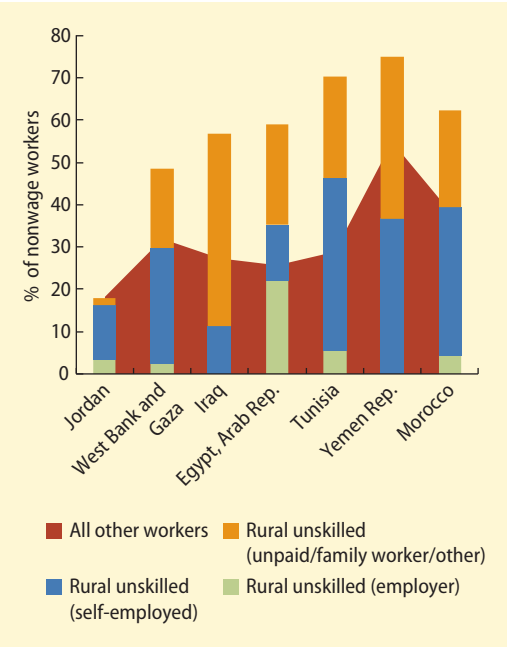
Source: Based on the Arab Republic of Egypt's SYPE 2009, Jordan's LMPS 2010, and Morocco's HYS 2010. See the appendix for more information on these surveys.

FIGURE 2.21 Education level of unskilled rural workers as a percentage of the working population in selected economies in MENA, 2006–10



Source: Based on the Arab Republic of Egypt's LFS 2010, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the West Bank and Gaza's LFS 2008, and the Republic of Yemen's HBS 2006.
Note: MENA = Middle East and North Africa.

FIGURE 2.22 Prevalence of nonwage employment among rural unskilled workers in selected economies in MENA, 2006–10



Source: Based on the Arab Republic of Egypt's LMPS 2006, Iraq's HSES 2006, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the West Bank and Gaza's LFS 2008, and the Republic of Yemen's HBS 2005–06.
Note: MENA = Middle East and North Africa.

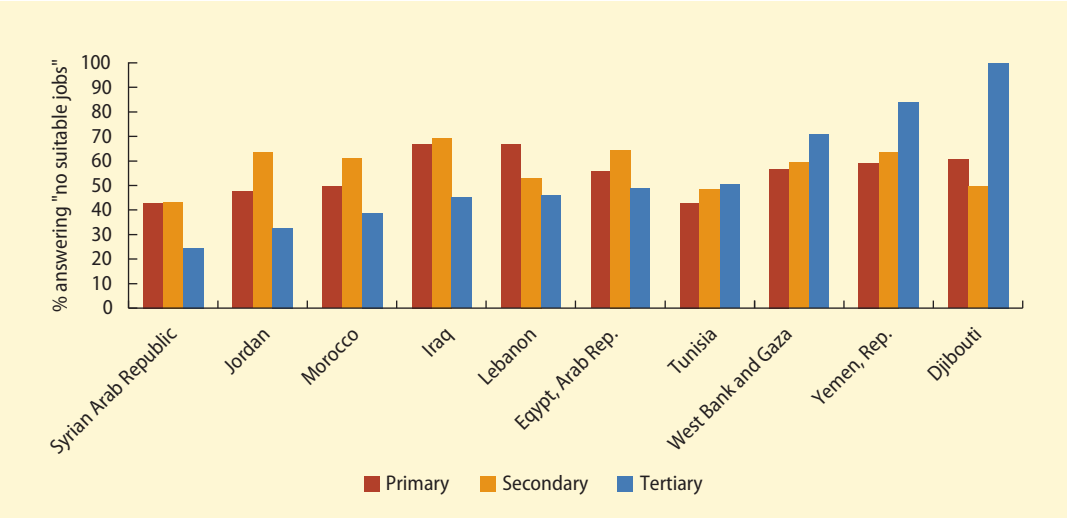
unskilled workers, compared to 40 and 22 percent among adults.

An additional dimension of working poverty, besides low earnings associated with low consumption, is that workers operate largely unprotected from risk due to the informal nature of their employment. Gatti et al. (2012) have showed how in MENA informality decreases as wealth increases, even if in some countries informality is so widespread that it also affects wealthier segments of the population.

Compared to the overall working population, rural unskilled workers are more likely to be entrepreneurs (mostly of the subsistence level) (figure 2.22). Most rural unskilled workers are unpaid family workers, employers, and especially self-employed rather than wage employees. Unpaid family work is far more prevalent among women than among men, while the opposite is true for entrepreneurship. As their firms are almost entirely informal, these workers are not eligible for social security mechanisms and remain highly vulnerable to economic shocks.

The high propensity of self-employment among rural unskilled workers is also an indication of the difficulty that this group faces in finding a wage job. In MENA, entrepreneurship continues to be the employment of last resort in the absence of wage jobs, and for the low skilled, entry into entrepreneurship is not as difficult as entering wage employment. A recent Gallup survey among existing and aspiring entrepreneurs found that more than half of entrepreneurs said that they had become entrepreneurs because they could not find a suitable wage job (figure 2.23). Yet, the same survey shows that on average less than 10 percent of those "aspiring" to be entrepreneurs reported the inability to find wage employment as the reason for their choice. This body of evidence suggests that entry into self-employment

FIGURE 2.23 Percentage of those entering entrepreneurship in selected economies in MENA because of no suitable job in the wage labor market, by educational level, 2011



Source: Based on Gallup World Poll. See the appendix for more information on the poll.
Note: Question: "Why did you become an entrepreneur?" Answer: "No suitable job." MENA = Middle East and North Africa.

(of the low-productivity type) is not as constrained as finding a wage job, especially for unskilled individuals. However, as discussed further in chapter 7, this is not necessarily the case for higher-skilled workers who would need to forgo higher wage income to prefer entrepreneurship.

Notes

1. This term is used in labor economics to define the lowest wage rate at which a worker would be willing to accept a particular kind of job.
2. Standard Mincerian regressions are used to provide an estimate of the gender wage gap. To avoid a strong selection bias, the analysis that follows is restricted to those individuals living in urban areas who are wage earners and work full time (between 30 and 60 hours a week). In their basic form, Mincerian regressions estimate the natural logarithm of hourly wages as a function of a number of key observable characteristics, such as gender, age (nonlinear), years of education, and years of experience. A dummy variable for male workers is then added to this standard specification. The exponential of the coefficient on this variable captures an estimate of the gender wage gap.
3. According to the available microdata, informality rates among low-skilled women (defined as those with at most a secondary school education) are 69 percent in Egypt, 43 percent in Iraq, 39 percent in Jordan, 67 percent in urban Morocco (estimates from the Morocco Household and Youth Survey), and 42 percent in Tunisia.
4. Estimates using available microdata for Egypt, Iraq, Jordan, Morocco, and Tunisia indicate that having additional women or seniors in the household helps women increase their labor force participation, probably because these household members can share chores and child care. However, this effect is small, suggesting that the lack of child care is not as important a determinant of female participation as marriage (results are available on request).
5. Women, Business and the Law Database (2012), http://wbl.worldbank.org.
6. Apart from gifts or inheritance specifically designated to one spouse, or property clearly intended to be under sole ownership.
7. This definition of youth joblessness was prominent in the World Development Report 2007 (World Bank 2006), and has been widely used for MENA by La Cava et al. (2012a, b), O'Higgins (2005), and Kabbani and Kothari (2005).

8. Such analysis is restricted to young males, who can be assumed (based on the sociological literature) to be all willing and unconstrained to enter into employment after completing their education. This measure assumes that secondary-educated students enter the labor market around the age of 19 and that university graduates enter the labor market around age 23.
9. To ensure comparability between self-reported reservation wages and actual wages, wages are normalized as hourly earnings and then transformed into monthly wages using a typical workweek.
10. Even accounting for the forgone income due to unemployment, lifelong returns to a public job in Morocco continue to be better than in the private sector (Bodor and Robalino 2009).

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Where Are the Barriers? PART 2

From a complaint letter: *Mr President, I went to great trouble and made great efforts in order to obtain a score of 98 (Humanities) and I was able, through God's bounty, to pass all the tests for admission to the Police Academy. Is it then just, Mr President, that I should be denied admission to the police force for no better reason than that my father is a decent but poor man who works as a property guard?*

From the answer to the letter: *With reference to your complaint presented to the Presidency of the Republic concerning your rejection by the acceptance examination at the Police Academy. We have to inform you that the matter has been reviewed with the director of the Police Academy and it is evident to us that the complaint is unfounded. We wish you success.*

— Alaa Al Aswani, *The Yacoubian Building*

Introduction

The second part of this report presents evidence of the distortions and the incentives that lead to the unfavorable labor market outcomes described earlier. To set the stage, chapter 3 reviews the evolution of the Middle East and North Africa's economies, taking into account their development model, sector composition, economic growth, and demography in past decades. This long-term look provides a macroeconomic context for the more specific analysis of the labor supply, labor demand, and labor intermediation process. In particular, chapter 4 assesses the dynamics of the private sector by examining those aspects of the investment climate that most stifle productivity and employment growth among firms. These barriers include the discretionary enforcement of regulations, barriers to competition, distortions to input prices (including capital), and the ensuing lack of innovation. Chapter 5 focuses on the current labor market regulations and social insurance design, which affect the formality and distribution of jobs, and looks at their associated benefits. It identifies the mechanisms that make some groups

"insiders" and discusses why these may no longer be sustainable. Finally, chapter 6 discusses the supply and intermediation of skills in the labor market. First, it shows how the incentives built into the educational system are not designed to equip students with the skills demanded by the economy; next, it analyzes the extent to which candidates are able to signal their skills and access job opportunities on a meritocratic basis. Finally, it discusses why jobs are seldom attained by the most qualified candidates.

A Long-Term View of MENA's Economies and Labor Markets

3

Main findings

- In the past two decades, MENA's economies progressively shifted their economic policies away from government-led strategies. However, growth has been volatile, driven largely by natural resources, foreign aid, or investment in low-productivity sectors, and it has not led to a structural transformation of the economy.
- The generation of predominantly low-productivity jobs (such as those in agriculture and construction), and the low share of manufacturing and high-value-added services, reflect the incomplete structural transformation of the regional economies.
- Economic growth will require additional investments (with a stronger role for private investment and foreign direct investment) and policies that support an enabling environment for the private sector.
- While employment grew at a relatively fast pace compared to other regions, the demographic pressure outpaced job creation and diluted the effect of GDP growth
- Yet, the youth bulge is a tremendous opportunity, as it will create a larger tax base and a smaller need for public spending on the dependent population, enabling countries to prepare for those decades when the dependency ratio will begin to rise again.

Introduction

Uneven and uncertain growth patterns, together with the lack of sound policies to ensure macrostability, still represent a barrier to effective job creation in the Middle East and North Africa (MENA) by hurting long-term investment in the more dynamic sectors of the economy. In addition, demography challenges the ability of many economies to fully absorb the large numbers of young labor market entrants (what is known as the youth bulge). This chapter aims to describe the economic and demographic developments of the past 50 years in the MENA region, which have contributed to shaping the macroeconomic and labor market situation observed today.

The chapter provides a long-term overview of growth and economic trends in the

region, describes how shifts in economic policies over time have contributed to employment quality and patterns, analyzes the role of demographic trends, and explores the macroeconomic constraints faced by the region, particularly the barriers to structural transformation and accelerated growth and employment creation given MENA's unique demographic challenges.

While this report covers the region as a whole, it is important to recognize MENA's extraordinary diversity and heterogeneity. Countries differ in their social and economic characteristics, such as their natural resource endowments, and also in their institutional and other development. An effort to take this diversity into consideration is made throughout the report by referring to country groupings (see table 3.1). In particular, subregional trends provide detailed context and background, beyond the regional analysis and evidence presented in the report. These country typologies highlight issues and features common to subgroups that are distinct from the economic, social, and demographic constraints and challenges faced by the region as a whole.

A long-term view of growth and economic trends

MENA's growth performance in the past 50 years has been mixed and highly volatile (see figures 3.1 and 3.2). After two decades of solid growth (1960s and 1970s), most countries in MENA suffered a sharp drop in output and a period of economic stagnation in the 1980s, led by the oil crisis. Countries in the region started to recover in the mid-1990s, albeit at different paces. These periods coincide with three interrelated policy shifts: (1) a shift from public sector–dominated to private sector–led economies; (2) a move from closed to globally integrated economies; and (3) a transition from oil-dominated to more diversified production structures.

TABLE 3.1 Heterogeneity in economies in MENA

Labor availability	
Labor abundant[a]	
Resource rich[b]	Algeria, Islamic Republic of Iran, Iraq, Syrian Arab Republic, Republic of Yemen
Resource poor	Djibouti, Arab Republic of Egypt, Jordan, Lebanon, Morocco, Tunisia, West Bank and Gaza
Labor importing[c] and resource rich	Bahrain, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates
Population size	
Large[d]	Algeria, Arab Republic of Egypt, Islamic Republic of Iran, Iraq, Morocco, Saudi Arabia
Small	Bahrain, Djibouti, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Tunisia, United Arab Emirates, West Bank and Gaza, Republic of Yemen
Income	
Low income	Djibouti, Republic of Yemen
Lower-middle income	Arab Republic of Egypt, Iraq, Morocco, Syrian Arab Republic, Tunisia
Upper-middle income	Algeria, Islamic Republic of Iran
High	Kuwait, Oman, Saudi Arabia, United Arab Emirates
Geography or colonial heritage	
Maghreb	Algeria, Libya, Morocco, Tunisia
Mashreq	Arab Republic of Egypt, Iraq, Jordan, Lebanon, Syrian Arab Republic, West Bank and Gaza
Members of the Gulf Cooperation Council	Bahrain, Kuwait, Oman, Qatar, United Arab Emirates

Note: MENA = Middle East and North Africa.
a. Refers to net inflows of workers' remittances.
b. As defined by the World Bank (2004), "resource-rich countries" are those in which extractive industries account for, or are expected to soon account for, more than 50 percent of government revenue.
c. Refers to net outflows of workers' remittances.
d. Population over 20 million.

Each phase provides useful insights into today's economies and labor markets.

Early post-independence period, 1960s–80s: High growth fueled by oil revenues

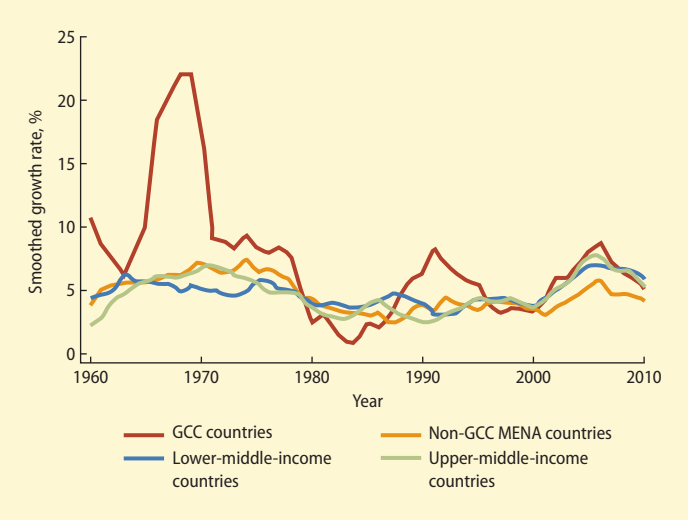
The region's growth model from the 1960s to the mid-1980s was government led, featuring high public spending and protected national markets. In the 1960s, MENA's growth performance was the highest in the world, averaging 7.0 percent (or 4.6 percent per worker), reflecting not only accelerated accumulation of production factors but also increased productivity linked to investment in physical capital, starting from a low base. These trends are reflected in the high rates of measured growth in physical capital accumulation and total factor productivity (TFP), which captures the efficiency with which inputs (or factors) are used (see table 3.2). The 1970s continued to feature strong growth, driven by high rates of capital accumulation, which were in turn made possible by the availability of financial resources during the oil boom.

The growth strategy during these decades was mainly financed by high oil revenues in resource-rich countries—mainly the Gulf Cooperation Council (GCC)—and by workers' remittances[1] and public borrowing in the resource-poor countries. Public capital investment in infrastructure, education, and health largely drove growth.[2] Highly procyclical fiscal policies reflected the windfall of oil revenues and intraregional financing flows, with large outlays going to universal food and fuel subsidies.[3] Productivity growth eventually slowed down as the region remained dependent on oil windfalls and largely isolated from the global economy.

Falling oil prices and structural changes: 1980s–90s

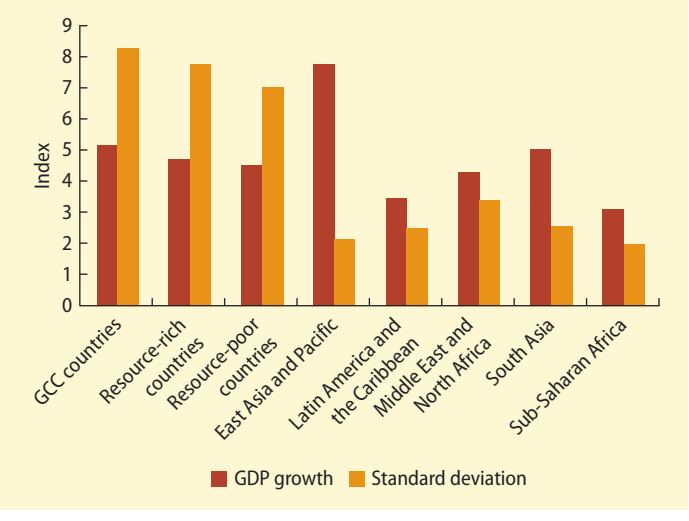
The government-led development model of the early years delivered dividends, but could not be sustained. As international oil prices plummeted in the 1980s, the foundations of growth from the earlier decades collapsed. With eroding macroeconomic balances and growing debt burdens, and despite heavy external assistance (which permitted spending for several more years), investments

FIGURE 3.1 Five-year moving average of real GDP growth rates in GCC and non-GCC MENA countries, 1960–2010



Source: World Development Indicators.
Note: GCC = Gulf Cooperation Council; MENA = Middle East and North Africa; GDP = gross domestic product.

FIGURE 3.2 Growth volatility in MENA and other regions, 1970–2008



Source: World Development Indicators.
Note: MENA = Middle East and North Africa. Standard deviation of per capita growth in gross domestic product (GDP) 1970–2008.

TABLE 3.2 Decomposition of growth in MENA, 1960s–90s
Percentage points

	Gross domestic product	Physical capital	Labor force	Total factor productivity
1960s	7.0	7.3	0.8	3.4
1970s	6.1	9.6	2.8	0.6
1980s	3.8	6.1	3.3	–0.6
1990s	3.7	2.3	3.3	0.8

Source: Keller and Nabli 2002.
Note: MENA = Middle East and North Africa.

declined dramatically, with the rate of growth of the physical capital stock almost halved[4] compared to the previous decade. Most countries experienced a dramatic decline in capital accumulation and in TFP between the 1970s and the 1980s.[5] By the late 1980s, it was clear that the past development model had failed and that a paradigm shift was needed. In the late 1980s, a handful of countries in the region—Jordan, Morocco, and Tunisia—embarked on programs of macroeconomic stabilization and policy reforms, followed in the 1990s by the GCC countries. Reforms varied markedly in timing and intensity,[6] but all included reducing subsidies and public spending to some extent, liberalizing trade and encouraging exports and investment, and strengthening the institutional foundations of a market-led economy, including consolidation of the rule of law.

The structural reforms initiated in the mid-1990s allowed the region to catch up on several fronts, even if they remain largely incomplete (as explained in the following section). Thanks to the increased global integration of the region,[7] export growth (excluding minerals and fuels) was higher than the average of developing countries, leading to an increase in world market share despite strong competition from Asia.[8] A progressive shift away from procyclical fiscal policy and the government-led growth model also helped reduce macroimbalances,[9] particularly in the GCC (see annex 3A). Average real gross domestic product (GDP) in MENA rose from 3.6 percent per year between 1996 and 1999 to 4.6 percent between 2000 and 2003 and to 5.8 percent between 2004 and 2008. The individual country results show that most of the changes in GDP growth were associated with changes in TFP (see box 3.1 for the case of Tunisia), reflecting a more efficient use of production factors and increases in employment (proxied by the labor force), while human and capital stocks exhibited much lower variation over this period (figure 3.3).

While these initial reforms brought tangible benefits to the macroeconomic environment, they did not lead to a change in the structure of production (see figure 3.4). The mining sector still represents roughly 50 percent of value added in the GCC countries (figure 3.5). Agriculture contracted as elsewhere in the world but did not give way to vibrant and innovative manufacturing and services sectors, particularly in the case of resource-rich countries, where the literature has often referred to the "Dutch disease" (that is, the apparent relationship between an increase in exploitation of natural resources and a decline in the manufacturing sector) as a potential explanation. The services sector, whose share of GDP has increased only modestly in resource-poor countries in the past 30 years and has actually decreased in resource-rich countries.

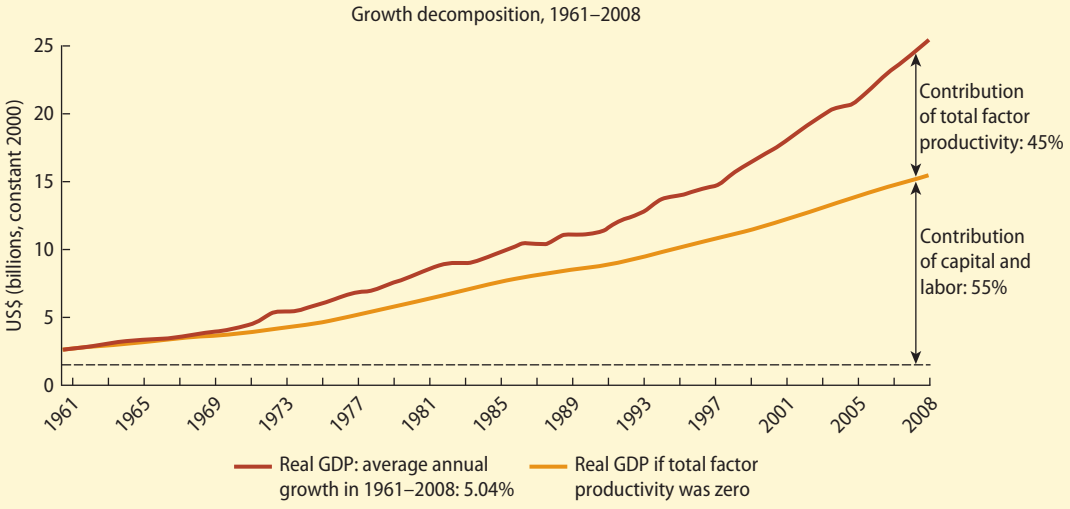
Contribution of growth to employment generation

During the era of state-led industrialization in the 1960s and the oil boom in the 1970s, unemployment in MENA countries declined steadily (World Bank 2004). The region had modest unemployment rates, similar to those in the advanced industrial economies. Up to the early 1980s, some labor-abundant countries even reported shortages of workers, as rural areas were being depopulated by rural-urban and international migration. The GCC countries became increasingly reliant on millions of foreign workers, especially from other MENA countries, to compensate for acute national labor shortages.

BOX 3.1 Productivity gains and contribution to growth from early reforms in Tunisia

In Tunisia, trade integration has been a key driver of technical progress and productivity growth since the mid-1990s (World Bank 2008). Through easier access to technology-intensive equipment and machinery, greater penetration of new markets, and enhanced competitive pressure, trade integration has led to higher growth in total factor productivity (TFP) and a higher contribution of the latter to growth (figure B3.1.1).[a] Annual growth in TFP ranged between 1.24 percent in the 1990s and 1.40 percent in 2000–06. As a result, TFP's contribution to growth in gross domestic product jumped to 43 percent in 2007. Tunisia's TFP growth, however, remains below that of comparable (and successful) countries, such as the Republic of Korea (1.9 percent) and Malaysia (1.5 percent). A recent World Bank publication (see World Bank 2010) argues for a second generation of reforms and a change in the growth model of the country, aimed at facilitating the transition to a more technology-intensive economy to support productivity and thus competitiveness and growth.

FIGURE B3.1.1 Contribution of total factor productivity to growth in Tunisia, 1961–2008

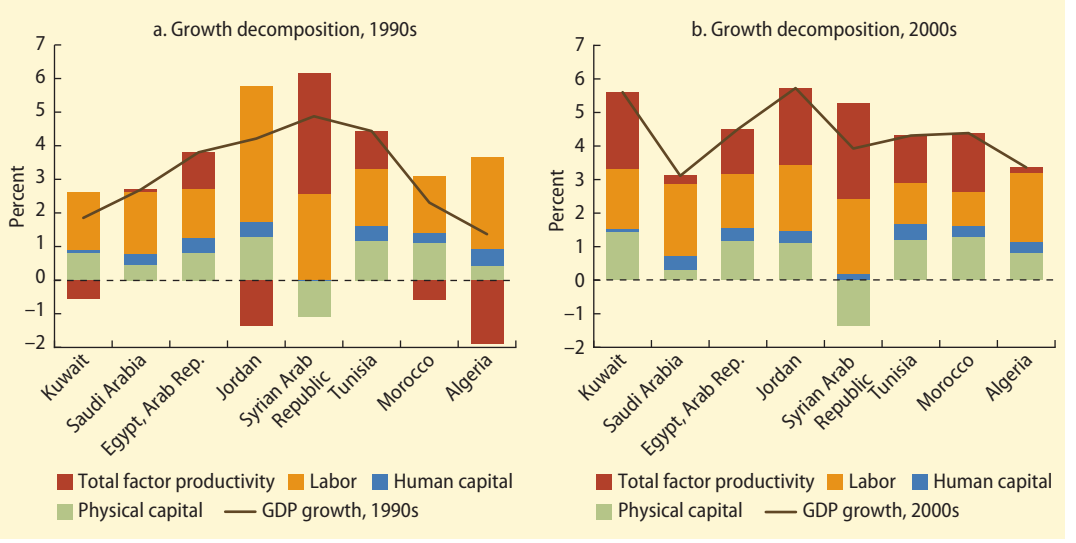


Source: World Bank 2010.
Note: GDP = gross domestic product.
a. In 1995, trade protection vis-à-vis the European Union (EU) was gradually unraveled as part of the Tunisia-EU Association Agreement, and by January 2008, the free trade area with the EU was completed for industrial goods. These reforms, supported by earlier investments in human and physical capital, have effectively led to a sharp increase in productivity (World Bank 2008).

By the early 1990s, the collapse of oil prices and the emergence of serious macroeconomic imbalances, together with continued rapid labor growth, propelled unemployment rates to their highest in decades (figure 3.6). This well-known unemployment challenge remains entrenched in the region today.

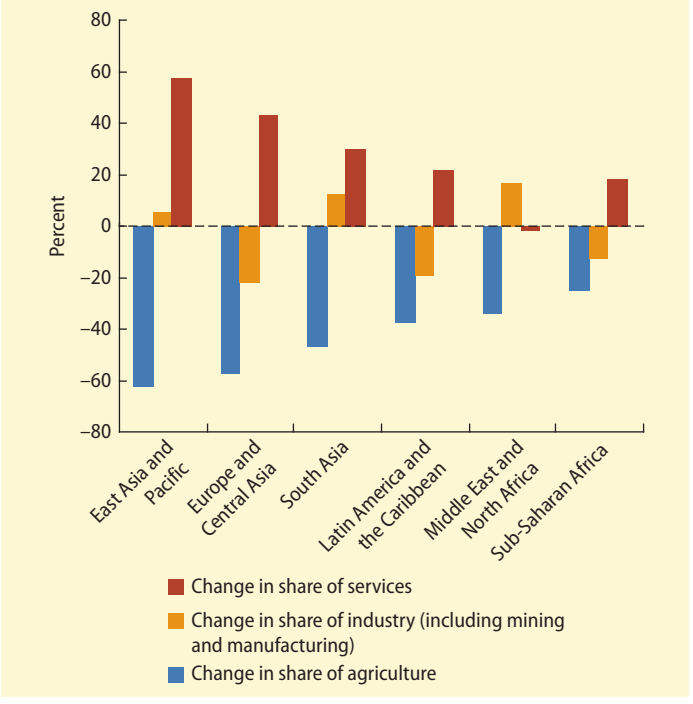
Two main factors appear to be behind these disappointing employment outcomes. First, employment was created in low-quality jobs,[10] skewed toward the informal sector[11] (particularly construction) or special employment programs to support job creation (mainly in resource-rich countries). Second, the number of jobs created, while comparable to other countries in the world, was not enough to absorb the increasing number of new entrants into the labor market.

FIGURE 3.3 Decomposition of growth in GDP adjusted for human capital in selected countries in MENA, 1990s and 2000s



Source: Based on World Development Indicators for data on GDP growth data, the International Labour Organization (ILO)-Key Indicators of the Labour Market (KILM) for data on labor, the Nehru and Dhareshwar database (1993) for data on physical capital; and Barro and Lee (2010), for data on education and human capital.
Note: MENA = Middle East and North Africa; GDP = gross domestic product.

FIGURE 3.4 Changes in the composition of GDP in selected world regions, 1980–83 and 2007–10



Source: Diop, Marotta, and DeMelo 2012.
Note: GDP = gross domestic product.

Effect of slow structural transformation

The typical MENA country differs in significant ways from other middle-income countries in the composition of employment generation.[12] A first difference is the relatively large contribution of the agricultural sector to employment growth (figure 3.7). A second significant difference is the relatively low contribution to job creation of manufacturing and private services, especially the trade, tourism, logistics, and communication sectors (figure 3.8), which were the main engines of growth and job creation during the 2000s in rapidly growing middle-income comparators such as Indonesia or Malaysia. A third difference is the significance of the public sector (as shown in chapter 1).

International evidence indicates that employment outcomes in the long term are driven mainly by structural changes, which reallocate labor between sectors with different productivities. MENA countries are, like other developing economies, characterized by large productivity gaps between different economic sectors (such as agriculture,

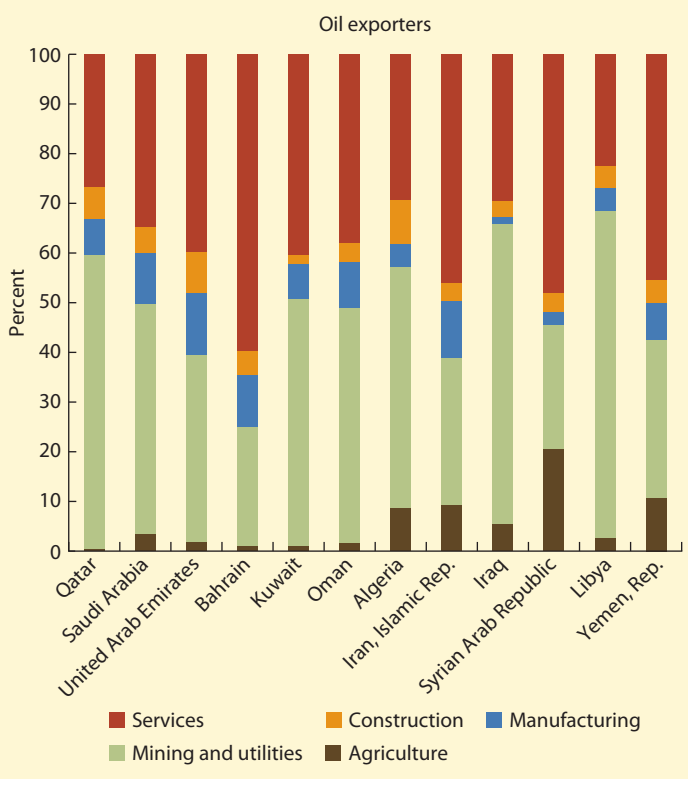
government services, information and communication technology, and manufacturing). Therefore, moving labor between sectors is likely to be associated with significant aggregate productivity changes. A decomposition based on the methodology developed by McMillan and Rodrik (2011) breaks down growth in labor productivity into two components: within-sector productivity growth and productivity growth due to changes in relative labor shares for the Arab Republic of Egypt, Jordan, and Morocco (see box 3.2). The three countries have reached different degrees of structural transformation. Jordan's structural transformation is the most advanced, as reflected in its low share of labor in agriculture in 2008 (12 percent). Egypt is at an intermediate stage (with a 27 percent share of labor in agriculture in 2007), while Morocco is at an earlier stage (with a 40 percent share of labor in agriculture in 2010).

The evidence suggests that the development process in Jordan resulted in an increased share of labor in lower-productivity sectors (that is, retail trade or construction) that absorbed the large number of new labor market entrants. In contrast, the reduction in the share of labor working in agriculture drove labor reallocations, on average, to higher-productivity sectors in Egypt and Morocco (see box 3.2). However, it appears that, even when labor moved out of agriculture toward relatively more productive sectors, in many cases it went toward low-value-added sectors in absolute terms (construction and tourism) and not toward the higher end of the value-added chain (financial or telecommunication services), which continue to generate too few jobs.

Mismatch of the pace of job creation and growth in the labor force

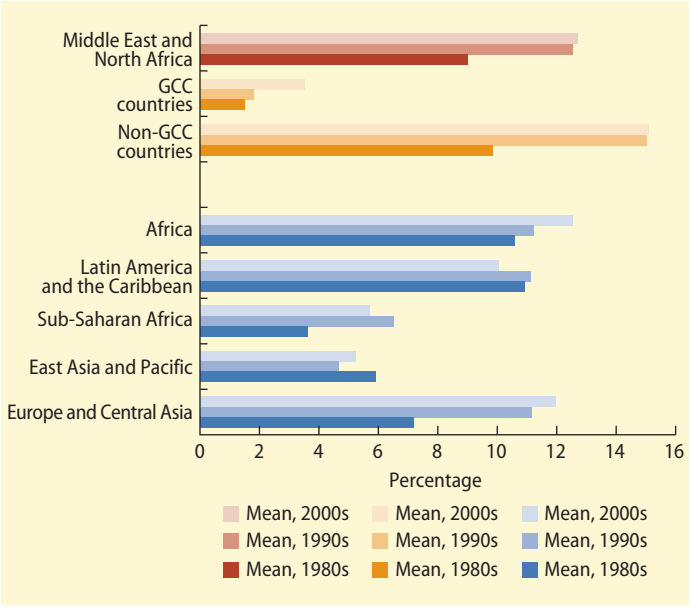
The high unemployment rates for the region mask the fact that MENA countries created jobs at a higher pace than other parts of the world during the past decade. In the second half of the 2000s, MENA's employment elasticity of 0.65 compared favorably with employment elasticity of nearly all regions and countries in the world (World Bank 2011), and its annual employment growth was the highest in the world between 1998 and 2008 (figure 3.9). This elasticity was especially high in the resource-rich countries (on average 0.91), despite a production structure skewed toward capital-intensive industries. By contrast, resource-poor countries such as Egypt, Jordan, Lebanon, and Morocco displayed a propensity to create employment that was substantially lower than the MENA average. However, the level of employment creation in the whole region did not keep pace with population growth (figure 3.10).

FIGURE 3.5 Changes in the composition of GDP, excluding mining, in GCC Countries, 1980–83 to 2007–10



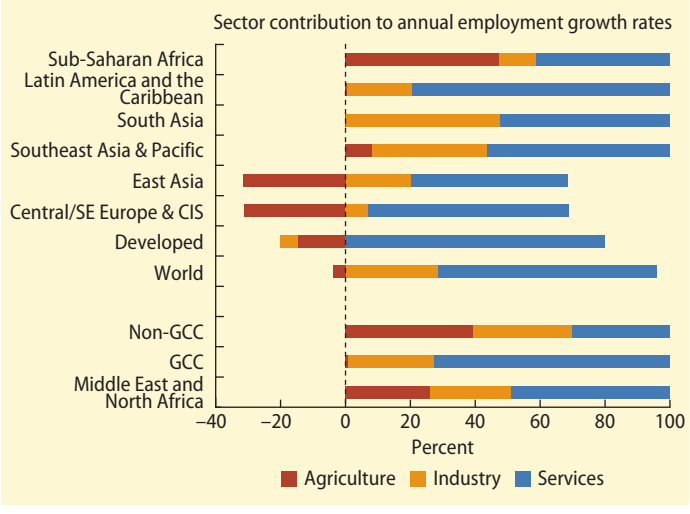
Source: World Bank 2011.
Note: GDP = gross domestic product; GCC = Gulf Cooperation Council.

FIGURE 3.6 Unemployment rates in selected world regions, 1980s–2000s



Source: Based on data from ILO-KILM.
Note: GCC = Gulf Cooperation Council.

FIGURE 3.7 Employment creation in MENA by sector, 1998–2008



Source: Based on World Development Indicators.
Note: SE = Southeast; CIS = Commonwealth of Independent States; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

Demographic challenges

Against the backdrop of these economic changes, less visible changes have occurred in the demographics of MENA. As in most of the developing world, MENA countries have experienced demographic changes of unprecedented and extraordinary proportions during the past 50 years, with important implications for the economy and the labor market. In this section, the demographic changes in MENA are examined in an effort to pinpoint their main drivers and their implications for the labor market and the economy at large in the years to come.

Fertility and mortality trends

Population trends offer a summary snapshot of demographic changes. Population growth has been declining overall, but subregional patterns are highly diverse. Figure 3.11a shows long-term trends in population growth between 1950 and 2010. On average, population growth has decreased by half since the 1950s, from about 4 percent to about 2 percent on an annual basis. However, trends within regions are very different. The low-income countries such as Djibouti and the Republic of Yemen and the GCC countries show remarkable swings during short periods. For example, in the 1970s and during the most recent period, annual population growth in GCC countries ranged between 2 and 8 percent (if migrants are included). These gross trends are the result of a complex web of factors, including fertility, mortality, and migration. Dissecting population growth into these components gives important insights into economic and labor market trends.

Fertility rates started to fall as growth accelerated during the past two decades (figure 3.11b). This remarkable fall in fertility rates coincides with the period when most countries had started to grow at sustained levels, suggesting that the well-known relationship between fertility and growth observed in postwar Europe and the United States would also hold for the MENA region. As countries become richer and education improves, fertility declines. All MENA countries seem to follow this pattern, with intraregional differences explained by differences in well-being,

as suggested by the later decline in fertility in Djibouti, Iraq, and the Republic of Yemen.

Infant mortality (figure 3.11c) also declined for all countries. From over 200 deaths per 1,000 children in the 1950s, rates are now well below 50 per 1,000, converging across groups of countries toward one-digit deaths per 1,000. This trend is evident throughout the post-independence period, suggesting that health and sanitation improved even during periods of economic stagnation. The combined effect of fertility and mortality changes is that the natural rate of increase of the population has slowed significantly since the 1950s, although it remains positive in all countries.

However, to explain recent changes in population growth, we must also look at net migration (figure 3.11d). Two different patterns emerge. The GCC, and to a minor extent the low-income countries, shows much sharper fluctuations in net migration rates. These countries have been largely receivers of immigrants, and immigration flows have played a very important role in population trends over relatively short spells of time. The Maghreb and Mashreq countries show much less variation over time, and for long periods their net migration was negative.

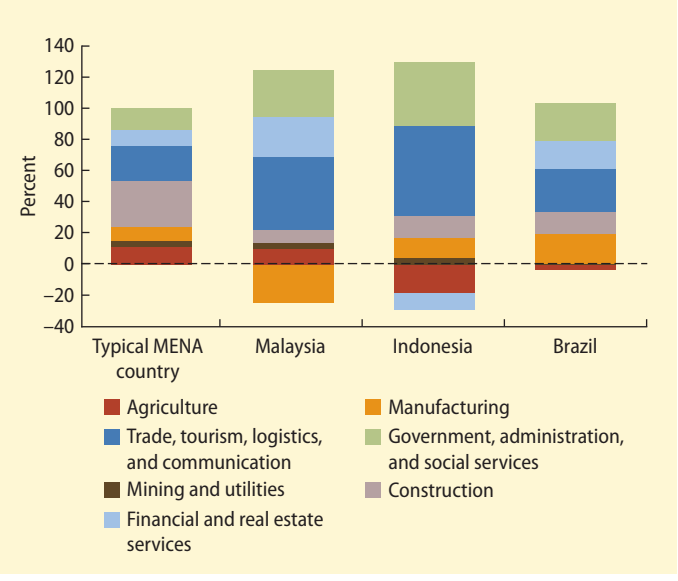
The most important migration flows within the MENA region are explained partly by differentials in economic conditions across countries (GCC and neighboring countries) and partly by the displacement of people due to conflicts (Djibouti, Iraq, Lebanon, and the West Bank and Gaza). Maghreb countries experienced periods of large emigration flows, mostly to southern European countries such as France, Italy, and Spain, especially in the 1970s and 1980s.

Demography and growth

These historical demographic changes have had important implications for macroeconomic indicators. In high-income countries, the choice of whether to look at GDP growth or GDP per capita growth has become almost irrelevant, but in countries that experience important short- and long-term changes in population size, GDP and GDP per capita are two very different measures.

Figure 3.12 illustrates this phenomenon: the difference between GDP growth and GDP per capita growth is plotted for Egypt and Morocco. During the past decade, Egypt and Morocco had economic growth rates of around 4–5 percent per year, but between one-third and one-half of that growth was dampened by population increase.

FIGURE 3.8 Sectoral contribution to annual employment growth in a typical country in MENA and in Brazil, Indonesia, and Malaysia, average 2000s



Source: World Bank 2011.
Note: MENA = Middle East and North Africa.

Demography and the labor market

From a labor market perspective, the balance between the working-age population (WAP) and the non-working-age population is crucial to an understanding of the changes in the main labor market indicators. It is important to discriminate between purely demographic factors and economic factors. Consider, for example, the three main labor market indicators: the

BOX 3.2 Structural change and employment outcomes in the Arab Republic of Egypt, Jordan, and Morocco

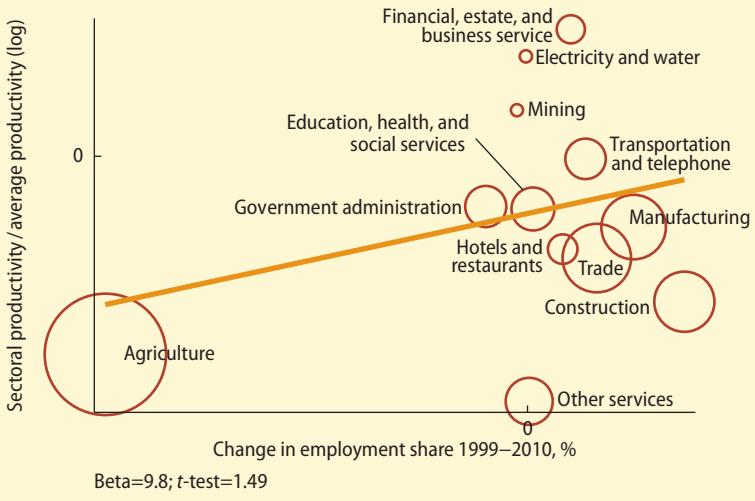
Morocco

Figure B3.2.1 plots the average labor productivity (relative to the average across all sectors) and the change in the employment share for 12 sectors in Morocco between 1999 and 2010. The size of the circle reflects the employment share in 2010. The plot shows that structural change contributed to aggregate labor productivity growth in Morocco in this period. Specifically, aggregate labor productivity growth was 3.5 percent, of which within-sector growth accounted for 2.3 percent and structural change for 1.2 percent. The structural change component was positive because of the declining labor share of the large, low-productivity agricultural sector. The abundant labor from agriculture was absorbed mainly by construction, manufacturing, and wholesale and retail trade. The labor shares of transport and telecommunication as well as finance, real estate, and business services also increased between 1999 and 2010, but they started from low levels, and the total labor share in both sectors still accounted for only 6.7 percent in 2010.

Egypt

In Egypt, the reduction in the share of labor working in the large and low-productivity government service sector supported aggregate productivity growth over the past decade. Overall, however, growth due to reallocations of labor (structural change) should have been even higher, given both Morocco's and Egypt's stage of development. If the labor share of higher-productivity sectors does not increase, both countries are likely to have negative or stagnant growth effects due to labor reallocations in the near future, once agricultural employment shrinks to a more sustainable level.

FIGURE B3.2.1 Structural change in Morocco, 1999–2010



Labor share in 2010	
Agriculture	40.3%
Trade	12.8%
Manufacturing	11.4%
Construction	9.9%
Other services	6.1%
Education, health and social services	5.0%
Government administration	4.6%
Transportation and telephone	4.5%
Hotels and restaurants	2.4%
Financial, estate, and business service	2.2%
Electricity and water	0.4%
Mining	0.4%

Source: World Bank 2012b.

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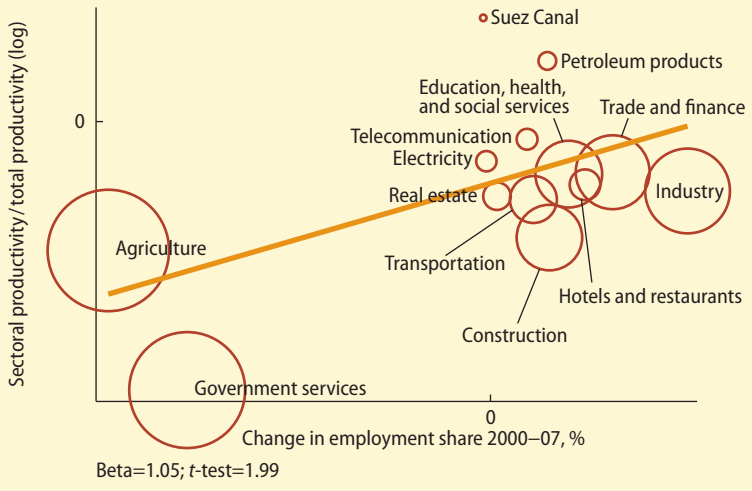
BOX 3.2 Structural change and employment outcomes in the Arab Republic of Egypt, Jordan, and Morocco *(continued)*

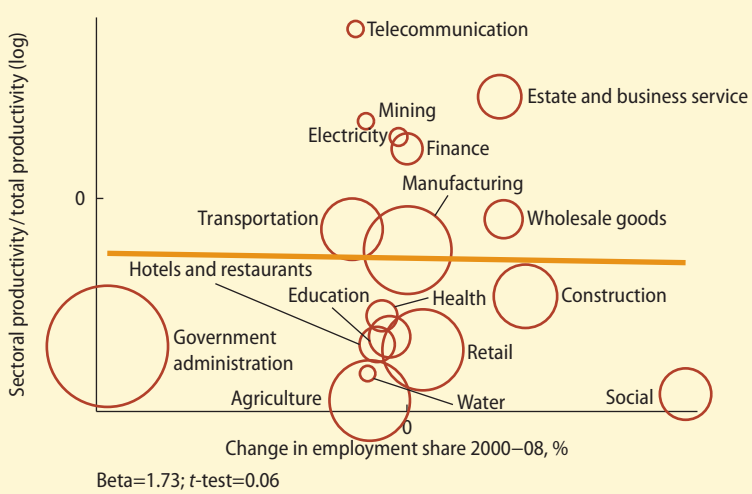
FIGURE B3.2.2 Structural change in the Arab Republic of Egypt, 2000–07



Labor share in 2007	
Agriculture	27.0%
Government services	24.6%
Industry	13.1%
Trade and finance	10.0%
Education, health, and social services	8.2%
Construction	7.9%
Transportation	4.0%
Hotels and restaurants	1.7%
Real estate	1.4%
Telecommunication	0.8%
Electricity	0.8%
Petroleum products	0.6%
Suez Canal	0.1%

Source: World Bank 2012b.

FIGURE B3.2.3 Structural change in Jordan, 2000–08



Labor share in 2008	
Government administration	26.7%
Manufacturing	13.9%
Retail	11.9%
Agriculture	11.8%
Construction	7.3%
Transportation	6.8%
Social	4.8%
Estate and business service	3.4%
Education	3.1%
Wholesale goods	2.6%
Hotels and restaurants	2.3%
Finance	1.7%
Health	1.7%
Electricity	0.6%
Telecommunication	0.5%
Mining	0.5%
Water	0.4%

Source: World Bank 2012b.

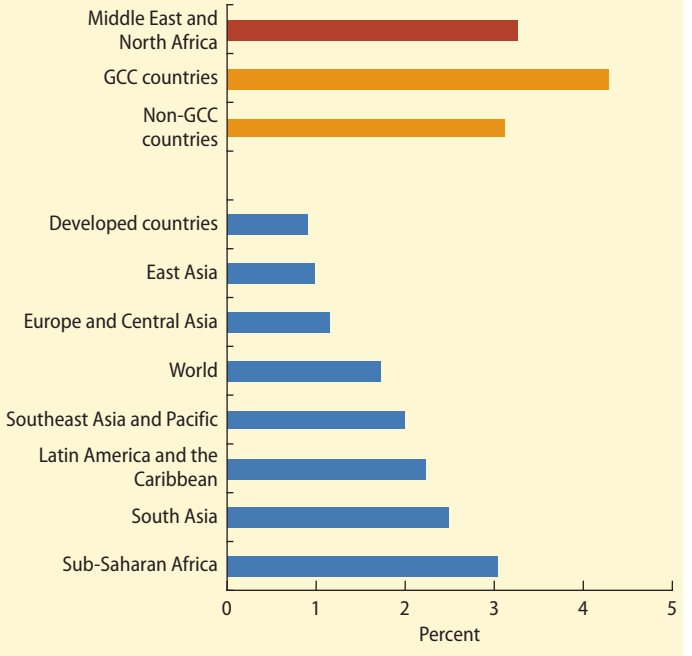
(continued next page)

BOX 3.2 Structural change and employment outcomes in the Arab Republic of Egypt, Jordan, and Morocco *(continued)*

Jordan

Jordan initiated major economic policy reforms in 2000–01 that led to privatizations, inflows of foreign direct investment, increased trade openness, and higher rates of private investment. Aggregate growth in labor productivity in Jordan was 3 percent from 2000 to 2008, of which within-sector labor productivity growth accounted for 3.5 percent and structural change for –0.5 percent. Figure B3.2.3 illustrates that the employment shares of the highest-productivity sectors declined somewhat, while the employment shares increased in several low-productivity sectors: social and personal services, construction, and retail trade. In contrast, apart from wholesale trade and real estate and business services, sectors with the highest productivity (transport, telecommunication, electricity, and mining) saw their shares reduced. Government administration, which is a large, low-productivity sector, also reduced its employment share, mitigating the negative aggregate productivity impact. These findings suggest that the reforms led to an increase in firm productivity within modern sectors but that it came at least partly at the expense of lower relative employment shares in these sectors.

FIGURE 3.9 Total annual employment growth in selected regions of the world, 1998–2008



Source: ILO-KILM.
Note: GCC = Gulf Cooperation Council.

unemployment rate (UR), the employment rate (ER), and the labor force participation rate (LFPR):

$$UR = \frac{U}{E + U}; \; ER = \frac{E}{E + U + I};$$
$$LFPR = \frac{E + U}{E + U + I},$$

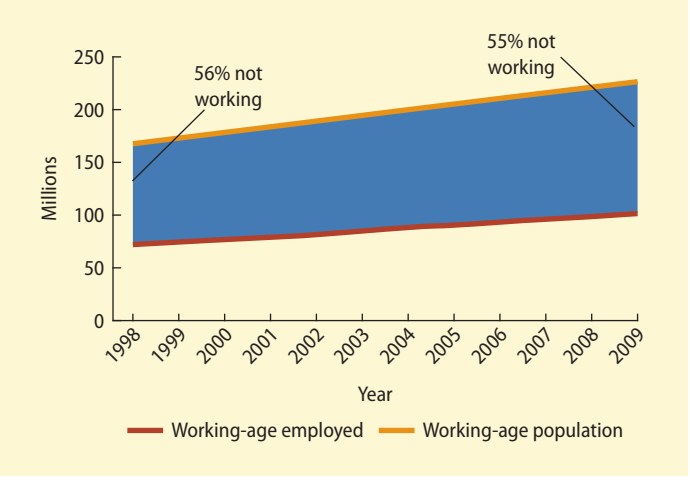
where E = employed; U = unemployed; and I = inactive; working age population (WAP) = $E + U + I$; labor force (LF) = $E + U$.

Changes in the WAP arise from changes in demographics, whereas changes in the rates of E, U, or I could be induced by a demographic factor, an economic factor, or both. For example, if the employment rate decreases, that decrease could be due to an increase in the WAP with no changes in employment (the new WAP entrants fall into the pools of the unemployed or the inactive) or to a decrease in employment. In the first case, the economy has not been able to create new jobs for the new entrants, whereas in the second case, the economy has destroyed jobs.

This phenomenon is illustrated further by looking at the Egyptian labor market between 1970 and 2010. Labor market stocks, labor market indicators, and labor market population shares are shown in figure 3.13. Labor market stocks clearly show positive and steep trends over the period (figure 3.13a). The pools of inactive and unemployed steadily grew, as did employment. During this period, the WAP rapidly increased (explained by the entry of the baby-boom generation into the labor market), and increases in the inactive and unemployed populations were greater than increases in the employed population. Overall, Egypt has created an increasing number of jobs every year for the past 40 years, clearly not an economy that destroys jobs.

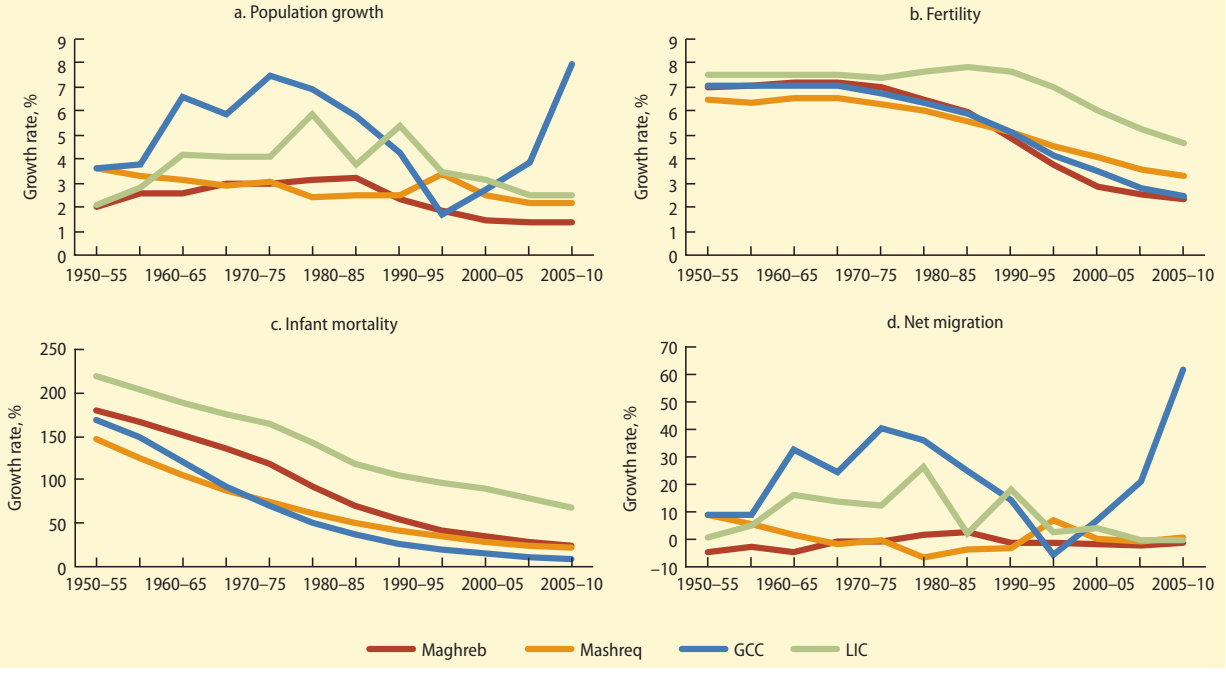
The standard labor market indicators allow observation of the labor market from a different angle (figure 3.13b). The labor force participation rate and the employment rate in Egypt both peaked around 1990 and then declined slowly; the unemployment rate rose throughout 1970–95 and stabilized at around 10 percent in 1995. But after normalizing the labor market stocks by the population (in other words, sterilizing the demographic effect), we can see

FIGURE 3.10 Growth in employed and working-age population in non-GCC countries in MENA, 1998–2009



Source: Based on the ILO's EAPEP (Economically Active Population, Estimates and Projections) database.
Note: GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

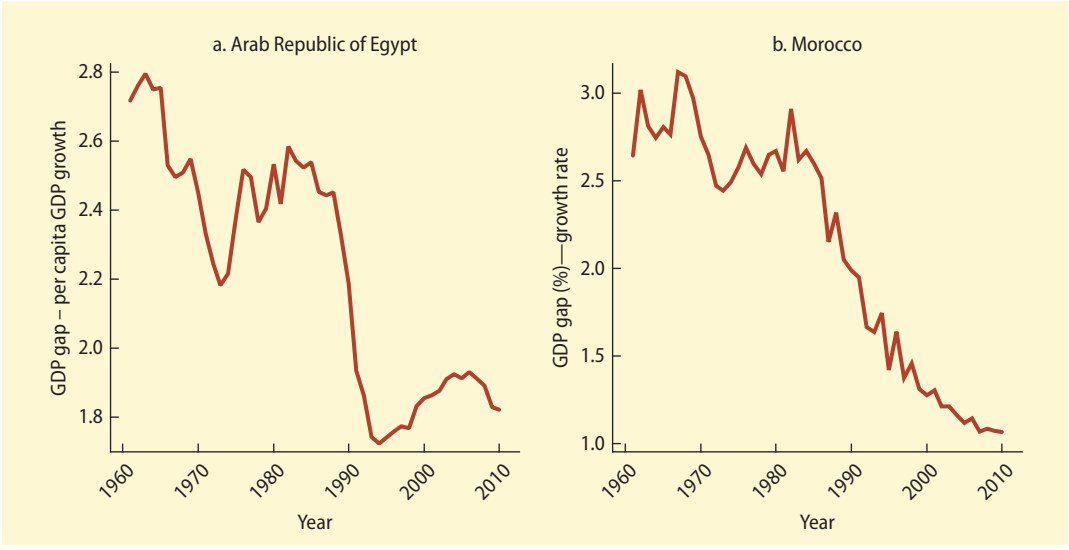
FIGURE 3.11 Demographic trends in MENA, 1950–2010



Source: UN Population Information Network 2007.
Note: MENA = Middle East and North Africa; GCC = Gulf Cooperation Council; LIC = low-income country.

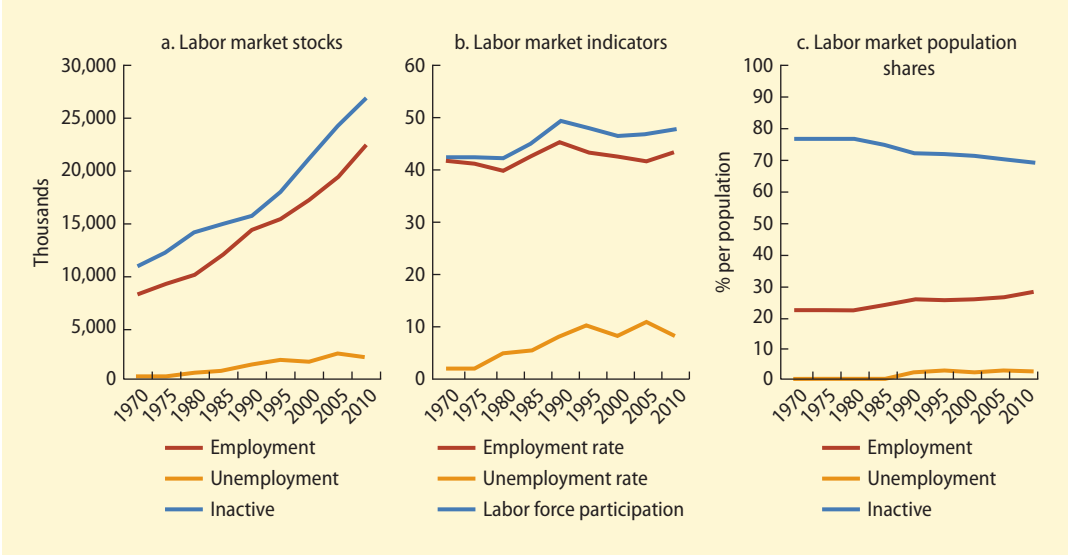
FIGURE 3.12 Difference between GDP growth and GDP per capita growth, Arab Republic of Egypt and Morocco, 1960–2010

percent



Source: Based on World Development Indicators.
Note: GDP = gross domestic product.

FIGURE 3.13 Labor market developments in the Arab Republic of Egypt, 1970–2010



Source: ILO-Laborsta.

that the inactive population slowly declined between 1970 and 2010, thanks to moderate increases in both employment and unemployment (figure 3.13c). Therefore, Egypt has not performed so poorly in terms of job creation, once the baby-boom effect is taken into account. A demographic transition similar to the one observed in Egypt requires policies tailored for the new and young entrants.

Population changes: Opportunities and challenges

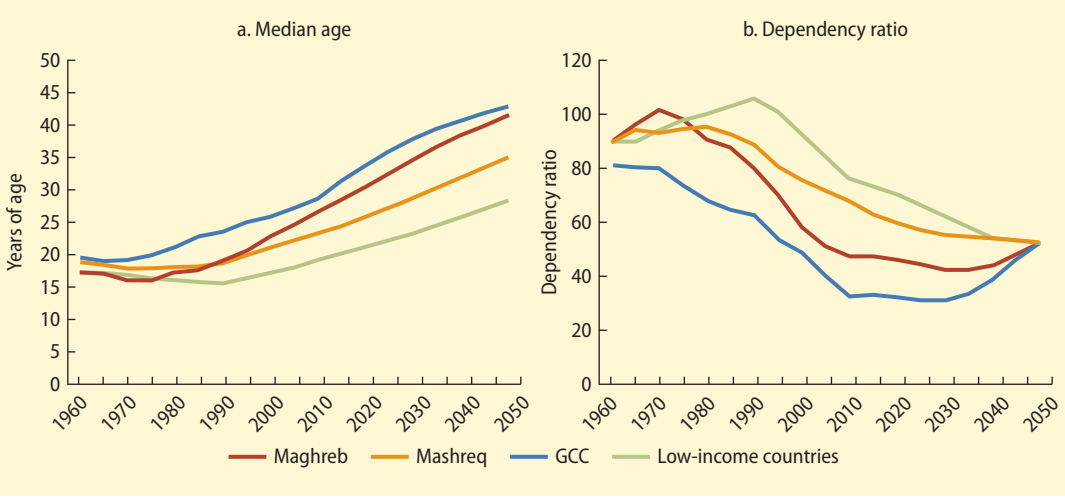
An additional impact of the demographic transition in MENA is that the median age is expected to increase (figure 3.14). Between the 1960s and the 1980s, high fertility rates, combined with improvements in infant mortality, created a baby boom that reduced the median age, but this trend has inverted since the 1980s because of the subsequent drastic reduction in fertility. The implication is that the dependency ratio (the ratio of the population ages 0–19 and ages 65+ relative to the population aged 20–64) will continue to decline until around 2040 and then may stabilize or rise further.

The U-shaped median age curve has well-known implications for the economy. In the first phase, countries experience a baby boom, in which both the number of children and the number of pensioners increase relative to the labor force. In the second phase, as the baby-boom generation enters the labor market, the larger labor force is in a better position than the previous generation to bear the cost of society. A window of opportunity appears for countries to introduce contributory pension systems, which we will discuss in chapter 5.

Tunisia is an example of this phenomenon. Its baby-boom generation, born 15–20 years ago, is entering the labor market, and the largest concentration of its population is 15–29 years old. This generation will be of pensionable age around 2050, when the population just entering the labor market will have stabilized at much lower levels. That is, the population pyramid typical of poor countries by then will have converted to the inverse pyramid typical of richer countries.

In essence, the MENA region is caught in an economic and demographic conundrum. On the one hand, the youth bulge now entering the working-age population places a heavy burden on job creation. On the other hand, the youth bulge is a tremendous economic opportunity for countries, as it creates a larger tax base and a smaller need for public spending on the dependent population (children and pensioners).

FIGURE 3.14 **Median age and dependency ratio in selected subregions in MENA, 1960–2050**



Source: UN Population Information Network 2007.
Note: MENA = Middle East and North Africa; GCC = Gulf Cooperation Council.

An unfinished reform agenda

The preceding sections described what can be defined as an unfinished reform agenda. Because of this, many of the constraints to sustained growth typical of the old development model are still present today, to some extent. This section will present a brief overview of the main barriers that need to be addressed in order to reach sustained growth, a necessary precondition for continued employment creation as well as for an accelerated pace. They require a host of policy measures that include removing obstacles to structural transformation, diversifying away from natural resources, deepening trade integration, and strengthening macroeconomic management. They also relate to other factors, such as governance and accountability, which create the preconditions for greater participation in the economy and for an inclusive and shared growth process.[13]

Characteristics of successful growth lacking in MENA

Freund and Rijkers (2012) show that "employment miracles"[14] are much less frequent in MENA than in other regions. They find that employment miracles tend to coincide with an acceleration of growth, an overall improvement in macroeconomic conditions (manifested, for example, in higher trade flows, high investment, and lower government spending), and improvements in the regulatory framework (see box 3.3). Overall, MENA seems to lack these macroeconomic conditions and most of the common characteristics

BOX 3.3 Employment miracles

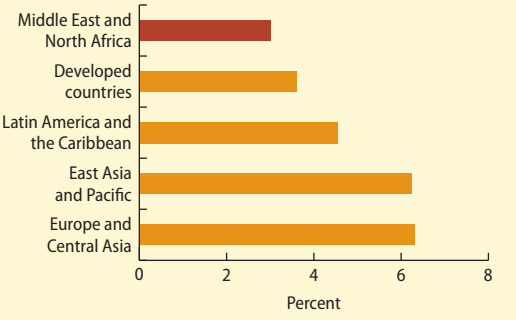
How can policymakers engineer enduring reductions in unemployment? To address this question, Freund and Rijkers (2012) document the incidence and determinants of "employment miracles," defined as substantial and sustained reductions in unemployment that have occurred throughout the world over the past three decades. More specifically, an employment miracle is a period of unemployment decline of (1) at least three percentage points and (2) at least one-quarter of its initial level over a four-year period that (3) persists for at least another three years. In addition, (4) employment miracles start with a strict decline in unemployment, and (5) contiguity is ruled out to avoid double-counting the same employment reduction spell as two separate episodes.

The frequency with which such miracles occur is encouraging; each year approximately 1 in every 20 countries embarks on one. Unfortunately, they are less prevalent in MENA (see figure B3.3.1). Moreover, the associated decline in unemployment is large: average unemployment, seven years after the onset of the decline, stood at less than half its initial level.

Employment miracles tend to coincide with an acceleration of growth and an overall improvement in macroeconomic conditions manifested, for example, in higher trade flows, high investment, and lower government spending, as well as improvements in the regulatory framework (see figure B3.3.2).

Except for suffering higher initial unemployment, countries that embark on miracles do not differ, on average, from ones that do not in their macroeconomic preconditions, their governance, or their

FIGURE B3.3.1 Incidence of "employment miracles" by region, 1980–2008



Source: Freund and Rijkers 2012.

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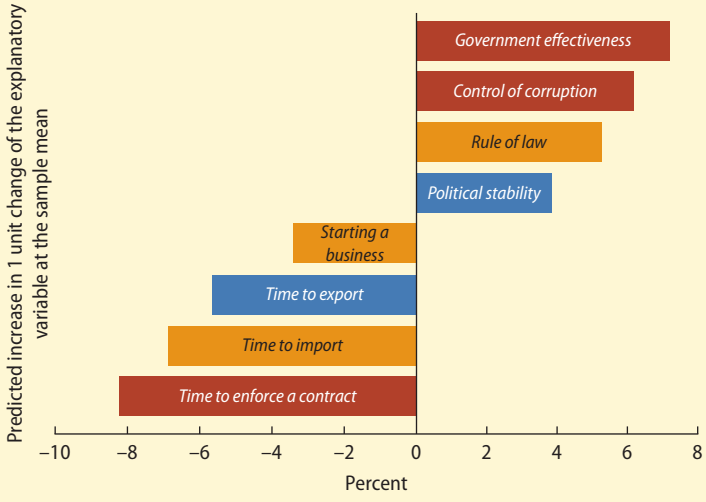
BOX 3.3 Employment miracles *(continued)*

FIGURE B3.3.2 Predictors of the incidence of "employment miracles"



Source: Freund and Rijkers 2012.
Note: NB Times are in logs. Red, orange, and blue denote significance at the 1%, 5%, 10% level, respectively.
a. The Index of Economic Freedom aims to measure 10 components of the right of every human to control his or her own labor and property. Such index assigns a grade in each component, ranging from 0 to 100, where 100 represents the maximum freedom. The 10 economic freedoms are grouped into four broad categories or pillars of economic freedom: (1) *rule of law* (property rights, freedom from corruption); (2) *limited government* (fiscal freedom, government spending); (3) *regulatory efficiency* (business freedom, labor freedom, monetary freedom); and (4) *open markets* (trade freedom, investment freedom, financial freedom). A country's economic freedom score is a simple average of its scores on the 10 individual freedoms (see http://www.heritage.org/index/).

regulatory frameworks at the time of onset. Business regulation and good governance are especially strongly correlated with the incidence of employment miracles, which perhaps should not come as a surprise, since sound regulation and good governance often go hand in hand (see figure B3.3.2). A one-percentage-point improvement in economic regulation (as proxied by the Economic Freedom Index)[a] is associated with an increase in the probability of the onset of an employment miracle of approximately 3.6–5.0 percent, all things being equal.

associated with successful growth and competitiveness. The Commission on Growth and Development (2008) has identified five of these characteristics:

- *Committed, credible, capable government.* It is important that government has the capacity to devise, and the institutions to implement, a growth strategy.
- *Macroeconomic stability.* Modest inflation and sustainable public finances are necessary to spur growth.
- *High rates of savings and investment.*
- *Full exploitation of the world economy.* Knowledge acquired in the global economy and exploitation of global demand are the foundation of economic "catch up" and sustained growth, and the promotion of foreign direct investment and foreign higher education can support knowledge transfer.
- *Letting markets allocate resources.* Policies need to ensure that product and labor

markets are flexible enough to allow a structural transformation from agriculture to manufacturing and to ensure that there is, at a minimum, no bias against exports.

Each of these characteristics is discussed next in the context of MENA.[15]

Lack of macroeconomic stability

The fundamentals of sound fiscal and monetary policies—prerequisites for sustained economic performance—have been largely missing in the MENA region over the past 30 years. Their absence is reflected in the region's high output volatility, the highest in the world (see table 3A.2 in annex 3A). Volatility of the real effective exchange rate (REER)[16] hampered the development of nonresource-based activities (Gelb 1988), resulting in a so-called volatility-induced inefficient specialization pattern and the low diversification outcome presented earlier.[17] A volatile REER increases uncertainty and reduces the incentive to invest in nonresource tradables. It dims the prospects for development in more dynamic sectors of the economy that are not capital intensive and have higher potential to create employment (see Hausmann, Panizza, and Rigobon 2004).

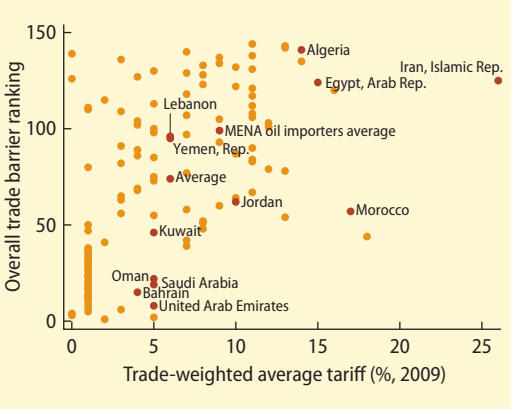
Procyclical fiscal policy has also fueled macroeconomic instability, accompanied by the lack of high and sustained investment. In many MENA countries, public finances are tied up in large subsidies and short-term consumption expenditures.[18] Food and fuel subsidies alone amount to about 6 percent of GDP on average for the region as a whole (World Bank forthcoming), with wide variation by country. Chapter 4 will discuss how energy subsidies distort relative prices and incentives, in addition to their fiscal costs.

Incomplete global integration

Trade and investment raise productivity through more efficient allocation of resources, economies of scale, increased competition, faster rates of capital accumulation and technical progress, and increased flows of ideas, knowledge, and innovation from abroad. Increased trade and investment flows not only promote faster economic growth and job creation but also help countries move up the global value chain, diversify, and improve their resilience to external shocks.[19]

Despite recent liberalization, MENA's trade regimes remain more restrictive than those of comparator countries. MENA countries have streamlined and lowered tariffs over the past two decades, often in the context of trade agreements with the European Union and the United States. However, tariffs remain high (averaging 12 percent), and several countries rank at the higher end among 139 countries surveyed on a measure of overall trade restrictiveness (see figure 3.15 and table 3A.3 in annex 3A).[20] As a consequence, MENA trade remains below the potential of countries at the same level of development. Cross-sectional results (Behar and Freund 2011) show that despite some evidence of convergence, MENA's exports to the outside world were only one-third of their potential even in recent years, after controlling for the standard determinants of trade. At historical growth rates, it would take 20 years for MENA countries to reach their full potential. If natural resources are excluded, exports are

FIGURE 3.15 Trade restrictions in selected countries in MENA, 2009



Source: Based on World Economic Forum 2012.
Note: MENA = Middle East and North Africa. Overall trade barriers are ranked from 1 to 139, with 1 being the least restrictive.

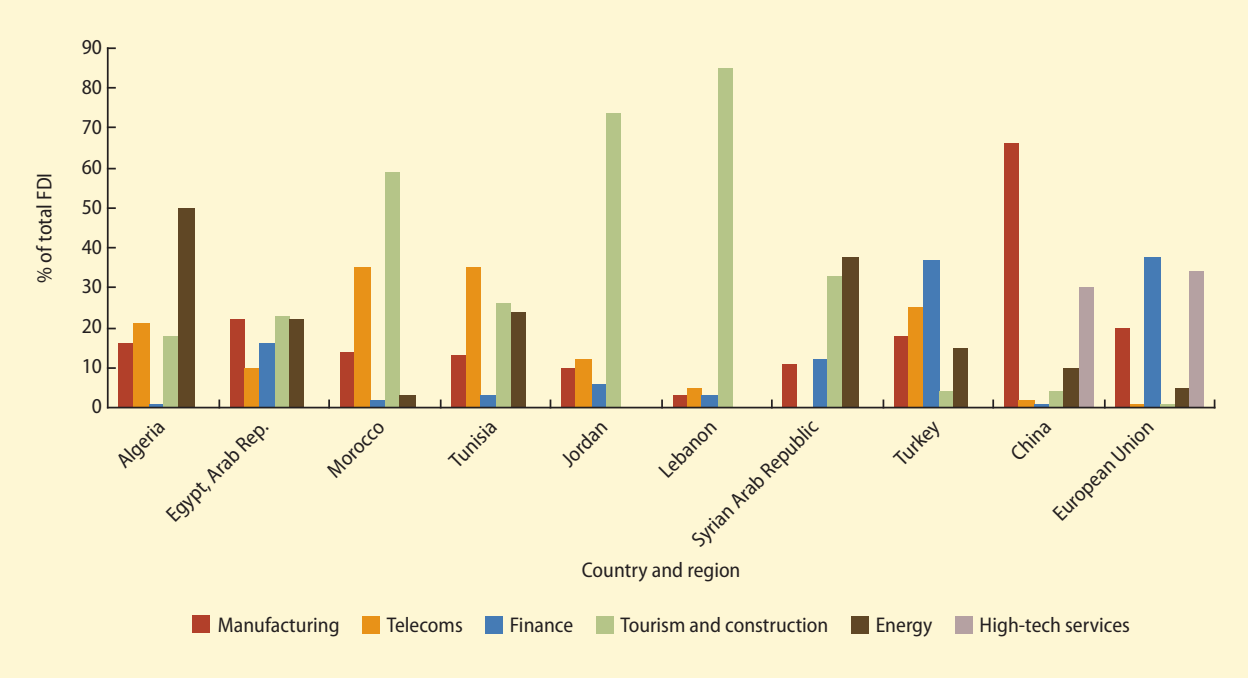
also at only one-third of the benchmark, but the improved export performance over time is much slower, implying that it could take twice as long to reach potential. Furthermore, the level and composition of foreign direct investment (FDI) make only limited contributions to the region's development and employment generation, having been biased toward either capital-intensive or low-skilled, labor-intensive sectors (such as oil, construction, and tourism) rather than toward more dynamic, employment-creating sectors (figure 3.16 and chapter 4).

Moreover, the quality of human capital in MENA is not strong enough to fuel innovation and increase productivity. Assuming constant TFP growth and constant gross capital formation in the next decade (and projecting increases in the labor force in line with demographic assumptions), the growth potential of most MENA countries appears to be considerably constrained. Overall prospects for growth are moderate, mainly because of a lack of technological progress and productivity growth. In an analysis of the correlates of TFP (see box 3A.1), it appears that the effect of globalization on TFP depends positively on the quality of human capital. Thus, despite the progress it has made, MENA still needs to deepen its global integration and invest in human capital and knowledge-driven absorptive capacity. By itself, global integration might not bring the expected benefits in increased growth and productivity if not accompanied by reforms in other important areas (see chapters 4 and 5).

Unfulfilled potential of the private sector to spur economic growth

While the private sector has a larger role in MENA today than before, it remains a far-from-strong engine of growth (World Bank 2009). Governments have, by and large,

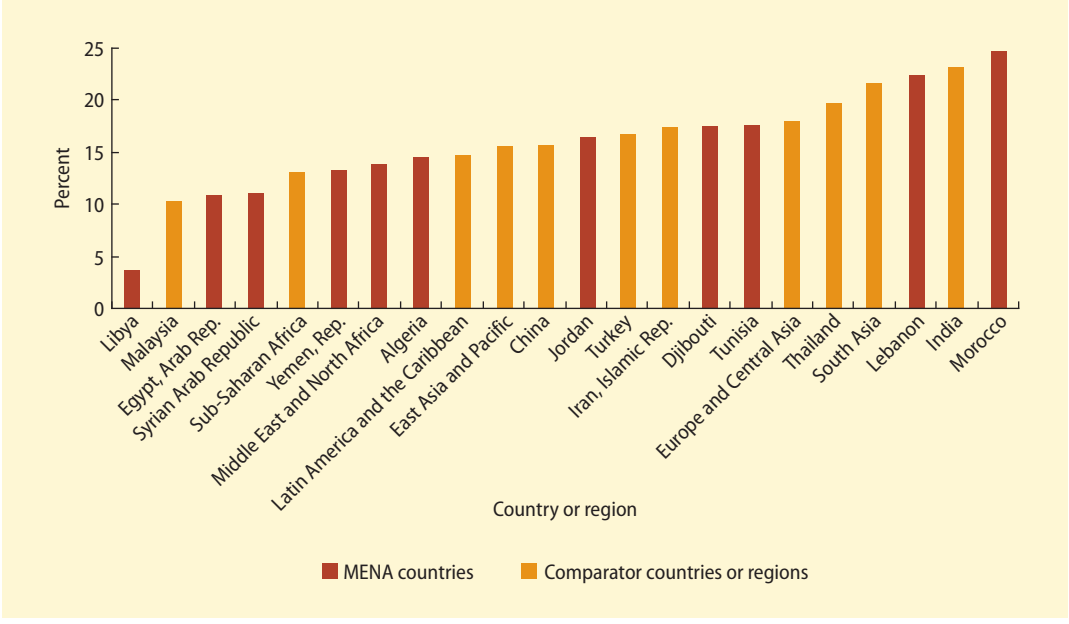
FIGURE 3.16 Structure of foreign direct investment in selected countries in MENA, in China, and in the European Union, 2000–07



Source: United Nations Conference on Trade and Development (UNCTAD) database; World Development Indicators 2000–07.
Note: MENA = Middle East and North Africa; FDI = foreign direct investment.

failed to establish rule-based modes of interaction with the private sector. Except for some of the resource-poor countries (oil importers in the Maghreb), where the ratio of private investment has actually increased due to a substantial increase in FDI, the composition of investment in most of the resource-rich countries favors public investment. MENA lags behind all other regions, with the exception of Sub-Saharan Africa, in the share of private sector gross fixed-capital formation in GDP (figure 3.17). This is only one part of the story, however. The composition and efficiency of investment also contribute to the private sector's limited impact on growth and job creation (see chapter 4). Freund and Bolaky (2008) find that all 12 MENA countries included in their sample of 126 countries are above the median in regulation of their economies. In the same vein, drawing on *Doing Business* data for a sample of 133 countries, Amin and Djankov (2009) find that the proclivity to undertake microreforms that reduce unjustified regulatory restrictions is much lower in countries whose exports are concentrated in abundant natural resources. The lack of a level playing field that would allow the private sector to play a pivotal role in achieving structural change is explored in more detail in chapter 4.

FIGURE 3.17 Private sector gross fixed-capital formation as a percentage of GDP in selected countries and regions, average 2004–09



Source: World Development Indicators.
Note: GDP = gross domestic product; MENA = Middle East and North Africa.

Annex 3A Macroeconomics

TABLE 3A.1 Decomposition of average GDP growth rates in selected countries in MENA, 1960–2000, by decade

	Decade	Growth of GDP per laborer (%)	Physical capital per laborer (%)	Human capital per laborer (%)	TFP growth (%)
Kuwait	1980s	–5.80	–1.20	0.40	–5.00
	1990s	–0.90	–0.10	0.10	–0.80
	2000s	3.60	0.50	0.10	3.00
Saudi Arabia	1960s	5.30	2.70	0.00	4.20
	1970s	6.40	17.00	0.00	–0.40
	1980s	–9.10	–2.60	0.50	–7.00
	1990s	–0.10	–0.60	0.40	0.10
	2000s	–0.20	–0.90	0.50	0.30
United Arab Emirates	1980s	–7.50	—	0.50	—
	1990s	–1.30	–2.00	0.80	0.00
	2000s	0.50	–1.10	0.70	0.90
Egypt, Arab Rep.	1960s	3.00	3.30	0.30	1.50
	1970s	4.40	5.70	1.00	1.50
	1980s	2.90	2.00	0.60	0.40
	1990s	1.70	0.00	0.50	1.20
	2000s	2.10	0.30	0.40	1.40
Jordan	1960s	–1.30	–6.50	11.40	–6.70
	1970s	6.40	10.30	8.10	–2.60
	1980s	–2.40	0.70	0.60	–3.80
	1990s	–2.20	–1.00	0.50	–1.70
	2000s	2.90	0.10	0.40	2.40
Syrian Arab Republic	1960s	1.00	1.30	0.80	0.00
	1970s	6.30	5.50	1.50	3.20
	1980s	–2.70	–2.90	0.40	–0.10
	1990s	1.10	–3.00	0.00	4.00
	2000s	0.50	–2.70	0.20	3.00
Yemen, Rep.	1980s	—	—	0.30	—
	1990s	0.60	–0.30	0.40	0.50
	2000s	–0.20	–0.10	0.50	–0.60
Tunisia	1960s	3.40	4.60	0.90	1.00
	1970s	2.80	2.40	1.50	0.90
	1980s	0.40	0.70	0.40	–0.70
	1990s	2.00	0.30	0.50	1.20
	2000s	2.50	0.60	0.50	1.50
Morocco	1960s	2.20	1.80	–3.20	3.50
	1970s	1.00	4.30	0.80	–1.20
	1980s	0.80	0.40	0.40	0.00
	1990s	–0.30	0.20	0.30	–0.90
	2000s	3.00	0.80	0.30	1.80
Algeria	1960s	3.00	1.40	0.60	2.10
	1970s	2.70	5.30	1.10	–0.10
	1980s	–1.30	0.30	0.70	–2.30
	1990s	–3.10	–1.10	0.60	–2.50
	2000s	0.20	–0.30	0.40	0.20

Source: Data from the 1960s to 1980s are taken from Keller and Nabli (2002). The authors followed the same structure and data set to update the calculation to recent years.
Note: — = not available; GDP = gross domestic product; MENA = Middle East and North Africa; TFP = total factor productivity.

TABLE 3A.2 Economic growth and its volatility, 1982–2010

	Mean growth[a] (1)	Coefficient of variation[b] (2)	Mean change in growth[c] (3)	REER volatility[d] (4)
GNI per capita 1982				
Low (20)	2.03	2.99	4.55	49.46
Lower middle (52)	0.96	5.00	3.31	35.34
Upper middle (32)	1.90	2.36	3.63	21.44
High (33)	1.86	1.52	1.93	8.71
GNI per capita 2010				
Low (24)	0.76	8.11	4.18	45.15
Lower middle (38)	1.72	3.62	3.72	33.96
Upper middle (32)	1.96	2.81	3.99	22.15
High (43)	2.24	1.87	2.44	11.12
MENA (17)	1.40	4.76	4.78	52.20
GCC (6)	1.37	5.58	5.29	110.41
Non-GCC (5)	2.28	2.81	4.50	23.66

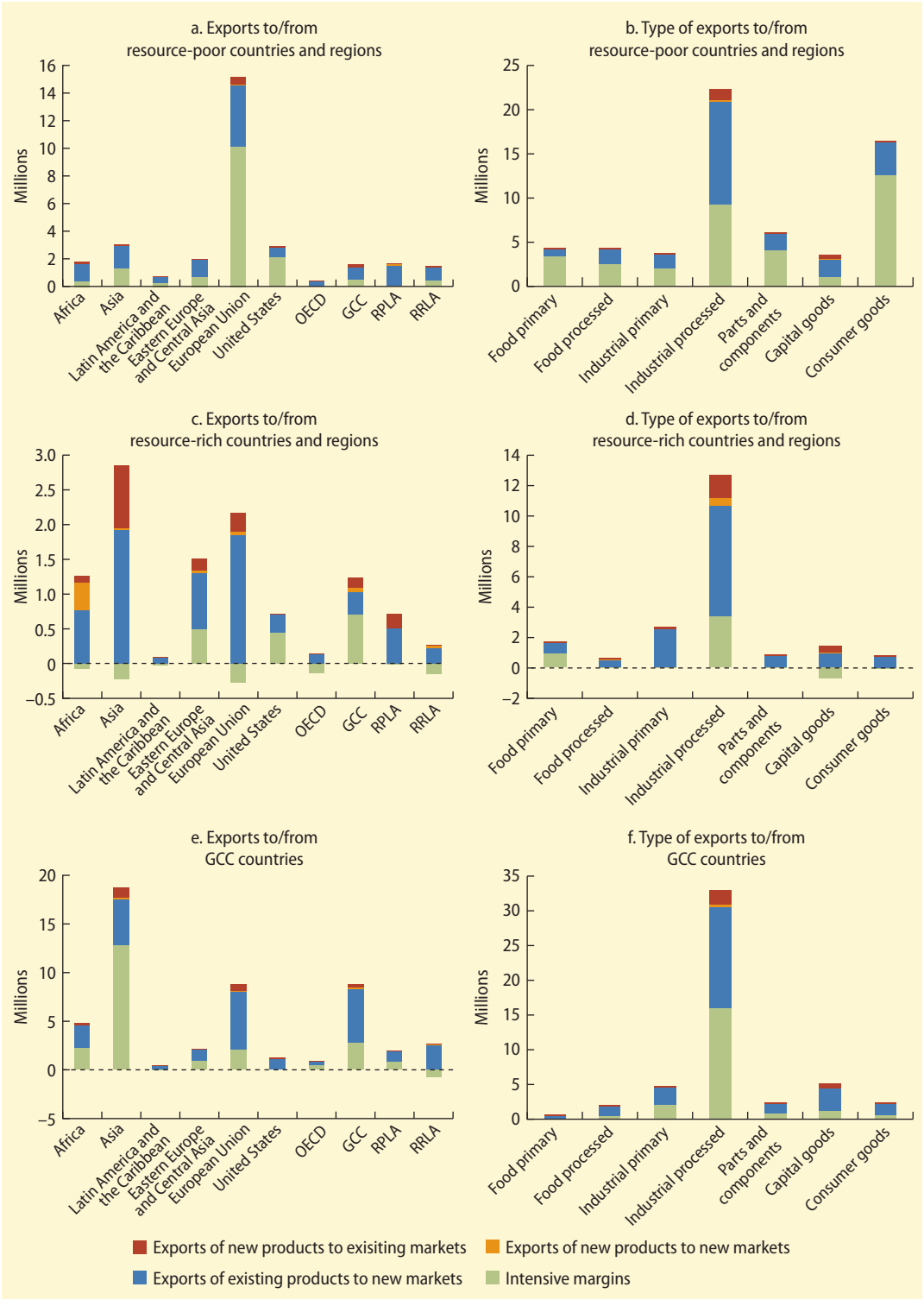
Source: Diop, Marotta, and De Melo 2012.
Note: Number of countries in parenthesis. GCC = Gulf Cooperation Council; GNI = gross national income; REER = real effective exchange rate; MENA = Middle East and North Africa.
a. Mean growth is the average growth rate over the period 1982–2010, that is, approximately 38 observations per country resulting in sufficiently large samples to give significantly different mean growth rates in each sample.
b. Standard deviation divided by the mean.
c. Mean change is the absolute mean change in growth rates observed between two years.
d. The standard deviation of the monthly real effective exchange rate is computed over the period 1980–2010. The sample is not exactly the same as those for columns 1 to 3.

TABLE 3A.3 Policy indicators affecting trade in selected countries in MENA

	TAR-AGR (1)	TAR-MAN (2)	TTRI Value (rank: 125) (3)	OTRI Value (rank: 102) (4)	LPI value (rank: 164) (5)	IE (DB) (rank: 183) (6)	Tr. across borders (rank: 183) (7)	Rule of law (rank: 213) (8)
	1990–95	1990–95						
Year	2006–09	2006–09	2006–09	2008	2006–09	2006–09	2010	2009
RPLA	—	—	58.4	—	79.6	102	60.6	102.6
Egypt, Arab Rep.	35.8/54.6	23.6/9.2	3.3 (68)	10.0 (59)	94	106	21	97
Jordan	a–/16.7	a–/10.0	4.6 (108)	11.3 (66)	80	100	77	81
Lebanon	–/11.4	–/5.1	1.9 (50)	—	33	107	95	145
Morocco	66.5/26.7	63.9/10.8	1.8 (48)	14.1 (75)	131	128	80	106
Tunisia	29.6/38.6	28.0/21.0	0.9 (18)	11.7 (69)	60	69	30	84
RRLA	—	—	—	—	119.2	133.6	135.4	169.2
Algeria	25.4/21.5	21.3/15.9	0.7 (9)	1.5 (4)	135	136	124	156
Iran, Islamic Rep.	–/28.5	–/24.6	1.9 (49)	2.7 (14)	104	137	131	171
Iraq	–/–	–/–	—	—	156	153	179	210
Libya	–/0	–/0	—	—	137	—	—	161
Syrian Arab Republic	–/15.8	–/12.8	—	—	80	143	120	132
Yemen, Rep.	–/7.0	–/5.3	—	—	103	99	123	185
GCC	—	—	49.8	—	41	38.5	50	77
United Arab Emirates	–/4.7	–/4.2	3.6 (71)	3.5 (20)	24	33	3	76
Bahrain	–/7.7	–/3.9	2.6 (58)	3.3 (19)	32	20	33	77
Kuwait	–/3.1	–/4.2	—	—	36	61	113	73
Oman	8.2/4.9	5.1/3.7	1.4 (31)	3.1 (16)	60	65	87	66
Qatar	–/5.9	–/4.1	1.8 (47)	—	55	39	46	81
Saudi Arabia	11.8/3.0	12.4/4.1	1.7 (42)	2.6 (12)	39	13	18	89

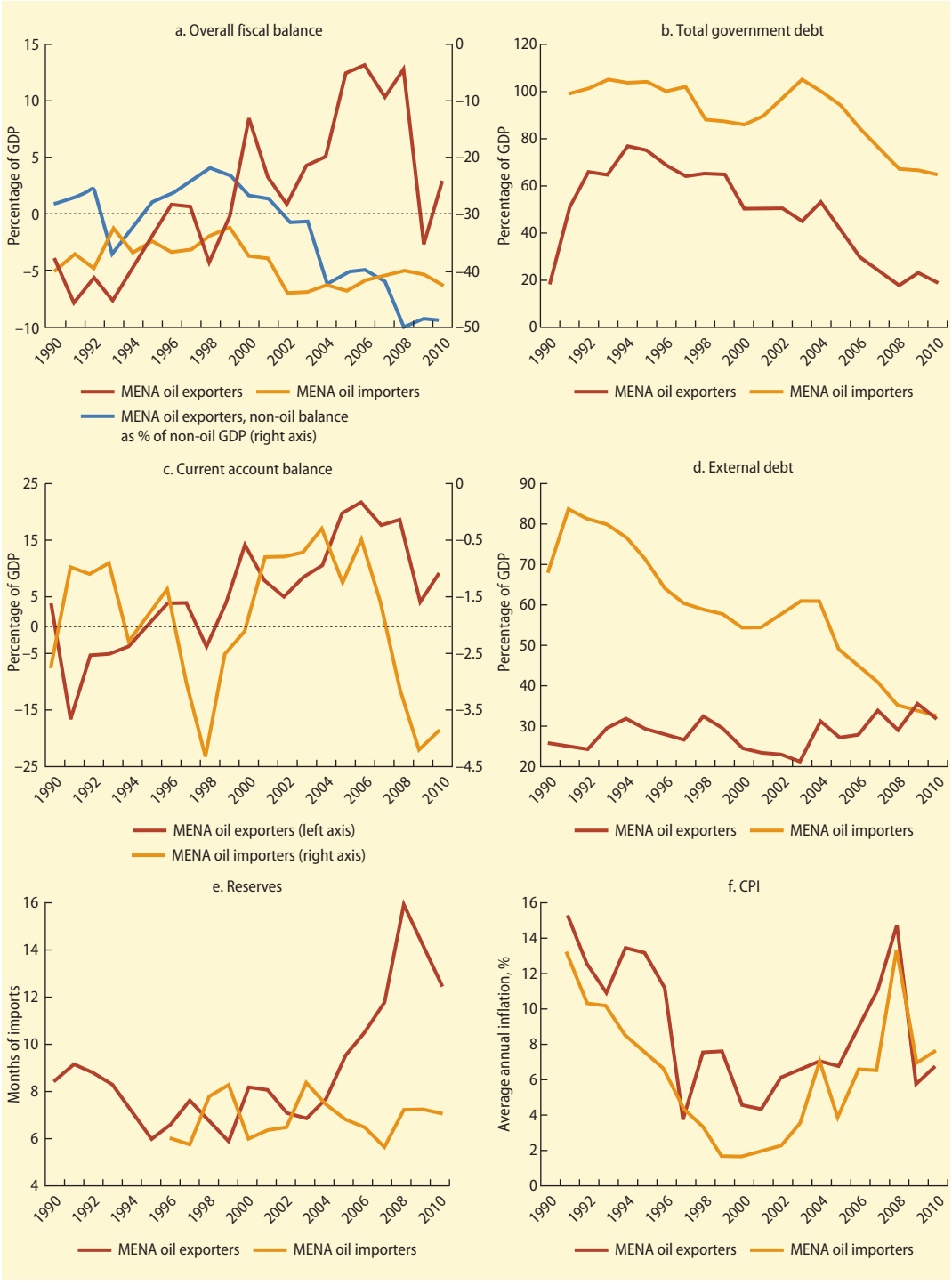
Sources: Columns 1–2, World Integrated Trade Solution (WITS), columns 3–5, World Trade Indicators; column 6, *Doing Business*; columns 7 and 8, World Governance Indicators.
Note: For all ranks, a higher value means a worse rank. — = not available. MENA = Middle East and North Africa; GCC = Gulf Cooperation Council; TAR-AGR = applied tariffs in agriculture; TAR-MAN = applied tariffs in manufacturing; RRLA = resource rich, labor abundant; RPLA = resource poor, labor abundant; OTRI= Overall Trade Restrictiveness Index; TTRI= Tariff-Only Trade Restrictiveness Index; LPI = Logistics Performance Index; DB = *Doing Business*.

FIGURE 3A.1 Intensive and extensive margins of exports, excluding oil products, in various world regions, 1997–2007



Source: Based on Comtrade.
Note: OECD = Organisation for Economic Co-operation and Development; GCC = Gulf Cooperation Council; RRLA = resource rich, labor abundant; RPLA = resource poor, labor abundant.

FIGURE 3A.2 Main trends in selected macroeconomic indicators for MENA since the 1990s



Source: IMF 2011.
Note: MENA = Middle East and North Africa; GDP = gross domestic product; CPI = consumer price index.

BOX 3A.1 Factors contributing to higher total factor productivity

The results of a growth accounting exercise for the MENA region show that physical and human capital has contributed at steady rates to output growth over the past three decades for most countries in the region. Output growth rates, however, varied significantly over time. As a result (and by construction), TFP, also known as the Solow residual, is highly volatile as it accounts for all the other unexplained factors that might lead to an increase in output growth. For a better understanding of what drives these changes in output growth rates, some of the factors that might contribute to a more productive use of inputs are pinpointed using the framework suggested by Benhabib and Spiegel (1994), which sees human capital as the main driver for technological progress (educational attainments are considered to promote domestic innovations on the one hand and the adoption of foreign technologies on the other).

The empirical results of this model[a] in MENA (table B3A.1.1) support this assumption. Human capital does not have a significant impact on TFP, suggesting that domestic innovations are not the driving force in productivity (column 4). Benhabib and Spiegel (1994) find similar results for low- and middle-income countries. Only in high-income countries are domestic innovations found to contribute significantly to productivity. Benhabib and Spiegel (1994) argue that for technologically advanced economies, domestic innovation is more effective than technology adoption from abroad. Likewise, less developed countries do not have the prerequisites for effective domestic innovation, and it is more efficient for them to adapt technologies from abroad. Allowing for a nonlinear relationship between TFP and the share of the working-age population with secondary or tertiary education shows that only after reaching a certain threshold of education (found at 64 percent of secondary and tertiary education) does its contribution through domestic innovations turn positive. The specification of column 5 includes an interaction term between the level of a country's development (approximated by GDP per capita) and the human capital variable, which tests whether human capital speeds up technology adoption. The results show that, holding the level of development constant, countries with a higher level of education can adapt technology faster and thus are better able to catch up with leading countries.

TABLE B3A.1.1 Correlates of total factor productivity growth

Log (TFP)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
L.log(TFP)	0.845***	0.900***	0.864***	0.820***	0.660***	0.810***	0.704***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.002)	(0.000)	(0.000)
L.log(GDP per capita)		−0.0362	−0.0137	0.0271	0.125	0.0288	0.0884
		(0.577)	(0.867)	(0.661)	(0.121)	(0.715)	(0.133)
L.Secondary+			−0.00107	−0.00561*	−0.00382***	−0.000450	−0.00406**
			(0.444)	(0.065)	(0.007)	(0.807)	(0.038)
L.Secondary+ sq.				0.0000434*	0.0000903**		
				(0.067)	(0.028)		
L.log(GDP per capita)* Secondary+					−0.00111*	−0.000241	−0.000859**
					(0.057)	(0.593)	(0.032)
L.Globalization						0.00204	−0.00288
						(0.208)	(0.107)
L.Global* Secondary+						0.000110**	(0.015)
Constant	0.956**	0.946***	0.902***	0.923**	1.141**	0.811**	1.217**
	(0.032)	(0.000)	(0.004)	(0.014)	(0.021)	(0.034)	(0.022)
Observations	288	285	269	269	269	257	257
R^2	0.841	0.861	0.857	0.862	0.872	0.847	0.861

Note: All specifications include fixed time and country effects. *P*-values in parentheses. GDP = gross domestic product; TFP = total factor productivity. * p < 0.1, ** p< 0.05, *** p< 0.01.

(continued next page)

BOX 3A.1 Factors contributing to higher total factor productivity *(continued)*

The insignificant coefficient on the measure of globalization (column 6) suggests no relationship between deeper globalization and a country's TFP growth. When the globalization variable interacts with the human capital variable, the effect of globalization intensity depends positively on the level of human capital (column 7). Given two countries with the same level of human capital, the one with the higher index of globalization is able to adopt more technology from abroad and thus, on average, has a higher TFP. Applying the same logic as in column 4, it is estimated that whenever the share of the working-age population with secondary or tertiary education exceeds approximately 26 percent (in the case of MENA countries),[b] globalization speeds up the process of technology adoption and thus increases TFP and ultimately output growth.

a. Data on GDP per capita are taken from the World Development Indicators. The share of secondary- and tertiary-educated individuals in the total working-age population (15–64) is obtained from the Barro and Lee (2010) dataset on educational attainment. The IIASA/VID Educational Attainment Model (Lutz et al. 2007) would be preferable, because the back projections are undertaken in a more sensitive manner, but the coverage of the MENA countries is slightly better in the Barro and Lee (2010) dataset. To measure the dimension of globalization, we use the KOF Index of Globalization (Dreher 2006) obtained from the Quality of Governance dataset (Teorell et al. 2011). This index accounts for the three main dimensions of globalization: (1) economic globalization, measured by flows of capital, goods and services; (2) political globalization, characterized by the diffusion of government policies; and (3) social globalization, which captures the spread of ideas, information, images, and people (Dreher 2006).

b. The GCC countries (in our sample, Bahrain, Kuwait, Saudi Arabia, and the United Arab Emirates) show the highest average level of educational attainment in the working-age population since the 1980s. However, while Bahrain had already reached the critical level of education in the mid-1990s, Saudi Arabia and the United Arab Emirates did so only in the past several years. Educational attainment in Kuwait is below the level necessary to positively contribute to productivity through the channel of domestic innovation. Since the 1980s, the average educational attainment in the Mashreq region (in our sample, Egypt, Jordan, Syria, and the Republic of Yemen) has clearly been below the GCC average; however, the sharp increase in educational attainment in Egypt and, in particular, Jordan enables the two countries to effectively adopt and implement new technologies. Syria and the Republic of Yemen both have educational levels that are insufficient for a positive contribution of domestic innovation to TFP. Concerning the Maghreb region, which is represented by Algeria, Morocco, and Tunisia in our sample, our model predicts that the level of human capital in those countries is not high enough to effectively innovate domestically.

Annex 3B Demographics

TABLE 3B.1 Population increase, net migration, and rate of population change in selected economies in MENA, mid-1980s–mid-2000s

Economy group	Economy	Rate of natural increase in population (%)			Net migration rate (%)			Average annual rate of population change (%)		
		1985–90	1995–2000	2005–10	1985–90	1995–2000	2005–10	1985–90	1995–2000	2005–10
GCC	Bahrain	4.1	2.9	2.6	6	7	90	3.3	2.6	11.1
GCC	Kuwait	3.3	2.9	2.3	12	14	22	3.6	3.5	3.8
GCC	Oman	7.9	4.5	2.5	1	–20	12	3.9	0.3	2.7
GCC	Qatar	4.5	3.3	2.4	27	16	133	5.1	3.3	15.2
GCC	Saudi Arabia	6.2	4.5	3.0	7	–9	8	4.0	1.6	2.7
GCC	United Arab Emirates	4.8	3.0	1.9	33	35	106	5.9	5.1	12.3
GCC economy average		*5.1*	*3.5*	*2.5*	*14.3*	*7.2*	*61.8*	*4.3*	*2.7*	*8.0*
Low-income	Djibouti	6.4	5.1	4.0	37	9	0	6.7	3.1	1.9
Low-income	Yemen, Arab Rep.	8.9	7.0	5.5	–1	–1	–1	4.0	3.1	3.1
Low-income economy average		*7.7*	*6.0*	*4.7*	*18.0*	*4.0*	*–0.5*	*5.4*	*3.1*	*2.5*
Iraq	Iraq	6.2	5.4	4.9	–8	0	–1	2.3	3.2	2.9
Mashreq	Jordan	6.4	4.3	3.3	8	–8	7	4.0	1.9	2.9
Mashreq	Lebanon	3.3	2.7	1.9	–15	0	–1	0.4	1.6	0.8
Mashreq	Syrian Arab Republic	5.9	4.0	3.1	–3	–2	–1	3.1	2.4	2.0

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TABLE 3B.1 Population increase, net migration, and rate of population change in selected economies in MENA, mid-1980s–mid-2000s *(continued)*

Economy group	Economy	Rate of natural increase in population (%)			Net migration rate (%)			Average annual rate of population change (%)		
		1985–90	1995–2000	2005–10	1985–90	1995–2000	2005–10	1985–90	1995–2000	2005–10
Mashreq economy average		*5.2*	*3.7*	*2.7*	*–3.3*	*–3.3*	*1.7*	*2.5*	*2.0*	*1.9*
Maghreb	Algeria	5.3	2.9	2.4	–1	–1	–1	2.7	1.5	1.5
Maghreb	Libyan Arab Jamahiriya	5.7	3.3	2.7	–1	–1	–1	2.4	1.8	1.9
Maghreb	Morocco	4.5	3.0	2.4	–2	–4	–4	2.1	1.3	1.0
Maghreb	Tunisia	4.1	2.3	2.0	–1	–1	0	2.3	1.1	1.1
Maghreb economy average		*4.9*	*2.9*	*2.4*	*–1.3*	*–1.8*	*–1.5*	*2.4*	*1.5*	*1.4*
Egypt, Arab Rep.	Egypt, Arab Rep.	4.8	3.5	2.9	–2	–3	–1	2.3	1.7	1.8
	Israel	3.1	2.9	2.9	3	9	8	1.9	2.4	2.3
	Malta	2.1	1.8	1.3	–4	5	–5	1.0	0.6	0.4
	West Bank and Gaza	6.4	5.8	4.7	1	2	1	3.4	4.2	2.6

Source: UN Population Information Network.
Note: Variables are defined in table 3A.2.2. GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

TABLE 3B.2 Demographic variables defined

Variable	Definition
Population	De facto population in a country, area, or region as of 1 July of the year indicated. Figures are presented in thousands.
Population by sex	De facto population as of 1 July of the year indicated classified by sex (male, female, both sexes combined). Data are presented in thousands.
Population sex ratio	Number of males per 100 females in the population.
Median age	Age that divides the population in two parts of equal size; that is, there are as many persons with ages above the median as there are with ages below the median.
Population change	Population increment over a period; that is, the difference between the population at the end of the period and that at the beginning of the period. Refers to five-year periods running from 1 July to 30 June of the initial and final years. Data are presented in thousands.
Population growth rate	Average exponential rate of growth of the population over a given period. It is calculated as ln(Pt/P0)/t, where t is the length of the period. It is expressed as a percentage.
Rate of natural increase	Crude birth rate minus the crude death rate. Represents the portion of population growth (or decline) determined exclusively by births and deaths.
Crude birth rate	Number of births over a given period divided by the person-years lived by the population over that period. It is expressed as number of births per 1,000 population.
Crude death rate	Number of deaths over a given period divided by the person-years lived by the population over that period. It is expressed as number of deaths per 1,000 population.
Net reproduction rate	The average number of daughters a hypothetical cohort of women would have at the end of their reproductive period if they were subject during their whole lives to the fertility rates and the mortality rates of a given period. It is expressed as number of daughters per woman.
Total fertility	The average number of children a hypothetical cohort of women would have at the end of their reproductive period if they were subject during their whole lives to the fertility rates of a given period and if they were not subject to mortality. It is expressed as children per woman.
Mean age at childbearing	The mean age at childbearing is the mean age of mothers at the birth of their children if women were subject throughout their lives to the age-specific fertility rates observed in a given year.
Life expectancy by sex	The average number of years of life expected by a hypothetical cohort of individuals who would be subject during all their lives to the mortality rates of a given period. It is expressed as years.
Net migration rate	The number of immigrants minus the number of emigrants over a period, divided by the person-years lived by the population of the receiving country over that period. It is expressed as net number of migrants per 1,000 population.
Net migration	Net number of migrants; that is, the number of immigrants minus the number of emigrants. It is expressed in thousands.
Sex ratio at birth	Number of male births per one female birth.

Source: World Bank.

TABLE 3B.3 Reproduction rates and average annual population growth in selected economies in MENA, mid-1980s–mid-2000s

Economy group	Economy	Total fertility rate (%)			Adult mortality rate (%)			Net reproduction rate (%)			Average annual population growth (%)		
		1985–90	1995–2000	2005–10	1985–90	1995–2000	2005–10	1985–90	1995–2000	2005–10	1985–90	1995–2000	2005–10
GCC	Bahrain	4.1	2.9	2.6	106.6	90.7		1.9	1.4	1.3	3.3	2.6	11.1
GCC	Kuwait	3.3	2.9	2.3	96.8	89.7		1.6	1.4	1.1	3.6	3.5	3.8
GCC	Oman	7.9	4.5	2.5	128.5	120.4		3.5	2.1	1.2	3.9	0.3	2.7
GCC	Qatar	4.5	3.3	2.4	82.5	67.6		2.1	1.6	1.2	5.1	3.3	15.2
GCC	Saudi Arabia	6.2	4.5	3.0	153.4	123.4		2.8	2.1	1.4	4.0	1.6	2.7
GCC	United Arab Emirates	4.8	3.0	1.9	121.7	85.7		2.3	1.4	0.9	5.9	5.1	12.3
GCC economy average		5.1	3.5	2.5	114.9	96.3		2.4	1.7	1.2	4.3	2.7	8.0
Low-income	Djibouti	6.4	5.1	4.0	347.6	315.0		2.3	1.9	1.6	6.7	3.1	1.9
Low-income	Yemen, Rep.	8.9	7.0	5.5	283.9	222.1		3.4	2.8	2.4	4.0	3.1	3.1
Low-income economy average		7.7	6.0	4.7	315.8	268.6		2.9	2.4	2.0	5.4	3.1	2.5
Mashreq	Jordan	6.4	4.3	3.3	142.2	126.2		2.9	2.0	1.5	4.0	1.9	2.9
Mashreq	Lebanon	3.3	2.7	1.9	149.9	130.6		1.5	1.3	0.9	0.4	1.6	0.8
Mashreq	Syrian Arab Republic	5.9	4.0	3.1	119.8	97.9		2.7	1.9	1.5	3.1	2.4	2.0
Mashreq economy average		5.2	3.7	2.7	137.3	118.3		2.4	1.7	1.3	2.5	2.0	1.9
Maghreb	Algeria	5.3	2.9	2.4	151.6	120.6		2.3	1.3	1.1	2.7	1.5	1.5
Maghreb	Libyan Arab Jamahiriya	5.7	3.3	2.7	151.0	120.1		2.6	1.5	1.3	2.4	1.8	1.9
Maghreb	Morocco	4.5	3.0	2.4	155.4	125.3		1.9	1.3	1.1	2.1	1.3	1.0
Maghreb	Tunisia	4.1	2.3	2.0	119.5	101.6		1.9	1.1	1.0	2.3	1.1	1.1
Maghreb economy average		4.9	2.9	2.4	144.4	116.9		2.1	1.3	1.1	2.4	1.5	1.4
Iraq	Iraq	6.2	5.4	4.9	128.5	177.6		2.7	2.4	2.2	2.3	3.2	2.9
Egypt, Arab Rep.	Egypt, Arab Rep.	4.8	3.5	2.9	169.2	119.6		2.0	1.6	1.3	2.3	1.7	1.8
	Israel	3.1	2.9	2.9	80.5	65.5		1.5	1.4	1.4	1.9	2.4	2.3
	Malta	2.1	1.8	1.3	81.7	68.4		2.9	2.7	2.2	1.0	0.6	0.4
	West Bank and Gaza	6.4	5.8	4.7	150.2	129.5		1.0	0.9	0.6	3.4	4.2	2.6

Source: UN Population Information Network.
Note: Variables are defined in table 3A.2.2. MENA = Middle East and North Africa; IDA = International Development Association; GCC = Gulf Cooperation Council.

Notes

1. Intraregional migration flows are very important in the region. According to the International Organization for Migration, out of 13.0 million Arab migrants in the world, 5.8 million reside in Arab countries. Migration contributes to the circulation of financial and human capital within the region. Remittances sent to Egypt, Jordan, and Lebanon from other Arab countries are 40–190 percent higher than trade revenues between these and other Arab countries.
2. During that decade, MENA realized the highest rates of growth in the world in both physical and human capital, but the efficiency in using these inputs declined. Algeria's rate of physical capital accumulation almost quadrupled between the 1960s and the 1970s, but TFP growth went from 1.9 percent per year to –0.7 percent. Jordan tripled its rate of physical capital accumulation, but TFP growth declined by 40.0 percent (from 2.8 percent per year to 1.7 percent). Morocco doubled its rate of accumulation, but TFP growth fell from 1.8 percent per year to –0.3 percent per year. In the Gulf, Saudi Arabia's doubling of its physical capital accumulation was accompanied by a decline in average annual TFP growth from 4.7 percent in the 1960s to zero in the 1970s (Keller and Nabli 2002; rates are per laborer).

3. The largest increase in intraregional aid occurred in the 1970s, followed by a sharp decline in the following decade. Between 1973 and 1986, Arab countries were the largest donors to the Arab region. In 1980, inter-Arab overseas development aid flows reached a maximum of some US$9 billion, accounting for almost 60 percent of total overseas development aid flows to Arab countries at that time. In absolute terms, during the 1970s, the Arab countries provided almost 3.5 times as much bilateral aid as the next highest donor group and 1.5 times more aid than all other donors combined. The strong rise in oil prices during the 1970s led to increased investment flows from the countries of the GCC to the rest of the region and to a surge in workers' remittances attributed to lower oil revenues and an increased tendency of oil-rich countries to invest in their own infrastructure projects (see UN 2007).
4. In per capita terms, the growth rate of capital stock was cut by almost three quarters.
5. See table B3A.1.1 in annex 3A.
6. A group of resource-poor countries, including Morocco and Tunisia, followed by Egypt and Jordan, implemented earlier and more intensive reforms toward more open and private sector–led economies than the rest of the countries of the region. Other reformers, including Algeria, the Islamic Republic of Iran, and Syria (all resource-rich countries) also pursued reforms but later on, more gradually, and more sporadically than the early reformers. Algeria, for instance, with macroeconomic imbalances stemming from the collapse in oil prices, aggressively pursued macroeconomic stabilization, but structural reforms have been far more limited. Early on, the GCC managed to achieve an open trade system with free movement of capital and advanced financial systems. Some of the smaller GCC countries encouraged growth in selected sectors such as financial services and tourism (Bahrain and the United Arab Emirates). Oman made substantial efforts to broaden private sector participation and improve the foreign investment climate, with privatizations and changes in its foreign capital investment law. In Saudi Arabia, reforms began later and progressed more slowly.
7. MENA became more open as a region, as average protection, which started from higher averages than competitors, fell more rapidly than elsewhere, with the region's average applied most-favored nation tariff rate falling by a third over 2000–07, to 15 percent.
8. MENA countries also expanded the reach of export markets during the 2000s, as shown by the sharp increase in existing exports to new markets (see figure 3A.1 in annex 3.1).
9. See Diop, Marotta, and DeMelo (2012).
10. This trend is captured by the relatively strong, positive correlation between the pace of employment creation, as given by the employment growth elasticities, and informality rates in MENA in the 2000s.
11. According to a recent report by the World Bank (2012b), the average country in the region produces about one-third of its GDP and employs two-thirds of its labor force informally.
12. As recently argued in World Bank (2011).
13. The latter are, however, not reviewed in this chapter.
14. Defined as a period of unemployment decline of at least three percentage points and at least a quarter of its initial level over a four-year period that persists for at least another three years.
15. The observations reported below refer to well-known and widely accepted policy recommendations for the region, and it is by no means an exhaustive list. As there is no "one-size-fits-all" policy option, policies need to be tailored to individual countries' needs; yet common issues across the region can be raised and addressed.
16. Defined as the standard deviation of the REER, this is about four times higher in MENA than in countries belonging to the high-income group (see table 3A.2 in annex 3.1).
17. For a more detailed discussion of the role of REER in MENA, see Diop, Marotta and DeMelo (2012).
18. This is due to a lack of political incentives or institutions that impose constraints on policy makers (Elbadawi and Soto 2011; Ross 2012). There is no fiscal rule in any country of MENA. The political economy of the MENA countries could be a major reason for the lack of a fiscal rule, owing to the limited political accountability in most MENA countries.
19. See World Economic Forum and OECD (2005) and World Bank (2012c).
20. Chapter 2 of Diop, Marotta, and DeMelo (2012) presents a series of policy indicators affecting trade that show the region is lagging in global integration. For further information on how, despite recent trade integration reforms,

MENA did not succeed in fully exploiting the benefits of participating in global production networks, increasing global trade in services, and regional integration, see Lopez-Calix, Walkenhorst, and Diop (2010) and World Bank (2003).

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Privileges, not Competition: The Dynamics of the Private Sector in the Middle East and North Africa

4

Main findings

- The process of creative destruction is attenuated in MENA, limiting productivity growth. This is reflected in a suboptimally small private sector, skewed toward unproductive small-scale activities.
- The lack of dynamism, which is also manifested in low rates of firm entry and exit as well as in lower growth of incumbent firms, comes at a significant cost in terms of employment.
- Distortive policies, such as subsidies on fuel and high taxes on labor, depress the demand for labor and simultaneously stifle incentives to innovate.
- Burdensome business regulations are often used as a means to redistribute rents rather than to catalyze creative destruction. Their implementation is discretionary and inconsistent, resulting in an uneven access to key inputs, such as credit, licenses, permits, customs clearing, and the like.
- The ensuing uncertainty in policy implementation hampers investment and job creation, especially of those high-value-added jobs to which the increasingly educated youth in MENA aspire.

MENA's lack of economic dynamism

Two features of MENA economies seem to be at the root of the private sector's lackluster performance in job creation: (1) MENA's inability to diversify into higher productivity activities, and (2) the lack of creative destruction; that is, the dynamic process of reallocation from lower to higher productivity activities.

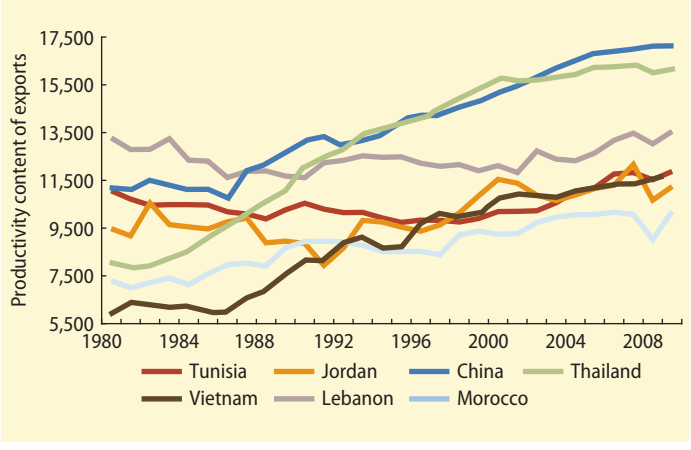
Lackluster performance in higher-value-added activities

While on average, private investment rates in the Middle East and North Africa (MENA) lag behind comparator economies, up to the time of the economic crisis a few countries—including the Islamic Republic of Iran, Jordan, Lebanon, Morocco, and Tunisia—had achieved investment rates comparable to China and Turkey. Yet, even these countries

failed to create sufficient productive employment for skilled labor in manufacturing and services, attesting to the region's lack of success in diversifying into higher-productivity activities.

Rather than the *quantity*, the *quality* of private investments appears to be lacking in these countries. For example, the investment inflows into MENA countries are often neither technology nor skills intensive. Figure 3.16 in chapter 3 disaggregates foreign direct investment (FDI) stocks into the main economic sectors. Despite some of the highest FDI inflows in the world in some countries (Jordan and Lebanon), FDI inflows are biased toward low-value-added service sectors (often reflecting real estate investments from countries in the Gulf Cooperation Council, or GCC), which typically have very low potential for technology spillovers. In contrast, FDI inflows into China or the European Union are concentrated in manufacturing or higher-technology services, which potentially facilitate foreign technology and knowledge transfers. This process of integration into the global economy through foreign technology adoption has been essential to high and sustained growth in total factor productivity (TFP) and facilitated moving up the value chain.

FIGURE 4.1 Evolution of the productivity content of exports in selected regions and countries in Asia and MENA, 1980–2009

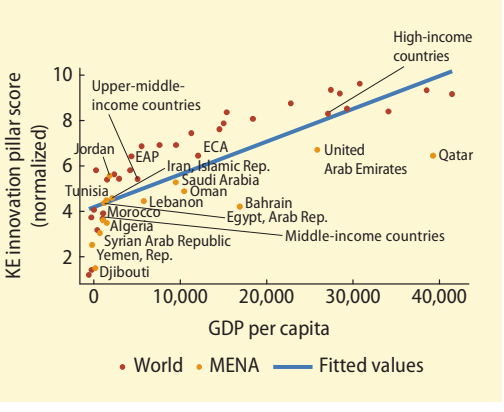


Source: Based on Comtrade data.
Note: MENA = Middle East and North Africa.

The evidence also shows that, compared to firms in fast-growing East Asian countries, firms in MENA are slow in diversifying their exports into higher-productivity goods.[1] Figure 4.1 illustrates the evolution of the productivity content of exports over time in Jordan, Lebanon, Morocco, and Tunisia relative to selected East Asian countries. The productivity content in all four countries has increased somewhat since the 1990s. Nevertheless, the region's evolution appears stagnant compared to the increases observed in China, Thailand, and Vietnam. For instance, Thailand's export sophistication index was comparable to Morocco's in the early 1980s but exceeded those of Jordan, Morocco, and Tunisia by almost 50 percent in 2008.[2]

These dynamics are also reflected in the low generation and use of knowledge in the production processes across the MENA region. Overall, MENA countries innovate less than other countries at similar levels of development. This is illustrated in figure 4.2, which plots the World Bank knowledge economy score on innovation; this score proxies the degree of production and use of knowledge against gross domestic product (GDP) per capita.[3] Moreover, even among the highest

FIGURE 4.2 Knowledge economy innovation score and GDP per capita for selected world regions and countries in MENA, 2009



Source: Knowledge Economy Innovation Score and World Development Indicators.
Note: GDP = gross domestic product; EAP = East Asia and the Pacific; ECA = Europe and Central Asia; GDP = gross domestic product; KE = knowledge economy; MENA = Middle East and North Africa.

performers in the region (Jordan, Qatar, and the United Arab Emirates), most research and development are publicly financed rather than driven by the private sector (figure 4.2).

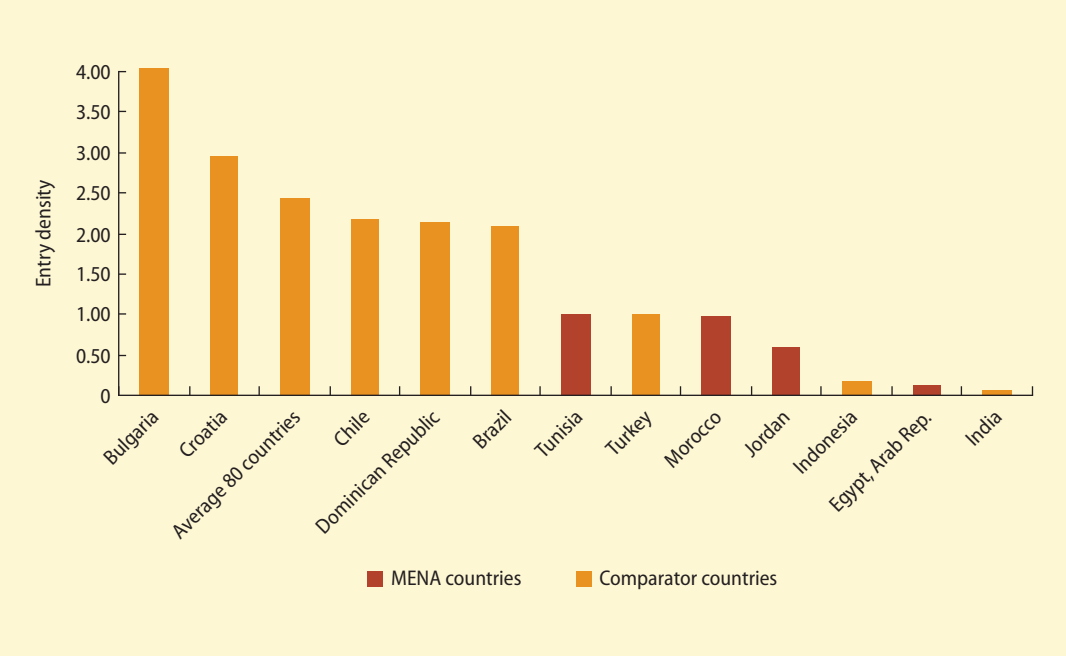
Lack of creative destruction

A dynamic process of creative destruction underpinned technological upgrading in fast-growing East Asian and Eastern European economies.[4] In these countries, resources were reallocated toward more productive uses among existing firms as well as from exiting to entering firms. In contrast, firm dynamics in the MENA region are stagnant. The region experiences lower firm entry and exit as well as lower growth of incumbent firms than relevant comparator countries in other parts of the world. This low turnover significantly limits the scope for creative destruction.

Figure 4.3 shows that the Arab Republic of Egypt, Jordan, Morocco, and Tunisia have some of the lowest densities of firm entry among emerging economies. Entry densities are measured by the average yearly number of newly registered limited liability firms per 1,000 working-age people (between ages 15 and 64) in the period 2004–09. In this sample, almost two-thirds of the 80 emerging countries for which data are available had a higher entry density than the two best performers in non-GCC countries in MENA: Morocco and Tunisia. For instance, with a working-age population comparable to Jordan's, Croatia's number of newly registered firms was five times higher than Jordan's.

A lack of turnover is also manifested in lower firm exit. Figure 4.4 illustrates entry and exit rates among Moroccan manufacturing firms. The average annual exit rate for manufacturing firms is 5.1 percent over the sample period, which is substantially lower than exit rates documented in other developing countries; for instance, in Chile and Colombia, exit rates have been measured as

FIGURE 4.3 **Average entry density for selected emerging economies, 2004–09**

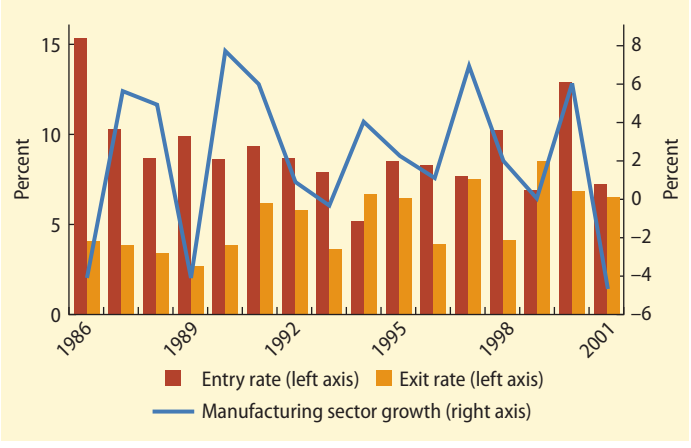


Source: Klapper and Love 2010.
Note: Entry density = the number of newly registered limited liability firms per 1,000 working-age people (those between ages 15 and 64). The average of 80 countries represents the average entry density in the 80 developing countries for which data are available. MENA = Middle East and North Africa.

amounting to about 11.0 and 12.0 percent, respectively.

Moreover, the results from a census of firms in Morocco and Tunisia show that employment growth stagnates in incumbent firms: few firms grow so that small firms stay small. In particular, table 4.1 documents transitions of firms among crude size categories in Morocco and Tunisia. Even after 10 years, one-person, microfirms, and small firms are extremely unlikely to have become large firms. In addition, very few microfirms graduate into the small size category.

FIGURE 4.4 Firm turnover and sector growth in Moroccan manufacturing, 1986–2001



Source: Bartelsman, Haltiwanger, and Scarpetta 2004.
Note: The total firm turnover is the entry rate plus exit rate. The entry rate is defined as the number of new firms divided by the total number of incumbents and entrant firms producing in a given year. The exit rate is defined as the number of firms exiting the market in a given year divided by the population of origin; i.e., the incumbents in the previous year.

Furthermore, table 4.1 shows that the smallest firms are also the most likely to exit. As a result, the two countries have relatively many small firms despite comparatively low entry rates because firms tend to enter small and not grow. This lack of economic dynamism is at the root of MENA's unemployment problem: firms fail to create enough new jobs to absorb a rapidly growing labor force.

In contrast, firm dynamics in competitive economies are typically characterized by an "up-or-out" pattern: firms that are successful enough to stay in business grow, while the least productive ones exit. A comparison of average firm size by age in Brazil and Jordan illustrates the lack of that dynamic in MENA countries; firms start out larger in Jordan but grow more slowly over time, such that firms in Brazil are about twice as large after 10 years in operation (figure 4.5).[5]

Competition is a catalyst in the process of creative destruction, which, in turn, is crucial for productivity growth and hence employment creation. In particular, industries that are *contestable*—that is, in which firms can enter and challenge incumbents—tend to exhibit much more rapid productivity improvements, not only because more productive firms are entering the market but also because the *threat of entry* itself serves as a disciplining device, forcing incumbents to innovate more rapidly. Figures 4.6 and 4.7 show that across industries in a sample of 24 industrial and developing countries, the contribution of entrants to aggregate

TABLE 4.1 Mobility among size categories for firms in Morocco and Tunisia, 1996–2010

Long-term transition matrix, percentages										
Tunisia: all private firms 2000–10 (excluding cooperatives) Status in year *t* + 10						Morocco: manufacturing only, 1996–2006 Status in year *t* + 10				
Status in year *t* (baseline)	Exited	1-person firm	Micro firm	Small firm	Large firm	Status in year *t* (baseline)	Exited firm	Micro firm	Small firm	Large firm
1-person firm	30.8	65.5	3.4	0.3	0.0					
Micro firm	19.0	41.2	37.0	2.8	0.1	Micro firm	52.1	36.5	11.3	0.1
Small firm	14.8	28.4	14.0	39.5	3.3	Small firm	44.6	9.5	41.2	4.8
Large firm	15.8	23.3	2.9	15.2	42.7	Large firm	40.7	0.6	12.9	45.9

Source: Rijkers and Arouri 2012.
Note: Microfirms = 2–9 employees; small firms = 10–99 employees; large firms = 100 or more employees. In Morocco, the microcategory also contains one-person firms, but there are only a few (the data include only firms whose turnover exceeds a specific threshold).

productivity growth is strongly correlated with the contribution of incumbents to aggregate productivity growth (figure 4.6). Moreover, in industries with more firm turnover, both (surviving) incumbents (figure 4.7a) and (surviving) entrants (figure 4.7b) tend to increase productivity faster. This process of creative destruction is lacking in MENA.

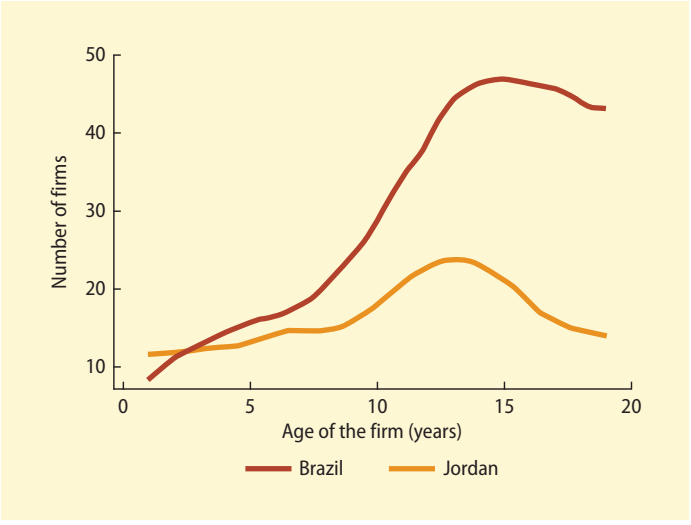
Although the average private sector performance in MENA is not rosy, aggregate statistics obscure some significant success stories. Many of the region's successful entrepreneurs, however, come from the highest political and country leadership spheres.[6] In some countries, this factor is transparent and highly visible. In others, networks of businessmen allied with the ruling elites of society, the military, or politicians dominate the private sector. Although such ties are not always sufficient for success, they can often get things started in a heavily regulated environment. High entry barriers protecting monopolies, privileged positions in highly regulated sectors, preferential access to large public procurement contracts, and other noncompetitive practices have made some of the region's most publicized and spectacular successes possible.

Overall, the lack of firm turnover is a symptom of a discriminatory business environment that prevents unproductive incumbents from going out of business and limits incentives for innovation, thereby undermining the process of creative destruction. The following section shows that this lack of economic dynamism in MENA takes a significant toll on employment, in particular on skilled labor.

Firm dynamics and employment creation

The private sector in MENA countries is suboptimally small and skewed toward unproductive small-scale activities. Figure 4.8 depicts the firm-size distribution of formal enterprises in Tunisia, which is overwhelmingly populated by one-person businesses.[7] The figure also illustrates that the few existing large firms tend to account for a disproportionate share of employment.

FIGURE 4.5 Relationship between firm size and age in Brazil, 2009, and Jordan, 2006



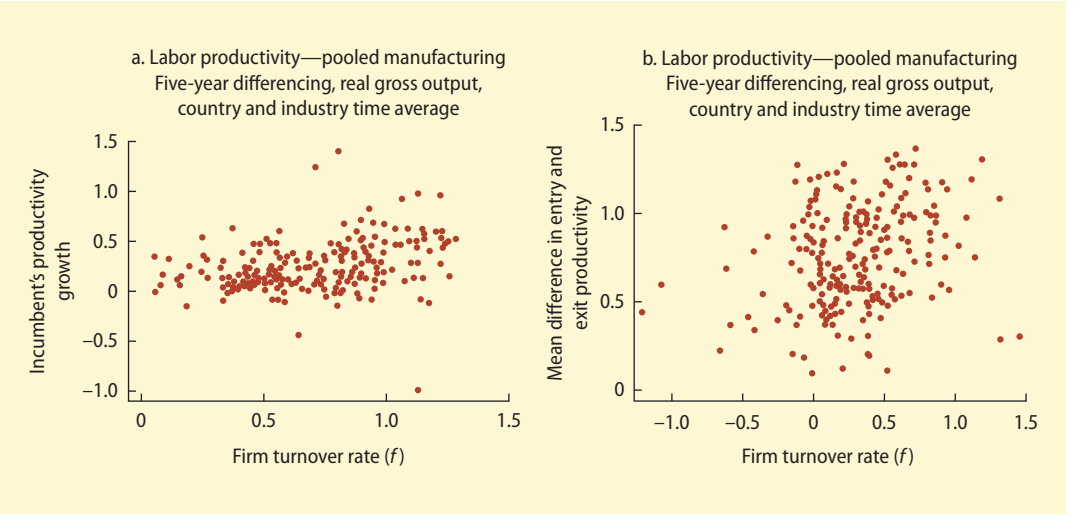
Source: Based on Enterprise Surveys in Jordan (2006) and Brazil (2009).
Note: Data apply to private domestic firms only.

FIGURE 4.6 Relationship between the contribution of net entry and incumbents to productivity growth

Source: Bartelsman, Haltiwanger, and Scarpetta 2004.
Note: Data exclude Brazil, República Bolivariana de Venezuela, and outliers.

While micro and small firms typically grow very little if at all in MENA countries, the literature on firm growth suggests that, in more competitive economies, younger and smaller firms have higher employment growth rates than older and larger firms (see, for example, Ayyagari, Demirguc-Kunt,

FIGURE 4.7 Firm turnover and productivity growth in 24 industrial and developing countries, various years, 1979–2000



Source: Bartelsman, Haltiwanger, and Scarpetta 2004.
Note: Data exclude Brazil, R. B. de Venezuela, and outliers.

FIGURE 4.8 Distribution of firms in Tunisia by size and share of employment, 1997–2009

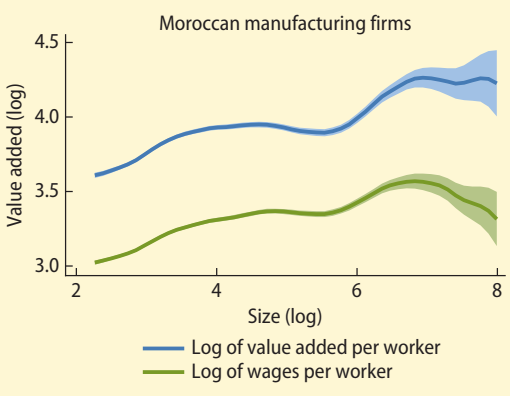
Source: Repertoire National des Entreprises Tunisien (statistics provided by the Institut National de la Statistique, Tunisia).
Note: Data cover all formal private firms except cooperatives.

Maksimovic 2011; Hall 1987; Hart and Oulton 1996; Mansfield 1962). Haltiwanger, Jarmin, and Miranda (2010) have given nuance to these findings, showing that net employment growth is associated with firm age rather than firm size in the United States. Young firms appear to be the driver of job creation; in particular, the authors show that firm startups contribute substantially to net job creation. However, this engine stalls if firm entry is obstructed or if the privileges of mature incumbents inhibit the growth opportunities of young firms by excluding their access to competitive regulatory services, land, or credit.

The importance of enabling firm growth is illustrated in figure 4.9, showing that larger firms both have higher labor productivity and pay higher wages in Morocco. They also tend to hire more skilled workers. These findings highlight the importance of creating an enabling environment in which firms can grow, exploit economies of scale, and create well-paid jobs. Conversely, economic structures or policies discriminating against young (small) firms, owing to their lack of influential connections, reduce their opportunities to grow and hence reduce the scope for productive private sector job creation.

Most microeconomic studies also find a positive relation between innovation and employment creation.[8] In this regard, it is

FIGURE 4.9 Labor productivity, wages, and firm size in Moroccan manufacturing, 1996–2006



Source: Ministry of Industry, Trade, and New Technologies (Morocco).

useful to distinguish between product and process innovation. Product innovation is generally found to increase labor demand and hence firm-level employment growth. Process innovation is associated with productivity growth, which might reduce the demand for labor in the short term. Indeed, the findings for process innovation are less clear-cut and also indicate job destruction in some cases (see, for example, Hall, Lotti, and Mairesse 2008; Harrison et al. 2008).

Product and process innovation in developing countries takes the form of diversification into new products and the adoption of foreign technologies (or organizational structures), respectively. Both processes have been found to increase the demand for skilled labor. Conte and Vivarelli (2010), Hanson and Harrison (1999), and Fuentes and Gilchrist (2005) find that imported skill-biased technological change through foreign technology adoption has been an important determinant of the recent increase in the relative demand for skilled labor in developing countries. As these findings suggest, a dynamic private sector that enables foreign technology adoption or diversification into new products is essential to create new jobs that can absorb the large number of university graduates in MENA countries.

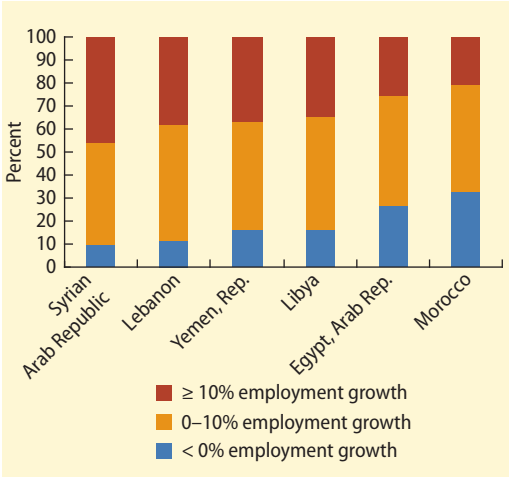
A relatively recent finding in the literature that links employment growth to firm dynamics extends these results by suggesting that a small group of fast-growing firms, often referred to as *gazelles*, are the main drivers of employment creation. That is, a handful of firms experience high employment growth while most other firms hardly grow at all (see Bottazzi et al. 2007). This small group of high-growth firms experiences a period of accelerated growth that levels off over time, leading to a "tent-shaped" distribution of employment growth rates. This pattern has been confirmed in various countries, industries, and years, making it a robust feature of the firm growth process (Coad and Hoelzl 2010).[9] Thus, a few rapidly growing firms create most of the new jobs.[10]

Found in all industries, gazelles are usually young firms that are more innovative and take more risk. There is no evidence that gazelles cluster in specific industries, but, if anywhere, they tend to be overrepresented in knowledge-intensive service industries (Henrekson and Johansson 2010), and they tend to rely more on innovation for their growth (Goedhuys and Sleuwaegen 2009).

The few existing high-growth firms in MENA are more likely to innovate, consistent with the findings from other regions. Stone and Badawy (2011) use World Bank Enterprise Surveys to identify firms with 10 percent or more employment growth in MENA countries. The authors find that these firms are more likely to innovate (58 percent of fast-growing firms reported innovating, compared to only 39 percent of slower-growing firms); to offer formal training to their employees (32 percent versus 18 percent); to use e-mail and have a website; to have an international quality certification (for example, ISO 9000); to have a workforce in which 5 percent or more received a tertiary education; and to be located in Lebanon, Libya, the Syrian Arab Republic, or the Republic of Yemen as opposed to Egypt or Morocco (figure 4.10).

In sum, these findings suggest that young firms have the highest potential to create new jobs in MENA, in particular for skilled labor.

FIGURE 4.10 Employment growth in selected countries in MENA, 2007–10



Source: Stone and Badawy 2011.
Note: MENA = Middle East and North Africa.

During their expansion, these firms tend not only to create employment but also to demonstrate economic dynamism by adopting new technologies and processes or by diversifying into new products. However, so far, such firms are rare in MENA economies.

Explaining the lack of economic dynamism in MENA

The following sections document how policy distortions—including burdensome business regulation and their inconsistent implementation as well as energy subsidies that distort relative input prices—depress the demand for labor. MENA's performance is benchmarked against that of dynamic emerging economies in other regions.

Energy subsidies depress the demand for labor

One reason for MENA's lackluster performance in generating jobs is that labor taxes and subsidies on other inputs, such as energy, increase the relative cost of labor and limit its demand. High energy subsidies in Arab countries continue to distort price signals, resulting in a misallocation of investments toward energy-intensive industries. In turn, this misallocation has discouraged investments in labor-intensive industries and hence has limited job creation. As a result, economies in the Arab world are among the most energy-intensive in the world (figure 4.11).

Energy-intensive production is associated with large investments in capital. Figure 4.12 compares the capital intensity in Egyptian and Turkish firms in selected sectors and shows how in some manufacturing (textiles and garment, food products, and chemicals), firms in Egypt are more capital intensive than firms in Turkey,[11] despite Turkey's higher GDP per capita.

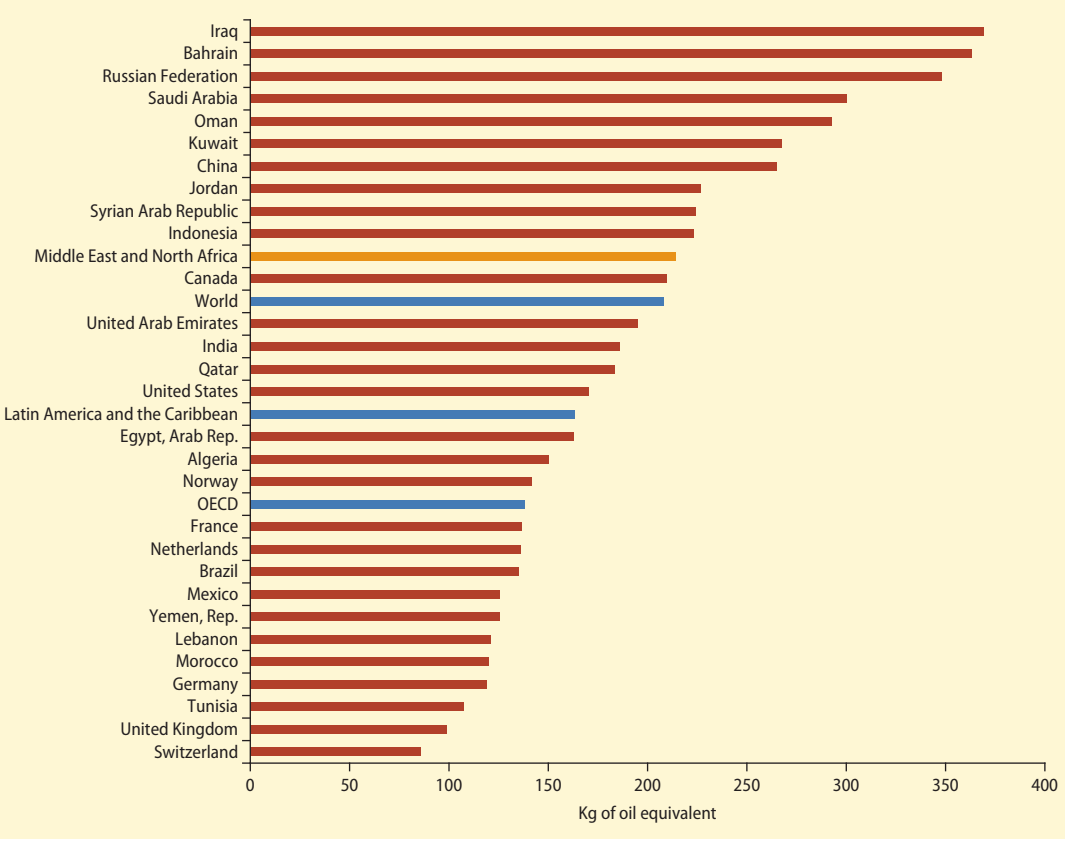
Fuel subsidies are disadvantageous not only because they repress the demand for labor but also because they suppress incentives to innovate, thereby impeding productivity growth, which is a crucial determinant of long-run labor demand. They tend to benefit older and publicly owned firms disproportionately, which in turn are likely to use more outdated technologies and consequently to use more energy (see, for example, figure 4.13, which depicts the kernel density of energy use in Egypt by firm age and ownership). In benefiting less efficient firms, subsidies not only distort the demand for labor but also repress market forces that would push older and public firms to innovate and improve energy efficiency to remain competitive.

Moreover, subsidies are fiscally very costly. For the year 2010, they have been estimated to account on average for about 9 percent of GDP in MENA countries (Silva et al. 2013). Their removal could pay a double dividend in employment creation if (some of) the freed-up fiscal space were used to reduce labor taxation, which may affect the demand for labor.

A business environment that maintains privilege

On average, MENA economies rank average in overall business environment—on par with China; worse than, say, Turkey but better than Brazil or Indonesia. A comparison of the scores of MENA countries in

FIGURE 4.11 Energy use per US$1,000 of GDP in selected countries and regions, 2010
constant 2005 PPP

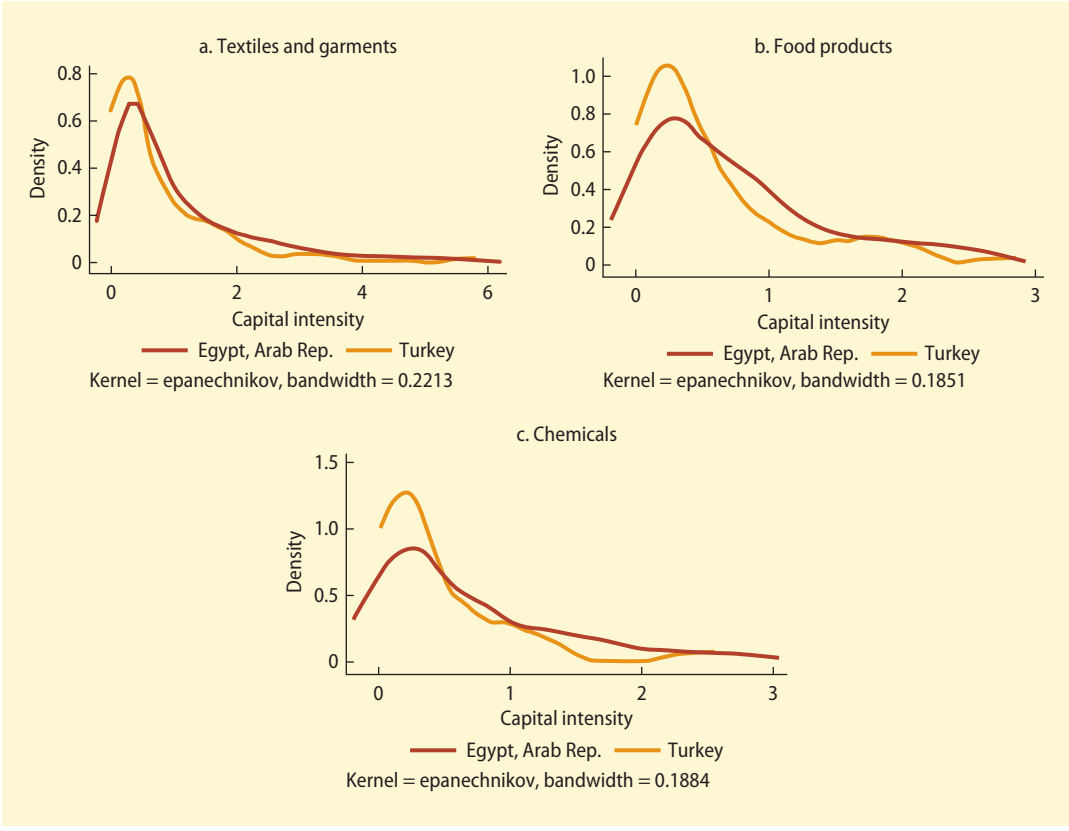


Source: World Development Indicators (database).
Note: GDP = gross domestic product; kg = kilogram; PPP = purchasing power parity; OECD = Organisation for Economic Co-operation and Development.

Doing Business 2012 (World Bank 2012a) with those of the rest of the world results in a natural grouping, based on the average ranking across all policy dimensions (see figure 4.14, which reports the overall rankings of MENA countries and selected dynamic emerging economies in 2012):[12]

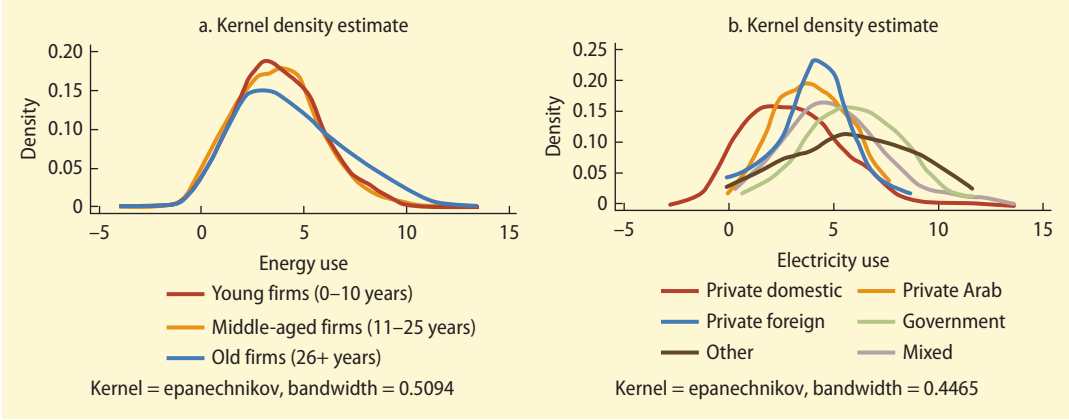
- The legal business environment in the GCC countries (excluding Jordan and the Republic of Yemen) compares well with the de jure regulations in the most advanced countries in the Organisation for Economic Co-operation and Development in many policy areas. Nevertheless, most GCC countries are among the worst performers worldwide in enforcing contracts.
- A second group comprises economies with a legal business environment that is among the most hostile to and restrictive for private sector development in the world, apart from a few bright spots in some policy areas in individual countries. These economies include Algeria, Djibouti, the Islamic Republic of Iran, Iraq, and, to some degree, also Syria and the West Bank and Gaza. For instance, with the exception of the Islamic Republic of Iran, all of these economies have some of the highest regulatory barriers to entry (costs of starting a business) in the world. As such, they require first-generation legal and regulatory reforms in most policy areas.

FIGURE 4.12 Capital intensity in three manufacturing sectors in the Arab Republic of Egypt and Turkey, 2004–08



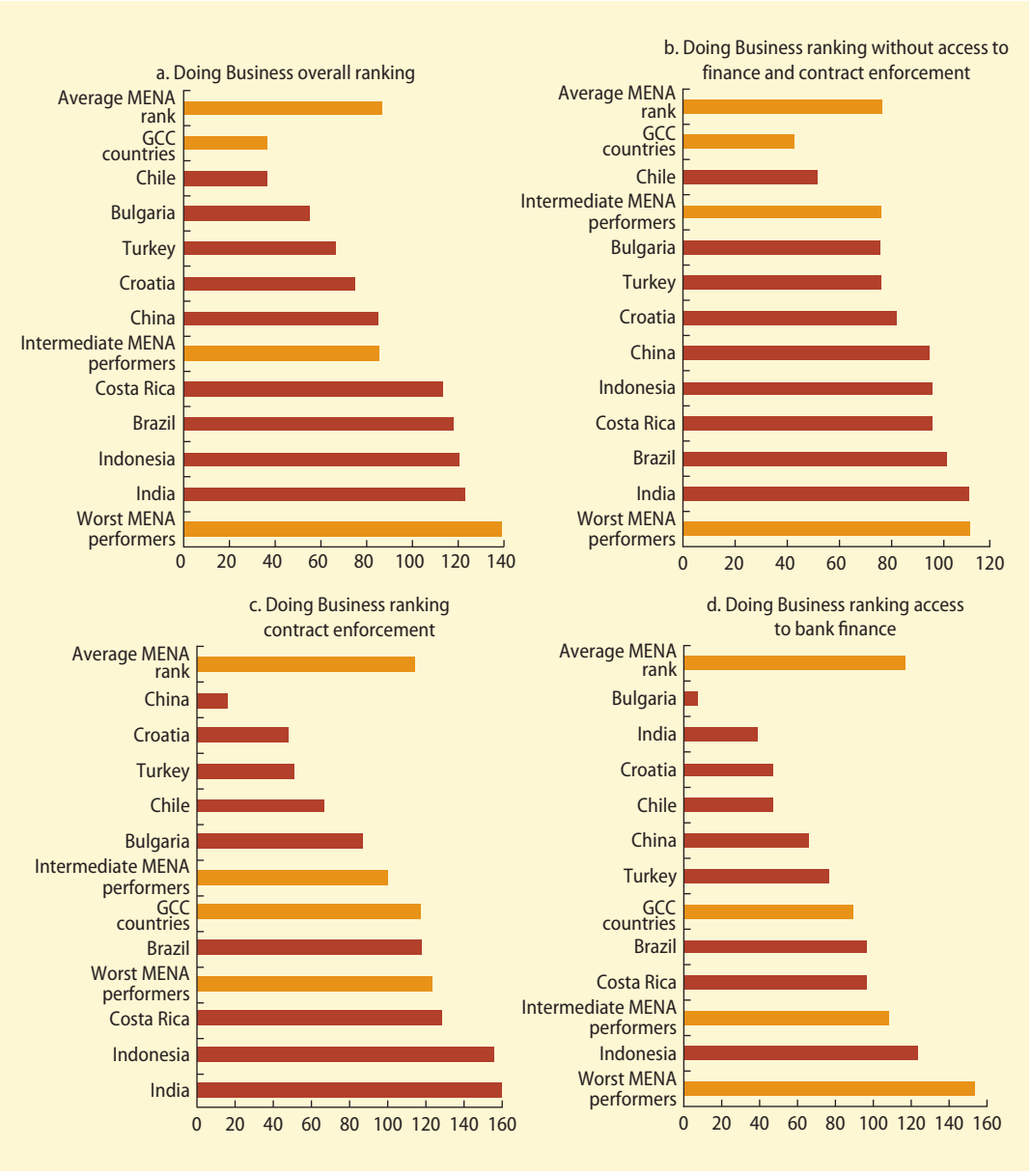
Source: Based on Enterprise Surveys data.
Note: Firms with a capital-value added ratio above 6 in textiles and garments are excluded and above 3 in the food and chemical sectors. The sample covers 714 Egyptian and 151 Turkish firms in textiles and garments, 282 Egyptian and 54 Turkish firms in chemicals, and 231 Egyptian and 84 Turkish firms in the food sector.

FIGURE 4.13 Energy use of firms in the Arab Republic of Egypt by firm age and ownership, 2004, 2007, and 2008



Source: Abouleinein, El-Laithy, and Kheir-El-Din 2009.

FIGURE 4.14 Doing Business rankings for economies in MENA and for selected dynamic emerging economies, 2012



Source: World Bank 2012a.
Note: MENA = Middle East and North Africa; GCC = Gulf Cooperation Council. The GCC includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates; intermediate MENA performers include the Arab Republic of Egypt, Jordan, Lebanon, Morocco, Tunisia, and the Republic of Yemen; the worst MENA performers include Algeria, Djibouti, the Islamic Republic of Iran, Iraq, the Syrian Arab Republic, and the West Bank and Gaza.

- In a third group of countries—such as Jordan, Morocco, and Tunisia and, to some extent, also Egypt, Lebanon, and the Republic of Yemen—the business environment ranks comparably to that of dynamic emerging economies that have successfully managed to diversify into higher-value-added activities. All of these countries have improved their legal business environment over the past decade. While legal

policy gaps remain urgent in some areas (for example, access to bank finance and contract enforcement), the overall legal business environment can only partially explain these countries' disappointing performance in higher-value-added activities. Thus, these countries appear to require a second-generation type of reform in many policy areas to unleash economic dynamism and creative destruction.

Against this backdrop of average overall rankings, MENA countries underperform systematically in two dimensions: access to bank finance and enforcing contracts. This is the case even for GCC countries, which otherwise rank relatively well in other policy dimensions. Access to long-term external finance is generally considered an important factor in promoting riskier investments in higher-value-added projects as it facilitates risk sharing. The Enterprise Surveys show that, on average, 39 percent of firms in MENA consider limited access to finance a major constraint to their operations. This is the highest share in the world's regions, excluding Sub-Saharan Africa.

"Enforcing contracts" measures the number of official procedures, the time, and the costs involved in enforcing a sale-of-goods dispute from the moment the plaintiff files the lawsuit until the actual payment. Hence, it indicates a problem of implementation rather than legislation. The following sections discuss these points in greater detail.

Restrictive access to credit

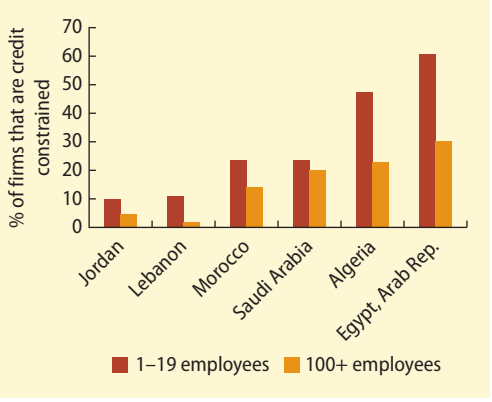
Even countries that have reformed other aspects of their business environment often rank poorly when it comes to access to credit. The World Bank (2011) report on financial access and stability in MENA shows that despite financial reforms in several MENA countries in the past, financial systems remain undiversified, uncompetitive, and exclusive.[13] The report identifies three major factors inhibiting access to finance: limited depth of credit information, deficient collateral and insolvency regimes, and weak bank competition.[14] The following discussion summarizes the main shortcomings in MENA countries with regard to these three factors.

Many MENA countries do not have a fully operational credit bureau. This restricts banks' information on potential borrowers, in particular the smaller firms for which the information asymmetry is most pronounced. Consequently, the collateral required is among the highest in the world, which often bars the access of smaller firms to credit.[15] Often, land is the only asset recognized as appropriate collateral for bank loans, while in most MENA countries, large fractions of society (firm owners) are de facto excluded from (access to) land ownership. Keefer (2007) shows that banks in MENA often use collateral requirements as a credit-rationing tool instead of as a mechanism for allocating credit based on risk analysis.

Figure 4.15 shows that smaller firms are more credit constrained than larger firms in almost all MENA countries. The gap is particularly severe in Egypt, where almost 60 percent of firms with less than 20 employees are estimated to be credit constrained (as compared to 30 percent of larger firms).

The restrictive access to credit can to some extent be explained by barriers to (foreign) entry that reduce competition in financial markets and exclude firms from

FIGURE 4.15 Share of credit-constrained firms in selected countries in MENA, various years, 2004–08



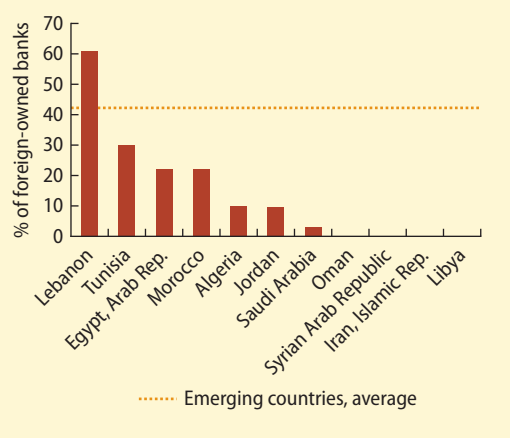
Source: World Bank 2009.

financial services. Barriers to entry arise from widespread state ownership of banks and a lack of transparency in financial systems. Moreover, apart from Lebanon, MENA countries have very low shares of foreign ownership in banking compared to other emerging countries (figure 4.16).

In addition, low transparency in the operations of both enterprises and banks results in high numbers of nonperforming loans and exclusion from access to bank loans in general. As figure 4.17 shows, MENA's share of nonperforming loans is the highest in the world. This symptom is directly linked to weak risk-management systems and the prominence of state-owned banks. In almost all MENA countries, governments have used state-owned banks to finance or cover losses of state-owned enterprises (or private businessmen with preferential access). Only a few countries have a fully operational, privatized banking sector (for example, Jordan, Lebanon, and Oman). Thus, reforming public banks is an urgent policy priority in many MENA countries.

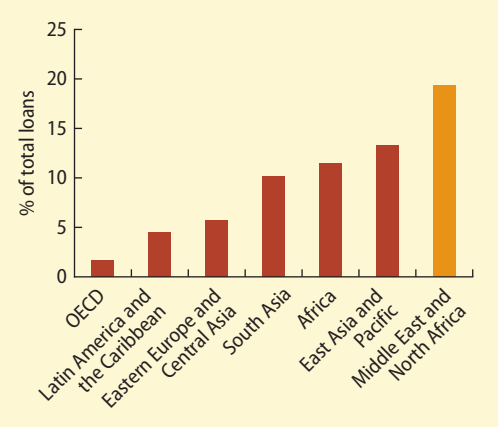
High collateral requirements, credit rationing, and other features of financial markets in MENA suggest that inadequate formal rules alone cannot explain poor access to finance in the region. Instead, the predominance of discretion over rules—which is reflected in the discretion of state-owned banks in credit allocation, less-than-independent supervisory institutions, a lack of access to land (collateral), inefficient and unequal enforcement of laws, and a lack of transparency in the banking system—seems to be at the core of the exclusion of many (often smaller) firms from access to credit.

FIGURE 4.16 Foreign ownership of banks in selected countries in MENA, 2006



Source: World Bank 2009.

FIGURE 4.17 Percentage of nonperforming loans in banks in OECD countries and in various world regions, 2007



Source: World Bank 2009.
Note: OECD = Organisation for Economic Co-operation and Development.

The World Bank (2011) report on financial access concludes that banks in MENA have failed to provide access to large segments of the population and the enterprise sector because they have focused on large, well-connected firms.

The concluding chapter of this report provides an interpretation of the historically high credit rationing in MENA as an important element of the political-economy equilibrium that has undermined private sector development to sustain the interests of a restricted elite.

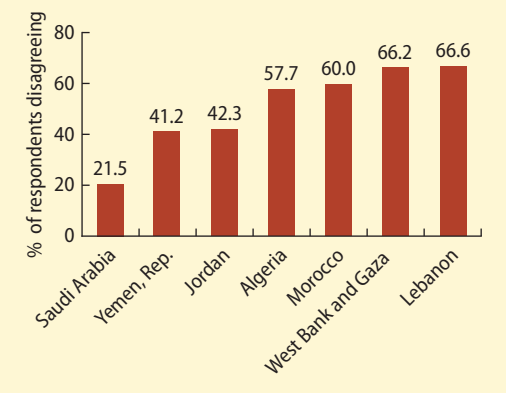
Policy implementation uncertainty

This section provides fresh evidence that the discriminatory and uncertain implementation of policies and regulations, rather than the legislation itself, distinguishes the

region from fast-growing emerging economies. Uncertainty over policy implementation reduces the expected profitability of higher-productivity investments and, as a result, hinders technological upgrading. For instance, inconsistent policy implementation creates a de facto business environment that is not the same for all firms in the same industry. This situation leads to an uneven playing field and undermines the competitiveness of firms. Both the lack of competition and the higher uncertainty prevent firms from investing in new, riskier, higher-productivity products or foreign technologies, ultimately resulting in a lack of economic dynamism and employment creation.

The resulting discriminatory policy implementation of business regulations is a key concern for entrepreneurs in MENA. Investors in MENA, especially managers of smaller enterprises, consistently lament policy uncertainty and the favorable position of some incumbent firms at the expense of new entrants and competitors. Corruption, anticompetitive practices, and regulatory policy uncertainty all rank high among the concerns of business managers in Enterprise Surveys in the region. Figure 4.18 illustrates the degree to which managers of firms included in these surveys see the implementation of rules and regulations as inconsistent and unpredictable.

FIGURE 4.18 Percentage of survey respondents in selected economies in MENA disagreeing that interpretations of regulations are consistent and predictable, 2005–08



Sources: World Bank 2009.
Note: Those surveyed were asked whether interpretations of regulations are consistent and predictable.

Table 4.2 summarizes the averages and dispersion of the number of days that firms had to wait for different regulatory services across countries. The survey results confirm that legal business regulations are relatively competitive in Jordan and Morocco along these four dimensions of regulatory services. However, in the same countries large variations exist across firms: the coefficients of variation in waiting times along the four dimensions of regulatory services are higher than in most other emerging economies, so that, in this sample, Jordan ranks seventh and Morocco ninth.[16]

The de facto evidence suggests that waiting time for different regulatory services varies substantially across firms, and that this pattern is very common throughout MENA.[17] For instance, firms below the 25th percentile of the distribution of waiting time in Lebanon or Syria wait on average between 1 and 30 days to obtain a construction permit; in contrast, firms above the 75th percentile wait between 190 and 380 days. Similarly, the median firm in the Republic of Yemen waits about 20 days for imports to clear customs, while the 10th and 90th percentile firms wait between 1 and 55 days.[18]

This uneven implementation provides fertile terrain for rent seeking and results in a large number of firms striking deals to speed up the implementation of legal procedures.[19]

For example, based on pooled firm survey data, table 4.3 shows that the waiting time for regulatory services is positively correlated with government officials' requests for bribes.[20] This is consistent with a "hold-up" problem, whereby officials use their discretion to delay regulatory services so that they can demand bribes.

The discretion in implementing legislation originates from the nature of incentives in the public administration. With recruitment and promotion that have frequently been based on regional or sectarian considerations rather than merit and a weakly institutionalized public administration, accountability to the broad citizenry is limited.

Uncertainty and innovation

Finally, international evidence shows that discriminatory policy implementation reduces economic dynamism (competition or innovation) and firm growth. For example, empirical findings for Jordan suggest that uncertainty over policy implementation reduces (perceived) pressure from domestic competition (table 4.4).[21] Interestingly, no correlation emerges in the same data between implementation uncertainty and pressure from foreign competition (column 4). Taken together, these findings suggest that it is unlikely that the observed correlation between policy uncertainty and domestic competition is due to spurious factors.

Moreover, firm-level data for both Egypt and Jordan show that the lower the perceived predictability and implementation of regulation within firms of the same size, location, and sector, the lower is the firms' probability of innovation (table 4.4). In these regressions, uneven policy implementation is proxied by the coefficient of variation in firms' reporting that policy is predictable. For robustness, results are also tested using the difference between

TABLE 4.2 Averages and dispersion of firms' waiting days for regulatory services in selected developing countries, various years, 2004–08

	Construction permit	Operating license	Import license	Clear customs imports
	Average number of days			
Indonesia	32	21	11	3
Jordan	*43*	*6*	*5*	*9*
Morocco	*61*	*4*		*4*
Croatia	182	26	12	2
India	28	29	15	14
Bulgaria	94	62	21	3
Turkey	42	37	21	10
Chile	143	84	17	17
Brazil	139	83	43	15
	Coefficient of variation (standard deviation divided by the mean)			
Bulgaria	1.04	1.59	1.17	1.10
Brazil	1.31	1.14	1.25	1.10
Indonesia	1.93	1.43	0.94	1.09
India	1.33	1.40	1.82	1.02
Croatia	1.25	1.69	1.27	1.25
Turkey	1.65	2.88	1.67	1.34
Morocco	*1.72*	*1.87*		*1.46*
Chile	1.94	2.62	1.59	1.39
Jordan	*1.75*	*2.33*	*2.14*	*1.50*

Source: World Bank 2012b; Enterprise Surveys in different years.
Note: Survey question: "What was the wait, in days, to obtain a construction permit, operating license, import license, or clear customs for imports?" The dispersions across firms are measured by the coefficient of variation (standard deviation divided by the mean).

TABLE 4.3 Relationship between delays in policy implementation and demands for bribes in MENA, various years, 2004–08

	The determinants of policy implementation times — OLS							
	Time it takes to get an operating license (log)		Time it takes to get a construction permit (log)		Time to export (log)		Time to import (log)	
Dependent variable	**(1) coef/se**	**(2) coef/se**	**(3) coef/se**	**(4) coef/se**	**(5) coef/se**	**(6) coef/se**	**(7) coef/se**	**(8) coef/se**
Gift requested by government official? (1=Yes, 0=No)	0.955***	0.407***	0.715***	0.605***	0.110**	0.243***	0.390***	0.312***
Firm size (ln)		0.270*		−0.157		−0.034		−0.158*
Firm size^2 (ln)		−0.021		0.014		0.002		0.012
Country dummies	No	Yes	No	Yes	No	Yes	No	Yes
Sector dummies	No	Yes	No	Yes	No	Yes	No	Yes
R^2	0.067	0.356	0.061	0.214	0.005	0.076	0.055	0.146
Number of observations	914	845	429	664	670	665	805	802

Source: Hallward-Driemeier, Freund, and Rijkers 2012.
Note: MENA = Middle East and North Africa; coef/se = coefficient/standard error; OLS = ordinary least squares. Significance is based on robust standard errors that are clustered by firms' location-industry-size. *, **, and *** indicate significance at the 10 percent, 5 percent, and 1 percent levels, respectively. Data are from pooled MENA Enterprise Surveys across countries with available data.

TABLE 4.4 Effect of policy implementation uncertainty on competition and firm growth in Jordan and the Arab Republic of Egypt, 2006–07

Dependent variables	Pressure from domestic competition to reduce costs		Pressure from foreign competition	Employment growth (Jordan, 2003–06; Egypt, Arab Rep., 2006–07)		Probability to innovate	
Jordan							
Coefficient of variation of firms' reporting implementation as consistent and predictable	−1.01*		0.822	−0.647**		−0.807	
Difference 75–25 percentile in firms' reporting implementation as consistent and predictable		−0.155**			−0.072**		−0.206*
R^2	0.120	0.122	0.336	0.199	0.197	0.238	0.241
Number of firms	467	467	419	436	436	487	487
Egypt, Arab Rep.							
Coefficient of variation of firms' reporting implementation as consistent and predictable	0.025		0.060	−0.111**		−0.787**	
Difference 75–25 percentile in firms' reporting implementation as consistent and predictable		0.013			−0.002		−0.090
R^2	0.031	0.031	0.043	0.420	0.418	0.109	0.106
Number of firms	902	902	899	878	878	905	905

Source: Based on Enterprise Survey data for 2006, World Bank 2012b (Jordan); based on Enterprise Survey data for manufacturing firms in 2007 (Egypt).
Note: All regressions include sector dummies (apart from specification 1), heteroscedasticity robust standard errors that are clustered at the group level; * and ** indicate significance at the 10 percent and 5 percent levels, respectively. The average and standard deviations are computed over grouped firms in each location-sector-size group. Innovation is a binary variable equal to 1 if the firm introduced a new product or new process, or licensed a foreign technology in the past three years and 0 otherwise (roughly half the firms in the sample innovated).

the 75th and the 25th percentile in firms' reports. The probability of innovating is then estimated with a probit regression where the dependent variable takes a value of 1 if a firm either introduced a new product or a new process or licensed a new technology within the past three years, and equal to 0 otherwise. About 42 and 50 percent, respectively, of firms in the sample in Egypt and Jordan were innovators according to this definition. Similarly, higher uncertainty in policy implementation is also negatively correlated with employment growth in Jordan: that is, the higher the disagreement (coefficient of variation) about whether government implementation is "consistent and predictable" within a location-sector-size firm group, the lower the employment growth or probability to innovate for firms in these groups. The results for the sample of manufacturing firms in Egypt in 2007 are consistent with the findings for Jordan.[22]

The employment price of privilege

The process of creative destruction—which is crucial for productivity growth and job creation, as evidenced by the recent experiences of fast-growing East Asian and Eastern European economies—is weak in MENA. As a result, the private sector in the region is small, skewed toward unproductive small-scale activities, and stagnant. The lack of dynamism is manifested, among other ways, in lower entry and exit of firms, lower growth of incumbent firms, and lower innovation than in relevant comparator countries in other parts of the world.

Entrants and young firms have the highest potential for creating new jobs in MENA, in particular for skilled labor. During their

expansion, these firms tend not only to create employment but also to contribute to productivity growth by adopting new technologies and processes or diversifying into new products. Moreover, international evidence has shown that incumbents innovate faster and increase productivity more quickly when the threat of entry is higher.

Therefore, the lack of economic dynamism in MENA countries comes at a significant cost in employment, in particular for skilled labor. At the same time, the lack of creative destruction and firm entry into higher productivity activities constrains the scope for product and process innovations (foreign technology adoptions), which are the main drivers of employment creation (for skilled labor) in other countries. It also prevents the exit of inefficient incumbent firms that employ resources that could more productively be deployed elsewhere.

MENA's lackluster record of job creation is due to distortions that depress the demand for labor and limit incentives to innovate, such as fuel subsidies, a relatively burdensome business environment, and, crucially, inconsistent and arbitrary implementation of regulation, which results in an uneven and unpredictable business environment. Uncertain policy implementation and the protection of privileged firms by government authorities reduce the expected profitability of higher productivity investments, hinder technology upgrading, and encourage informality. For many policy areas, the discrimination in implementing legislation, rather than the legislation itself, distinguishes the region from fast-growing emerging economies.

Notes

1. Several recent contributions provide empirical evidence that countries that export higher-productivity goods will grow faster; see, for example, Hausman, Hwang, and Rodrik (2007); Krishna and Maloney (2011).
2. This section follows the methodology of Hausman, Hwang, and Rodrik (2007), who derive an index (EXPY) that ranks traded goods by their implied productivity content.
3. See Knowledge Assessment Methodology (2011), at http://www.worldbank.org/kam, on how an innovation score is built.
4. The process of creative destruction describes firm entry, exit, and growth, whereby resources are reallocated toward higher-productivity firms.
5. Hsieh and Klenow (forthcoming) observe a similar pattern between young, small manufacturing firms in the United States relative to India. That is, young manufacturing firms in the United States grow quickly or exit, while in India, young firms do not grow.
6. This section draws substantially on World Bank (2009).
7. Earlier profiling of the labor market has shown that MENA has an extremely large informal sector and a high prevalence of microfirms constituted by self-employed individuals. A caveat is that the firm census does not cover informal firms, but since these tend to be small, it is arguable that the true firm-size distribution is even more skewed toward small-scale activities.
8. See, for example, Van Reenen (1997), Blanchflower and Burgess (1998), and Piva and Vivarelli (2004). Moreover, Coad and Hoelzl (2010) and Vivarelli (2012) provide extensive literature surveys on the relation between innovation and job creation.
9. For instance, Geroski and Gugler (2004) distinguish between the within- and between-variance of employment growth and find that most of the variation (around 60 percent) is due to changes in employment growth within individual firms over time.
10. For instance, empirical studies for developed countries found that 5 to 10 percent of the firms deliver 50 to 80 percent of employment creation (see, for example, Acs, Parsons, and Tracy 2008; Coad and Hoelzl 2010).
11. The results are based on Enterprise Surveys from Egypt and Turkey. The former contains observations for manufacturing firms from 2004, 2007, and 2008, while the latter contains observations from 2005 and 2008. The capital intensity is computed as the ratio of the net book value of machinery and equipment relative to value added (sales divided by the total cost of raw material and intermediate goods).

12. The *Doing Business* indicators measure the time and costs of official legal procedures for a representative domestic firm based in the capital or the largest business center of the country. Thus, comparing the business environment between Brazil, India, and Jordan compares effectively regulations in São Paolo, New Delhi, and Amman.
13. World Bank (2011) provides a detailed review on the status of and constraints on financial development in MENA countries.
14. In fact, the *Doing Business* indicators focus on similar de jure aspects of access to credit: credit information registries, collateral, and bankruptcy laws.
15. The following paragraphs are based on World Bank (2009).
16. The analysis for MENA countries in table 4.2 is restricted to Jordan and Morocco since the corresponding questions are formulated differently, and in another context in Enterprise Surveys of Egypt, Lebanon, and Syria, and hence cannot be compared straightforwardly. In fact, waiting times for construction permits and for operating and import licenses in Egypt and Syria were substantially and systematically longer and more dispersed (outliers) than the waiting times observed in the other countries in table 4.2. In addition, only manufacturing firms are observed in the Enterprise Surveys for Egypt, while the number of responding firms is very small for three of these indicators in Lebanon (between 7 and 21 firms).
17. Enterprise Survey questions referring to the waiting time for customs clearance are the only questions referring to regulatory services that are formulated identically and in the same context in MENA countries beyond Jordan and Morocco.
18. A similar analysis has been conducted by Hallward-Driemeier, Khun-Jush, and Pritchett (2010) and Hallward-Driemeier and Pritchett (2011) for Sub-Saharan African countries.
19. See Hallward-Driemeier, Freund, and Rijkers (2012) for more details.
20. The results for the control variables in table 4.4 are not reported as their impact is not statistically significant after the binary variable on requested bribes is included. Note that the coefficient on bribes remains significant even after controlling for firm size, age, location, and ownership.
21. A variable proxying for "policy implementation uncertainty" is built as follows. Firms are grouped by their location, sector, and size, for 30 groups of firms (each containing at least five firms). For each group, the coefficient of variation of the perceived consistency of policy implementation across firms is computed. The spread between the 75th and the 25th percentiles of the perceived policy implementation consistency is computed as an alternative measure of policy implementation uncertainty. In addition, control variables measuring the (initial) size, location, age, exporting status, and the original level of employment of firms are included in the regressions. Results for the control variables are consistent with findings in the literature on firm growth (not shown in table 4.3). While significant analog impact on domestic competition among manufacturing firms is found in Jordan, the relationship is not significant in the Egypt sample.
22. Employment growth is only observed over one year (2006–07) for most enterprises in the Egypt sample.

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MENA's Institutional Framework: Reinforcing the Status Quo

5

Main findings

- In MENA, institutional arrangements that regulate wages and contracts reinforce segmentation between labor market insiders (that is, the formally employed) and outsiders.
- In some countries, collective wage agreements or minimum wages tend to exclude job seekers whose productivity does not meet the wage floor, while high taxes can exacerbate their effect.
- On average, public sector employment offers more comfortable contractual terms than the private sector, often generating a de facto wage floor that induces eligible candidates to queue for the former.
- The hiring options for private employers are relatively flexible, but dismissal is administratively more difficult in MENA than in other regions.
- Firms can afford to hire along gender, age, or socioeconomic segments because, historically, competition has been low, while citizens' limited "voice" has also placed little pressure on firms to perform.
- Segmentation probably cannot be sustained at its current level, because global competition in product markets is increasing and because pension systems require a broader base of contributors to sustain themselves.

Insiders and outsiders in MENA's labor markets

Chapters 1 and 2 described signs of segmentation in labor markets in the Middle East and North Africa (MENA) region: men participate more, are employed more, and earn more than women; the same is true for prime-age adults compared to youth. In other words, workers who already have a job (typically middle-aged men) are stable in their positions and more likely to have access to social security, while newcomers (young, first-time job seekers) and women usually fare worse. If they have a job at all, it is likely to be in the informal sector.

A situation in which incumbent workers enjoy more favorable employment opportunities than newcomers is called an "insider-outsider" labor market.[1] Chapters 1 and 2 pointed out the inefficiencies that

characterize labor markets in MENA, many of which are linked to segmentations: different segments—young men, young women, prime-age men, prime-age women—emerge as separate pools of workers whose mobility is limited and who may be excluded from the labor market altogether.

This chapter identifies the mechanisms that place some groups "inside" and others "outside" MENA's labor markets. It investigates why this segmentation—and source of aggregate inefficiency—has persisted for a relatively long time in MENA, discusses why it may no longer be sustainable, and reflects on alternatives that might remedy the situation.

How does segmentation between insiders and outsiders arise?

Theory

To understand how segmentation arises, we must understand the theory of how employment is generated when labor markets are not segmented.[2] In such markets, firms continuously demand labor and skills, either because of normal staff turnover or because of new investments. Firms try to hire the best people they can get, as long as the new employees' productivity is above or equal to the market wage. In a competitive market, the market wage is fixed for the individual firm and cannot be influenced by it. Thus to make a profit, a firm tries to hire people who produce more than they cost (the wage).

Labor and skills are supplied by people who have acquired skills in their former jobs or through education. They seek a work-life mix in line with their acquired skills and inclinations. In their decisions, they trade the "cost" of giving up an additional hour of leisure against the reward from the wage earned for that hour of work. They give up leisure as long as the marginal utility lost is below the marginal utility gained from the wage. The wage is fixed in a competitive market, and the individual cannot influence it.

In the labor market, firms' quantitative and qualitative demands and people's quantitative and qualitative supply meet. People enter employment, which is defined by a contract (specifying the terms of hire, dismissal, and hours) and a wage. If no further institutional or market failures interfere, the wage resulting from that interaction clears the market: in other words, exactly everyone who wants a job at that market wage gets one.

Practice

In practice, the market can experience failures. People naturally know more about their own skills and effort than an employer does when first meeting them. This "information asymmetry" makes it hard for an employer to estimate the productivity of a prospective employee. "Quality signals" like a good education or (better) previous similar work experience with good references can help bridge the information gap. Obviously, the gap is harder to bridge for young people without work experience.

Various institutions can intervene in markets. Some are needed to reduce the risk to individuals participating in the market. Social insurance, for example, protects individuals against the risks of poverty, unemployment, poor health, and old age, leaving them free to take more and more productive risks. Other institutions, like taxes, are vital to financing the goods that the private sector will not supply sufficiently (like roads and schools). Social insurance and taxes are often financed through the payroll (wages), which effectively drives a wedge between the market-clearing wage and the prevalent wage, creating a gap between labor supply and demand. Something similar happens if labor demand is restricted through rigid regulation on contracts. Regulations affecting contracts and the wage that is effectively paid will always affect the employment outcome of the labor market.

When institutions affect different groups of the population differently, segmentation arises. Segmentation can occur

unintentionally, for example, as the regulatory environment changes over time. In that case, some regulations affect only younger people and newcomers to the labor market, such as women. Segmentation can also occur when a regulation has a learning curve, in which case the first generation of people subject to the regulation are less affected by the regulation than later generations.

Many of the above-mentioned institutions are vital and cannot be done away with. They must be designed carefully, however, to balance the intended benefits with the unintended effects on the employment outcome of the labor market (World Bank 2013). The sections that follow examine in considerable detail how labor market institutions in MENA relate to employment outcomes, especially segmentation. The discussion begins with the two basic elements of any formal employment—wages and contracts. The next sections review the process for establishing wages and contracts in the private sector, including its possible inflexibilities, and compare it to the process in the public sector. The final section explores the role of social insurance regulation in labor market outcomes.

Wages and nonwage costs

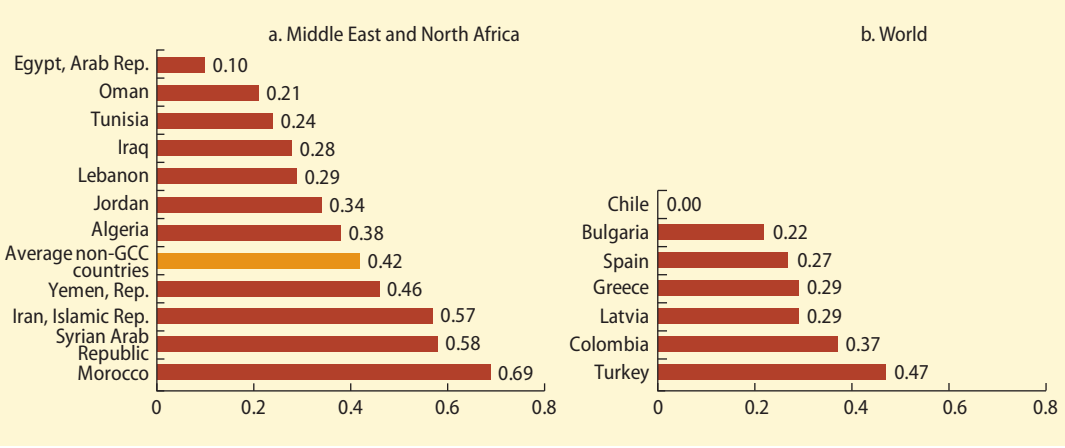
If the prevailing labor law precludes adjusting wages downward (that is, establishes wage floors), formal employment will be unlikely for the people whose productivity is below the floor. While minimum wages that are carefully set have little consequence for aggregate employment (see Machin, Manning, and Rahman 2003), higher wage floors—for example, those resulting from high public sector wages or collective wage agreements negotiated by insiders—can have substantial negative impact.

Effects of minimum wages

Minimum wages in MENA cover a broad range and tend toward the higher end, from 10 percent of the average value added per worker in the Arab Republic of Egypt to nearly 70 percent in Morocco, with an average of 42 percent. Many MENA countries lie above typical comparator countries in Eastern Europe and Latin America (figure 5.1).

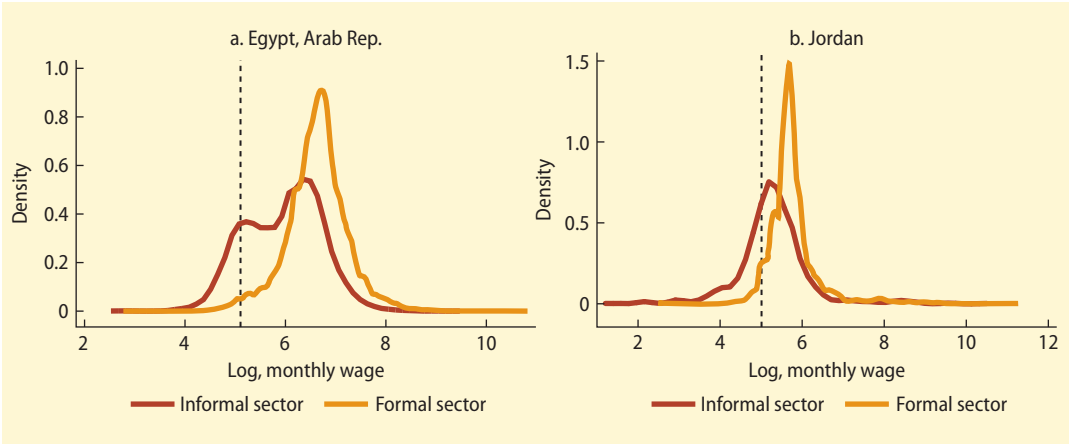
However, while minimum wages appear to influence the overall wage distribution in MENA, they are rarely enforced strictly. In Egypt and Jordan, a measurable share of

FIGURE 5.1 Minimum wage as a share of value added per worker in selected countries in MENA and in selected comparator countries, 2010



Source: World Bank 2012.
Note: Preferred comparators for MENA usually include the Mediterranean rim and Eastern Europe. MENA = Middle East and North Africa; GCC = Gulf Cooperation Council.

FIGURE 5.2 Hourly wage distribution and minimum wage in the Arab Republic of Egypt and Jordan, 2010



Sources: The Arab Republic of Egypt's Labor Force Survey (LFS) 2010; Jordan's Labor Market Panel Survey (LMPS) 2010. See the appendix for more information on these surveys.
Note: Dotted line represents the mandated minimum wage.

wages falls below the current official minimum wage (figure 5.2). This phenomenon is problematic, because employers who break the minimum wage rule are bound to break further rules attached to formal employment, such as affiliation to social insurance coverage and respect of work contracts. If minimum wages are set so high that they force some employers to circumvent them, they also force people into informality.[3]

Potentially, small firms could suffer the most harmful impact of minimum wages. Larger firms, which are well represented in employer associations, can influence the national or sectoral setting of minimum wages and thereby set them high enough to eliminate smaller competitors who cannot afford to pay the wage. An example of this is Germany's (liberalized) postal sector case in early 2008, when a minimum wage was introduced with strong support from the incumbent Deutsche Post. The minimum wage was valid only for four months (after which a court ruling eliminated it), but during that time 27, smaller providers left the market, eliminating 5,693 jobs.

Effects of collective wage agreements and bargaining on the labor market

The region also has several collective wage agreements (CWAs). A CWA is the result of bargaining on wages between worker representations (trade unions) and employer representations. Often, a CWA is a matrix with two dimensions: worker category (competence, responsibility level, or educational level, or a combination of these) and seniority in years. Each field for a particular type of worker of a particular seniority contains a wage range from minimum to maximum or only a minimum. In several countries, these agreements have a sectorally or nationally binding character. In other words, all employers in a given sector or in the entire country need to abide by the agreed wage ranges, and workers within the same category and the same seniority need to fall within the same wage range. The countries in MENA for which there is evidence create these matrices through CWAs (rather than setting them statutorily by central government), with the CWA reaching the rank of labor legislation. Another significant difference between MENA and Northern and Eastern Europe, for example, is that the worker category in the wage matrix depends strongly or solely on the educational degree, whereas in Europe, it depends on competency as reflected in the actual work and responsibilities carried out, largely irrespective of formal educational level.

BOX 5.1 The conventions collectives in Tunisia

In around 70 sectors in Tunisia, centralized employer and employee representatives agree on a pay scale with wage floors for different professional levels. Countrywide, the overarching Convention Collective Cadre between the UTICA (employer representation) and the UGTT (general trade union) determines the default. Individual companies can deviate if needed, within a regulated negotiation ritual, but only in agreement with their worker representatives. The default situation is always the convention, and if employer and employees do not reach an outside agreement, the government arbitrates.

The CWAs work by levels, where each level reflects the education, competence, and soft skills in a mix that is ultimately the discretion of the employer. A university education is usually required for the four or five highest levels. That is, there are de facto wage floors for vocational graduates and higher graduates according to their degree. The differences are quite remarkable in most sectors, ranging from 200- to 400-dinar differences in starting salaries. "Downgrading" is not allowed.

The legislation establishing CWAs and the enforcement of those laws vary widely across the region. The United Arab Emirates, for example, has no trade unions (Chartouni 2011); Egypt has unions but no enforced CWAs (Hendy and Selwaness 2011); and in Algeria, only the public sector experiences enforced CWAs, while the private sector largely evades them (Musette and Mohamed-Meziani 2011). Interviews with union officials and employer representatives in Algeria confirmed that "most larger enterprises refuse to respect the CWA" and that "the CWA[s] are viewed as burdensome and therefore not applied …. The enterprises are not ready to play along" (Musette and Mohamed-Meziani 2011). Jordan has CWAs for a few private sectors, and wage rules are legally enforced; in the words of a local legal expert: "For example, banking and insurance employees managed to get 14th and 15th salaries [that is, 14 or 15 monthly salaries in a year], in addition to other financial incentives, while it is more difficult for the textiles industry employees to obtain such benefits" (Mryyan 2011). Wage violations are punishable in Jordan, which sees more than 3,000 cases every year. As all infringements need to go to court (labor inspectors have no authority to resolve them), settlements take time, and many cases are dropped (Mryyan 2011). Last, Tunisia has enforced CWAs that set wage floors by professional level in over 70 sectors (see box 5.1) (Boughzala 2011).

Centralized wage setting can be problematic; international evidence shows that it often locks in an exogenous rise in unemployment, for example, through an oil-price or demographic shock. This is because, on the employee side, wages are monopolistically negotiated by unions whose voting members are all employed. The unemployed, who would profit from a wage reduction against an increase in jobs, cannot vote. As a consequence, the negotiations rarely result in stagnating or lower wages, even if required by the labor market situation (see, for example, Benassy 1995; Gaertner 1981). This situation of insiders (employed, voting union members) and outsiders (unemployed, nonvoting) is particularly severe if the unemployed are largely first-time entrants in the job market.

As in the case of minimum wages, collective bargaining can also exclude smaller firms or new market entrants. If the bargaining process is dominated by larger firms, they can afford to set the wage floors at levels that exclude smaller competitors who achieve fewer economies of scale.

The organization of collective bargaining may matter for its impact. Nickell and Layard (1997) find that unionization, both in union density (share of union members

in the workforce) and collective bargaining coverage (wages affected by the CWA), is associated with higher unemployment rates when bargaining is at the sectoral level. Higher (national) and lower (firm-level) centralization of bargaining do not significantly increase unemployment. Later studies, while confirming lower unemployment with centralized bargaining, do not find a confirmation of this hump-shaped relationship, however; see, for example, Aidt and Tzannatos (2002) and OECD (2006).

Collective agreements in which the professional category largely or solely depends on the formal educational level, like in various MENA countries, set a de facto wage floor for university graduates and can contribute to high graduate unemployment. A CWA enforced de facto by educational level, as in Jordan and Tunisia (Mahjoubi 2003), for example, could explain a large part of graduate unemployment and inactivity. On the one hand, employers do not absorb an ever-growing graduate population at the wages foreseen for graduates. On the other hand, graduates who can afford to wait have an incentive to "queue" until a formal job, with a CWA salary, becomes available. Those who cannot afford to wait will accept lower categories and wages informally.

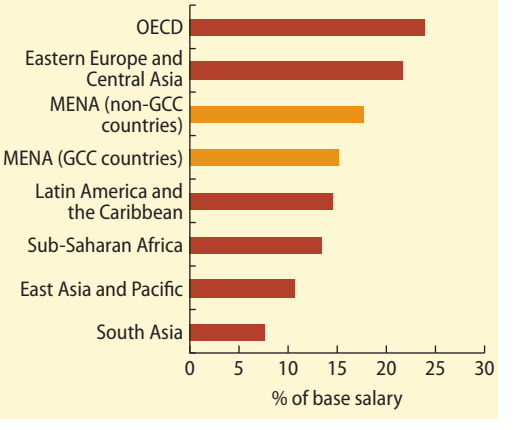
Effect of taxes and public sector wage packages on unemployment

High taxes and contributions can exacerbate wage floors. MENA countries, especially outside the Persian Gulf, have a relatively high share of labor taxes, ranking only below the countries in the Organisation for Economic Co-operation and Development (OECD) and Eastern Europe (see figures 5.3 and 5.4). However, the social insurance and public services provided in MENA countries are inferior to the average of the OECD, and the efficiency of spending these resources warrants additional study.

Empirically, taxes can significantly increase unemployment. The higher the payroll tax level, whether in the tax wedge (Elmeskov, Martin, and Scarpetta 1998) or the overall tax rate (Nickell and Layard 1997), the higher the unemployment rate. The effect is not very large at the average wage, but it can be more significant at lower levels of the wage distribution. The tax rate can therefore figure in firms' and workers' decisions on whether to operate in the formal sector, and it can even affect the very basic decision of whether to hire someone.

Public sector wage packages can also constitute a wage floor, especially for graduates of institutions of higher education. Fixed national pay scales that are out of sync with the private sector can generate a de facto wage floor and induce eligible candidates to queue. Data from Tunisia show that the public sector offers a substantial wage premium over the private sector for all educational levels but most strongly for secondary and tertiary education (see figure 5.5). At the same time, people working in the public sector do so on much better contractual terms, with nearly 90 percent enjoying an open-ended contract, compared to around 30 percent in the private sector. In Egypt, Jordan, the United Arab Emirates, and the West Bank and Gaza, the public sector wage package for

FIGURE 5.3 Labor taxes and contributions to social insurance as a percentage of the base salary in world regions and the OECD, 2011



Source: World Bank 2012.
Note: Calculations on labor taxes include social contributions and labor taxes paid by the employer (see http://www.doingbusiness.org/methodology/paying-taxes) and are not the classical "tax wedge," which also takes into account taxes paid by the employee. OECD = Organisation for Economic Co-operation and Development; MENA = Middle East and North Africa; GCC = Gulf Cooperation Council.

the educated also outperforms average private sector packages.

Unless public sector jobs are associated with a much higher risk of being dismissed or downgraded, the public sector's more generous wage and work package gives job seekers an incentive to prefer and seek public sector jobs. Qualitative and quantitative evidence from Egypt and Tunisia confirms that many young people queue for public sector jobs: in other words, they remain inactive or unemployed until an opportunity to join the public sector arises (Assaad 1992; Grun et al. 2008; Youssef 2004). In this way, the public sector makes it difficult for the private sector to recruit.

As a large share of employees in MENA work in the public sector (table 5.1), the incentives it sets are important. More than half of Iraqi nationals and nationals from the United Arab Emirates work in the public sector, compared to about one-third in Jordan and one-fourth in Egypt, Tunisia, and the West Bank and Gaza.

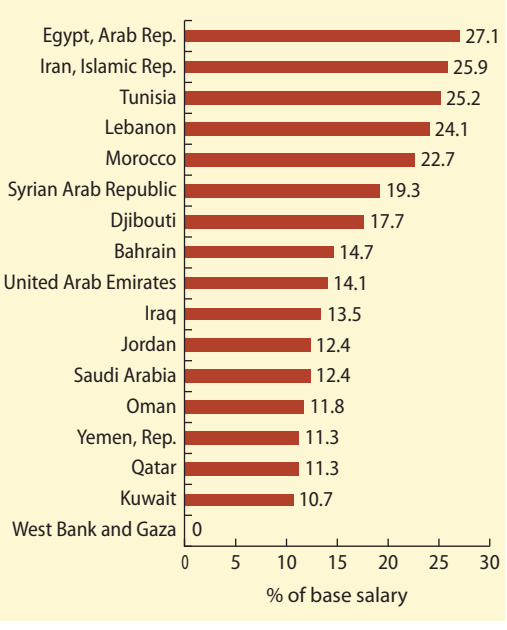
Contracts

The basic elements of a work contract, apart from the wage, are its duration (temporary, fixed term, or open ended), the work hours (including annual leave), and the dismissal procedures, including any severance pay.

Hiring and firing in MENA

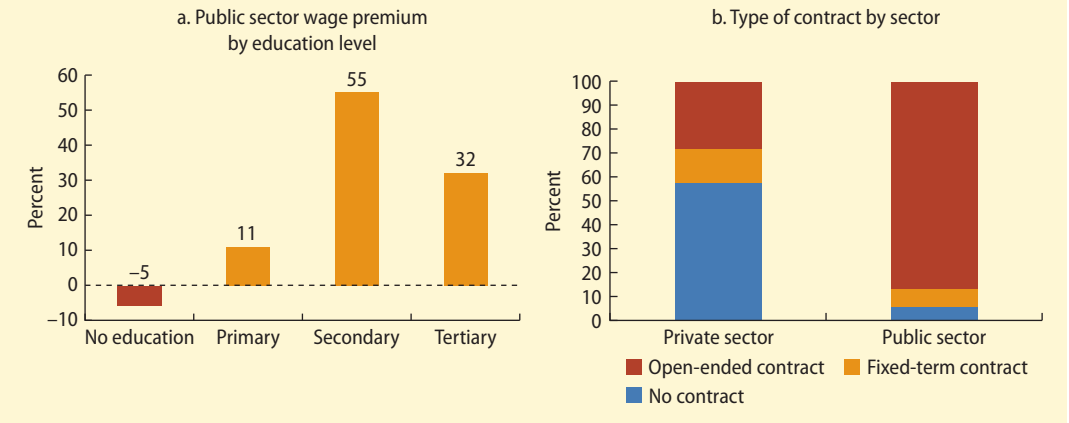
The hiring options for private employers are relatively flexible in the region. With the exception of Algeria and Djibouti, all economies in the region allow fixed-term contracts

FIGURE 5.4 Labor taxes and contributions to social insurance as a percentage of the base salary in selected economies in MENA, 2011



Source: World Bank 2012.
Note: MENA = Middle East and North Africa.

FIGURE 5.5 Wages and job protection by employment sector in Tunisia, 2011



Source: World Bank and Institut National de la Statistique (forthcoming), using Tunisia's LFS 2011. See the appendix for more information on the survey.

TABLE 5.1 Share of employment by sector in selected economies in MENA for the latest available year, 2005–10
Percent

Economy	Public sector	Private formal sector	Private informal sector
Egypt, Arab Rep.	26.6	17.5	55.9
Iraq	54.0	0.8	45.2
Jordan	33.5	22.0	44.6
Morocco	11.4	13.4	75.2
Tunisia	22.0	15.2	62.8
West Bank and Gaza	21.0	79.0	—
United Arab Emirates (all)	30.0	70.0	—
United Arab Emirates (nationals)	91.7	8.3	—
United Arab Emirates (expatriates)	21.6	78.4	—
Yemen, Rep.	8.8	11.9	79.3

Source: The Arab Republic of Egypt's LFS 2010, Iraq's Household Socioeconomic Survey (HSES) 2006–07, Jordan's LMPS 2010, Morocco's LFS 2009, Tunisia's LFS 2010, the United Arab Emirates' LFS 2009, the West Bank and Gaza's LFS 2008, and the Republic of Yemen's Household Budget Survey 2005–06. See the appendix for more information on these surveys.
Note: — = not available.

for permanent tasks. A fixed-term contract can last a maximum of 12 months (Morocco), 24 months (Djibouti, Lebanon, and the West Bank and Gaza), 48 months (Tunisia), or 60 months (the Syrian Arab Republic) and has no limit in all other countries in the region.[4] Morocco reformed its labor code in 2003, allowing firms to hire under temporary contracts. Dismissal regulations remain restrictive, however: Morocco has one of the most generous severance pay systems in the world. In combination with flexible hiring, restrictive firing provides incentives to game the system—for example, by hiring on temporary contracts only—which also leaves workers without access to adequate income protection.

Dismissal (from the formal sector) is more difficult in MENA than in other regions of the world. Most MENA countries (all except most Gulf countries, Lebanon, and Morocco) require the employer to notify a third party for the dismissal of just one worker, and Egypt, the Islamic Republic of Iran, Jordan, Syria, and Tunisia also require the approval of the third party—usually the labor inspection or a committee chaired by it. Morocco and Tunisia require employees to be retrained or reassigned before redundancy and have prescribed redundancy (as well as reemployment priorities) for certain groups of workers. All these rules also mean that challenging dismissal decisions legally is comparatively easy for formal workers. All things considered, the legislation in MENA's non-Gulf countries imposes more procedural restrictions for dismissal than anywhere else in the world. Within the region, Egpyt, Jordan, and Tunisia are the most restrictive. Several empirical studies show that difficult dismissal can discourage work effort and increase absenteeism (see, for example, Jimeno and Toharia 1996).

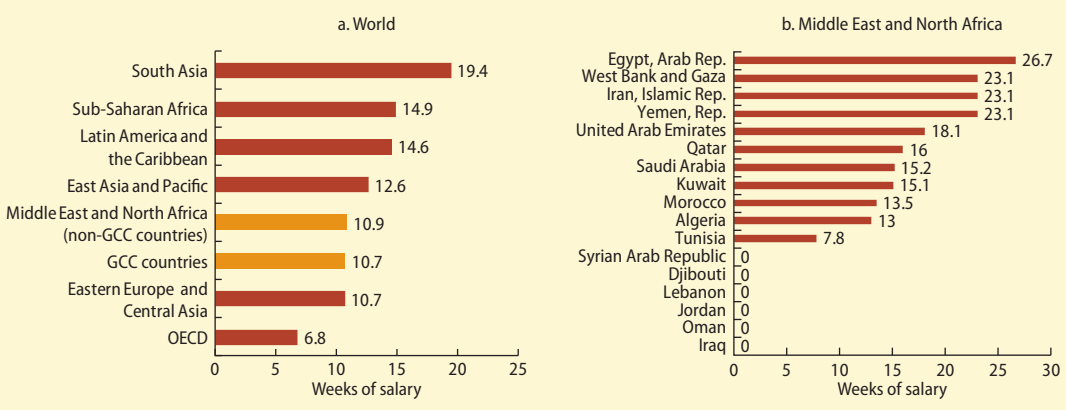
Egypt enacted a new labor law in 2003 giving employers more flexibility in aligning the labor force with economic conditions. The law introduced fixed-term contracts (that can be extended indefinitely), relaxed dismissal laws to an extent, gave workers the right to strike, and passed rules to address collective bargaining and worker-employer disputes. Yet the cost of firing a redundant worker in Egypt remains one of the highest in the world (figure 5.6). Although labor regulation is not identified as a leading constraint to business there (World Bank 2009), labor regulations and mandatory contributions continue to prevent many enterprises from expanding formal employment. According to reports from hotels, service firms, and manufacturing firms, they would hire a net of 15, 9, and 21 percent more workers, respectively, if there were no restrictions on hiring and firing workers.

Severance pay is rather low overall in MENA, but the low average masks wide divergence across countries. In addition to relatively strong employment protection through difficult dismissals, Egypt also requires a severance pay that exceeds the averages of all other world regions. Legislation in the Islamic Republic of Iran, the West Bank and Gaza, and the Republic of Yemen also results in relatively high costs of redundancy.

Pervasive and distortionary public sector privileges

Public sector employment offers more comfortable terms than the private sector, on average (table 5.2). In Egypt, Jordan, Tunisia,

FIGURE 5.6 Cost of redundancy in selected regions in the world and in selected economies in MENA, 2011



Source: World Bank 2012.
Note: Severance pay for redundancy dismissal (average for workers with 1, 5, and 10 years of tenure, in salary weeks). MENA = Middle East and North Africa; GCC = Gulf Cooperation Council; OECD = Organisation for Economic Co-operation and Development.

TABLE 5.2 Standard open-ended contract packages in the public and the private sectors in selected countries in MENA, 2011

	Public Sector			
Country	**Work hours/week**	**Paid leave in days/year**	**% of workers dismissed/year**	**Severance pay**
Algeria	40	22	<1%	Right to retire after 10 yrs
Egypt, Arab Rep.	36	From 14 for new hires to 45 for over 50 yrs old	<1%	Unused annual leave plus compensation
Jordan	38–42	21–30	<=3 cases/yr	0
Tunisia	Officially as in private	Officially as in private	<0.005%	One month pay/yr of service, max 12 yrs
United Arab Emirates (nationals)	35–40	15–30, plus leave for social activities, 2 mo health travel leave, 6 mo study leave	Extremely rare for nationals	Pension for nationals; expats: one month pay/yr for first 5 yrs, 1.5 for next 5, 2 for next 5
	Private Sector			
Algeria	40	22	—	13
Egypt, Arab Rep.	48	21; 30 for over 50 yrs old/after 10 yrs	4%	26.7
Jordan	40–53	14–21	9%	0
Tunisia	As in public; extra hrs expected	As in public	6% (only 1% if open-ended)	7.8
United Arab Emirates (nationals)	48	30	—	18.1

Sources: Based on legislation analysis and expert interviews by Musette and Mohamed-Meziani (2011; Algeria), Hendy and Selwaness (2011; the Arab Republic of Egypt), Mryyan (2011; Jordan), Boughzala (2011; Tunisia), and Chartouni (2011; United Arab Emirates) World Bank 2012. Note that we have no further information on the specific severance pay for civil servants in Algeria and the Arab Republic of Egypt.
Note: — = not available; MENA = Middle East and North Africa.
a. Average for workers with 1, 5, and 10 years of tenure, in salary weeks (World Bank 2012).

and the United Arab Emirates, the number of official or expected work hours is higher in the private sector than in the public sector. Annual leave for the two sectors is the same in Algeria and Tunisia, but it is greater in the public sector in Egypt, Jordan, and the United Arab Emirates. Dismissals in the public sector are extremely rare in all countries for which data are available, while the dismissal rate reaches 9 percent for the private sector in

some countries. Severance arrangements are invariably more generous in the public sector.

Some public staff "double dip" and pursue employment on the side. There is evidence from Egypt showing that public sector health staff hold private clinics during public sector shifts and on public premises. One-quarter (25 percent) of all public personnel in public facilities are absent on an average day (Grun, Etter, and Jillson 2010).

Employment legislation and job creation in MENA

Legislation on contracts is important, because, according to international evidence, strict legislation to protect employment, on balance, tends to reduce aggregate employment and to increase unemployment. For example, Heckman and Pages (2000) show that in Latin America, more stringent job security laws are associated with lower employment and higher unemployment, particularly among young workers. Ahsan and Pages (2007) report that regulations concerned with labor disputes and job security hurt covered workers. Other studies using macroeconomic data have also found negative efficiency effects of high severance pay (see Nicoletti et al. 2001). Nickell and Layard (1997) find that strong employment protection slows turnover and therefore short-term unemployment but increases long-term unemployment. The OECD (1999) finds that stricter protection leads to lower employment-to-population ratios through higher inactivity rather than to higher unemployment. Micco and Pages (2006) also find a negative employment effect. The evidence is not unequivocal, however. Some recent studies (Baccaro and Rei 2005; Bassanini and Duvall 2006) do not find significant employment impacts. One reason may be that enforcement matters. Ahsan and Pages (2009) and Almeida and Carneiro (2009) show that negative effects depend on the strictness of enforcement.

Strict employment legislation also tends to increase a country's vulnerability to shocks. Bentolila, Dolado, and Jimeno (2011) estimate that differences in the enforcement of employment protection between France and Spain explain why France's unemployment rate did not rise nearly as much as Spain's during the recession. Based on analysis of a panel of 60 developing and developed countries, Caballero et al. (2004) show that strict labor regulations, if enforced, slow down the speed of adjustment to shocks.

Effect of strict employment protection on productivity

Restrictive legislation can sometimes hurt productivity by limiting the movement of labor. Caballero and Hammour (2000) show that rigid dismissal legislation reduces formal sector employment and contributes to the growth of the informal sector; depresses job creation and technological innovations; enables survival of inefficient, low-productivity units; and suppresses entry of potentially highly productive new firms. Several new empirical studies support these findings. Bassanini and Venn (2007) find that strict statutory employment protection for regular contracts reduces productivity growth, most likely by restricting the movement of labor into emerging high-productivity activities. Eslava et al. (2010) examine the impact of labor and capital reforms on productivity in Colombia, showing that increased labor and capital turnover after the reforms in the early 1990s increased productivity. Further studies show that restrictive legislation slows down the speed of labor reallocation from low- to high-productivity activities (Besley and Burgess 2004; Boeri and Jimeno 2005; Haltiwanger, Scarpetta, and Schweiger 2010; Messina and Vallanti 2007; Micco and Pages 2006). However, rigid dismissal has also occasionally been shown to increase productivity, through higher training commitments by employers (who cannot get rid of people) or higher capital investments for the same reason (Autor, Kerr, and Kugler 2007; Belot, Boone, and van Ours 2007).

Labor turnover tends to be relatively low in the region (table 5.3) but is comparable to that in Eastern Europe. With the

TABLE 5.3 Job turnover in the past year as a share of those currently working in the private sector in selected economies in MENA, 2006–10
Percent

Economy	People starting new jobs	People losing jobs
Egypt, Arab Rep.	0.6	4.0
Iraq	2.0	1.2
Jordan	5.2	8.8
West Bank and Gaza	15.0	27.0
Tunisia[a]	10.5	6.3[a]

Sources: The Arab Republic of Egypt's LMPS 2006, Iraq's HSES 2006–07, Jordan's LMPS 2010, the West Bank and Gaza's LFS 2008, and Tunisia's LFS 2010 (see Appendix); expert interviews by Hendy and Selwaness (2011), Mryyan (2011), and Boughzala (2011).
Note: MENA = Middle East and North Africa.
a. Formal layoff from open-ended contract only.

extreme exception of the West Bank and Gaza, job entry ranges from 2 to 10 percent of all jobs per year, while layoffs range from 1 percent to 9 percent of total employment per year. Comparable figures for OECD countries are generally in the 10 percent range, and available figures for Eastern Europe range from 2 percent to 16 percent, with most countries above 8 percent.

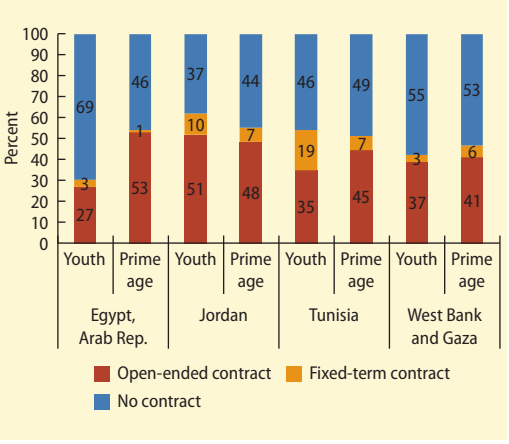
Effect of strict legislation on youth and first-time job seekers

Strict employment protection legislation primarily hurts access to jobs by vulnerable groups such as youth and women, thereby leading to more exclusion. Blanchard (1998) shows that an increase in dismissal costs leads to higher unemployment among marginal groups of workers because of their inferior access to jobs. Because the productivity of young workers is not easily revealed before hiring, their probability of being hired is lower in the presence of increased firing costs. OECD (1999) finds that stricter employment protection legislation reduces employment among prime-age women and youth, thus exacerbating exclusion effects, as difficult firing leads to longer unemployment spells and job duration, a trend that likely benefits prime-age males. Similarly, Kugler and Saint-Paul (2000) show that greater firing costs increase discrimination against unemployed workers, because they increase the costs associated with hiring a bad worker.

In other words, large dismissal costs contribute to the segmentation of labor markets, in which well-protected workers in the formal sector (who tend to be predominantly prime-age males) contrast with much less-protected workers in the informal sector and the unemployed. Evidence from the region, reviewed in the sections that follow, shows these effects among youth and women.

Consistent with the above observations, youth have less stable labor contracts than prime-age workers in MENA. In Egypt, Tunisia, the United Arab Republic, and the West Bank and Gaza, youth have significantly fewer open-ended contracts and more term or sometimes even noncontractual work relationships (see figure 5.7) (although in Jordan, as an exception, youth have more stable contracts than prime-age workers). Temporary jobs can be problematic, because they can exacerbate any dualism in the labor market (Bentolila, Dolado, and Jimeno 2011). The Spanish experience shows how temporary contracts become a "permanent" perpetuation of insecurity—a

FIGURE 5.7 Types of work contracts in all sectors in the Arab Republic of Egypt, Jordan, Tunisia, and the West Bank and Gaza for the last available year, 2006–10



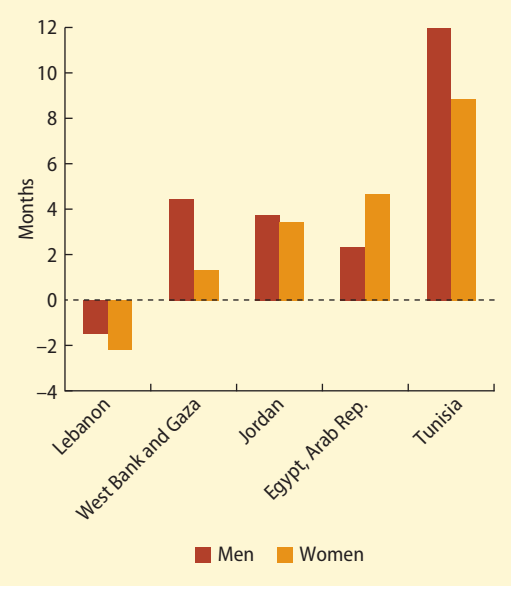
Source: The Arab Republic of Egypt's LMPS 2006, Jordan's LMPS 2010, Tunisia's LFS 2010, and the West Bank and Gaza's LFS 2008. See the appendix for more information on these surveys.

trap rather than a bridge to an open-ended job. Temporary work spells are unlikely to end in permanent jobs regardless of workers' tenure. These results can probably be generalized to all dual labor markets, such as those in MENA.

Interestingly, the relative disadvantage of youth that is so pronounced in the public sector is much milder in the private sector. In the private sector, youth have only marginally fewer open-ended contracts than older workers, and they have more term contracts. In most countries, however, older workers have more noncontractual relationships. This situation may reflect the institutional differences between both sectors, which restrict layoffs (and thereby job turnover) much more in the public sector.

In Egypt, Jordan, Tunisia, and the West Bank and Gaza, first-time job seekers have a much longer unemployment spell than the average jobless. As figure 5.8 shows, first-time job seekers in Tunisia search 9.0 months longer than the average unemployed: in Jordan, nearly 4.0 months longer, in Egypt, 3.0 months longer, and in the West Bank and Gaza, 2.6 months longer. Only in Lebanon do first-timers find a job faster than the average (by about a month).

FIGURE 5.8 Duration of unemployment for male and female first-time job seekers in selected economies in MENA, 2006–11



Source: Lebanon's Employer-Employee Survey 2011, the West Bank and Gaza's LFS 2008, Jordan's LMPS 2010, the Arab Republic of Egypt's LMPS 2006, and Tunisia's LFS 2010. See the appendix for more information on these surveys.

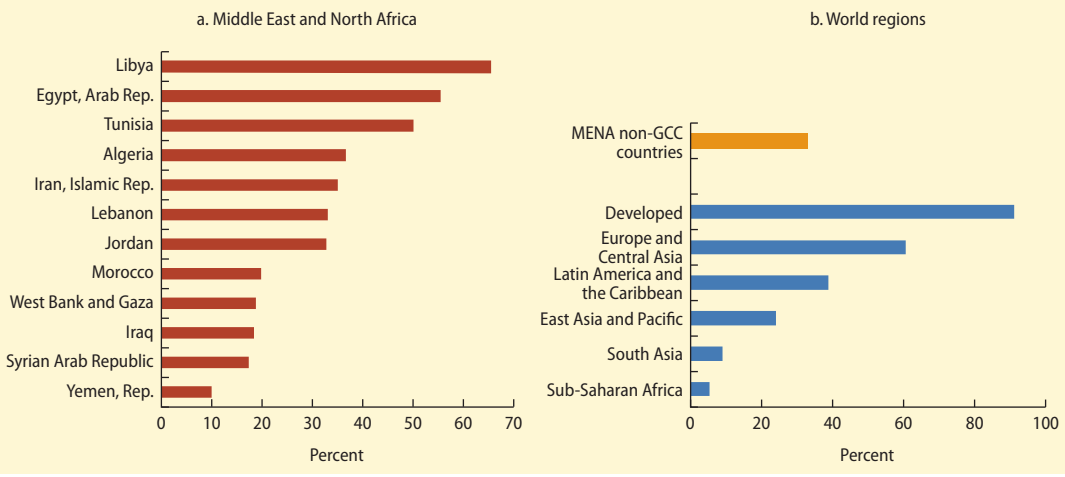
Regulation of social insurance

The protection against key social risks (old age, disability, death, unemployment, and health needs) is linked to labor market participation. While many argue that widespread access to protection (specifically, the extension of social insurance coverage) should be delinked from employment, the reality in MENA and the rest of the world is that access to social insurance tends to require formal employment status (or at least formal employment for somebody in the household).

Low coverage of the poor, the young, and the uneducated

The share of contributors to mandatory social insurance schemes within the labor force is widely used as a coverage measure. In MENA, social insurance coverage is low: only 33 percent of the labor force contributes to social insurance and thus has access to effective tools of social risk management (figure 5.9a). Rates of coverage in individual countries vary a great deal, but even at the highest levels—that is, for countries not in the Gulf Cooperation Council (GCC)—at least a third of the labor force does not participate in a social insurance scheme (figure 5.9). Coverage is strongly related to the level of economic development, as measured by gross domestic product (GDP) per capita (see Forteza, Lucchetti, and Pallares-Miralles 2009), and the problem is not specific to MENA. At 6 percentage points below that of Latin America and the Caribbean and 11 percentage points above that of East Asia and the Pacific, MENA's coverage rate reflects its composition of low- and middle-income countries (figure 5.9b).

FIGURE 5.9 Percentage of the labor force contributing to social security in MENA and other regions of the world, 2000–07



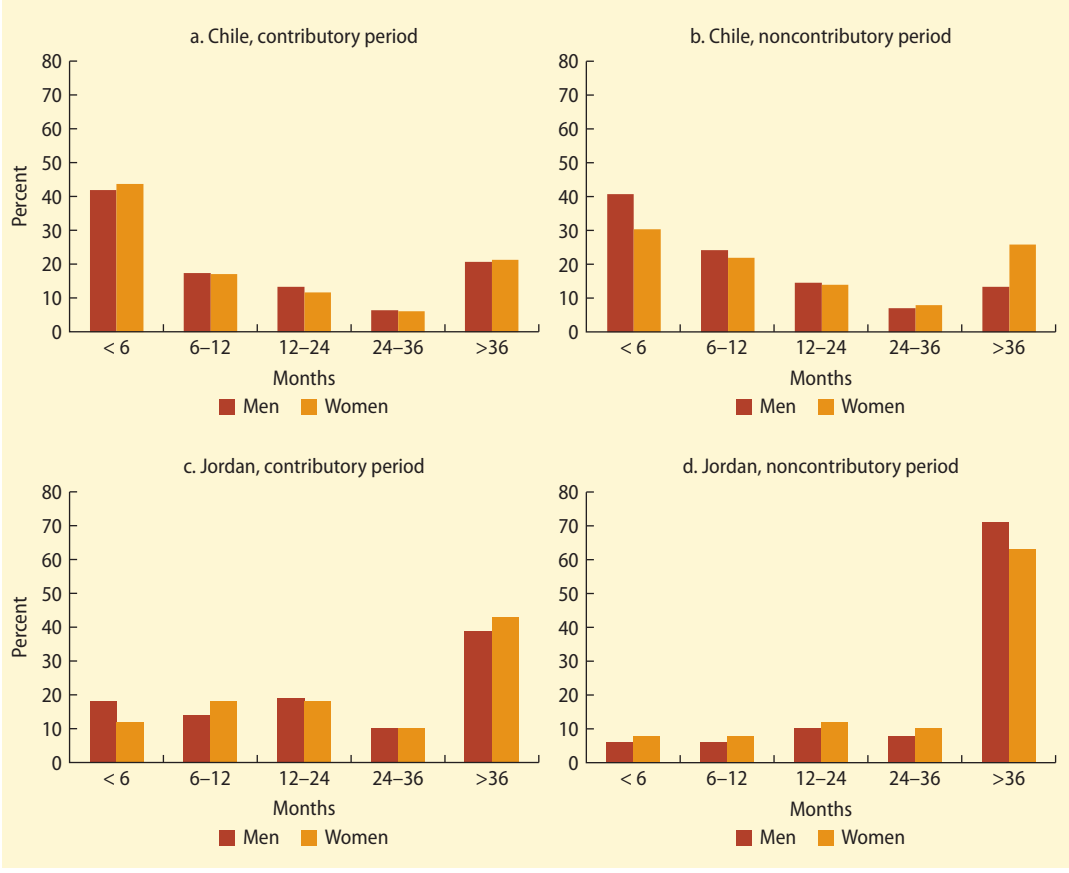
Source: Gatti et al. 2012, based on the International Labour Organization's Key Indicators of the Labour Market (ILO-KILM). Coverage in GCC countries in the ILO-KILM is essentially limited to Bahrain.
Note: MENA = Middle East and North Africa; GCC = Gulf Cooperation Council.

The phenomenon of informal employment (employment without social insurance) is heavily biased toward vulnerable groups: the poor, the young, and the uneducated. In general, the incidence of informal employment decreases with wealth in MENA: informality rates within the poorest income quintiles in Morocco, Lebanon, and Syria are 92, 83, and 83 percent, respectively, versus 73, 59, and 35 percent in the richest quintiles (Angel-Urdinola and Tanabe 2012). Not surprisingly, the informality phenomenon is associated with the notion of the working poor (Gatti et al. 2012) and the young. Youth informality rates are especially high for individuals up to their mid-20s, reaching 40–70 percent in Egypt, Iraq, Jordan, Morocco, and the Republic of Yemen. For individuals older than 25, informality decreases steadily in a manner consistent with the phenomenon of queuing for a public sector job (Bodor, Robalino, and Rutkowski 2008). Employment without social insurance coverage is also prevalent among those who enter the labor market with a low level of education. Informality among graduates with a tertiary education is in the range of 24–41 percent in Egypt, Iraq, Jordan, Lebanon, Morocco, Syria, and the Republic of Yemen compared to 72–98 percent among those with primary education or below (Gatti et al. 2012).

Covered insiders and uncovered outsiders

A comparison of the patterns of contributions to social insurance in Jordan with those in Chile provides further evidence of a divide between insiders, who possess higher-quality jobs with insurance coverage, and outsiders, who are forced to accept lower-quality jobs without coverage. In Chile, periods of contributing and not contributing to social insurance have similar patterns: 21 percent of contributory spells and 18 percent of noncontributory spells last more than three years (figure 5.10a and 5.10b, respectively). In the labor market, contributory status signals the existence of a formal (covered) job, whereas noncontributory status may be associated with informal (uncovered) employment as well as with unemployment or (temporary) exit from the labor force. Long contributory and long noncontributory spells are substantially more frequent in Jordan than in Chile: 40 percent of contributory spells and 70 percent of noncontributory spells exceed three years (figure 5.10c and 5.10d, respectively). This

FIGURE 5.10 Months of contributory and noncontributory spells of social insurance for men and women in Chile (2008) and Jordan (2010)
Percent



Source: Administrative data from Social Security Corporation (Jordan) and Pension Superintendency (Chile).

"stickiness" is consistent with low mobility between formal and informal jobs and, in a broader sense, with the existence of a boundary between covered insiders and uncovered outsiders (see Gatti et al. 2012).

Segmentation of coverage between public and private sector employees

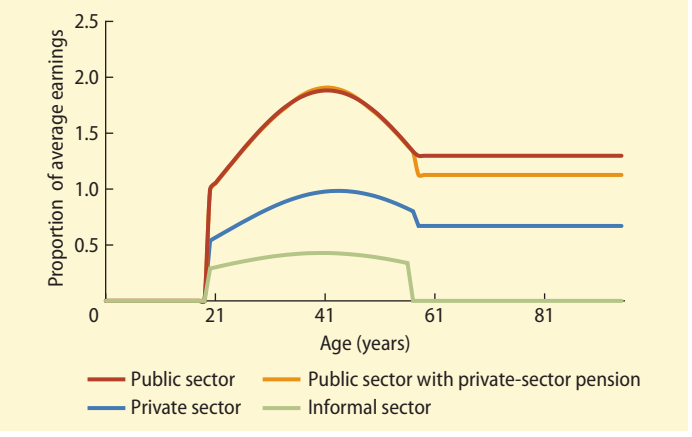
Social insurance benefits and the rules of participation in the system have historically been specific to the sector of employment in MENA (Pallares-Miralles, Romero, and Whitehouse 2012), beginning with the civil service and only later expanding to the private sector. This development has generated a rather fragmented landscape of systems (Palacios and Whitehouse 2006), although current trends point toward the provision of social insurance under a unified scheme. The unification of social insurance provision, at least for new labor market entrants, has occurred in Egypt, Jordan, and Syria. The legislative mandate for unification was also approved in Djibouti and Iraq, where the preparatory work for implementation is in progress. In Saudi Arabia, distinct social insurance schemes for private and public sector workers prevail, but the benefit packages are almost identical, with full portability arrangements in place for those who change the sector of employment. In the absence of such arrangements, the social insurance system has limited labor mobility and effectively segmented the labor market, because vested

social insurance rights were lost when workers moved between the private and the public sectors. Strong segmentation of the social insurance system is still the norm in the Maghreb. For example, Morocco has four distinct mandatory social insurance schemes. The Caisse Nationale de Securité Sociale covers private sector workers, the Regime Collectif d'Allocations et de Retraites covers workers at state-owned enterprises and contractual workers in the private sector, the Caisse Marocaine de Retraite provides pension benefits to civil servants and the military, and the Caisse Nationale d'Organismes de Protection Sociale provides health insurance to public sector workers.

Beyond the institutional segmentation lies a great heterogeneity in the social insurance benefits and contribution requirements: not only do public sector workers tend to earn more, but also their social insurance benefits are more generous.

As figure 5.11 illustrates, higher average earnings do not fully explain the higher defined-benefit pensions for public sector workers; the pension of a representative, full-career-path civil servant in Morocco is 15–20 percent higher than his or her pension calculated under the rules of the private sector pension scheme. As mentioned, such generous pension schemes discourage labor from moving to private employment and strengthen the segmentation between the public and the private employment sectors.

FIGURE 5.11 Life-cycle earning profiles according to sector of employment and the generality of sector-specific pension benefits in Morocco



Source: Bodor, Robalino, and Rutkowski 2008.

Financial sustainability—or not

The exclusion from access to social insurance runs deeper than just lack of coverage, since the pension systems currently in place redistribute income to insiders at the expense of outsiders. Pay-as-you-go (PAYG) is the predominant mode of financing pension systems in MENA. Under PAYG, benefits to current pensioners are financed through the contributions of those currently in formal jobs, but PAYG schemes are operating on unsustainable financial paths. Robalino and Bogomolova (2006) show that the pension systems of a set of MENA countries incurred unfunded contingent liabilities in the range of 55–105 percent of their country's GDP. These contingent liabilities are also increasing. One can calculate these contingent liabilities as the present value of all future pensions to be paid to current pensioners plus the present value of all future pensions to be paid to current contributors (active employees), based on contributions completed to date.

MENA's pension system benefits are not perceived as generous, but if the value of contributory streams, the source of funding, and the pension benefit streams are compared, then the overall packages are quite generous. The implicit pension debt is increasing, because any unit of contribution creates more earned pension rights for the contributor than the value of this unit of contribution: that is the core of the pension system sustainability problem. At some point, the unfunded implicit liabilities must be financed, and there are only two options: defer the burden to future plan members (that is, intergenerational redistribution) or subsidize pension payments from the government's general revenues. As those with jobs in the formal sector are generally in a better income position than the rest of the population, the unsustainable and accelerating accumulation of pension liabilities points toward solutions that

channel general revenues toward those who are already better off.

Segmentation in the migrant-dominated private labor markets of the GCC

Moving abroad for better work opportunities is widespread in MENA, with the potential for further growth.[5] Remittances received in Egypt, Morocco, and the Republic of Yemen amount to 5.0–9.5 percent of GDP; the corresponding figures are 20.3 percent in Jordan and 22.0 percent in Lebanon (World Bank 2011).[6] The GCC as a region is one of the world's key destinations for temporary migrants; the share of the migrant population there varies between 27.8 percent in Saudi Arabia and 86.5 percent in Qatar, with remittance outflows in the range of 6.8–11.3 percent of GDP in Bahrain, Oman, and Saudi Arabia (World Bank 2011). While the GCC primarily hosts migrant workers from East and South Asia, it is also a relevant destination for workers throughout MENA: more than 30 percent of the migrants in Kuwait, Qatar, and Saudi Arabia are from other Arab countries.[7]

Institutional segmentation between the citizens of a country and migrant workers is the international norm: national governments tend to protect their domestic labor markets in favor of their citizens. The GCC labor migration phenomenon is a unique case. GCC governments do not constrain the access of firms to foreign labor; instead, they establish distinct rules for the employment and social protection of nationals and foreign workers. The employment of GCC nationals is backed by strong employment protection legislation and the provision of social insurance benefits. In addition, administrative requirements are in place for firms to employ a threshold share of nationals in their workforce (so-called Bahrainization, Emiratization, Kuwaitization, Omanization, Qatarization, and Saudization policies). In contrast, foreign workers are bound by the rules of the sponsorship system. Their legal presence in the host country is legitimized only through their contract with their employer (sponsor), and they need to leave the country upon conclusion of the fixed-term (often three-year) contract unless their employer seeks the renewal of their work permit on their behalf. As a rule, the sponsorship system allows no mobility within the host country labor market.

Recent reforms have started to alleviate these economically costly restrictions. Bahrain formally abolished the sponsorship system, theoretically allowing firm-to-firm mobility for foreign workers but with little institutional support thus far. Saudi Arabia introduced the Nitaqat Saudization firm classification system, which allows foreign workers of firms with lower-than-required threshold Saudization performance to move to better-performing firms. Within the so-called free zones of the United Arab Emirates, firm-to-firm mobility of foreign workers has been in place for some time.

Social protection is differentiated across nationals and foreign workers and heavily favors the former. The only standard benefit offered to foreign workers is an end-of-service cash payment conditional on past wages and the length of employment with the firm, but anecdotal evidence suggests that employers do not necessarily comply with this mandate. With the exception of Bahrain's unemployment insurance provision to foreign workers, mandatory social insurance coverage in the GCC hardly extends beyond covering work-related injury.

On the one hand, the GCC economies provide jobs to millions of workers from low- and middle-income countries where income-generating opportunities are worse; on the other hand, though, the employment conditions of foreign workers in the GCC are often considered exploitative. Although social protection provisions for foreign workers in the GCC do not meet international standards, the good news is that the GCC governments have initiated efforts to improve policies affecting the mobility and protection of foreign workers. The rationale for such initiatives includes capturing the productivity gains from using the human capital of migrant workers in

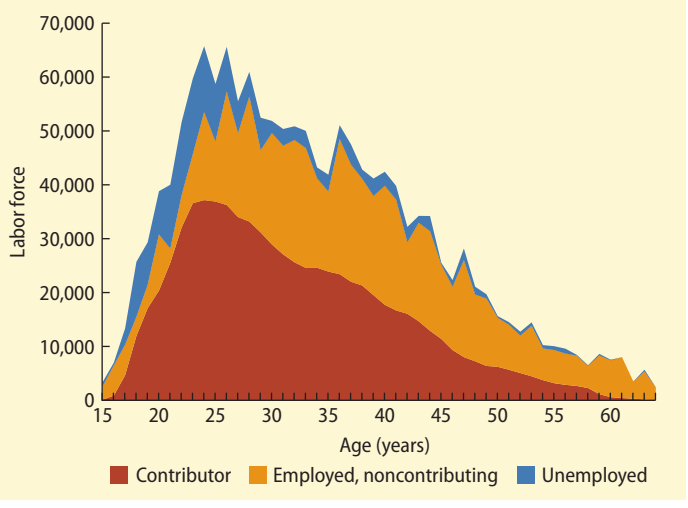
a better way. An interesting emerging idea is the use of "mobility savings accounts." These accounts, which would replace the employer mandate for the end-of-service benefit, would consist of an employee- and employer-funded mandatory saving mechanism that would enable such saving to "sponsor" the foreign worker's job search in the host country for a given period after the initial fixed-term work contract ends.

Demographic shifts and the need for reforming MENA's social insurance systems

Threats to the financial sustainability of MENA's pension schemes are at least partially hidden by the current demographic transition and pension system maturation. MENA is at a stage where the ratio of contributors to beneficiaries is favorable to current finances. Although contribution payments to PAYG schemes in MENA generate more pension entitlements than the value of those contributions, paradoxically, the current financial balances of PAYG pension schemes tend to be in surplus, owing to the age structure of contributors and pension beneficiaries. For example, Jordan's age cohort of people older than 50 who are approaching (or already partially entering) retirement has fewer than 10,000 contributors (figure 5.12). In contrast, the scheme has more than 30,000 contributors between 22 and 30 years of age.

From a fiscal or even a political perspective, it is clear that the positive PAYG balance coincides with the scheme's increasing implicit indebtedness. Until the parameters of the defined-benefit pension systems are adjusted to sustainable levels, the higher current revenues from large, young entry cohorts actually worsen the system's long-term financial position. The benchmark range for the long-term sustainable internal rate of return (IRR)—that is, the implicit percentage return the pension system pays on contributions in the form of pension payments—for a PAYG pension scheme is 2–4 percent. In contrast, the pension system IRRs in Egypt and Syria are 6–10 percent and 7–14 percent, respectively, depending on the variation of individual contribution patterns over the active life cycle. The situation resembles that of borrowers who improve their current financial position by borrowing at an interest rate of 6–14 percent but who can afford to service the debt in the long run at an interest rate of only 2–4 percent.

FIGURE 5.12 Age-specific composition of the labor force across pension system contributors, employed noncontributors, and the unemployed in Jordan, 2010



Source: Administrative data from Social Security Corporation (Jordan) and Jordan's LMPS (2010; see appendix for more information).

A further concern is that the active age population in MENA's middle-income countries is leveling off or even starting to decline. Under these circumstances, the deteriorating financial position of PAYG schemes will become difficult to conceal. These schemes could gain a short-term boost by the politically popular move of eliminating the boundary between insiders and outsiders and enrolling current noncontributors (see "noncontributing" employed in figure 5.12), who would pay large contributions without claiming benefits for decades. Without reform, however, these gains are likely to be illusory, because they would raise the current financial balance of the pension system while increasing its unfunded liabilities over the long term. A more realistic option would be to give outsiders access to social risk-management tools and at the same time reset

the IRRs of the pension systems to sustainable levels (for example, by adjusting pension system parameters, realigning income replacement rates with contribution rates, and increasing the effective age of retirement and the length of contributory paths).

Effects of flawed pension system designs

Because the IRR for participating in pension schemes in MENA countries is high, even compared to returns from alternative saving options, those who are allowed to join social insurance systems have strong incentives to do so, at least under the current generous conditions. By international standards, minimum vesting periods are short in MENA's pension schemes, and early retirement provisions are generous—often there is no reduction in benefits if an individual retires before the statutory age (table 5.4). A large number of workers in the formal sector retire when they are in their early 50s and begin to claim their pension benefits while they continue to be economically active. In Egypt, Jordan, and Syria, one of the most lucrative strategies for participating in the pension system is for an individual to enroll upon entering the labor market and to claim pension benefits as soon as he or she meets the requirements for the vesting period and age of early retirement (Gatti et al. 2012).

Such design flaws undermine the financial sustainability of the pension schemes and give rise to unfunded government liabilities that

TABLE 5.4 Pension design parameters of mandatory formal sector schemes in MENA, 2009–11

	Life expectancy at birth	Statutory retirement age		Minimum vesting period		Early retirement age		Vesting for early retirement age	
		Female	Male	Female	Male	Female	Male	Female	Male
Algeria	73.5	55	60	10	15	Any age/45	Any age/50	32/14	32/20
Djibouti	58.5	55	55	—	—	Any age	Any age	25	25
Egypt, Arab Rep.	73.5	60	60	10	10	Any age	Any age	20	20
Iran, Islamic Rep.	73.3	55	60	19	19	Any age/45	Any age/50	35/30	35/30
Iraq	70.2	60	60	25	25	55/50	55/50	25/30	25/30
Jordan	73.6	55	60	15	15	50	50	22	25
Libya	75.1	60	65	20	20	—	—	—	—
Morocco	72.5	60	60	14	14	55	55	If employer pays	If employer pays
Syrian Arab Republic	76.1	55	60	15	15	Any age/50	Any age/55	25/20	25/20
Tunisia	74.4	60	60	10	10	50	50	30	30

Country	Average wage measure
Algeria	Maximum of the average of the wages of 5 last years and the average of 5 best years without revalorization
Djibouti	Average of the wages of the last 10 years/last month's wage
Egypt, Arab Rep.	Convoluted combination of unrevalorized average basic wage of the last 2 years and unrevalorized full career average variables wages
Iran, Islamic Rep.	Average of unrevalorized wages in the last 2 years
Iraq	Gradually expanding to revalorized full career average wages in public sector/unrevalorized average of last 3 years of wages in private sector
Jordan	Average of unrevalorized wages in the last 8 years
Libya	Average of unrevalorized wages in the last 3 years
Morocco	Average of unrevalorized wages in the last 8 years
Syrian Arab Republic	Average of last year's unrevalorized wages with wage increase not to exceed 15% and 30% in the last 2- and 5-year periods respectively
Tunisia	Average revalorized wages in the last 10 years in main scheme; different rules in 4 other national schemes

Source: Gatti et al. 2012.
Note: — = not available.

represent implicit subsidies of formal sector employment. They also indirectly limit the government funds available for encouraging voluntary entry into the social insurance system—in other words, to extend the system's coverage to individuals and households outside the formal sector that have limited saving capacity.

The other high-return strategy for gaming the pension systems in Egypt and Syria is for an individual to concentrate the minimum number of contributory years toward the end of his or her career. In this way, the naturally high earnings at the end of an individual's career are registered (or even artificially inflated) by the flawed average-wage measure of the formulas for defined pension benefits, which, in this case, consider only wages in the few years before retirement (table 5.4).

In summary, these flaws in defined-benefit pension systems exacerbate the financial unsustainability of PAYG schemes, heighten their advantages for formal workers, and operate against expanding social insurance coverage to informal workers. In other words, they do little to diminish the formal-informal segmentation of MENA's labor markets.

Unemployment insurance: From protecting jobs to protecting income

In addition to covering only part of the population, the scope of social insurance in MENA is limited; for example, adequate unemployment coverage is the exception rather than the rule (table 5.5). Lebanon, Libya, Morocco, Syria, the United Arab Emirates, and the Republic of Yemen have neither unemployment insurance (UI) (which is a contribution-based tool intended to support consumption during spells of unemployment between jobs) nor unemployment assistance (UA) (which is a noncontributory tool for poverty reduction specifically among the unemployed). As a social insurance program that covers the risk of temporary income loss when a person loses a job, UI is a means of sharing the social costs of reallocating labor among firms through periods of unemployment.

Algeria has a contributory unemployment benefit program, but it deviates from the standards of UI in its ad hoc mechanism for determining benefits. Egypt's current UI mechanism has been in place since 1975

TABLE 5.5 Unemployment benefit programs in MENA, 2011

Non-GCC MENA countries	Type of unemployment benefit	Remarks
Algeria	Unconventional unemployment benefit	Ad hoc benefit formula is an average of last salary and the minimum wage with a ceiling of 3 times the minimum wage
Egypt, Arab Rep.	UI	Hardly any UI beneficiaries due to restrictive conditions
Iran, Islamic Rep.	Unconventional unemployment benefit	Resembles early retirement schemes with maximum benefit length in excess of 4 years
Jordan	UI + UA	Introduced in 2011
Lebanon	None	—
Lybia	None	—
Morocco	None	—
Syrian Arab Republic	None	—
Tunisia	Unconventional unemployment benefit	Not UI as wage and benefit are disattached by minimum wage ceiling
Yemen, Rep.	None	—
GCC countries		
Bahrain	UI + UA	Introduced in 2006
Kuwait	None	Benefit conditional on unemployment may not be consistent with citizenship status-based cash transfer
Oman	UA	Introduced in 2011 for a year
Saudi Arabia	UA	Introduced in 2011 for the short term
United Arab Emirates	None	—

Source: United States Social Security Administration and International Social Security Administration (ISSA) (2010, 2011), and World Bank operational work in Oman and Saudi Arabia.
Note: — = not available. MENA = Middle East and North Africa; GCC = Gulf Cooperation Council; UA = unemployment assistance; UI = unemployment insurance.

but is hardly operational because of highly restrictive conditions on obtaining benefits. The Islamic Republic of Iran's unemployment benefit scheme mixes family support objectives with long-term benefit eligibility (in excess of four years) as a means of helping beneficiaries in their inactivity rather than as a way to move them into a new job. Tunisia's unemployment benefit scheme does not live up to the principles of UI; by setting the benefit ceiling at the minimum wage, it delinks the prior lay-off wage from the unemployment benefit. Oman and Saudi Arabia introduced ad hoc temporary unemployment assistance schemes in 2011 as a response to social tensions around unemployment. UI in its more complete sense exists only in Bahrain (introduced in 2006) and Jordan (2011). Income protection for the unemployed in MENA could be far more effective, especially given its potentially significant role in addressing the region's key labor market challenges.

Why does segmentation persist in MENA?

Hiring in segments—giving priority to prime-age workers over youth, or to men over women, for example—is not efficient. It bypasses talent in lower-priority groups, which remains unemployed or stagnates in precarious jobs that lack growth opportunities. On average, choosing to hire in segments contributes to the low-productivity equilibrium we observe in labor markets in MENA.

A primary reason why MENA firms can afford to hire along segments is that they face little competition. Chapter 4 provided ample evidence that firms in MENA have very few local competitors and experience very little creative destruction. One of the consequences of this stagnation is that in MENA, firms are under less pressure to hire the most productive workers. Another reason that can explain why segmentation endures is that "voice" does not have a long tradition in MENA, and among other consequences, limited voice can reduce the pressure on firms to perform.

According to the exit-voice theory (Hirschman 1970), citizens can respond to declining quality in (public or private) goods by switching providers and making use of competition (exit) or by complaining to providers and asking for quality improvements (voice). Both strategies can lead to higher quality and productivity by pressuring firms to improve.

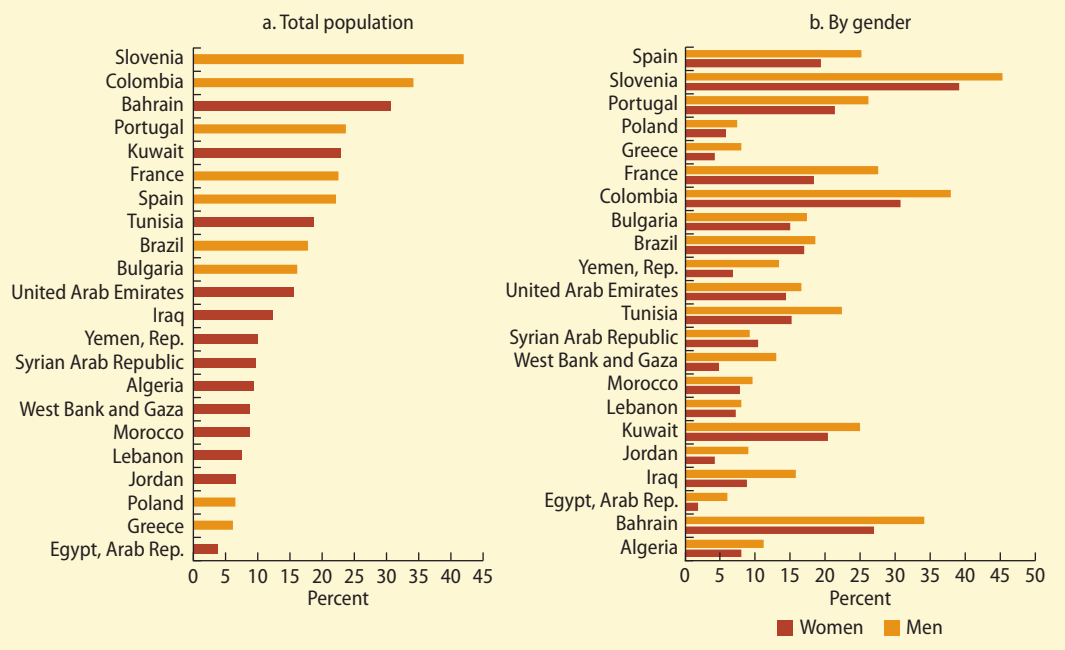
However, as recent Gallup data show, a culture in which citizens and clients express their opinions to public officials is only nascent. People in MENA's non-GCC countries voice their opinions significantly less than people in comparator countries from Eastern Europe and Latin America (figure 5.13). As will be discussed in the concluding chapter of this report, until recently, the political climate in many countries did not encourage freedom of speech or voice.[8] With few worries about exit or voice, firms in MENA face even less pressure to improve or to hire the best workers, without regard to segments.

What happens if segmentation persists?

The divide between labor market insiders and market outsiders may be bridged as countries in the region continue to integrate their trade with Europe and the rest of the world. Jordan and Tunisia in particular have made great strides (Diop and Ghali 2012). Integration will invariably translate into stronger competition and induce domestic firms to operate at their most profitable level. Firms that want to maximize profits will need to hire the most productive workforce and will therefore discriminate less along the traditional lines of youth and gender. Evidence on exporting firms in Europe confirms this tendency (Heinze and Wolf 2010).

Yet if segmentation persists in MENA's labor markets, a number of important opportunities will be missed. First, countries will fail to obtain the best development results from their young and increasingly educated population. The institutionally forced marginalization of masses of outsiders in

FIGURE 5.13 Percentage of those who have "voiced" an opinion to a public official in the past month in selected world economies, 2010



Source: Gallup World Poll 2011. See the appendix for more information on the poll.

low-quality, informal jobs prevents them from realizing their true value-adding potential and limits economic development outcomes. In an era when human capital is emerging as the primary asset of production, this missed opportunity can have particularly serious repercussions.

Second, MENA countries could fail to capture the potential for building social cohesion that is associated with widespread access to social insurance. Social risk management usually works best with universal access. Institutional exclusion from such public mechanisms may very well have been the subtext of a dominant message of the Arab Spring—the lack of dignity felt by outsiders. Failure to respond could undermine the achievements of that movement.

A third opportunity—linked to integrating the large number of young noncontributors into pension systems—must go hand in hand with close attention to the system's financial sustainability. A simple promise to extend the current social insurance benefit package to masses of young system entrants would almost certainly be broken, because the systems are not financially constituted to deliver benefits sustainable in the long term. However, widespread participation in a reformed social insurance system, realigned to establish a closer relationship between contributions and benefits, would distribute the system's unfunded liabilities more equitably, both between and within generations.

Finally, youth are a sizable and increasingly vocal part of the population in all MENA countries. The population under 25 years of age ranges from about 40 percent in Tunisia to nearly 70 percent in the Republic of Yemen. The Arab Spring was largely youth led, enabled by social media tools that youth wield with dexterity. Given this relative knowledge advantage, and the independence of social media from state control, the voice of this group will inevitably be

heard—preferably in constructive ways, in open public debate.

The unsustainable status quo

Labor regulations are not the prime driver of segmentation in MENA, but they cement the disadvantages of disadvantaged and excluded groups. Strict legislation on employment protection discourages access to jobs by new entrants such as youth and women. For example, youth have less stable labor contracts than prime-age workers in MENA and face longer unemployment spells. Labor regulations also exacerbate the barriers to private sector participation discussed in the previous chapter: restrictive legislation limits productivity gains by limiting the movement of labor, and labor turnover is indeed low in the region.

The current degree of segmentation in MENA's labor markets is likely to be unsustainable economically or socially. MENA's social insurance systems operate on a financially unsustainable path and have started running deficits in some countries. Even with sustainable parameters, most countries' pension systems cannot afford to exclude young, unemployed contributors. Moreover, the Arab Spring was a clear expression of the frustration and sense of exclusion generated by this equilibrium in labor markets.

Notes

1. Assar Lindbeck and Dennis Snower developed what is known in labor economics as the insider-outsider theory, which studies the behavior of economic agents in markets where some participants have more privileges than others.
2. The following arguments are taken from Grun et al. (2008).
3. Most minimum wages in the world have no measurable impact on overall unemployment, but they do affect youth unemployment. Although work by Card and Krueger (1997) found no significant aggregate employment effect, critiques of this work (for example, Deere, Murphy, and Welch 1995) and empirical work with a different result (for example, Neumark 1999) have opened a debate. Elmeskov, Martin, and Scarpetta (1998) and Nickell and Layard (1997) find no significant impact of the minimum wage on overall unemployment but conclude from existing research that higher minimum wages increase unemployment of all groups whose productivity falls, or might fall, below the wage, such as youth.
4. Regarding international evidence on this phenomenon, see Mankiw (2006).
5. All references in the contractual section come from raw data in World Bank (2012), unless otherwise noted.
6. For a comprehensive overview of the situation and potential for migration in the MENA region, see Luthria, Pouget, and Trenner (forthcoming) and Zlaoui and Koettl (2009), as well as Keller (2010).
7. Both Jordan and Lebanon struggle with the phenomenon of skilled outmigration combined with unskilled immigration. See Jordan Ministry of Planning and International Cooperation (2011) and Robalino and Sayed (2012) for a more in-depth discussion of this topic.
8. According to the 2009 Polity IV rankings for MENA, voice and accountability scores are significantly lower than income in comparator countries. According to the Freedom House Freedom of Press Index, only Egypt and Morocco are rated "partially free"; all other MENA countries had a "not free" press in 2009.

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Unemployable and Unemployed: Skills Gaps and a Meritocracy Deficit in MENA

6

Main findings

- Despite the achievements in enrollment rates, education systems in MENA continue to lag behind in providing the quality education and skills that are relevant for private sector employment. The system continues to operate under a logic of "selecting" candidates for public employment rather than a logic of fostering learning.
- Many employers make hiring decisions based on criteria other than candidates' skills and qualifications because of the inability of formal education to signal candidates' ability.
- The "meritocracy deficit" in the private sector reduces the incentives among youth to seek the most relevant education and relieves pressure on education to focus on quality.
- Vocational and training systems continue to operate in isolation from the private sector; existing partnerships are poorly institutionalized and operationalized.
- In addition to the mismatch between supply and demand for skills, there is a mismatch between graduates' aspirations and the availability of acceptable and decent jobs.

Becoming employable in MENA: A matter of educational quality and relevance

The "road not traveled for education reform" in the MENA region also refers to the fact that education systems must now travel over new and relatively unexplored terrain. Education systems have a tendency to spawn a new set of challenges for every problem resolved. Once everyone is in school, we must ensure that they do not drop out. Once they remain seated, we must make sure that they learn something. Once they appear to be ready to learn, we must make sure that the material is useful for their future.

World Bank, 2008a

One of the key goals of all educational and training systems is to generate employable graduates. Although employability entails the capital accumulation of skills, competencies, academic certificates, and professional qualifications and refers to the capacity of graduates to function in a job, it does not imply the acquisition of a job (Yorke 2006). An employable graduate is not just one who demands a job but rather one who is in a position to offer relevant skills to the labor market. Today's graduates in countries in the Middle East and North Africa (MENA) have invested heavily in education but fall short of options in the labor market. As one young woman in a rural part of the Arab Republic of Egypt puts it, "Education will not help us find employment. Many university graduates can't find work. They are exactly like those with primary education or like farmers. At least farmers have land. But university graduates have nothing."[1]

Great progress, greater expectations, and even greater aspirations

Following independence, most MENA countries sought to rapidly expand access to education, particularly to higher education. As a result, impressive progress has been made in enrollment and completion rates in both secondary and tertiary education (see figure 6.1). Enrollment in secondary schooling increased almost threefold between 1970 and the mid-2000s, and the increase was nearly fivefold in higher education (World Bank 2008a). This process brought about a broadening of educational opportunities and a narrowing of gender and socioeconomic gaps in access to education. Figure 6.2 shows average gross enrollment in secondary and tertiary education by region and gender. In MENA, where enrollment in primary education is nearly universal, average enrollment is over 70 percent in secondary school and close to 30 percent in tertiary education for both men and women.

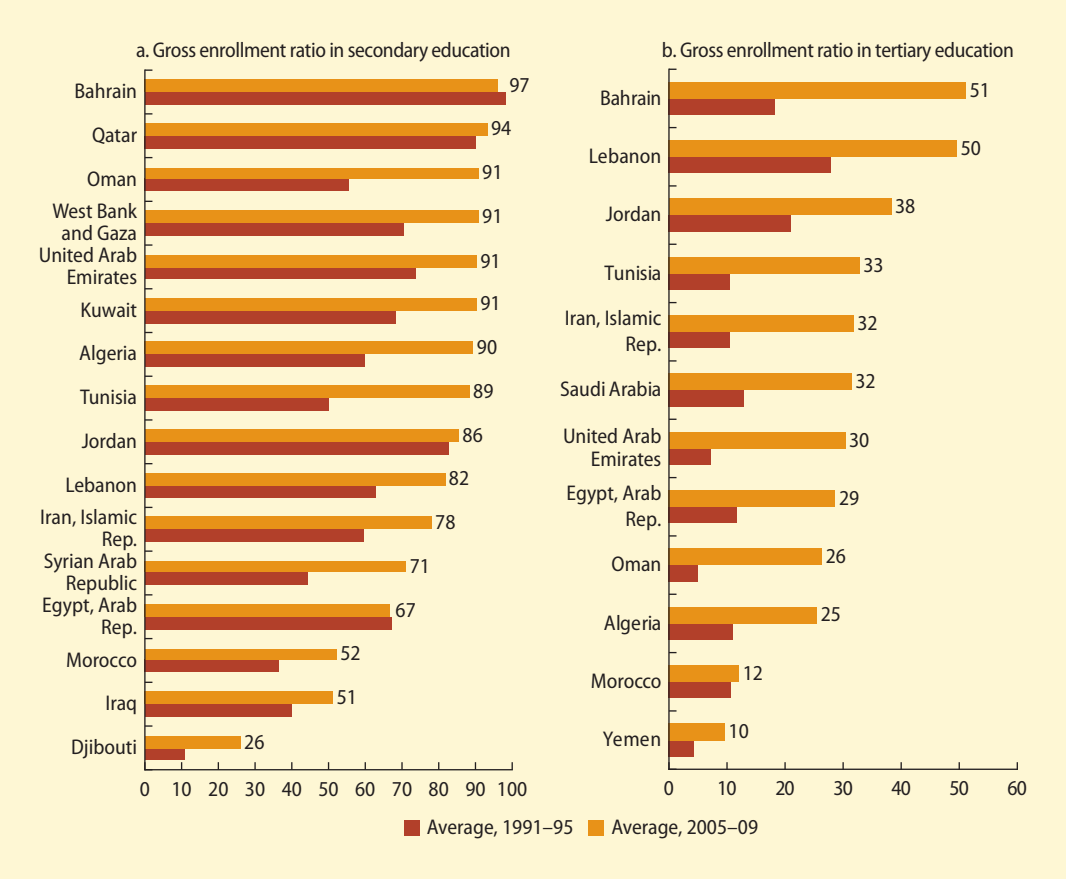
Educational systems have been very responsive to the increased demand for tertiary education. Most countries in MENA have brought enrollment in tertiary education in line with comparator countries (see figure 6.3). Notable outliers are some of the oil-rich countries in the Persian Gulf—Oman, Qatar, Saudi Arabia, and the United Arab Emirates—which have achieved enrollment rates near the world average of 30 percent but are still below the level predicted by their high income. The enrollment in tertiary education in Djibouti, Morocco, and the Republic of Yemen is also below what their income would predict.

As has been the case in many other countries around the world, the rapid expansion of secondary and higher education has led to increasing expectations from families and employers alike. Just as employers expect to see readily employable graduates equipped with relevant skills and competencies, an increasing number of parents expect to see their investment pay off when their children complete secondary and tertiary education. As far as students are concerned, the increasing expectations from society, coupled with large increases in educational attainment, have led to even greater aspirations for their employment. However, it appears that the dramatic expansion of post–basic education in MENA is not living up to the expectations of employers, families, and young graduates: many graduates are not getting jobs (see chapters 1 and 2); many employers claim that young graduates are not well equipped with relevant skills; and the quality of education in MENA is low by international standards, with too many students not learning in school. In short, youth in MENA are not just at risk of being unemployed but, even worse, are also at risk of being unemployable.

Low quality and low relevance: Skill gaps and mismatches

The low quality and relevance of education are widely seen as the most important reason for the failure of MENA's educational and training systems to produce employable graduates, endowed with the knowledge and skills required for the labor market and for life (ETF and World Bank 2005; World Bank

FIGURE 6.1 **Educational attainment in secondary and tertiary education in MENA, 1991–2010**

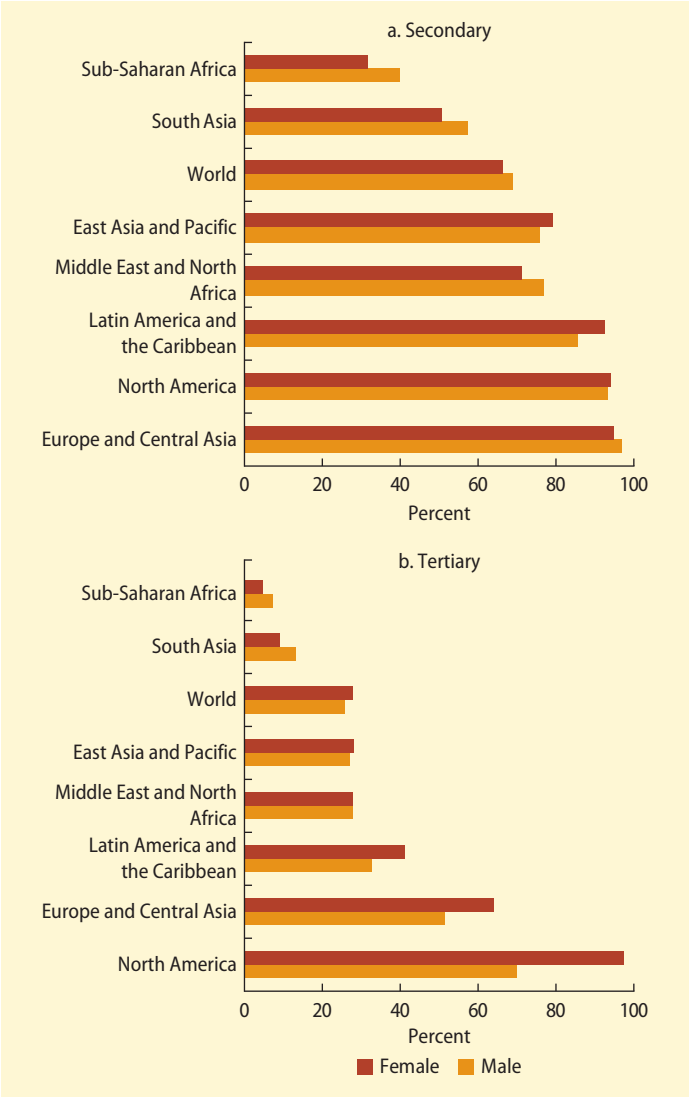


Source: EdStats (database).
Note: MENA = Middle East and North Africa.

2008a). In the words of a university student in Egypt, "[Employers] will tell you that what you learned at university is not what you will use for work." To be sure, despite remarkable progress in access and completion rates, evidence on learning outcomes—as measured by the Trends in International Mathematics and Science Studies (TIMSS) among eighth graders and by the Programme for International Student Assessment (PISA) among 15-year-olds—points to the relatively low quality of education in the region.[2]

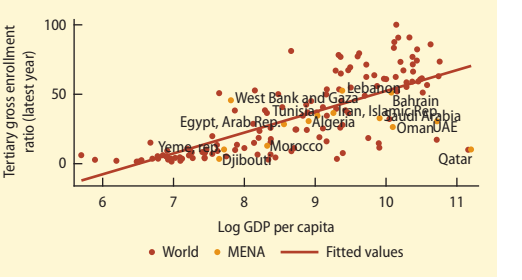
In absolute terms, MENA countries fail to raise even half their student population to "low" levels of learning. Figure 6.4 illustrates the region's poor quality of education by comparing eighth graders in MENA at different levels of achievement to an international benchmark.[3] The figure shows that, with the exception of Jordan and Lebanon, more than three-fourths of students in MENA possess only a basic or below basic knowledge of mathematics in 2007, well below the world median. While MENA has a large number of low and very low achievers, it has few high performers at the other end of the scale. There are virtually no students in the "advanced" category, with Jordan and Lebanon in 2007 leading the MENA countries with 10 and 9 percent in the "high" category. Recent data for 2011 suggest a significant improvement in competencies in GCC

FIGURE 6.2 Gross enrollment in secondary and tertiary education by gender in selected world regions, 2009



Source: EdStats (database).

FIGURE 6.3 Gross enrollment in tertiary education in selected economies in MENA by GDP per capita, 2005–09



Source: Based on EdStats and World Development Indicators.
Note: GDP = gross domestic product; MENA = Middle East and North Africa; UAE = United Arab Emirates.

countries, driven by Qatar and Saudi Arabia, and the addition of the United Arab Emirates. In contrast, non-GCC MENA countries improved only marginally (such as Tunisia) or even deteriorated (such as Jordan). Overall, these findings indicate that the educational system is not capable of producing a critical mass of students who have the fundamentals to perform well in labor markets. This failure is bound to have detrimental impacts on the labor market, as critical reasoning skills are increasingly seen as central to success in high-value-added jobs.[4]

On average, MENA countries underperform in TIMSS and PISA compared to countries at similar levels of income per capita, with the notable exception of Jordan, Lebanon, Tunisia, and the Syrian Arab Republic. According to these measures, learning outcomes are particularly poor in the Gulf countries, given their high rates of economic development. For some (such as Egypt, Morocco, Saudi Arabia, and the West Bank and Gaza), the performance in TIMSS even worsened between 2003 and 2006. Results for mathematical literacy among 15-year-olds in the four countries participating in PISA are even less encouraging. While students in Jordan scored as expected given its level of income, Qatar, Tunisia, and the United Arab Emirates performed significantly worse compared with countries with similar levels of income (figure 6.5).

TIMSS and PISA are administered to eighth graders and 15-year-old students and provide a solid assessment of the quality of education at these ages. There is, however, no comparable assessment at higher levels of education and training (tertiary and technical and vocational education and training, or TVET). Moreover, these tests measure quality of learning only among those who are in the school system, while there are many who have dropped out of school who might score even lower on these measures.

Effect of poor educational quality on attendance and school completion

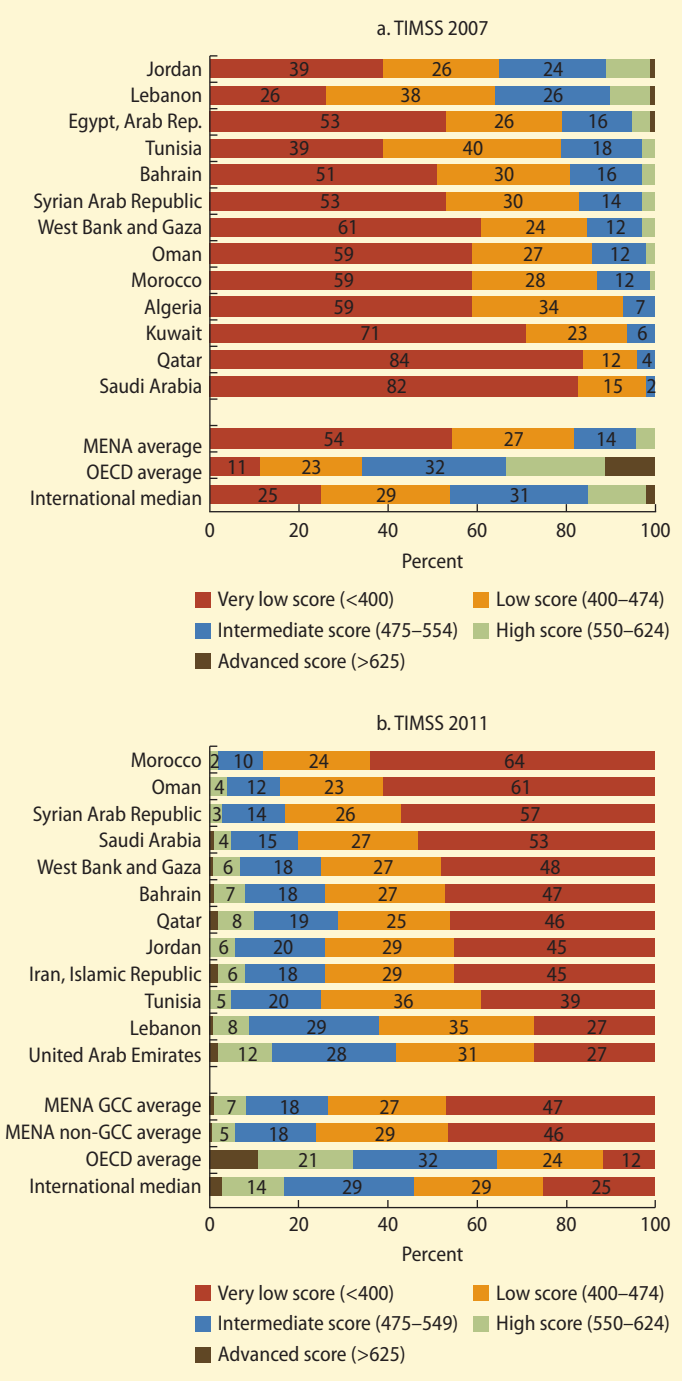
The dropout rate provides an alternative indicator of educational quality, provided *quality* is defined as the capacity of the system to give a personalized educational response to every student by responding to individual needs, interests, and characteristics.[5] Recent survey data indicate that school dropout is highest in lower-secondary, followed by primary, education (figure 6.6).

Many factors in the schools themselves condition the quality of instruction, such as inadequate facilities, overcrowded classrooms, inappropriate language of instruction, and teacher absenteeism; these may contribute to student dropout (Colclough, Rose, and Tembon 2000). In particular, there is evidence that students and parents take the perceived quality of education into account when making decisions about whether to stay in school or drop out. For example, evidence from Egypt shows that student decisions on whether to stay in school are influenced by the quality of their school, measured as the gain in achievement that a student can expect from attending a given school for an additional year. As Hanushek, Lavy, and Hitomi observe, "Holding constant the student's own ability and achievement, a student is much less likely to remain in school if attending a low quality school rather than a high quality school" (2006, 2). Data from 2005–06 show that about one in five parents in Egypt cites poor school quality as a reason that their child dropped out of primary school and about one in 10 for dropping out of lower-secondary school (El-Zanaty and Gorin 2007).

Pervasive skill mismatches

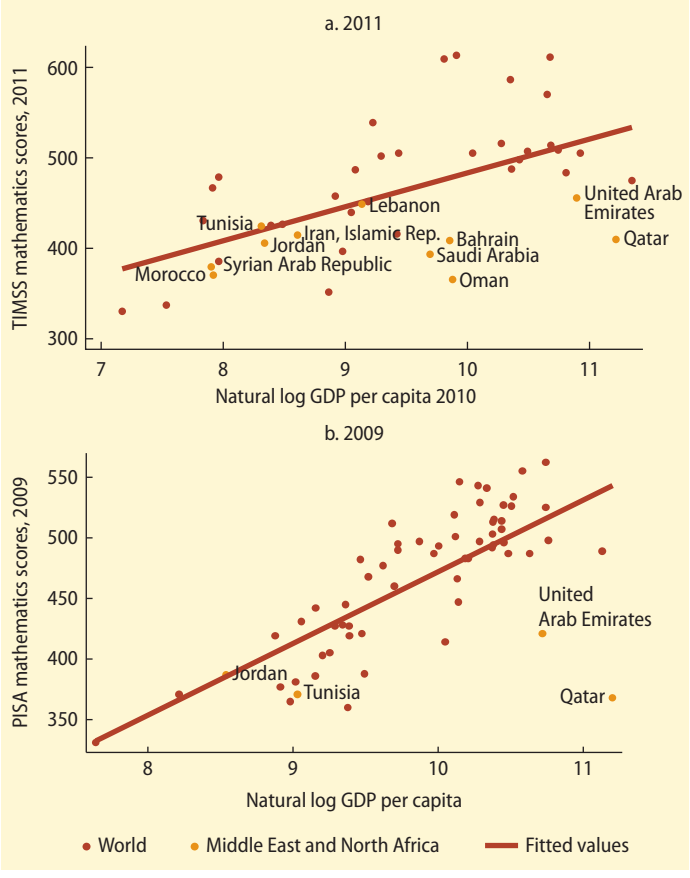
In addition to quality of education, the relevance of graduates' skills is crucial for employability. The extent of skill mismatches, however, is hard to quantify, given the lack of data and limitations in measuring the skill content of demand. Skill mismatches, therefore, are mostly inferred rather than measured directly. Stakeholders' perceptions of constraints to graduates'

FIGURE 6.4 Selected economies in MENA, the region as a whole, and the OECD benchmarked against the international median in mathematics, 2007 and 2011



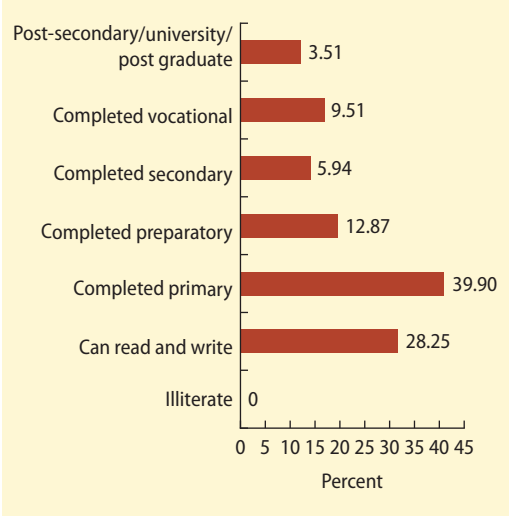
Source: Based on Trends in International Mathematics and Science Study (TIMSS).
Note: GCC = Gulf Cooperation Council; OECD = Organisation for Economic Co-operation and Development; MENA = Middle East and North Africa.

FIGURE 6.5 Quality of math education in selected countries in MENA as measured by TIMSS and PISA, 2011 and 2009



Source: TIMSS and IMF World Economic Outlook (database), January 2013 update.
Note: For panel a, the GDP per capita of year 2010 is an IMF estimate, not final figures, for Botswana, Chile, Georgia, Ghana, Honduras, Lebanon, Oman, South Africa, the United Arab Emirates, and the United Kingdom. GDP = gross domestic product; MENA = Middle East and North Africa; PISA = Programme for International Student Assessment; TIMSS = Trends in International Mathematics and Science Study.

FIGURE 6.6 Dropout rates by highest level of education attained in the Arab Republic of Egypt, 2009



Source: Based on data from the Egypt's Survey of Young People in Egypt (SYPE) 2009. See the appendix for more information on the survey.

education-to-work transition and the importance of skill mismatches often stem from qualitative work, such as focus groups with employers (see box 6.1 for an example in the West Bank and Gaza) or large-scale employer surveys.

According to surveys of private sector employers, the skills of job applicants have low relevance to their firms' business needs, and thus these employers question the system's ability to produce employable graduates.[6] Overall, more than one-third of employers in MENA identify skill shortages as a major constraint to business operation and firm growth.[7] This share is the highest in all developing regions of the world, comparing with 14 percent in South Asia and about 7 percent in Germany and the Republic of Korea, two countries with strong educational and training systems (figure 6.7). Other sources corroborate these perceptions, including the *Arab World Competitiveness Report 2011–12* (WEF and OECD 2011), which ranks inadequate education as the fourth-most-constraining issue to economic growth, after access to financing, restrictive labor regulations, and inefficient government bureaucracy (figure 6.8).

Two different types of skills are relevant to employers: hard skills (job-related or technical) and soft skills (such as the creativity, the ability to communicate clearly, and problem-solving and interpersonal skills).[8] Employer perceptions of skill mismatches seem to be stronger for TVET than for university graduates, and somewhat higher for technical and cognitive (hard) skills than for soft skills (figure 6.9). About one-third of employers interviewed in Egypt, Jordan, and the Republic of Yemen (IFC and ISDB 2011)

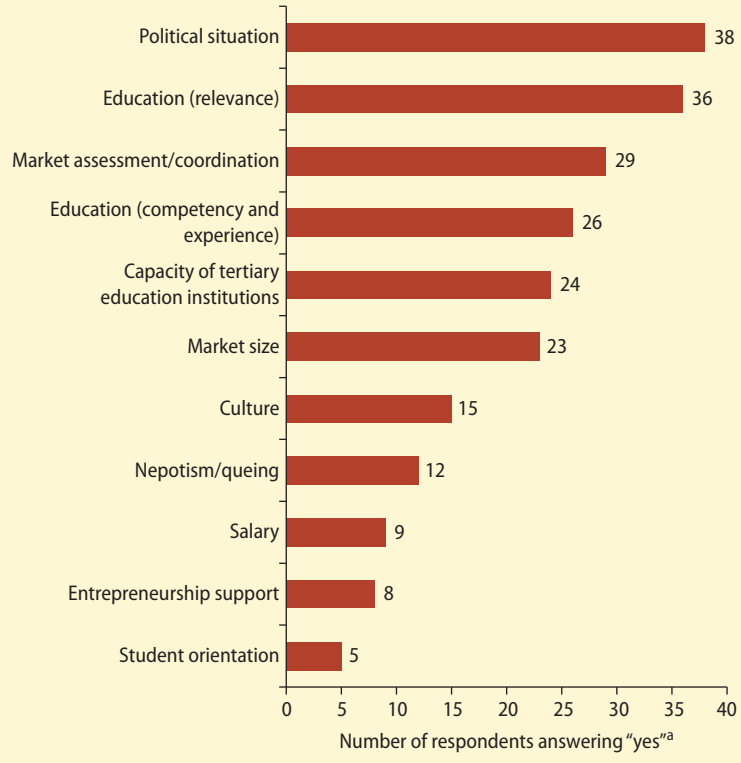
BOX 6.1 Perceptions of the main constraints to the education-to-work transition in the West Bank and Gaza

Six focus groups in the West Bank and five groups in Gaza met between March 17 and 23, 2011, to help stakeholders better understand the constraints facing graduates as they transition from education to work. The groups represented a mix of business owners and principals, students, and graduates of technical colleges and universities. The Ministry of Education and Higher Education and the World Bank conducted the interviews jointly. The participants were split into small groups of three to five and were asked to identify the "four constraints faced by young people to get into a paid job upon graduation." Figure B6.1.1 groups the responses and their frequencies into 11 categories.

The focus group participants clearly identified the relevance of skill to the needs of the labor market, the level of competency, and amount of experience of graduates among the most often named constraints to employment for youth. When asked to identify the constraints young women face to getting into a paid job upon graduation, participants noted that educational and training programs are mainly male oriented, that support for reconciling work and home duties is lacking, and that women are confined to employment in professions with limited absorptive capacity.

Participants noted specific skills and labor market mismatches:

FIGURE B6.1.1 Perceptions of the main constraints in transitioning from education to work in the West Bank and Gaza



Source: Brodmann et al. 2012a.
Note: Queuing = voluntary unemployment to wait for a public sector job.
a. That is, reporting that this is their main constraint.

(continued next page)

BOX 6.1 Perceptions of the main constraints to the education-to-work transition in the West Bank and Gaza *(continued)*

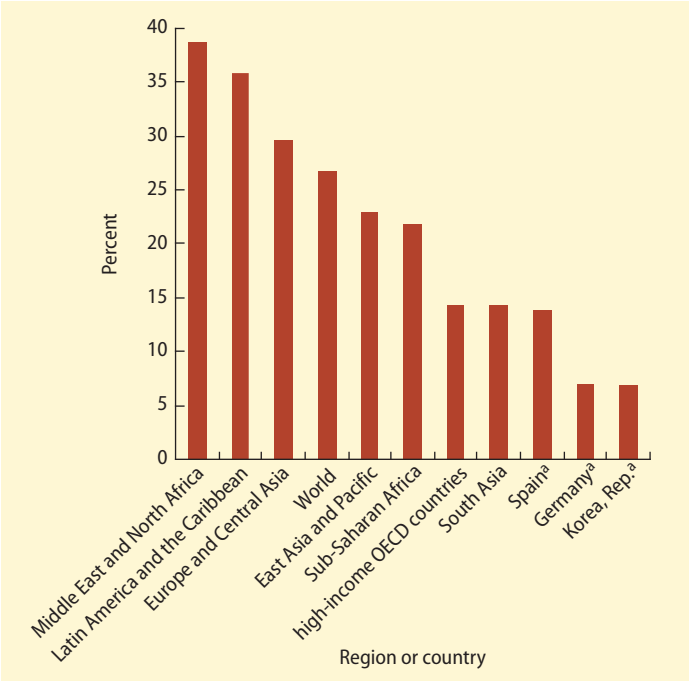
- Programs and skills not oriented to market needs
- Limited enrollment in technical specialties
- Limited attention to vocational education
- Large number of graduates in same specialties
- Lack of life skills
- Lack of continuous education
- Education becoming commercialized; too many colleges

They also identified gaps in competence and experience:

- Lack of job-relevant experience
- Lack of technical experience
- Industry's lack of capacity and experience in training students

Source: Brodmann et al. 2012a.

FIGURE 6.7 Share of firms identifying inadequately educated workforce as a major constraint to growth, by region and selected countries, 2005–11



Source: Enterprise Surveys (global dataset).
Note: OECD = Organisation for Economic Cooperation and Development.

assert that recently hired university graduates lacked soft skills.

Soft skills are usually not part of secondary school curricula and are not measured by achievement tests. However, this additional dimension of educational quality and relevance appears to be predictive of a wide range of outcomes,[9] such as educational attainment and employment outcomes, often more than cognitive skills.[10] However, achievement tests do not measure those soft skills, and the school curricula in MENA countries do not include them explicitly, with the exception of some "life skills" modules usually developed and implemented in training by nongovernmental organizations (NGOs). These interventions do not reach the majority of students, and their impact on student performance and skill acquisition is not systematically evaluated. In fact, whether soft skills are malleable and can be taught and learned in school and university is an open question.[11] In MENA, some evidence from a rigorous impact evaluation of an entrepreneurship training program in Tunisia suggests that the intervention affected a range of behavioral skills (personality traits), in particular, agreeableness and extraversion (Premand et al. 2012; see also chapter 7, box 7.12).[12]

Another indication of prevalent mismatches is the disconnect between labor market demand and patterns of students' demand for higher education, as shown, for example, in shares of enrollment in different fields of study. Figure 6.10 exemplifies the mismatch in Tunisia, where graduates in certain fields are in high demand in the labor market, whereas other fields have less labor market relevance. Graduates from technical

study fields (including architecture, medicine, telecommunications, electricity, engineering, and sciences) and health are recruited for jobs that correspond to their level of qualification, whereas graduates from law, humanities, and social sciences initially often work in jobs that require lower levels of qualification (figure 6.10).

This indicator of the education-to-work transition one-and-a-half to three years after graduation, however, does not account for the longer-term impact of field of study on employment outcomes. International evidence suggests that life-cycle implications for education matter. Hanushek, Machin, and Woessmann (2011), for example, use the International Adult Literacy Survey to show that individuals with general education initially face worse employment outcomes but that they experience more and better employment opportunities as they become older than individuals with more vocational-oriented degrees and diplomas.

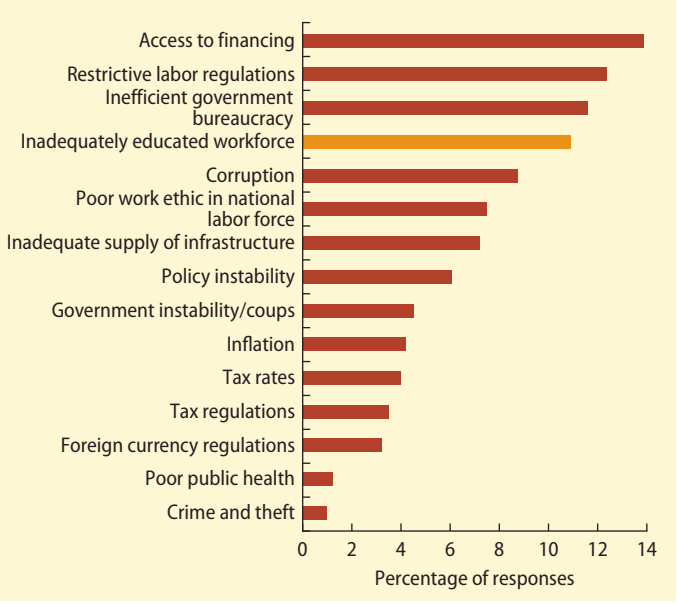
Overall, enrollment in different fields of tertiary education is unbalanced in MENA. A very high percentage of students studies humanities, education, and social sciences. In the West Bank and Gaza, for example, 73 percent of students are enrolled in these fields of study, with a meager 17 percent enrolled in scientific, technical, or engineering fields (figure 6.11).

Barriers to employability: Why are there skill gaps?

At least three sets of arguments can help explain the prevalence of these widespread mismatches and low relevance of skills:

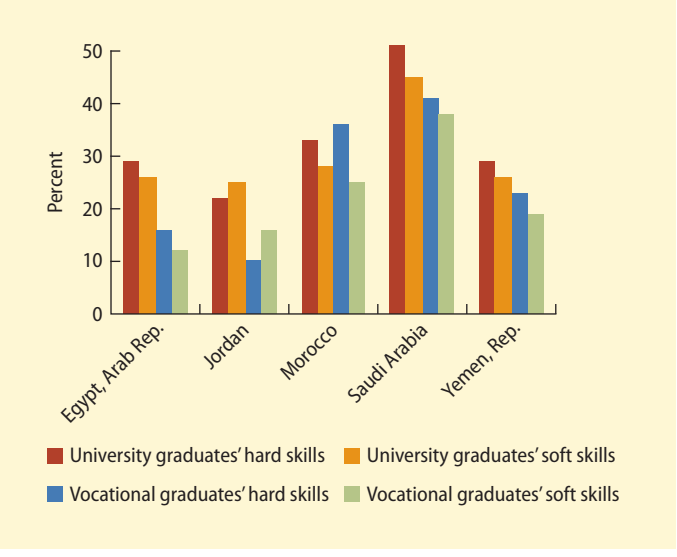
- Because the private sector and the educational and training sector operate in isolation, information and signaling failures occur on both sides.
- The public sector is the main "client" of the educational and training system and is thus the main shaper of students' choices and expectations.
- A "logic of selection"—through rigid tracking in secondary education, high-stakes

FIGURE 6.8 Most problematic factors for doing business in the Arab world



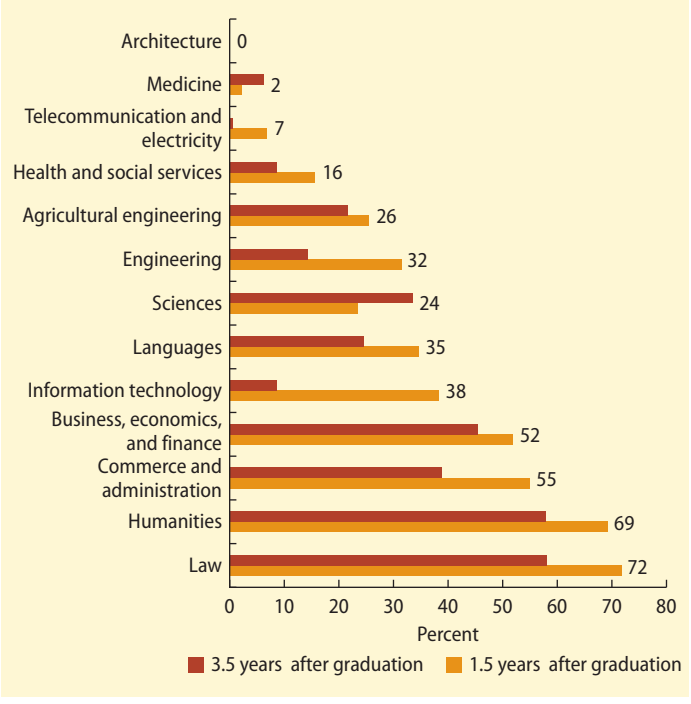
Source: World Economic Forum/OECD 2011.
Note: From a list of 15 factors, respondents were asked to select the 5 most problematic for doing business in their country and to rank them between 1 (most problematic) and 5 (least problematic). The bars in the figure show the responses weighted according to their rankings.

FIGURE 6.9 Mismatch in hard and soft skills of newly hired graduates in selected countries in MENA, 2010



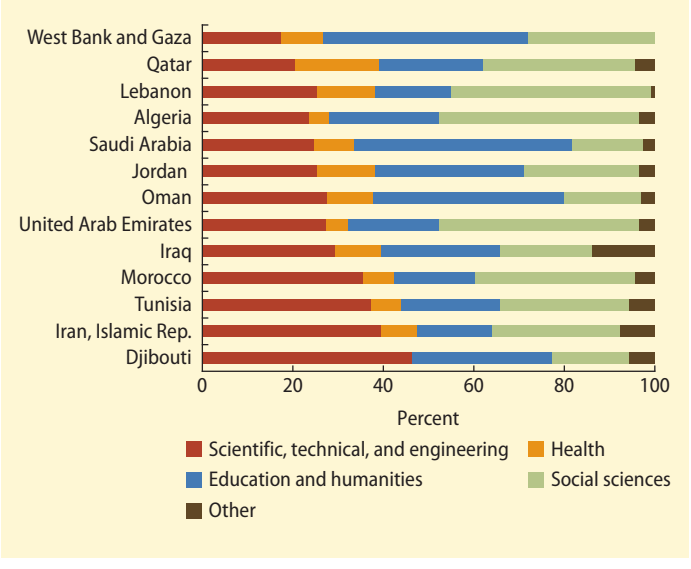
Source: IFC and ISDB 2011.
Note: Managers agreeing that graduates hired in the past year have the appropriate skills. Numbers show the percentage of the company's graduates hired in the past years that have appropriate skills. MENA = Middle East and North Africa.

FIGURE 6.10 Proportion of graduates employed below their level of qualification, by field of specialization, in Tunisia, 2005 and 2007



Source: MFPE and World Bank 2009.
Note: Calculated based on tracer survey from graduates of 2005 and 2007.

FIGURE 6.11 Distribution of university graduates by field of study in selected economies in MENA, 2004–10



Sources: Edstats (database); Tunisian data from Bureau des Etudes de la Planification et de la Programmation 2010, 2011.
Note: MENA = Middle East and North Africa. Data from Tunisia refer to students enrolled during the academic year 2010–11.

examinations, and the low status of TVET—prevails over a "logic of learning" in educational and training systems.

Isolation of the private sector from the education and training sector

In MENA, the private sector and the educational and training sector tend to operate in isolation, resulting in skill gaps and mismatches (see, for example, ETF and World Bank 2005; IFC and ISDB 2011; World Bank 2008a). The lack of communication and coordination between the sectors is both cause and consequence of major information and knowledge gaps on both sides. As a result, the educational and training system lacks the information necessary to respond to the needs of the private sector, whereas the private sector lacks the capacity and interest to play its role in a demand-driven skill development system. This issue is particularly relevant in the TVET subsector, where the role of employers is by definition crucial in ensuring that the skills acquired are relevant for access to the labor market. A similar mechanism is in play with respect to firms' incentives to train their workforce. Firms in MENA operate in a limited-competition environment and do not fully internalize the benefits of a skilled workforce.

There is little tradition of an institutionalized dialogue between the educational and training system, on the one hand, and the private sector, on the other. Efforts to adapt TVET to the requirements of the private sector include broadening the participation of other social partners in the governance of TVET systems. Several countries in MENA have created national and regional TVET councils with a view toward providing a stable governance body bringing together public and private stakeholders.[13] Such councils are meant to coordinate, facilitate, and incentivize private sector involvement in curriculum and program development, to partner in practical training and apprenticeship schemes, to contribute to funding for training, and, most important, to bridge the information gaps and failures between the private sector and the educational and training sector.

Many initiatives to include employer and union representatives in governance have not succeeded because of the ad hoc nature of committees and the lack of operational responsibilities among the participating social partners. Box 6.2 illustrates the example of Egypt, Jordan, and Tunisia. Even in cases where such public-private partnerships are purposefully institutionalized, they often fail to work, because the top leadership lacks

BOX 6.2 Private sector involvement in skill development systems in the Arab Republic of Egypt, Jordan, and Tunisia

In Egypt, the Supreme Council for Human Resources Development (SCHRD), a ministerial council chaired by the minister of manpower and migration, is the highest formal authority for formulating policies for human resource development. The council is a tripartite body and includes among its members all the relevant ministries (Education and Higher Education, as well as the sectoral ministries in charge of vocational training), representatives from the private sector through the federations of employers, and trade unions. The SCHRD was established in 2003 but has never met in session, among other reasons for lack of an executive arm and difficulties in coordinating the large number of high-profile members of the board, as well as the creation of parallel structures with similar functions under other ministries. In 2007–09, the prime minister initiated a process to reactivate the SCHRD under the leadership of the minister of manpower and migration. The newly established executive arm of the SCHRD met regularly during this period to prepare a new agenda for this governing body, which still needs to be decided upon by the prime minister. In the interim, the Ministerial Committee for Employment and Human Resources Development (chaired by the minister of state for military production, who represents the government), the Social Fund for Development, and the National Authority for Quality Assurance and Accreditation in Education have begun policy discussions on skills development.

In Jordan, an E-TVET (Employment-Technical and Vocational Education and Training) Council was set up by law in 2008 as the central element of sector governance to recommend policy directives and funding that could support priorities leading to high-employment outcomes. Despite strong expectations, the potential of the institution has remained mostly untapped. The institutional setup of the E-TVET Council and the secretariat accounts for this, as they are both perceived as part of the Ministry of Labor by all other stakeholders. Thus the council has not addressed policy issues in the sector beyond the scope of the Ministry of Labor, and the private sector employers have been less motivated and less involved in the activities of the council. In short, the lack of a consolidated vision for the sector and a clear mandate for the council and the absence of an empowered secretariat that can provide the necessary leadership have resulted in a de facto situation in which policy issues, directives, and key decisions in the TVET sector are increasingly being discussed, processed, and implemented outside the purview of the E-TVET Council. As a result, the mere presence of the three key TVET suppliers (Ministry of Education, Ministry of Higher Education, and Ministry of Labor) in one governance structure may not be enough to make it functional. Recent efforts on the part of the government to coordinate the roles of the three ministries in the council vis-à-vis the private sector may result in a more successful E-TVET Council.

In Tunisia, a strategy to improve business competitiveness included a reform of professional training through the Program for Upgrading the Vocational Training and Employment System. To promote the involvement of the private sector, the Ministry of Vocational Training and Employment introduced steering committees to help manage public training centers after the reform. The committees were headed by a private sector representative and composed of other private sector stakeholders and delegates from the Tunisian Vocational Training Agency. These steering committees, however, have been heavily criticized, as their role has been merely consultative. Due to the lack of a detailed regulatory framework that clarifies the role of private and public stakeholders, the private sector does not have a true voice in training centers' activities, thereby limiting its ability to demand and contribute to developing the skills and competencies it needs.

Sources: El-Ashmawi 2011; Mornet-Cariou and Rajadel 2011; and World Bank.

commitment or employers lack involvement. Evidence from focus group discussions with employers in the West Bank and Gaza and Tunisia[14] reveals that employers do not feel particularly represented by employer associations (whose funding often depends heavily on state subsidies), and thus they tend to develop stronger ties with the state than with the private sector they are supposedly representing.

As a result, employers are often unaware of private sector involvement in the TVET system at the national level. In Tunisia, for example, the interviewed employers knew nothing about the work of the Centre National de Formation de Formateurs et d'Ingénierie de Formation (CENAFFIF) with professional federations in the design of training courses. In fact, some had never heard of training centers' steering committees (*comités d'établissement*). It appears that close collaboration between employers and training centers depends mostly on individuals, that is, on personal and professional relationships more than on institutional frameworks. Local employers thus have little say in the type of training courses provided, especially for initial vocational education and training (VET).

Effect of the disconnect on the effectiveness of the TVET system

Because of the absence of regular dialogue between the private sector and the educational and training sector, information and knowledge failures occur on both sides. The private sector, for example, has few incentives or opportunities to contribute to curriculum development and financing, little interest in identifying its precise skill and competency needs, and little capacity to provide practical training to complement theoretical education. As for curriculum development, the responsibility lies with a central department—mostly the Ministries of Education, Technical and Vocational Education, and Higher Education. The national education, TVET, and higher education councils offer a path for the private sector to contribute and become involved. Given the difficulties in establishing functioning councils and committees, however, private sector involvement is mostly absent or limited. To be sure, in some cases the private sector contribution to curriculum development has been strong, but these examples are small scale and often initiated through the personal initiative of a few people, such as, for example, the cooperation between the Jordanian Vocational Training Corporation and the hotel industry.

The resource allocation and management of publicly run TVET centers often reflect a strong supply-driven approach, mostly with the private sector providing mandated financing without believing that it receives sufficient returns. In Tunisia, for example, TVET centers are financed 95 percent through public spending and only 5 percent through student fees and training services purchased by companies. Incentives for centers to complement their budget are weak or even negative, as these additional funds are deducted from the next year's budget allocation. Incentives to innovate and respond to demand are limited, as spending allocations are negotiated yearly based on projected enrollment figures rather than on performance.

As for the private sector contribution to public funds, in Tunisia, the vocational education and training tax is the country's oldest instrument for financing education, consisting of a 2 percent compulsory payroll tax and amounting to about 90 million Tunisian dinars (US$60 million) in 2010. The fund was reformed in 2009 because of disappointing results, with less than 40 percent of eligible businesses having taken part in the system. The new vocational training and apprenticeship promotion fund seeks to motivate small and medium firms to engage in training. With social partners having limited say in the management of the fund, and given the small number of staff and the lack of communication on existing financial instruments, many firms still shy away from providing training (Mornet-Cariou and Rajadel 2011).

The private sector also has little involvement in providing space for practical training, either for universities, where there are

practically no links to the private sector, or for technical and vocational education and training. The development of dual apprenticeship has been identified as a priority in some countries' strategies for TVET,[15] for example, in Jordan, Tunisia, and the Republic of Yemen. Setting up dual apprenticeship systems, however, requires the deep involvement of employers, whose priority is not training, and smaller businesses in particular, which are short on staff and rarely have a mid- or long-term strategy that would translate into an active human resource policy.

As for the educational and skills development system, problems in the quality of the evaluation and certification system, weak or nonexistent counseling and orientation services for students, and insufficient or no tracking of outcomes and labor market research lead to information failures. As a result, neither the administrators in the system itself nor those in the institutions can make informed decisions, and, at the same time, they cannot be held accountable for the results achieved and for not using those results to improve their policies, institutions, and programs. In MENA, diplomas and certificates do not provide information on what students know and are able to do. End-of-program and end-of-cycle examinations and testing are common in the region. However, how well this testing captures the quality of the training imparted is questionable. In some cases, testing is biased toward factual and academic knowledge and does not seek an adequate assessment of job-related skills and employability. Secondary school leaving examinations, for example, are designed as selective mechanisms for allocating scarce further educational opportunities. TVET graduation exams in Egypt are a good illustration (see box 6.3). Moreover, secondary school leaving examinations, for example, are designed as selective mechanisms for allocating scarce further educational opportunities.

Victims of the information failure

Timely and correct information is crucial for enabling prospective and current labor market participants to make informed choices. In fact, one could say that "unemployment

BOX 6.3 TVET end-of-year examination examples from the Arab Republic of Egypt

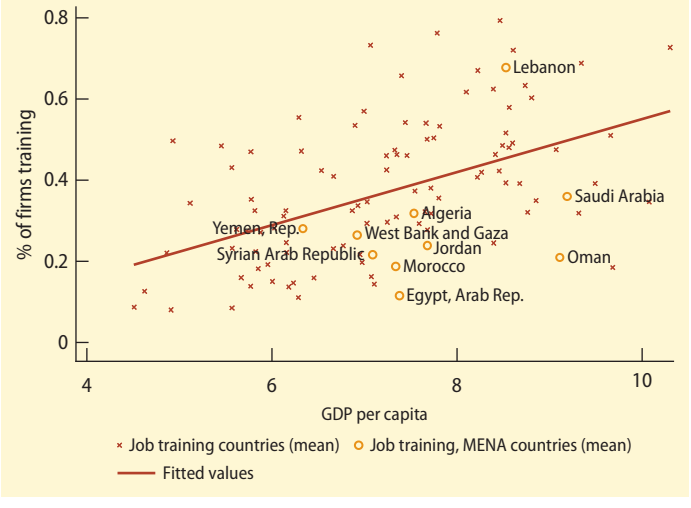
The following example is drawn from a review of a sample of end-of-year examinations and tests in TVET schools in Egypt. The assessment tool for Enterprise Training usually contains a theoretical part and practical part. The theoretical exam contained 15 open questions that called exclusively for reproduction of factual knowledge. For example, one of the questions for shoe manufacturing in the leather sector was to "list three non-leather materials used in manufacturing the upper part of the shoe." Meanwhile, the practical examination on the same level is task oriented: "Make a prototype or pattern on a sheet of packing paper of about 140 × 140 cm using the single shoe vamp piece to replicate the cutting of textile vamp lining. Use the best layout with correct direction of pieces. Textile lining material could also be used for cutting the pattern."

While the practical test amounts to performing a task, the structure of the test does not allow assessment of whether the student would be able to perform adequately in a production process. The task is a simulation of a work process without a real job context or a relevant job result. The disconnect with the real world runs even deeper, as there is no evidence that the equipment used in TVET centers is similar to that found in the workplace, and it is well known that not all students have access to equipment for practical training during the year. As a result, the knowledge and skills tested in these exams are unlikely to be linked to particular competencies, and there is no evidence of links to labor market requirements or needs.

Source: El-Ashmawi 2011.

cannot be reduced in the short and medium term without a realignment of expectations" (World Bank 2008b, 48). However, as a result of these information and signaling failures, both in the private sector and in the educational and training system, young people have limited information on which to base their educational choices. In focus group discussions in Morocco, for example, youth were asked how they made their educational choices following compulsory lower-secondary education. Most young people reported choosing the degree that they would enjoy most; less than a quarter chose their educational path according to what they perceived would be the most useful degree on the market (La Cava et al. 2012). This finding is striking, given that in all focus groups youth indicated full awareness of the labor market situation; they seemed to be lacking the tools to be strategic about their choices. Data from youth surveys show that about 80 percent of young people in Morocco reported making their educational choices completely on their own; the main source of information and advice was siblings. Given the very low level of education in Morocco among adults, parents seem to have limited ability to provide advice. Only 9 percent of youth reported making their choices based on the advice received from a professional figure outside their family, such as a teacher, an NGO operator, or a school counselor (La Cava et al. 2012).

FIGURE 6.12 Incidence of job training by selected economies' GDP



Source: Almeida, Gatti, and Saenz. 2012; calculation using the Enterprise Surveys' standardized data (one wave per country).
Note: Figure reports the average share of firms that report investing in job training around the world and the country's level of GDP per capita. GDP = gross domestic product.

The private sector has an important role to play, as it needs to send signals to the educational and training system and to students on the skills and competencies demanded.

The isolation of the private sector from the educational and training system is also manifested in the lack of continued workforce training. In contradiction of employers' complaints about skills, the investment in job training by the private sector in MENA is rather low compared to that in other countries with similar economic development and workforce education. Figure 6.12 illustrates the point with data for Algeria, Egypt, Jordan, Morocco, Oman, Saudi Arabia, Syria, the West Bank and Gaza, and the Republic of Yemen.[16] On average, only one out of four firms in the MENA region invests in formal training programs. Moreover, firms that invest tend to offer formal training to a relatively small share of the workforce. On average, only 33 percent of workers benefit from these programs. In stark contrast, more than 50 percent of firms in East Asia and the Pacific and more than 40 percent of firms in Latin America and the Caribbean invest in job training.

In MENA, based on findings from the Enterprise Surveys, larger firms are three to four times more likely to invest in training than smaller firms; these differences hold even after controlling for differences in sector, technological intensity, education of the workforce, and firm openness. Evidence also shows that in the MENA region, the degree of education of the workforce and on-the-job training are strongly complementary: firms with larger shares of skilled workers are much more likely to invest in training. In addition, innovation and training are also complementary, as firms adopting and adjusting their technology more frequently are more likely to invest in training. Even

though it is not possible to disentangle correlation from causality, these findings strongly suggest that the differences in the investment in training across firm size are not solely explained by the greater "net benefits" of this investment among larger firms. Most likely, there are also market failures related to lack of access to credit, lack of information, or a greater worker turnover disproportionately affecting smaller employers.

Public sector as the main client of the educational and training system

The government plays an important role in providing jobs in MENA. On average, one-fourth of jobs are in the public sector, ranging from 4 in 10 positions in Jordan and Saudi Arabia to less than 2 in 10 in the Islamic Republic of Iran, Morocco, and the United Arab Emirates (see chapter 5). Most MENA countries have considerably higher employment shares in the public sector than countries such as Turkey (15 percent) and Spain (22 percent). In some countries in the region, structural adjustment of the public sector has already happened (for example, Morocco), while others are in the process of reduction: in Egypt and Qatar, the employment shares in the public sector dropped by 10 percentage points between the early and the late 2000s. In the West Bank and Gaza, however, the public sector expanded over the same period, from 27.4 percent in 2000 to 34.9 percent in 2008. Employment in the public sector is the preferred career choice for the majority of youth in MENA, with the exception of Lebanon, Morocco, and the West Bank and Gaza.[17] Public sector employment is even considered a "right" in some countries, not least due to the tradition of job guarantee schemes for high school and university graduates in Egypt and Morocco in the 1960s that encouraged youth to stay in formal education and thus served important social objectives when first established (Salehi-Isfahani and Dhillon 2008).[18] With the abolition of such formal guarantees, the ongoing structural adjustments, and a rising number of graduates, competition for entry into the public sector has become fiercer. A young woman in Morocco comments on the current difficulty of moving into public sector employment, noting that some graduates "want to work only in public jobs. They refuse to look for other options. But government capacity recruitment has become limited. The young people cannot count anymore on the government to give them a job. They need to change this old mentality."

Students participating in focus group discussions in Egypt and Jordan expressed their strong desires to continue on to higher education, mainly because "society appreciates people with university degrees." Parents and students alike perceive "good jobs" as those requiring a university degree; both of these beliefs suggest a "social aspiration" in MENA. In the words of a secondary student from Jordan, "It is simply not prestigious if you hold less than a bachelor's degree." Despite the increasingly insecure and slow transition from education to public employment, aspiration to insider jobs in the public sector in many countries of the region has established a strong incentive for more parents and students to invest in and pursue university education, particularly women.[19] As a result, the educational system has created signals for public sector hiring rather than equipping graduates with the employability capital needed to succeed in the wider labor market.

In conclusion, the public sector not only regulates the educational and training system—with very little involvement of employers—but also is its main client. This long-standing relationship creates a historical inertia that provides little incentive for reform and keeps the educational system isolated from the private sector. Such inertia misguides many young people who are still making choices under the assumption that they will get a public sector job. With those jobs in increasingly short supply and with no employability capital in the private sector, these youth are at risk of not

finding a suitable opportunity to realize their potential.

A "logic of selection" over a "logic of learning"

Secondary and tertiary educational systems in MENA are characterized by high selectivity throughout, starting with early selection and rigid tracking by the end of lower-secondary education (grades 8 or 9), and leading to fierce competition for the most in-demand university faculties and programs in the last grade of upper-secondary education. As a result, children and young people are forced into learning strategies that increase their chances of succeeding in the high-stakes examinations that are crucial to gaining access to preferred options in higher education. With the "logic of selection" prevailing over the "logic of learning" in the educational system, students, parents, and educators in MENA focus more on examination scores than on the acquisition of relevant skills (aptly named the "scores versus skills debate").[20]

Early tracking and streaming[21] have negative consequences on subsequent educational and labor market outcomes, particularly for pupils from lower socioeconomic backgrounds, who tend to perform less well in early selection (Ireson, Hallam, and Hurley 2005; Jakubowski et al. 2010; OECD 2007). One disadvantage of highly stratified systems is that transitioning from a lower to a higher track is difficult and thus not common. In many MENA countries, tracking happens relatively early in pupils' lives, and few transition pathways—and viable second chances—exist (see box 6.4). High selectivity is then compounded by high rigidity, which renders it impossible to reverse tracking decisions made early in students' lives. For example, in Egypt, only 5 percent of graduates from technical secondary schools transitioned into postsecondary vocational education in 2008–09, down from 8 percent in 2003–04. The remaining graduates transitioned straight into the labor market (El-Ashmawi 2011).

National examinations as a high-stakes screening mechanism

As a result of the expansion of secondary education and the increase in the demand for tertiary education, the secondary education graduation exam, such as the baccalaureate in Algeria, Djibouti, Lebanon, Morocco, Syria, and Tunisia; the *Tawjihi* in Jordan and

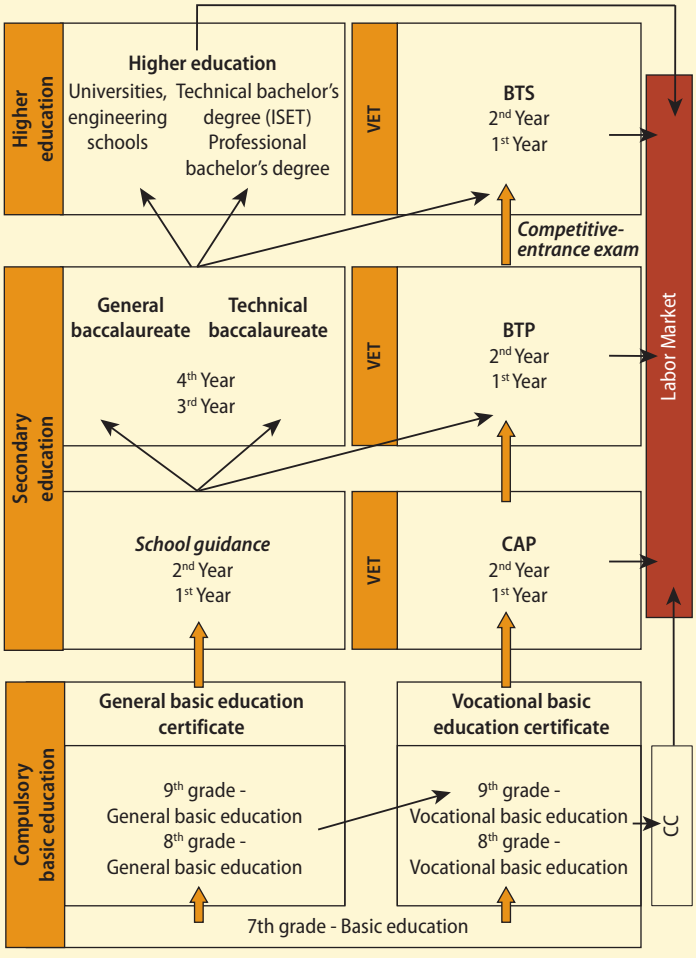
BOX 6.4 Transition paths in the Tunisian educational and training system

In Tunisia, vocational education and training start in the eighth grade and henceforth offer virtually no crossover to the general education track. Starting in the eighth grade, after seven years of basic education, students can opt for the vocational education system. During the first two years, they are theoretically free to switch from the general track to the vocational one and vice versa. In practice however, transitions occur only from general to vocational education. Students unable to complete the ninth grade of basic vocational education can pass a competency certificate, a short course of 6 to 12 months validating one specific skill. An estimated 15 percent of students who attained the ninth grade, general or vocational, opted for vocational education and training in 2009. The latter is provided by public or private training centers. Students follow a two-year course to complete a professional certificate. The overwhelming majority of students (about 80 percent, according to expert opinion) holding a professional certificate enter the labor market. A small proportion opts for an additional two-year course to obtain a technician certificate. Finally, students holding a technician certificate can take a competitive entrance exam to apply for another two-year program to complete a specialized technician certificate. Their average success rate on these competitive exams is low (about 7 percent, according to expert opinion). Graduates

(continued next page)

BOX 6.4 Transition paths in the Tunisian educational and training system *(continued)*

FIGURE B6.4.1 Transition paths in the Tunisian educational and training system



Source: Adapted from Toumi 2009.
Note: CC = competency certificate; BTP = technician certificate; CAP = professional certificate; BTS = specialized technician certificate; ISET = institute for higher technological studies; VET = vocational education training.

with a technician certificate are in direct competition with students holding a technical baccalaureate. The latter also have the option of going into the higher education system but are then more likely to choose technical or professional degrees. Figure B6.4.1 summarized this discussion.

Source: Mornet-Cariou and Rajadel 2011.

the West Bank and Gaza; and the *Thanawiya amma* in Egypt, Oman, Qatar, and Saudi Arabia, has become a key defining moment in a student's life. These exams also serve as entry examination for higher education. Despite increases in enrollment, graduation from upper-secondary education is challenging, and students who fail the examination leave with few relevant skills and no marketable diploma. A secondary student in

Jordan put it this way, "*Tawjihi* is a destiny determinant."

These national examinations share three fundamental traits: (1) they serve the double function of graduation and university access, so that failing the exam means that the student does not graduate from upper-secondary education; (2) they are used as a selection mechanism for determining access to university in general and to the most sought-after institutions and fields of study;[22] and (3) they are themselves a highly influential *institution* in shaping teaching and learning practices in secondary schools. As such, they are key factors in shaping school curricula (Eckstein and Noah 1996; Moreno 2006).

The primary objective of these high-stakes examination systems is to identify top academic performers—by measuring the acquisition of facts and knowledge through memorization rather than through critical and independent thinking or problem-solving skills—and to give them access to the most sought-after institutions and programs in higher education. To get there, not only do students and teachers spend time preparing for these examinations at the expense of developing a broader range of skills and competencies (Bray 2009), but also families in some countries spend considerable sums on private tutors. In Egypt, for example, 40 percent of young people report having received private tutoring after school (based on the Survey of Young People in Egypt 2009; see appendix). Parents invest heavily in private tutoring not because they believe that schools are low quality but also because the game at stake is "cut-throat selective competition" for scarce places in universities and programs in high demand. Because only a small fraction of students excel in these examinations, stakeholders perceive the system as academically sound and rigorous. Overall, however, due to the structure and allure of university-tracked education, students and their parents end up spending time, energy, and money acquiring knowledge that is not valued by private sector employers (Dhillon et al. 2008).

Following a long tradition, these national public examinations not only condition the wider social perception of what counts as quality of education but, in doing so, also essentially narrow the number of "avenues of success" for students in the educational system: the score on the examination is therefore perceived as the only measure of success. Thus, the combined effect of early tracking with a high-stakes, examination-based upper-secondary educational system is the exclusion of a large proportion of students from educational opportunities and acquisition of relevant skills and competencies. In other words, a "logic of selection" prevails over a "logic of learning" in educational and training systems. At the same time, this system continues to sustain the wedge between what employers and other stakeholders expect from the educational system (skills) and the wider social perception of what really counts (scores).

Equity challenge in higher education

In spite of rapid enrollment growth throughout the MENA region, tertiary education remains largely elitist, with strong disparities in access and success persisting in high-, middle-, and low-income Arab countries. In Egypt, for example, the latest household survey indicates that the probability of access to tertiary education is eight times higher for children from the richest quintile than for those from the lowest quintile. Inequality in tertiary education is, to a large extent, an extension of inequality at lower levels of education, reflecting structural barriers (income, ethnicity, gender, language, culture, religion, disability, and the like) and affecting the economic and social opportunities of many talented and capable young people (Salmi and Malee Bassett, forthcoming).

The main additional barriers at the tertiary level are of two kinds, financial and nonfinancial. The latter include inadequate information, motivation, academic preparation, and social capital. In particular, to cope with the demographic pressure on the systems and maintain fiscal affordability, access to some of the faculties was limited and made

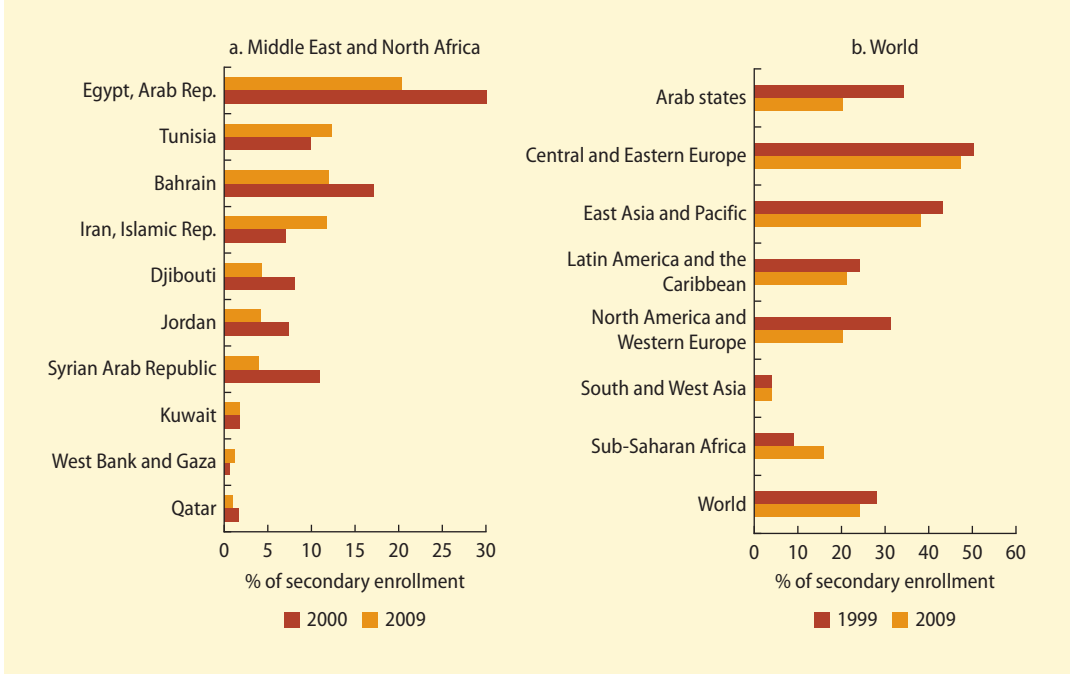
conditional on grades from the secondary school leaving exam. Quotas were adopted for the majority of science faculties—the ones that are more expensive to run, as they require functioning laboratories and other equipment—but also the ones that are more relevant to private sector needs. With high-stakes examinations and prevalent tutoring, the access to faculties that would be more likely to lead to high-paying jobs in the private sector is thus highly skewed toward young people from more affluent families.

The evidence suggests that hiring for higher-paying private sector jobs in larger firms is relatively more meritocratic than hiring in smaller and informal firms and thus in principle is more open to people from all social strata. However, since the access to the faculties that are more conducive to these jobs is still highly correlated with family background, opportunities to access more desirable jobs outside the public sector continue to be inequitably distributed.

TVET as a low-quality option

Tracking can be particularly detrimental when the option for those tracked into technical training produces low-quality skills. In fact, nowhere are problems of relevance more severe than in TVET, which is meant to be the part of the system most quickly and directly geared to employability. According to the evidence, over the past decade most countries in the region have seen a decrease in student demand for TVET, despite the fact that demand for upper-secondary and tertiary education increased dramatically during the period. Overall, student enrollment in technical or vocational secondary education as a proportion of total secondary education varies considerably across MENA countries, from less than 5 percent in Kuwait, Qatar, and the West Bank and Gaza to about 20 percent in Egypt (figure 6.13a). Enrollment figures have been decreasing drastically in countries such as Bahrain, Egypt, Jordan, and Syria. The decreasing demand for TVET

FIGURE 6.13 **Enrollments in technical and vocational training in MENA and worldwide, 1999, 2000, and 2009**



Source: World Bank Edstats; UNESCO 2011.

is a worldwide phenomenon but is particularly dramatic in the Arab states, which have seen a decrease of 14 percentage points from 1999 to 2009: that is, from 34 percent to 20 percent of total secondary education enrollment (figure 6.13b). While the share of TVET enrollments has also fallen across the board in all other world regions—with the exception of Sub-Saharan Africa—the reduction in MENA is by far the most dramatic of all.

Young people in MENA are avoiding what is perceived as an unreformed low-quality option that is visibly associated with academic failure in the context of the highly selective logic described above.[23] Some employers in focus group discussions in Egypt even voiced preferences for hiring young nondiploma holders who have *not* gone through the technical secondary system.[24] Hence, student demand increasingly concentrates on higher education, with the result that the overwhelming majority of young people in MENA have only one valid avenue for success within the educational and training system: the academic and highly selective upper-secondary education leading to the high-stakes graduation and university entrance examination.

Students going into TVET are normally those excluded from secondary general education by the system of examinations and marks. In addition, students in TVET programs are often from lower-income backgrounds, such as in Jordan, where 95 percent of those pursuing the academic secondary track come from middle- and upper-income backgrounds (Dhillon et al. 2008). Once in the VET system, graduates have a low social status that is very strongly felt, for example, in the Egyptian social system.[25] There are exceptions on a small scale, such as graduates of the Don Bosco Technical Institute or the Mubarak-Kohl-Initiative in Egypt. Despite the relatively higher quality of these students and graduates and the early workplace exposure they receive, these graduates still represent a very small fraction (1–2 percent) of the new entrants to the labor market every year (El-Ashmawi 2011).

The second transition: From employability to employment

Even if we acquire the right skills, even if new jobs are created, what does it matter if I do not carry the "right" family name? My less-talented classmate with the connections will end up landing the job anyway.

Young woman, Morocco

In MENA, being employable is not enough for youth—and outsiders in general—to transition from education to work. Instead, youth need to succeed in a "double transition": in addition to obtaining the competencies and credentials to be employable, they need to position themselves in the labor market. This section analyzes the second part of the "double transition" from education to work—namely, from employability to work—to characterize job search and hiring practices and how they relate to the structure of the labor markets in MENA and likely reinforce segmentations in those markets. The issues that matter for graduates' second transition are whether employability (skills and competencies) counts when employers make hiring decisions, whether education (credentials and qualifications) matters to employers, and whether hiring is transparent and based on merit.

The question of who gets hired into which type of jobs is crucial to understanding patterns of exclusion in the labor market. Many factors can affect the process of search and matching.

In labor markets, there is usually an asymmetry of information between the job applicant and the hiring employer. The applicant may know his or her level of ability, but the employer cannot observe it and uses certain "signals" to make inferences about an applicant's ability to perform a certain job (Spence 1973). Prospective employers might lack the information necessary to judge the quality of graduates effectively. First-time job seekers typically rely on the signaling value of diplomas and credentials, as they often lack

previous job experience or professional networks. With educational systems that have served predominantly as screening devices for access to insider positions in the public sector, the signaling value of diplomas for the private sector in MENA is often limited. In a competitive labor market, firms decide the number and quality of employees to hire to maximize profits. However, limited competition in product markets—as observed in MENA—is likely to decrease firms' demand for mechanisms that resolve these information asymmetries, both the signaling value of credentials and the public and private labor market intermediation services.

The prevalence of job search through informal channels and its impact on the labor market will be explored in the following sections.

Importance of informal channels

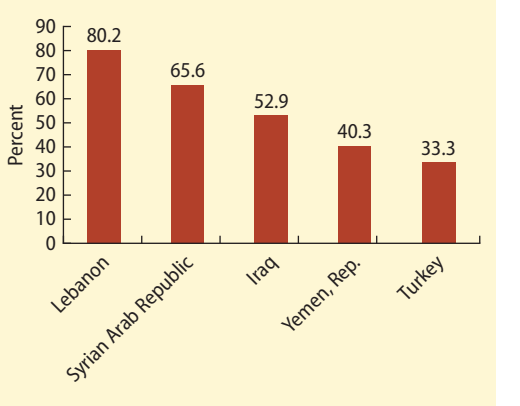
The importance of networks and connections for job matching is well established in the literature. Personal networks—including friends, relatives, colleagues, or acquaintances—work well for job seekers and hiring firms alike because of information flows in an environment of shared social capital and trust (Calvo-Armengol and Jackson 2004; Montgomery 1991; Mortensen and Vishwanath 1994). Granovetter (2005) finds that relying on existing social contacts and networks is less costly than a more formal search through job intermediaries. This observation is particularly important for individuals with less education—often from less affluent neighborhoods—who rely more extensively on informal contacts for employment, whereas the better educated use a mixture of contacts and formal search methods (Ioannides and Loury 2004; Whaba and Zenou 2005).

These preexisting networks and their unequal distribution do, however, introduce inequalities into the labor market and potentially reinforce divides. Evidence suggests a link between the quality of the network of professional contacts and an individual's transition into the labor market (Margolis and Simonnet 2002; Montgomery 1991), because the employment statuses of individuals within a network are correlated (Calvo-Armengol and Jackson 2004).

A relatively large share of employees finds jobs through informal networks. According to recent studies in the United States and Germany, around 44 percent of workers in the United States (Franzen and Hangartner 2006) and 34 percent in Germany (Caliendo, Schmidl, and Uhlendorff 2010) found their jobs through informal social networks. Survey data show that the importance of informal channels for matching and recruitment is particularly high in MENA, where 80 percent of private sector employees report having found their job through friends or relatives in Lebanon,[26] 66 percent in Syria, 53 percent in Iraq, and 40 percent in the Republic of Yemen—compared with, for example, 33 percent in Turkey (figure 6.14).

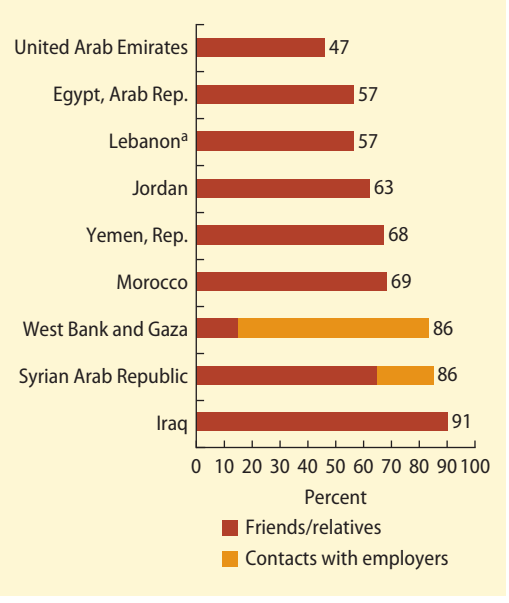
For the vast majority of the unemployed in MENA, informal networks constitute important channels of job search. Figure 6.15 shows that in places with very small private sectors, such as Iraq and the West Bank and Gaza, virtually all the unemployed rely on friends, family, or their own contacts with

FIGURE 6.14 Percentage of the employed who found their job through friends or relatives in the private sector in selected countries in MENA, 2005–10



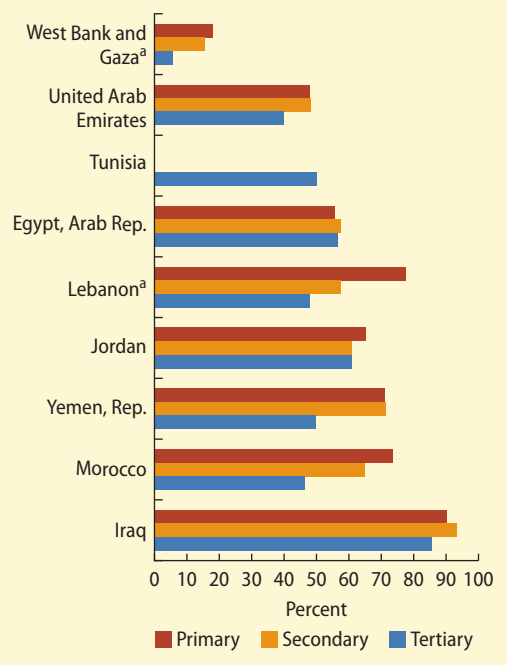
Source: Based on Iraq's Household Socioeconomic Survey (HSES) 2006–07, Lebanon's Employer-Employee Survey (EES) 2011, the Syrian Arab Republic's Employer-Employee Survey (EES) 2009, Turkey's Labor Force Survey (LFS) 2010, and the Republic of Yemen's Household Budget Survey (HBS) 2005–06. See the appendix for more information.

FIGURE 6.15 Percentage of the unemployed using informal networks in their job search in selected economies in MENA, 2005–10



Source: Based on Egypt's Labor Market Panel Survey (LMPS) 2006, Iraq's HSES 2006–07, Jordan's Labor Market Panel Survey (LMPS) 2010, Lebanon's Employer-Employee Survey (EES) 2011, Morocco's Household and Youth Survey (HYS) 2010, Syria's EES 2009, Turkey's LFS 2010, the United Arab Emirates' Labor Force Survey (LFS) 2009, the West Bank and Gaza's Labor Force Survey (LFS) 2008, and the Republic of Yemen's HBS 2005–06. See the appendix for more information on these surveys.
a. Mutually exclusive answers.

FIGURE 6.16 Percentage of the unemployed using friends or relatives in their job search in selected economies in MENA, by level of education, 2005–10

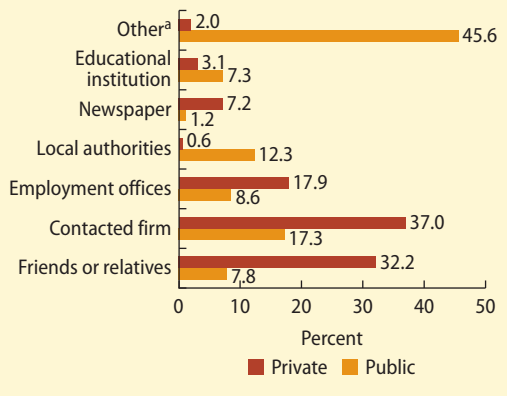


Source: Based on Iraq's HSES 2006–07, Jordan's LMPS 2010, Lebanon's EES 2011, Morocco's HYS 2009, the United Arab Emirates' LFS 2009, the West Bank and Gaza's LFS 2008, and the Republic of Yemen's HBS 2005–06. See the appendix for more information on these surveys.
a. Mutually exclusive answers.

employers during the job search. To a lesser extent, the same is true in countries with more employment in agriculture, such as Morocco and the Republic of Yemen.

Consistent with the literature, the intensity of using networks differs between lower- and higher-skilled job seekers (figure 6.16). In Morocco, for example, 74 percent of those with primary education report using networks in their job search, in contrast to 47 percent among those with tertiary education. This finding is consistent with a relatively higher prevalence of public sector employment (and the use of *concours*—that is, the competitive entrance examination—for employment admission) among skilled workers. Data from Tunisian university graduates (figure 6.17) support this hypothesis, indicating a significantly lower use of informal networks among

FIGURE 6.17 Ways university graduates found public and private sector jobs in Tunisia, 2005



Source: World Bank and Ministère de l'Emploi et de l'Insertion Professionnelle des Jeunes 2005.
a. Mostly *concours* (competitive entry examinations) for entering public sector.

public sector employees. Some evidence also suggests that parental employment and connections have had increasing importance in securing jobs in the formal sector, particularly for skilled workers and especially in the face of declining job opportunities in the public sector (Binzel 2011; Pierre and Robalino 2012; Gatti et al. 2012). In particular, Binzel argues that the gradual suspension of the public employment guarantee scheme in Egypt adversely affected intergenerational mobility among the increasingly well-educated youth, as access to desirable jobs depends more and more on personal connection and parental background.

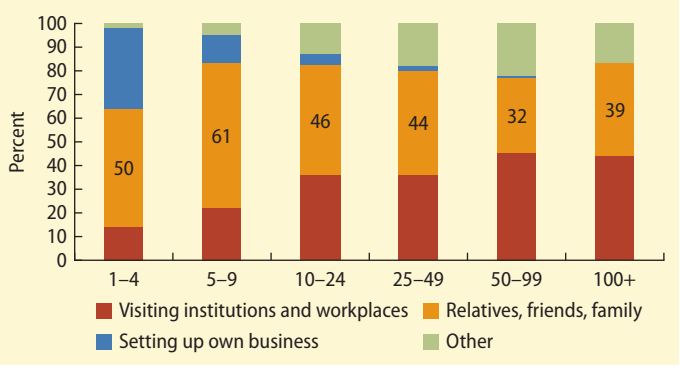
Employers and informal hiring networks

Evidence on employers' search and recruitment practices is limited. Firms' characteristics as well as the type of vacancy to be filled affect the choice of recruitment channel (Sabatier 2010). Evidence from international literature suggests that firms seeking qualified staff are more likely to use advertisements to fill vacancies—especially when competition between job seekers is low—whereas employers seeking to hire in the second segment of the labor market (that is, fixed-term, part-time, or low-skill jobs) are more likely to use local employment agencies (Gorter, Nijkamp, and Rietveld 1993, 1996; Russo, Hassink, and Gorter 2005). Findings from France suggest that public and private institutional intermediaries are overall more effective than personal and professional networks, with private agencies being more efficient at filling skilled vacancies and public agencies more efficient at filling nonskilled vacancies (Sabatier 2010).[27]

The choice of recruitment channel also depends on the employer's capacity to use a certain channel. Using data from the Netherlands from 1995 to 1999, Russo, Hassink, and Gorter (2005) find that formal searches cost seven times as much as informal ones. Not surprisingly, firm size matters, as smaller firms tend to favor personal contacts in recruitment, whereas larger firms are more likely to use formal channels in addition to informal ones. In Jordan, for example, about 30 to 40 percent of employees in larger firms (with 50 and more employees) report having found their job through informal channels, compared with 45 percent among small and medium firms (10–24 and 25–49 employees, respectively) and 60 percent among micro or small firms with 5–9 employees (figure 6.18).

Firms' use of specific recruitment channels (formal as opposed to informal) seems to be correlated with the importance of credentials in the job-matching process. In MENA, smaller firms attach greater value to personal references and contacts and therefore "trust" when recruiting, while larger firms attach greater value to credentials (Pierre and Robalino 2012; see also box 6.5). In interviews, when asked whether they believe that hiring is done in a meritocratic way, private recruitment agencies and headhunters[28] in Jordan and Lebanon unanimously stated that this was not the case (box 6.6). Recruiters agree that "usually and most of the time" hiring is based on personal contacts, as most of their clients are small or medium enterprises. One recruiter believes that there have been considerable improvements in the hiring process, especially for medium and large enterprises, but because small firms cannot afford to search for candidates, they hire

FIGURE 6.18 Importance of personal networks in finding a job in Jordan, by firm size, 2010



Source: Based on Jordan's LMPS 2010. See the appendix for more information on the survey.

BOX 6.5 Employers' hiring practices in Jordan and the Arab Republic of Egypt

Jordan: The importance of wasta

I applied to the phone office, they invited me for an interview but they told me that people pay to get hired. Maybe they hire employees' children.

Young woman, Egypt

In a study of the new social security law in Jordan, employers, employees, and key stakeholders describe the varying, and often contradictory, hiring practices of Jordanian employers. There is increasing focus on the merits of the potential employee—on experience and on the knowledge and skills related to the job for which he or she is applying—as well as on the attitude of the applicant and the confidence that the employer has in the applicant's potential as a dedicated and responsible employee. However, the customs of favoritism and *wasta*[a] continue to be practiced, and cultural challenges have not substantially abated. Gender discrimination and inequality are not uncommon, although such discrimination may have shifted over time: veiled women may not be hired, for example, and employers may hire women over men because women are willing to work for a lower salary. The latter is a troublesome trend: while more women may be employed under these circumstances, their work is undervalued and the ripple effect is an often-neglected issue in labor economics.

Egypt: "Sons of Employees" hiring scheme

Egyptian labor law stipulates that all citizens have a right to access jobs based on merit in an equal and equitable manner. However, in some public professions, such as university professorships, police work, and lower levels of the judiciary, sons of employees are given preference. In other cases, the son of a person who is about to retire or of someone who has reached 55 years of age is hired. This practice is practically nonexistent in the private sector and is formally discouraged by the Egyptian government, which has issued regulations to curtail the hiring of sons of existing employees in government factories and other public offices. Nevertheless, the practice persists. Indeed, there are documented complaints to government ministries from aggrieved family members who have not been hired, even though their mother or father served in the ministry for many years. Such petitioners believe that because their parents have worked in the office, they have the right to a job themselves.

Sources: Brodmann et al. 2012b; World Bank 2013.
a. *Wasta* translates as the use of personal connections to get things done or, in other words, to accomplish things through favoritism.

BOX 6.6 Hiring criteria of headhunters and private recruitment firms

Recruitment for management and executive positions is often performed by specialized headhunters or private recruiters. In phone interviews with such agencies in Jordan and Lebanon, the human resource specialists and recruitment managers were asked a number of questions related to the recruitment process.[a]

Which signal is most important in making hiring decisions?

Recruiters were asked to rank the three most important indicators in signaling whether a candidate who is a fresh graduate is right for the job. Figure B6.6.1 shows the frequency of responses of three agencies in Lebanon and one in Jordan (the response ranked first got three points; the one ranked second, two points; and the one ranked third, one point).

Do candidates' diplomas and academic credentials reflect their skills and competencies?

All of the interviewed recruiters stressed that diplomas give an indication of candidates' hard skills but that soft skills are lacking and not

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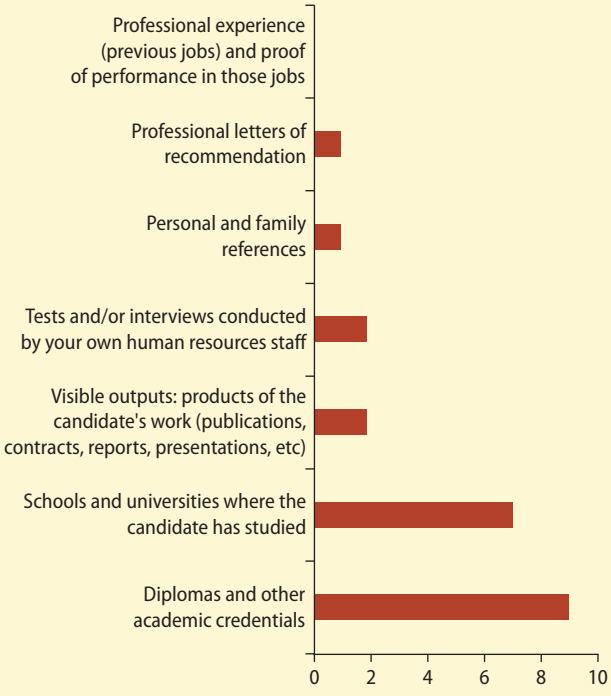
BOX 6.6 Hiring criteria of headhunters and private recruitment firms *(continued)*

FIGURE B6.6.1 Signals important for hiring



Source: Phone interview with recruiters, February 2012.

reflected in credentials. Evidence from a recent employer-employee survey in Lebanon suggests that skill gaps are in fact larger for managers than for those in nonmanagerial positions, with mismatches being largest in the following three areas for managerial staff: noncomputer office skills, computer skills, and ability to work independently (Pierre and Robalino 2012). One recruiter says, "There is a preconceived idea that students from top universities—such as the American University in Beirut—tend to have better soft skills than those from other universities."

What are the three most important problems encountered when hiring fresh graduates?

Recruiters were asked to name the three most important problems from the following list that recruiters face when hiring fresh graduates: (1) number of applicants; (2) applicants lacked required personal characteristics; (3) applicants lacked required job-related skills; (4) applicants lacked required personality traits; and (5) applicants expected higher wages than firm can offer. Overall, the number-one reason named was applicants' wage expectations, closely followed by lacking personality traits and lacking job-related experience. According to one recruiter, "Fresh graduates are not prepared for the job market, they do not know how to prepare a CV, have the right attitude in a job interview, etc."

Do you think hiring is done in a meritocratic way?

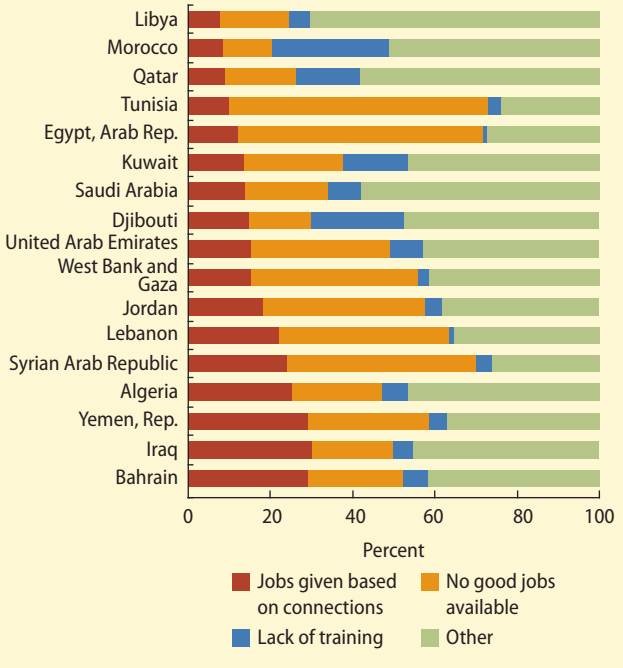
All recruiters unanimously said that hiring is not done in a meritocratic way.

a. The phone interviews were based on a standardized questionnaire with open-ended questions and asked of four agencies.

individuals with whom they have a close relationship.

Overall, the evidence for MENA corroborates the hypothesis that firms operating in a more competitive environment rely on more formal job search mechanisms and offer better employment conditions. In Tunisia, for example, data from the Tunisia Higher Education Graduate Tracer Survey show that university graduates who found their jobs through formal and thus more competitive mechanisms earn on average 10 percent more than those who found jobs through friends or relatives. Moreover, interviews conducted in Morocco with headhunters serving high-technology clusters confirmed that the search for talent tends to be more meritocratic in those sectors and firms that are more exposed to competition: that is, where finding good matches matters most. This evidence, though still limited and qualitative, is consistent with empirical findings by Heinze and Wolf (2010) in Germany indicating that wage discrimination margins are lower in sectors like exports, which are more exposed to competition.

FIGURE 6.19 Perceptions of youth about constraints to getting a job in selected economies in MENA, 2009



Source: Based on Gallup World Poll 2009. See the appendix for more information on the poll.
Note: MENA = Middle East and North Africa.

A meritocracy deficit?

The increasing demand for transparency and equality of opportunity in accessing jobs makes the importance of meritocracy and clear rules in job search and hiring even more salient. Young people and their families have high expectations for the future, they invest heavily in education and skills, and they expect these investments to pay off eventually. Yet among students, graduates, and employers in MENA countries, there is a widespread perception that education credentials serve a minor role in employers' hiring decisions. Educated youth in MENA have received a clear message from the labor market: to access one of the few insider jobs, you must wait your turn or already belong to an insider family.

Factors beyond individual control

The perception that connections are critical undermines the sense of dignity. In recent opinion polls, young people in MENA voice deep concerns about not succeeding in the second transition because of factors they feel are beyond their control, with the lack of job opportunities and the meritocracy deficit perceived as greater constraints than the lack of training received.

Figure 6.19 shows how young people perceive the main constraints to getting a job and starting a family. In Egypt and Tunisia and, to a lesser extent, Syria, the lack of good jobs is the predominant constraint. In all countries, the fact that available jobs are thought to be accessible only through connections is seen as a source of concern. Interestingly, lack of training is named a prominent constraint only in Morocco (28 percent), Djibouti (23 percent), and countries in the Gulf Cooperation Council (GCC) (7–16 percent).

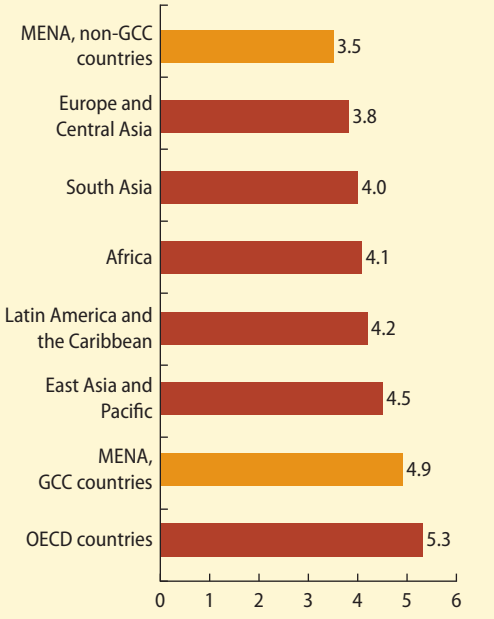
The prevalent use of nonformal job-matching methods is consistent with a number of explanations. Firms might have little or no incentive to invest in searching over wide pools of talent for several reasons: the structure of product markets[29]—little competition, distribution of firms by size—but also by the pervasiveness of arbitrary enforcement of rules, which makes other qualities, such as trust, more relevant. Also, hiring can be risky, especially if it is difficult to fire employees or if they require costly training. Improving competition and transparency is likely to increase incentives to find better matches. However, little infrastructure and regulation are in place to increase information flows. To some extent, this void reflects the degree of development and features of the labor markets in MENA, for example, high informal employment.

Informal networks and information and signaling failures

The widespread use of informal networks is a sign of information and signaling failures. These information asymmetries can be overcome to some extent through intermediation services that increase the pool of available workers and jobs. Another advantage of such formal job-matching mechanisms is that they reduce the perception of the influence of networks and connections. Comparative data on the extent to which hiring is done in a transparent and meritocratic way is not available per se. Firms' self-reports on how much they rely on professional management in making hiring decisions rather than on families and friends can be used as a proxy. Non-GCC MENA countries show the lowest scores of all world regions on this indicator of meritocracy in hiring (figure 6.20).

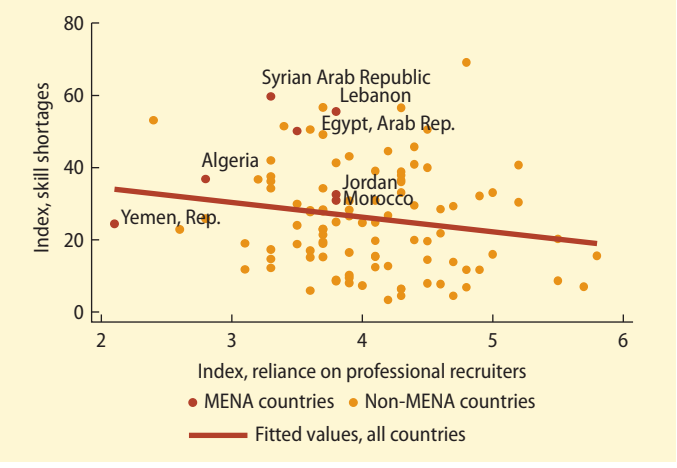
The relatively high use of informal recruitment mechanisms of firms in MENA stands in sharp contrast to the perceived skill mismatches reported by employers. Figure 6.21 plots employers' reports of skill shortages (from the Enterprise Survey) as opposed to the extent to which hiring decisions in MENA are based on professional management (from the Global Executive Survey). Overall, the higher the reliance on professional recruitment, the lower the

FIGURE 6.20 World scores on proxies of meritocracy in hiring, 2011



Source: Based on Executive Opinion Survey 2011.
Note: GCC = Gulf Cooperation Council; OECD = Organisation for Economic Co-operation and Development; MENA = Middle East and North Africa. See WEF and OECD (2011, 75) for a detailed description of the Global Executive Survey. Most questions in the survey ask respondents to evaluate, on a scale of one to seven, one particular aspect of their operating environment. One represents the worst possible situation; seven represents the best.

FIGURE 6.21 Employer-reported skill shortages versus reliance on professional recruitment in selected countries in MENA and in countries outside the region, 2006–11



Source: Based on the Global Executive Survey and Enterprise Survey.
Note: MENA = Middle East and North Africa. The reliance on professional management data (*x*-axis) is for year 2011.

reported level of skills shortages—a finding that supports the hypothesis that relying on a limited pool of suitable candidates increases the probability of not finding the best fit for the job in skills and competencies.

The intense use of informal recruitment mechanisms devalues the education credentials of job seekers, de facto rendering the employability of graduates insufficient for succeeding in the transition from education to work. Although the quantitative data are suggestive and not definitive, the data from interviews and focus groups are staggering in their uniform belief that employers make their hiring decisions on the basis of criteria that have little to do with the capital of employability brought by candidates. Although this area requires further research and data, the tentative conclusion drawn is that hiring in MENA suffers from a "meritocracy deficit."

Role of public employment services in job matching

Public and private employment agencies can play an important role in the job-matching process. For employers, they facilitate contacts with job seekers, and they even provide assistance in the screening and selection process. For job seekers, they provide an overview of open vacancies, and they can also assist in preparing for interviews or in updating qualifications to increase the chances of a good job match. In many countries, employment agencies work in close cooperation with social benefit organizations, social partners, private service providers, temporary work agencies, and educational institutions, as well as with other public organizations and NGOs (Andersen et al. 2009).

Public employment services have been established only recently in countries such as Jordan (2006), Morocco (2001), and Syria (2001) (table 6.1). Private intermediation, however, is forbidden in some countries, such as Tunisia, and has only recently been legalized in Syria. The efficiency of PES is low in many MENA countries (Angel-Urdinola, Kuddo, and Semlali 2013). Cost-effective counseling and labor intermediation programs, such as job search skills, training programs, career and job counseling, job clubs, job vacancy fairs, employer contact (intermediation) services, and the like, hardly exist in the region.[30] In terms of effectiveness,

TABLE 6.1 Public employment services in selected countries in MENA, 2009

Country	Legal name of national PES, and/or the ministry responsible for employment services	Year of establishment	Number of regional offices	Number of NGOs providing services	Number of private employment agencies
Egypt, Arab Rep.	Ministry of Manpower and Migration	1961	307	3	54
Jordan	Department of Employment and Training under the Ministry of Labor	2006	14	—	45
Lebanon	National Employment Office, Ministry of Labor	1977	3	4	—
Morocco	National Agency for the Promotion of Employment and Competence (ANAPEC), Ministry of Employment and Vocational Training	2001	74	—	—
Syrian Arab Republic	Central Nomination Unit at the Directorate of Labor, Ministry of Social Affairs and Labor	2001	28	4	Legalized in 2010
Tunisia	Independent National Agency for Employment and Labor (ANETI), Ministry of Vocational Training and Employment	1993	91	2	Illegal
Yemen, Rep.	Ministry of Social Affairs and Labor	1996	20	150	—

Source: Angel-Urdinola, Kuddo, and Semlali 2013.
Note: — = not available; MENA = Middle East and North Africa; NGO = nongovernmental organization; PES = public employment service.

only 0.3 and 2.8 percent of those employed in Lebanon and the Republic of Yemen, respectively, report having found a job through public or private employment services, while the corresponding number is between 30 and 50 percent in Egypt and Iraq.

An important factor contributing to the success of intermediation services is the institutional capacity of national employment services, including the network of offices, the legal framework in which they operate, and especially the number and professional level of the staff at local employment offices. Available data show wide variations in levels of staffing among surveyed MENA countries (table 6.2). In 2009, a very high staff caseload was reported in Syria, exceeding 14,000 registered job seekers per a single PES staff member. A high staff caseload does not allow employment services to deliver personalized job intermediation. Overall, PES in MENA predominantly follow a passive approach, as they expect employers to post open vacancies and few resources are put into marketing their services. The ratio of registered job seekers per one vacancy in Egypt and Lebanon (Beirut only) is comparable to international standards but is relatively high in Jordan and Morocco. Finally, job placement rates are not sufficient to absorb the unemployed. In Egypt, less than 5 percent of the registered job seekers are employed every month, in Jordan less than 3 percent, and in Morocco, about 1 percent.

Role of active labor market programs in facilitating the transition to work

Active labor market programs (ALMPs) can be an effective strategy for helping youth master the transition from education to work. The type of intervention depends on the specific constraints. For example, training to overcome skills deficits can yield promising results; wage subsidies or labor-intensive public works programs can be useful in an environment with limited demand; skill certification programs can be useful when workers have the rights skills but face difficulties in communicating them to potential employers; and entrepreneurship programs or microfinance have been used to overcome constraints to business start-up (see, for example, World Bank 2010b).

Publicly provided ALMPs in MENA face a number of shortcomings in program design, targeting, skill provision, certification, and assessment. Angel-Urdinola, Kuddo, and Semlali (2013) summarize the findings of an ALMP inventory collected through face-to-face interviews in Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia, and the Republic of Yemen between 2010 and 2011. Similarly, Angel-Urdinola, Semlali, and Brodmann (2010) review nonpublicly provided ALMPs from Algeria, Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia, the West Bank and Gaza, and the Republic of Yemen and

TABLE 6.2 Performance of public employment services in selected countries in MENA, 2009

Country	Number of registered job seekers, (thousands)	Number of registered job vacancies, (thousands)	Ratio of job seekers per one registered vacancy	Average placements per month, (thousands)	Job placements per 1,000 job seekers per month
Egypt, Arab Rep.	895.1	222.9	4.0	40.1	45
Jordan	28.0	2.6	10.8	0.7	25
Lebanon[a]	12.2	3.6	3.4	—	—
Morocco	517.0	27.7	18.7	4.4	9
Tunisia	105.4	—	—	1.6	—

Source: Angel-Urdinola, Kuddo, and Semlali 2013.
Note: — = not available; MENA = Middle East and North Africa.
a. Beirut only.

conclude that the majority of these programs lack the necessary mix of design features that make programs effective.

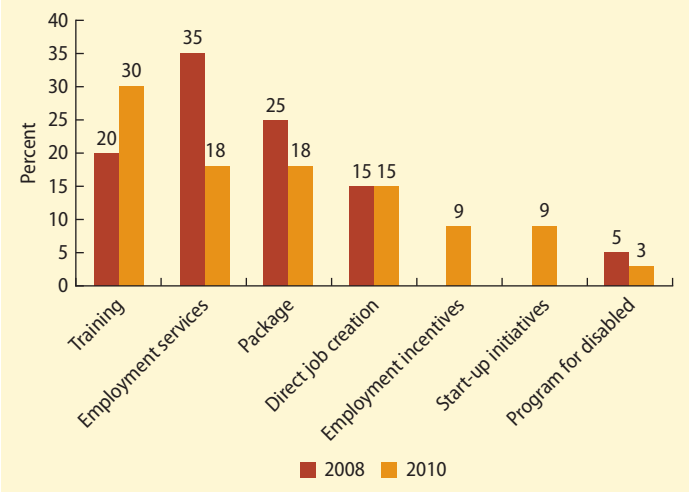
The majority of ALMPs provided by PES in the Middle East and North Africa focus on enhancing employability rather than on supporting job matching or providing employment services. As noted, job-matching services play a relatively minor role, and their importance even decreased between 2008 and 2010 (figure 6.22). In contrast, training plays an increasingly prominent role, accounting for about one-third of all ALMPs provided in 2010. The majority of training programs (62 percent) are in class, 23 percent are in class and on the job, and 15 percent are provided only on the job (Angel-Urdinola, Kuddo, and Semlali 2013). Training outcomes are often not monitored and hardly ever evaluated, which is particularly problematic, given that the majority of training is in the classroom and thus is mostly supply driven, that is, not coordinated with the private sector. In general, a mix of in-class and on-the-job training, in combination with additional employment services such as counseling or job matching, is regarded as international best practice (Angel-Urdinola, Semlali, and Brodmann 2010).

Focusing resources on those most in need—that is, targeting—is essential in light of fiscal constraints. Identifying the proper target group and adjusting the program design accordingly is crucial for obtaining promising results (World Bank 2010b). Tight targeting is difficult to achieve in practice; in MENA, given the data restrictions, targeting for ALMPs is generally ad hoc and categorical, so that programs are targeted to specific groups, such as first-time job seekers, women, and the long-term unemployed (Angel-Urdinola, Semlali, and Brodmann 2010). Many countries practice "creaming," whereby programs are targeted to the most qualified applicants. For example, about half of publicly provided ALMPs in Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia, and the Republic of Yemen target highly skilled persons (figure 6.23).

Most training programs in the ALMP inventory focus on providing hard rather than soft skills (Angel-Urdinola, Kuddo, and Semlali 2013). About half the training programs delivered by PES in MENA provide some type of certification, but certification practices vary from country to country. Countries like Syria and the Republic of Yemen largely lack standard certification and accreditation systems and national qualifications networks, whereas countries like Jordan and Lebanon have more developed accreditation systems (Angel-Urdinola, Kuddo, and Semlali 2013). Although far from ideal, the public sector is doing better than the private sector when it comes to program certification. A previous review of privately provided ALMPs revealed that only 10 percent of training programs included in an inventory granted beneficiaries some type of "recognized" credential at program completion (Angel-Urdinola, Semlali, and Brodmann 2010).

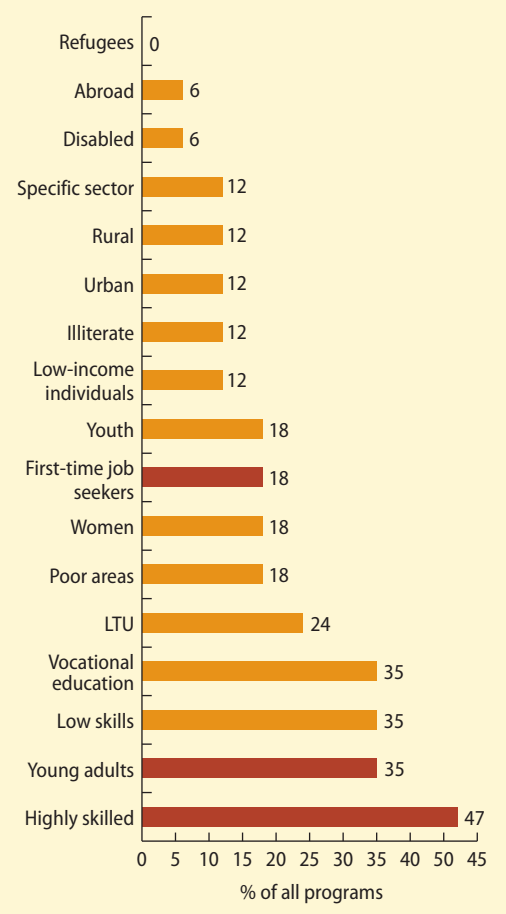
An efficient allocation of resources requires regular monitoring and periodic evaluation of ALMPs. Most programs included in the ALMP inventory include output-based monitoring but lack results-based

FIGURE 6.22 Distribution of active labor market programs by program type, 2008 and 2010



Source: Angel-Urdinola, Kuddo, and Semlali 2012.
Note: Countries included are the Arab Republic of Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic, Tunisia, and the Republic of Yemen.

FIGURE 6.23 Active labor market program targeting as a percentage of all programs, 2009



Source: Angel-Urdinola, Kuddo, and Semlali 2013.
Note: Data from the Arab Republic of Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic, Tunisia, and the Republic of Yemen. LTU = long-term unemployed.

or impact evaluations. The cost-effectiveness of ALMPs in MENA is largely unknown.

The employability challenge

Both supply- and demand-side factors constrain graduates' chances of cashing in their "employability capital"—or, as described in this report—making the "second transition." On the supply side, educational and skill development systems fail to produce and signal the relevant skills required by employers. As mentioned in previous chapters, the general lack of job opportunities, the use of low-wage, labor-intensive techniques, and finally the predominant use of informal job search and recruitment channels in the labor market are the major demand-side constraints.

In a region that is generating far too few jobs, and far too few high-quality jobs, and where jobs are allocated not on the basis of merit but on "nonmarket" criteria, the signals coming from the labor market do not emphasize skill acquisition as the route to employment. The signal instead is to acquire the "right" degree from the "right" university and then queue for a public sector job. This message reinforces many of the educational and pedagogical elements that emphasize success in the secondary school leaving and university access examination. The end results are relatively poor outcomes at the end of the compulsory schooling cycle, little pressure to change traditional patterns of pedagogy (that is, high selectivity and rigid tracking), and a rather moribund TVET system.

In a small, protected, and uncompetitive private sector, the labor market does not seem to consider and acknowledge the employability capital of graduates, and the educational and training system, in turn, does not seem to have the incentives or the capacity to second-guess a labor market that fails to signal. Hence, there is a low-level equilibrium trap: if the labor market does not really demand much, the educational and training system is not compelled to deliver much beyond a pipeline of prospective public sector employees.

Dignity and transparency are values in their own right, and demand for them is rising strongly in the region. Efforts to measure these concepts precisely, based on hard data, remain unsatisfactory. But the evidence from opinion polls, focus groups, and interviews highlights the frustration that individual investment in education and training has not been sufficient to secure access to jobs. The strong and rising social expectations for educational systems in MENA are not being fulfilled. This failure could severely undermine public confidence in education and training

and even lead to questioning the massive public investments made in the sector.

Notes

1. The quotations in this section draw on multiple sources. As part of the background work for this report, focus groups were carried out in March 2011 in the West Bank and Gaza (Brodmann et al. 2012a) and in Egypt and Tunisia in October 2011 (El-Ashwami2011; Mornet-Cariou and Rajadel 2011). Other focus groups and interviews were conducted as background work for La Cava (2012), La Cava et al. (2012), Dawani and Shanti (2011), and Brodmann et al. (2012b).
2. Research suggests that student achievement in the first years of schooling is linked to children's emotional and social skills (Ladd, Kochenderfer, and Coleman 1997; O'Neil et al. 1997; Wentzel and Asher 1995). Many studies show that high-quality child care supports the positive social, emotional, and cognitive development of young children and fosters school readiness (Peisner-Feinberg et al. 2001; Vandell and Wolfe 2002). Early investments in education through families and public interventions can reduce inequalities in educational achievement and reduce exclusion (Esping-Andersen 2008). For example, skills measured before secondary school are important for a host of later outcomes, including educational attainment, employment status, wages, and involvement in crime and health (Carneiro, Crawford, and Goodman 2007). Therefore, getting off to a good start is crucial, as the skills developed in early childhood form the basis of future learning and labor market success (World Bank 2010a). Coverage of early childhood education is still relatively low in MENA, with an average of 20 percent enrollment versus almost universal enrollment in high-income countries (EdStats). MENA countries are very diverse, however, with the Gulf countries (with the exception of Saudi Arabia), Lebanon, and Morocco having rather high rates of preprimary enrollment, whereas Djibouti, Iraq, Libya, and Syria have rates of less than 10 percent.
3. TIMSS uses five points on the scale as international benchmarks: "advanced" (>625), "high" (550–624), "intermediate" (477–554), "low" (400–474), and "below low" (<400). According to this definition, *high* means that "students can apply their understanding and knowledge in a variety of relatively complex situations and explain their reasoning," whereas *low* indicates that "students have some basic mathematical knowledge."
4. Evidence from the United States suggests that the importance of such skills is increasing as the task content of jobs has shifted over the past decades. In the United States, the proportion of the labor force employed in occupations that make intensive use of nonroutine cognitive tasks has increased substantially since 1960, whereas the percentage of the labor force employed in occupations involving routine cognitive and manual tasks, as well as nonroutine manual activities, has declined (Autor, Levy, and Murnane 2003).
5. Comparable data on student dropout rates are not available.
6. These firm surveys are representative only of the formal sector.
7. Skill shortages seem more severe for large firms compared with small firms in Morocco, Syria, and the Republic of Yemen, whereas the reverse is true in Algeria, Jordan, and the West Bank and Gaza.
8. With the exception of evidence that draws on secondary research and data, the classification of skills used in this chapter mostly follows the simple distinction introduced by World Bank (2010a): "cognitive," "technical," and "soft" skills. Note that there are overlaps. For instance, communication skills are often classified as soft skills, as they may be related to assertiveness (in the socio-emotional field), but they may also be related to literacy and verbal abilities (cognitive field).
9. Skills gaps and poor learning outcomes are phenomena that are not related just to what happens in secondary schools or tertiary institutions. These are processes that start very early in life and affect early childhood development, child nutrition and health care, access to preschool education, and school readiness. For references, see note 2.
10. International evidence, for example from the United States, suggests that soft skills such as self-discipline, perseverance, and passion for long-term goals surpass intelligence quotient (IQ) as a predictor of academic performance (Duckworth and Seligman 2005; Hanushek, Machin, and Woessmann 2011; Heckman, Stixrud, and Urzua 2006).

11. There is growing evidence that in fact certain soft skills such as "executive-function skills" or self-control are relatively malleable—quite possibly more malleable than IQ, which is notoriously hard to increase over a sustained period (National Scientific Council on the Developing Child 2009).
12. These findings are consistent with Cobb-Clark and Tan (2010), who find that agreeableness (the degree to which a person needs pleasant and harmonious relations with others) is negatively associated with the probability of being a manager or business professional.
13. Such councils have been recently created in Egypt, Jordan, and the West Bank and Gaza, and they also exist in Morocco and Tunisia.
14. These focus groups were carried out as part of the background work for this report in October 2011 in Egypt and Tunisia and in March 2011 in the West Bank and Gaza.
15. Students are to acquire a certain amount of competencies during the first few months they spend at the TVET center and then acquire another set of competencies on the job, before returning to the center for the next stage, and so forth. The learning process is conceived as a linear path.
16. Almeida and Aterido (2011) show that the stringency of labor market regulations does not significantly affect the extent to which firms invest in job training in the developing world.
17. According to a representative opinion poll among youth in MENA, close to half or more than half of youth state they would prefer to work in the public sector, assuming that the pay and working conditions were similar to working in other sectors or to being self-employed (Gallup 2009).
18. Public sector employment guarantees for high school and university graduates in Egypt and Morocco in the 1960s encouraged youth to stay in formal education and thus served important social objectives when first established.
19. See discussion in chapter 1 that preferences for public sector work are stronger among women and that women tend to prefer studying subjects more suitable for public sector jobs. This preference may reflect social norms about "suitable subjects for women" but could equally reflect a preference for public sector work. Jobs in the public sector offer terms more conducive to family life, such as flexible work hours, leave, and job security.
20. Expression used by Mona Mourshed (McKinsey and Company) at a presentation delivered to Bahrain's annual education conference in 2009.
21. Tracking and streaming are alternative denominations of similar practices of the ability grouping of students. While *tracking* would usually refer to totally different study programs for different groups of students of the same age (for instance, VET programs in upper-secondary education versus general ones), *streaming* refers to ability grouping in selected curriculum areas or subjects.
22. Ease of access to higher education differs by field of study. While passing the baccalaureate is a condition for university entrance in Tunisia, for example, access has traditionally been subject to an annual competition (*concours*) for architecture, engineering, medicine, and pharmacy but open to everybody who passed the upper-secondary examination (baccalaureate) for law, humanities, and social sciences. Probably as a consequence, repetition rates in the latter faculties are higher, and passage from the first to the second year is achieved only by about 50 percent of students. Overall exam passage rates are also modest, at barely 70 percent (World Bank 2008c).
23. Tunisia is an exception, as enrollment in TVET has been increasing (see box 6.4).
24. One employer referred to graduates from technical secondary schools as "technically defeated and morally destroyed" (El-Ashmawi 2011).
25. Focus group discussions with students in Egypt, October 2011 (El-Ashmawi 2011).
26. An explanation specific to Lebanon could be that both hiring and job search are conducted within social and religious networks, reflecting the high ethnic fractionalization within the country.
27. To some extent, this result may be particular to the case of France, where private and public employment agencies have traditionally specialized in recruiting for different kinds of jobs. Public agencies attract more low-skilled job seekers, whereas private agencies focus on job offers for skilled people (Sabatier 2010). This practice, known as "skimming," however, is not uncommon and is also observed in MENA (Angel-Urdinola, Semlali, and Brodmann 2010).
28. Headhunters usually deal with the elite segment of the labor market—often referred to in the literature as the "war on talent"—looking to fill managerial and specialized positions in high demand.

29. The use of informal networks for hiring is less prevalent among firms with foreign or mixed ownership. In Tunisia, for example, 34 percent of employees with a university degree working in private firms with Tunisian ownership report having found their job through friends or relatives compared with 24 percent in firms with foreign or mixed ownership (based on a Graduate Tracer Survey of the graduation cohort of 2004).
30. A typical example is Lebanon, where the role of the National Employment Office as a core provider of employment services and training programs has remained peripheral, partly as a result of its limited financial and institutional capacities. Its mandate is in practice limited to (1) running an electronic labor intermediation platform; (2) conducting occasional studies and labor market needs assessments; and (3) subsidizing some vocational training programs implemented by NGOs (Angel-Urdinola, Kuddo, and Semlali 2013).

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Policy Options

PART 3

A little knowledge that acts is worth infinitely more than much knowledge that is idle.

Advance, and never halt, for advancing is perfection. Advance and do not fear the thorns in the path, for they draw only corrupt blood.

— Khalil Gibran

Introduction

The third part of the report discusses the policy options that can address the barriers to achieving higher productivity, private sector–led job creation and improve job opportunities, especially among those who suffer most from the current low-productivity equilibrium. While the effort has been made to organize these policy options along a labor-demand, -supply, and -intermediation framework, it must be emphasized from the outset that these policies are strongly complementary and mutually reinforcing.

In particular, chapter 7 covers a range of policy options intended to realign the incentives toward private sector–led job creation and increased labor productivity and innovation, as well as to foster countries' entrepreneurship potential. The following chapter discusses how to improve labor market regulations and social insurance systems, with a view toward achieving greater protection against risk and reduce the wedge between labor market outsiders and insiders. Finally, chapter 9 discusses measures to refocus education and training systems on generating the skills that enhance young people's employability and on creating interventions to improve matching and intermediation in the labor market.

Aligning Incentives to Invest, Innovate, and Generate Employment

7

Main findings

- The creation of more and better-quality jobs requires removing the distortions that repress labor demand and encouraging the process of creative destruction that drives labor productivity.
- Priorities include reforming the financial sector to incentivize lending to small enterprises and removing the bias against labor-intensive activities by reforming energy and agricultural subsidies.
- Enhancing the transparency and accountability of public administrations and establishing effective competition authorities are key to reducing the scope of the discretionary application of regulations and making long-term investments possible.
- A combination of training, finance, and infrastructural investments can improve the productivity of the existing stock of subsistence entrepreneurs.
- The entry of educated and experienced workers into entrepreneurship—those who are best positioned to create high-value-added firms—can be incentivized by programs that enhance skills, improve market access, and reduce risks associated with forgoing wage employment.
- The proposed set of reforms would also realign the incentives for firms in MENA to invest in innovation, which can be further enhanced by public-private partnerships, including those between universities and private firms.

Introduction

As identified in chapter 4, major constraints to generating jobs in the Middle East and North Africa (MENA) include distortions that repress the demand for labor, burdensome business regulations, and discretionary enforcement of those regulations. As a result, the private sector in MENA, particularly the high-productivity segment, is smaller than optimal and cannot expand and diversify rapidly enough to absorb the growing labor supply. Chapter 10 will discuss the political economy that has sustained this system of favoritism and rents distribution in the private sector. This

chapter instead focuses on reform options and discusses four priority areas for reforming job creation strategies:

- Removing distortions that repress the demand for labor
- Lifting barriers that prevent firms from competing on a level playing field, including the barriers to accessing productive inputs
- Promoting incentives for firms to innovate
- Supporting entrepreneurship

Some of these policy recommendations are examined in greater detail in two previous World Bank flagships: *From Privilege to Competition* (World Bank 2009) and *Financial Access and Stability: A Roadmap for the Middle East and North Africa* (World Bank 2011). Those publications offer in-depth discussions of measures to reduce the discretionary enforcement of regulation and to increase access to credit and kick-start a more dynamic private sector. In addition, the recent *World Development Report 2013: Jobs* (World Bank 2013) presents a thorough review of the evidence on the importance of competition and a fair and rule-based investment climate.

Strategies to remove distortions that repress labor demand

Tax and subsidy schemes in MENA concurrently tend to place labor at a disadvantage. Thus, reducing labor taxes and subsidies to other factors of production is likely to generate more employment opportunities and, in the medium run, accelerate growth through enhanced allocative efficiency and innovation.

Removing energy subsidies

A salient priority is reforming energy subsidies, which make up the largest share of subsidies in most MENA countries (Silva, Levin, and Morgandi 2013) and favor energy-intensive production processes that rely on outdated technology. Ensuring that firms face appropriate energy prices would enhance competitive pressure and stimulate the adoption of more advanced, energy-efficient modes of production. Chapter 4 demonstrated that such a reform would level the playing field for smaller businesses and private sector firms, given that their competitors—large and public firms—benefit disproportionately from energy subsidies.

It is important to recognize the potential repercussions on the political economy of removing these subsidies. Given the magnitude of these subsidies, their main beneficiaries constitute a powerful constituency that could oppose their removal, especially when risks of short-term losses in employment associated with restructuring are high. Energy-intensive industries are especially likely to lobby, as they will be the most affected. In the Arab Republic of Egypt, for example, energy-intensive industries directly consumed more than 80 percent of the country's fuel oil and 28 percent of its diesel oil, which together amount to 50 percent of energy subsidies in the country (Abouleinein, El-Laithy, and Kheir-El-Din 2009). Ensuring sustainability and creating the necessary political support for reform will require adequately compensating losers and supporting their transition to more energy-efficient production. This approach is feasible, since removing energy subsidies would free up substantial fiscal space for subsidizing the technical assistance and credit that firms will need to make the technological transformation (as long as technical capacity and institutional facilities are in place). In the short run, the freed-up resources are probably best spent on compensating losers as subsidies are being phased out, while in the medium run, the freed-up resources could be used to reduce labor taxes. The effect of these changes would render labor relatively cheaper, which would result in additional demand for labor and could also increase the tax base of formal employment (see chapter 8). Removing energy subsidies would also have important (indirect) effects on the direct consumption of the poor and on overall consumer prices as well. It is essential that well-targeted social safety nets are in place to help low-income consumers cope

with the loss in purchasing power. Many countries around the world have successfully managed to remove energy subsidies in this way. The discussion of the specific design of social safety nets that favor this transition is beyond the scope of this report but remains absolutely essential and is discussed in detail in Silva, Levin, and Morgandi (2013) and in Fattouh and El-Katiri (2012).

Labor-reducing agricultural subsidies

Agricultural subsidies are another area where reform can simultaneously increase employment and fiscal space. For example, removing subsidies on wheat (which account for a large share of agricultural subsidies in MENA) could realign commodity prices and enhance allocative efficiency. The impacts on agricultural employment could be important, because wheat production is relatively capital intensive. By contrast, other agricultural products, such as olives, require more labor input, and reforming wheat subsidies might thus boost the demand for labor. Similar to the removal of energy subsidies, the removal of wheat subsidies could free resources to finance investments in agricultural productivity. Box 7.1 presents an example from the Syrian Arab Republic.

BOX 7.1 Agricultural employment and subsidies in the Syrian Arab Republic

An estimated 19 percent of the labor force in Syria works in agriculture. Most farms are operated by the owners and their families. The intensity of farm labor depends on the crop and the relative mechanization of farm operations. Cereal production is almost fully mechanized and therefore of low relevance for rural employment. In contrast, sugar beets and oilseeds provide employment in larger farms, as most small farmers will not engage hired labor for these crops. Industrial crops are the largest providers of casual employment in agriculture. The large cotton-producing areas attract significant flows of casual labor from across the country. Given the labor intensity of cotton picking, which is done mostly by women, even small and medium farms often employ additional labor to complement family labor, especially at harvest. The second main provider of seasonal employment is fruit tree crops, particularly olives, which employ unskilled laborers for harvesting and skilled labor for pruning. The third major element in Syria's casual agricultural labor market is vegetable cultivation, especially seasonally available employment in harvesting field vegetables.

Subsidized crops include wheat, sugar beets, and cotton. Producer prices of these "strategic crops" are administered by the government, often above international prices. In 2009, for instance, the domestic farm-gate price for cotton was about 115 percent over its international parity equivalent, while for sugar beets the farm-gate price was about 140 percent over parity. Similarly, domestic producer prices of durum and soft wheat were about 50 percent and 65 percent, respectively, over the parity prices in 2009.

Subsidies make some crops look more profitable than they are in reality and encourage farmers to produce them. This can be problematic if "artificially profitable" crops overuse inputs that are in scarce supply, such as water, or underuse inputs in high supply, like labor. Simulations show that for most governorates in Syria, wheat farming would continue to be profitable even if subsidies were completely removed. In the governorates with no comparative advantage for wheat production (Deir Ezzor, Reef Dimashk, and Daraa), the removal of subsidies would result in net losses, and most farmers would likely stop growing wheat. Irrigation-intensive (but also labor-intensive) crops such as sugar beets and cotton would probably not be produced if subsidies were removed. In light of Syria's water scarcity and labor abundance, and given the need for better alignment of domestic and international market prices, these crops could be replaced by others that are more labor intensive and have a high value in the market, such as fruits and vegetables, especially oilseeds, nuts, and fruits with limited irrigation needs, such as olives and figs.

Sources: Cafiero 2009; Saade, Abdou, and El-Amin 2011.

Strategies for competing and investing

Reducing the costs of entry, exit, and adjustment

Productivity growth and innovation are repressed in economic environments that are not contestable, and the slow pace of technology adoption, firm entry, and churning in MENA all attest to a lack of competition. Creating more jobs requires the expansion of existing firms, the generation of new firms, and, paradoxically, the destruction of unproductive firms that use inputs inefficiently. This change is unlikely to be feasible in the absence of greater competitive pressure and stronger contestability.

One effective means of enhancing competitiveness and encouraging competition is reducing the cost and barriers to entry, which are formidably high in MENA. Conversely, protracted and expensive bankruptcy procedures hamper the weeding out of inefficient firms and limit entry and risk taking, as forward-looking entrepreneurs can become discouraged.

For instance, countries could, at very low cost, do much to improve the contestability of restricted professions, where barriers to entry are often high and linked to excessive discretion. In Morocco and Tunisia, some professional services, such as accounting, could be made more accessible without compromising quality by, among other things, ensuring that clear criteria are specified for admission and anticompetitive practices are reformed (see box 7.2).

Experience from developed and developing economies alike shows that competitive markets also require institutions that prevent abuse from dominant players and ensure consumer protection. Empowering—or establishing—independent antitrust agencies is essential for bolstering competitiveness and for ensuring that liberalization and privatization do not lead to abuse of market power.[1] Most countries in the region have established competition agencies, while, besides those in the Gulf Cooperation Council (GCC), only Egypt and Tunisia have established consumer protection agencies. The recent assessment of these institutions in MENA noted the

BOX 7.2 Liberalizing entry into professions: Accounting in Morocco and Tunisia

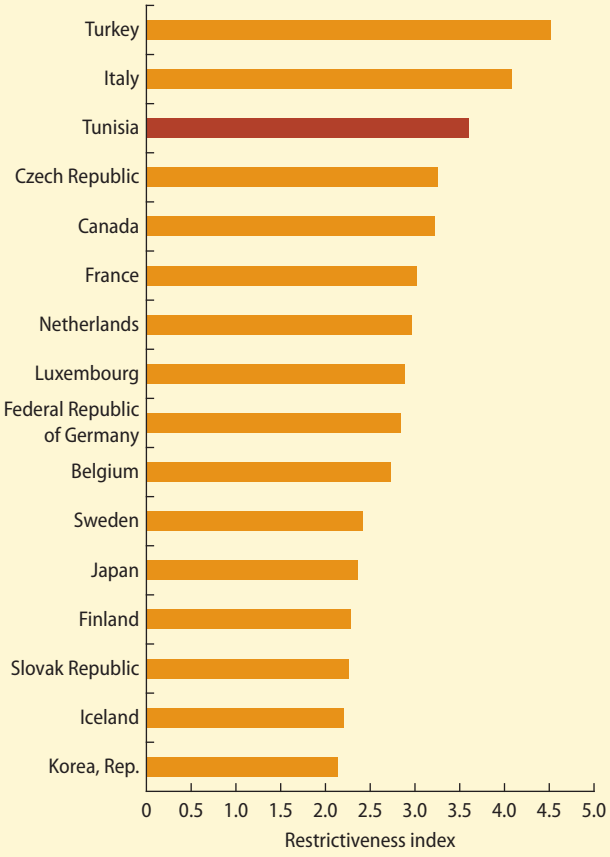
The regulations for the practice of law and accounting place Tunisia among the most restrictive regimes on the restrictiveness index of the Organisation for Economic Co-operation and Development (OECD), even behind countries with a similar French legal tradition (see figure B7.2.1).

Most restrictions are on the fee scale and nationality of employees. Not captured by this index but also important is the fact that foreign firms cannot practice law in Tunisia, only "legal consulting," and that all accounting firms must be 100 percent owned by Tunisians. Still, in principle, a foreign individual can be authorized to practice as an accountant, if a convention of mutuality exists between Tunisia and the individual's home country.[a] For lawyers, a competition restricts entry to the practical poststudy training, and after the training, candidates need to be accepted by the Tunisian bar association (Ordre des Avocats Tunisiens). While both steps correspond to international practice, there is little public material on the criteria that determine admission in either instance (some are still being clarified in decrees). The entry to the accounting profession requires a national competition for the Accounting Experts, but not for accountants, who can access the profession with a degree and an internship.[b] Still, the associations that in principle self-regulate admission to the audit and accounting professions are under the supervision of the Ministry of Finance, which also strictly regulates the audit practitioners' scale of fees. Fee ceilings reduce the profitability and therefore attractiveness of a market, and fee floors preclude unknown new entrants from cutting prices.

(continued next page)

BOX 7.2 Liberalizing entry into professions: Accounting in Morocco and Tunisia *(continued)*

FIGURE B7.2.1 OECD restrictiveness index for accounting services in selected countries, 2008



Source: OECD Services Trade Restrictiveness Index.

Morocco has a professional Ordre de Comptables like in Tunisia, but the commission in charge of admitting new accountants contains both the *ordre's* members and members of the administration and is presided over by the Ministry of Finance. Given the lightness of the legal texts, much discretionary power remains with the admitting commission. The law gives the committee the power to admit but does not hold it accountable for adhering to standards beyond those listed or, more important, for imposing irrelevant standards. An additional barrier to profitable practice could be the rule that accountants are not allowed to advertise.

Source: World Bank 2008.
a. Article 15 of law 88–108 of August 18, 1988.
b. The "experts comptables" (law 88–108 previously cited) can access the profession after a national exam, a ("validated") internship of three years with a professional or in the public administration, and a thesis. If these conditions are fulfilled, admission to the Ordre des Experts Comptables is automatic. For the "comptables" (law n°2002–16 previously cited), access to the profession depends on the degree diploma and an internship (there is no competitive examination).

growing role that competition agencies play but also highlighted how they all continue to lack full autonomy in the de facto exercise of their function (CUTS 2011). For example, several agencies have no clear legislation spelling out the process of staff appointments, long recognized as a crucial step toward impartial hiring (World Bank 2002). In addition, in all countries, ministers who are in charge of state-owned industries—which continue to enjoy significant protection against private and foreign firms—also tend to be the ultimate arbiters of competition cases, an arrangement that leads to conflict of interests. Moreover, the private sector, the media, and the public at large are relatively disengaged from the operation of these agencies and are not proactive in voicing complaints, thus minimizing the deterring function that these agencies could play (CUTS 2011).

Enhancing transparency and institutional accountability

As explained in chapter 4, the discriminatory and inconsistent implementation of business regulation—whereby public officials tend to favor a select few firms but hamper job creation by their (potential) competitors—has arguably been more pernicious than burdensome regulation itself. Discretionary and inconsistent implementation of regulations creates uncertainty that discourages investment, innovation, and ultimately job creation.

Improving the accountability of public administration can foster the consistent implementation of rules and regulations. These reforms may include several elements. Transferring responsibilities and decision making to lower tiers of public administration, while making lower-tier civil servants accountable to a broader base instead of to a single minister or high-ranking official, could enhance accountability and reduce the scope for opportunistic behavior. A complementary measure would be to increase the capacity of workers at lower tiers of public administration. Recruitment and promotion schemes in public administrations should be restructured based on merit or commitment to a development strategy instead of on regional and sectarian considerations. Finally, strategic incentives for public agencies should reward efforts to increase private sector growth and discourage discretion. Creating a performance tool that incorporates users' feedback can highlight the public sector's unwarranted involvement in the private sector and identify areas of particular arbitrariness in the decision making of public officials.

Increasing access to information can also enhance accountability. Business information should be made publicly available through online resources, and independent research and surveys should be permitted. Implementing uniform enterprise identification numbers would become a valuable resource for recording transactions between businesses and public institutions and would allow governments to better detect fraud and law infringements (World Bank 2009). Ensuring that new laws and regulations and the procedure for their implementation are unambiguous and publicly available will make the regulatory environment more transparent.

Investment-promotion agencies could also play an important role in enhancing the transparency and predictability of the regulatory environment for potential foreign direct investors, who are a very important driver of domestic competitiveness and potentially of employment. A recent review of the effectiveness of investment-promotion agencies in 124 countries suggests that they are particularly effective in countries where bureaucratic red tape and information asymmetries prevail (see Javorcik and Harding 2011).

Improving trade openness

Another means of enhancing competition is to further open economies to trade. This strategy could pay a double dividend: it would boost demand and spur productivity growth both by serving as a disciplining device and by allowing firms to capitalize on knowledge spillovers.

In addition, international trade agreements can signal a government's commitment

to providing a predictable policy environment, which is essential to guaranteeing a return on investment in industries with long gestation periods, such as those that use research and development (R&D) more intensively. For instance, an expansion led by foreign direct investment (FDI) in Jordan's pharmaceutical industry was triggered by an international trade agreement, which increased investors' confidence in the business environment (see box 7.3).

Expanding access to finance so that firms can grow and invest

Whenever entrepreneurs face a very uneven price of capital because of the discretionary allocation of credit, financial resources are not allocated to their most productive uses in the economy. Policies focused on strengthening financial infrastructure, increasing bank competition, and developing nonbank financial institutions can not only improve access to finance in the MENA region and revitalize the private sector but also lay the foundation for more sustainable economic growth (World Bank 2011). Improving access to finance for small and medium enterprises should be a priority; these businesses currently have very limited access to credit, in spite of a high willingness to pay, attesting to severe credit market failures.

Strengthen financial infrastructure

Effective credit reporting systems are a precondition for financial development. In financial systems dominated by the private sector (see below), a critical challenge is to ensure that private credit bureaus extend coverage to include small and medium enterprises. Without sufficient credit information, smaller entities cannot obtain the credit needed to expand their businesses. In economies where bureaus are state led, public credit registries should be upgraded to operate as best-practice private bureaus. It is also important that information-collecting policies mandate that all credit-reporting institutions collect in-depth credit information, as well as information from microfinance institutions, utilities, and retailers (see table 7.1).

BOX 7.3 Jordan's pharmaceutical sector and trade reforms

Trade reforms were crucial in creating an environment for developing the manufacturing sectors that support the pharmaceuticals industry in Jordan. Taking advantage of its accession to the World Trade Organization (WTO) in 2000, Jordan signed a free-trade agreement with the United States in which it pledged to harmonize its national legislation with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights. According to the Pharmaceutical Manufacturers Association of America, the U.S.-Jordan Free-Trade Agreement has made Jordan's market more appealing for pharmaceutical research and development, as well as for sales and licensing agreements. The benefits include expanded data protection, elimination of exclusions from patentability for biotechnology inventions, and limitations on compulsory licensing. These reforms allowed many European firms to benefit from a first-mover advantage by starting production of soon-to-expire protected drugs in Jordan. Many renowned global pharmaceutical players—including AstraZeneca, Sanofi-Aventis, Bristol-Myers Squibb, Eli Lilly, GlaxoSmithKline, Janssen-Cilag, Merck Sharp & Dohme, Novartis, Organon, Roche, Pfizer, and Schering-Plough—have established production sites or expanded their commercial activities in Jordan.[a] Jordan's pharmaceutical sector has attracted new investments, gained new export markets, and engaged in innovative research. According to the International Intellectual Property Institute, Pfizer doubled the number of its local employees, Sanofi-Aventis and Novartis tripled their local labor forces, and Merck increased its employment in Jordan by 500 percent between 2000 and 2004.

Source: World Bank 2012.

TABLE 7.1 Credit registry infrastructure in MENA

Public registry only	Private credit registries
Algeria	Bahrain
Djibouti	Egypt, Arab Rep.
Jordan	Iran, Islamic Rep.
Lebanon	Kuwait
Oman	Morocco
Qatar	Saudi Arabia
Syrian Arab Republic	United Arab Emirates
Tunisia	
West Bank and Gaza	
Yemen, Rep.	

Source: World Bank.
Note: MENA = Middle East and North Africa.

An overhaul of the current collateral regimes would increase protection of creditor rights. This measure is crucial to increasing lenders' willingness to extend credit to the less established and smaller borrowers. Ideally, legislation would deal with all aspects of secured lending. Such legislation would facilitate broader types of credit transactions by allowing generic descriptions of assets listed as collateral, provide flexibility for secured creditors to enforce their agreements extrajudicially, and establish a clear priority scheme for secured lenders. Registries of movable collateral (such as inventory, crops, and equipment) should also be modernized and include a single electronic database that is searchable and accessible to the public. Predictability of enforcement is a pivotal precondition for lender confidence.

Increase bank competition

Reforms in reporting credit information and creditors' legal rights will improve financial infrastructure and likely lead to increased competition because of a more secure lending environment for creditors. In addition, there is a need for greater supervision of competition in the banking system: an authority tasked with monitoring bank competition could both discourage anticompetitive behavior and reward good practices. When implementing licensing criteria, bank regulators should also consider sound competition to reduce the obstacles that prevent reputable banks from entering the market. Greater competition among banks will cause prices to fall and make services more accessible to consumers, and lenders will be more likely to penetrate new markets and extend services to underserved communities.

Develop nonbank financial institutions

Finally, developing nonbank financial institutions will help increase access to financial services and expand the range of services provided. Improvements in insurance services, which are essential for risk management, would directly contribute to development by reducing risks of large business losses and encouraging investment. Expanding contributions of private sector pension funds to capital market development could also contribute to long-term growth. Reverse factoring could be considered as a means of providing smaller enterprises with alternative sources of financing, particularly in areas with limited credit information. These enterprises can then rely on the financial standing of their customers and receive financing at a lower cost (World Bank 2011).

By developing a market for small loans, microfinance could make an important contribution to increasing financial access in MENA. According to a recent study testing the impact of microfinance in rural areas of Morocco, the introduction of microcredit in highly credit-constrained environments significantly increased access to financial markets, quadrupling the borrowing power of households (Crépon et al. 2011). However, a financial infrastructure that ensures sharing of credit information on small loans will be necessary for the continued success of this market. Without a mutual exchange of information on borrowers, lenders will not be aware of a borrower's existing lines of credit with other institutions and cannot accurately assess the borrower's creditworthiness or likelihood of default (World Bank 2011). Efforts to expand women's access to credit are also warranted (see box 7.4).

Facilitating innovation for high-productivity employment

Technological progress is the source of long-term growth, and innovation in its various

BOX 7.4 Improving financial access for women

Access to financial services is a problem for men and women in MENA; yet women tend to face more obstacles in obtaining credit. In Egypt, 92 percent of loan applications are rejected because of insufficient collateral. This problem is especially relevant to women, since cultural norms often prevent women from owning or managing their own assets. In addition, the fragmented microfinance sector remains small, deterring potential credit opportunities for women who are unable to obtain credit through commercial banks.

New gender-specific targets for reform are needed to improve financial access for women. Egypt has taken a number of steps to improve credit infrastructure in recent years, such as instituting private credit bureaus, but further progress is needed to create a more equal environment for women. Policy options include increasing educational resources for women entrepreneurs and developing more microfinance institutions that aim to improve women's access to credit.

A few banks in Egypt recognize the potential benefits of women borrowers and now offer training in business skills to enhance the performance of women owners of smaller enterprises. Such training programs not only help women take advantage of financial services but also simultaneously reduce credit risk to banks. Similar initiatives would expand financial access in the region by extending resources to a marginalized segment of the population while also investing in future development of a credit market.

Source: Nasr 2010.

forms is at the root of technological progress. Innovation—an important engine for moving economies up the production ladder—is at the core of a long-term strategy for more and better jobs. Innovation-based growth can also create the types of high-quality jobs to which the increasingly educated youth in the MENA region can aspire.

Increasing the density of highly innovative enterprises in a country or region can also have broad benefits by creating momentum for reform. Given the relatively early development of this sector in MENA, few entrenched interests will benefit from limiting entry in such sectors compared to sectors that have already matured. Thus, creating an investment climate conducive to highly innovative sectors may be less fraught with political problems and, moreover, may benefit the economy as a whole through knowledge spillovers.

Importance of a conducive investment climate for innovation

Global experience has shown that while some public policies can facilitate the invention and adoption of new technologies, innovation is typically led by the private sector: it is the profit motive that propels firms to innovate. Crucial preconditions for innovating profitably are a favorable business climate and a stable regulatory environment. When firms are able to adopt a medium-term planning horizon and reap the rewards of high-risk, high-return activities, such as research and development or experimentation, innovation is incentivized and occurs faster. However, chapter 4 has shown that MENA firms overall innovate less than firms in comparator countries, and they do so even less in countries and in industries where the regulatory environment is more discriminatory—that is, least predictable. For this reason, the main role that governments can play in facilitating higher adoption of innovative products or processes in MENA is to realign the incentives (and rewards) for the private sector to invest in innovation. Measures such as the reduction of barriers to competition; the provision of a stable policy and legal environment; the reduction of barriers to global demand, knowledge, and inputs; and the

improvement of access to finance (in particular, risk-tolerant financing such as venture capital) would all have a positive impact on job creation.

The introduction of competition among mobile telecommunication providers in MENA is a good example of how opening up protected sectors can accelerate investment, innovation, and consumer welfare, at no cost to the government (see box 7.5). In a relatively short period, the mobile telecom sector in MENA countries has reached nearly the same level of dynamism as more mature markets in Western Europe. It has also fostered the rise of regional operators originating in MENA economies.

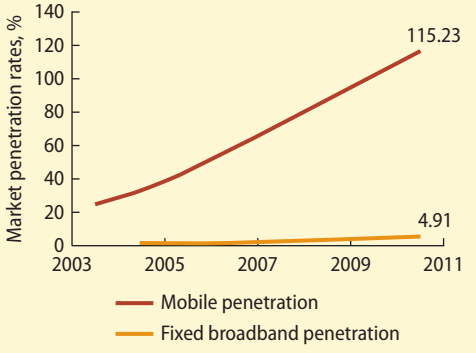
The prohibition against competition with state monopolies in broadband Internet service across MENA, however, has led to a stagnation in the sector, with high

BOX 7.5 Liberalization, investment, and job creation: The telecom sector in MENA

Since the early 2000s, the telecom sector has been the only sector with high-technological input to attain strong investment volumes in MENA. In the early 2000s, all countries in the region started gradually opening up to competition, breaking the monopoly and issuing a second wireless license. As land-line telecom companies still had limited know-how and a small customer base, the stakes of liberalization were limited. Probably for this reason, governments were able to follow international best practices, such as allowing operators to develop their own infrastructure and provide new services in many markets. Liberalization in some countries went hand in hand with the political economy of privilege. For instance, new entrants had to partner with local elites to secure a license (Tunisia), and issuing a third license took a relatively long time in MENA compared to other regions. Yet even moving from a monopoly to duopolistic competition produced staggering results, both in investments and new customers (for example, the customer base rose from 1 million to 15 million in two years in Morocco) (see figure B7.5.1).

The telecom sector also reveals the cost of *not* liberalizing. International calling and broadband services remain under the monopoly of national telecom companies in virtually all countries in MENA, and, as figure B7.5.1 shows, the broadband sector has experienced very limited growth. Broadband services remain expensive and poor in quality. In 2009, the costs per megabyte (MB) in Jordan, Morocco, and Tunisia were 5–50 times those in Bulgaria, Lithuania, and Romania, and MB used per capita were between 1/6 and 1/10 of those in Europe and Central Asia. Opening the sector to competition could create new investments and great potential for employment, especially in the rising outsourcing industry, which suffers from the cost of connecting to the world. Studies suggest that a broadband penetration of 10 percent could increase annual growth of gross domestic product by 0.24–1.50 percentage points and indirectly create 1.5–4.5 jobs (in accounting, legal, and other services) for each job it creates directly.

FIGURE B7.5.1 Mobile and broadband growth in MENA, 2003–11



Source: Rossotto 2011, based on the International Telecommunication Union World Telecommunications Indicators database, http://www.itu.int/ITU-D/ict/statistics/.
Note: MENA = Middle East and North Africa.

Source: Rossotto 2011; Katz et al. 2010; Analysis Mason 2010; McKinsey 2010; Qiang and Rossotto 2009; and Czernich et al. 2009.

prices, small customer bases, and low quality of service. The consequences for the rest of the economy have been severe, especially for the development of an advanced information technology (IT) sector and outsourcing industries (box 7.5). In both cases, local political-economy considerations played a role in governments' decisions on whether to foster or limit competition in the sector.

An attractive investment climate can also facilitate the entry of export-oriented FDI, which can be a vehicle of knowledge transfer.

Highly innovative firms in MENA

In many countries in the region, a subset of firms has shown a high degree of innovation and the ability to export their products (see box 7.6). Although such firms are exceptional, they constitute important role models.

Successful examples of innovation by firms in the region do not seem to be the

BOX 7.6 From emerging role models to innovation clusters: The experience of firms in Lebanon and Morocco

The example of two Moroccan firms illustrates the potential of innovation clusters. Such firms are becoming important role models for educated technical professionals in Morocco.

Hightech Payment Systems (HPS) was founded in 1995 by a group of Moroccan consultants and experts in monetics (electronic banking). More than 90 percent of its products are exported to well over 100 clients in 60 different countries in Europe (26 percent), the Middle East (36 percent), Asia, the United States, and Africa; it had revenues of more than US$30 million in 2010. The domestic market represents less than 10 percent of the total. With branches in Paris and Dubai, it has become a global company with three regional offices and two joint ventures in Bahrain (GPS) and in Mauritius (ICPS). The PowerCARD software currently operates 100 electronic financial transaction sites, which manage a total of 300 financial institutions. Its human capital is the vital key to its success: its labor force grew rapidly from 179 in 2009 to 350 in 2011, most of them under 35. They are recruited mostly from the Ecoles d'Ingénieurs in Morocco. These university graduates have satisfactory performances once they receive specific training related to monetics, which is not taught anywhere in the country. Returning Moroccans from the diaspora have proved central to the company's successful innovative strategy. The company has collaborators from 60 different countries. Its R&D budget reached 10 percent of sales, which compares favorably with its competitors. R&D personnel represents 35 percent of its total employees, and all of them are Moroccans.

Nemotek, established in 2008 by the Caisse de Dépôt et de Gestion, is located at the new Technopolis Park near Rabat. With its worldwide customer portfolio, Nemotek is considered one of the leading manufacturers of wafer-level cameras and is a world leader in microcamera technologies. In fact, it was the first company to buy a Micro Via Pack (MVP) license from Tessera[a] and the first to industrialize it. Significantly, it benefits from relatively high intellectual property protection compared to Asia. R&D is conducted in partnership with the Moroccan Association for Science, Innovation and Research, a public foundation specializing in nano materials, microelectronics, and biotechnology. Nemotek relies heavily on the Moroccan diaspora: it has been able to attract numerous highly qualified nationals back to the country, turning the "brain drain" into a "brain gain." It draws on other foreign competencies by employing engineers from all over the world.

MultiLane SAL is a Lebanese company that develops technology and products for the optical communication market. MultiLane's products support the global tier-1 suppliers of communication infrastructure and enable leading semiconductor companies to offer communication equipment for the next-generation network. Customers include

(continued next page)

BOX 7.6 From emerging role models to innovation clusters: The experience of firms in Lebanon and Morocco *(continued)*

Broadcom, Cisco Systems, Google, and Intel Corporation. The company's key asset is its 30 locally hired engineers. The team's expertise was developed following intensive applied training to each of its team members. MultiLane invests extensively in training, providing at least a year to each engineer. This model is rarely adopted in the industry, because operating companies usually prefer to attract expensive and highly experienced staff (who may be easily lured away again). In 2009, the company offered an intensive six-month course to the graduating class at the Lebanese University in very-large-scale integration (VLSI) and system-on-a-chip design and then hired many of the team under a subsidiary. MultiLane founder, Fadi Daou, is a repatriating entrepreneur. For 25 years, Fadi lived and worked outside Lebanon. During this time, he started and sold three high-tech ventures in the United States. In 2006, Fadi returned to Lebanon with the aim of creating technology and products from Lebanon to serve the global market. MultiLane and its subsidiary demonstrate how a highly trained workforce can attract multinational companies to invest and open R&D centers. Fadi is currently developing Houmal Technology Park to incubate companies that develop products and technology for the global market.

Sources: World Bank; Aridi 2011.
a. Tessera Technologies, Inc., is a company that develops, licenses, and delivers innovative miniaturization technologies and products for electronic devices, http://www.tessera.com/Pages/tessera.aspx.

direct result of government-led initiatives. By contrast, qualitative interviews with successful entrepreneurs suggest the opposite: companies often cited their ability to minimize their interactions with government bureaucracies as one of the reasons for their success. Companies that export software or services that do not require relying on customs officials or trade regulations and that operate in a relatively uncontested domestic market (with few incumbents lobbying to restrict competition among successful innovators) prove successful *despite* government intervention, rather than *because of* it.

In the same spirit, some countries have created export-processing zones as a way to reduce bureaucracy. While this approach was able to attract FDI in some countries such as Tunisia, the dual system of export zones on the one hand and ordinary domestic enterprises on the other undermines the ability of domestic actors to benefit from the same opportunities for growth.

Some salient examples of successful incubation of innovation have benefited from the direct protection of high-ranking champions in the government. On the one hand, these success cases attest to the enormous potential for job creation of comprehensive investment climate reforms. On the other hand, the ad hoc and sporadic nature of these successes underscores the need for broad-based and multifaceted regulatory reform that systematically addresses underlying political-economy constraints. An example is provided by the experience of the International University of Rabat, to date the only private university in Morocco. It has demonstrated promising achievements in R&D, provision of internationally competitive education, creation of start-ups, and private sector participation (box 7.7). However, the university's success largely rests on its ability to operate as a private autonomous entity, free from the regulations that govern all other institutions of higher education.

How institutions can facilitate innovation

The study of successful enterprises in MENA points toward the importance of institutions, such as diaspora networks, private universities, and venture capital funds, that mitigate market failures like

BOX 7.7 The International University of Rabat

The International University of Rabat (UIR) is the first private university in Morocco, led by a member of the Moroccan diaspora, a former professor at the Polytechnic University of Nantes. Established in 2006 in the framework of a new law, the UIR is an internationally oriented, R&D-driven university housed in the Technopolis of Rabat, an industrial area that aspires to host high-tech industries. In 2012, the university began providing its first undergraduate and graduate courses in English and French, at high but internationally competitive fees. The aim is to attract mostly elite students from the whole African continent who would normally study in Europe. UIR, under contract with the government of Morocco, is a public-private partnership that can use academic personnel from the public sector and acquire recognition of its degrees and diplomas from the Ministry of Higher Education. In addition, the university enjoys the patronage of a powerful segment of the local economy: it is built on land donated by the king and counts leading local financial institutions and companies among its board and financers.

However, the institution's autonomous status is the crucial element of its success. The school can bypass the civil service code and design its own terms of recruitment and management of talent, and, above all, diaspora members. Forty percent of the positions are reserved for faculty working in partner universities, which allows better integration with world-class universities. The university is able to pay internationally competitive salaries for a few magnet department heads, who in turn attract talented younger researchers. Staff members are expected to connect with clients in the local private sector and are rewarded on results (such as patents, research grants, and contracts with the private sector). The R&D strategy is tailored to generating "inexpensive innovations" for the domestic and African economy: (1) infrastructure development for transportation, tourism, and affordable housing; (2) renewable energy using local sources; and (3) local niches: railway, naval, automobile, and aerospace engineering. Recent successes include an R&D contract with Local Micro-Camera Export Company, the creation of a start-up producing patented solar and wind-fueled devices, and the technical assistance to the government-owned foreign currency exchange office.

information asymmetries. Although these institutions are typically not state led, the state still has an important role to play in creating an enabling environment (both de jure and de facto) that facilitates the efficient functioning of these institutions.

Private universities with a high degree of autonomy

Private universities, for example, have proved to be effective incubators of innovative ideas in MENA. Apart from the example of the International University of Rabat, a second case in point is the University of St. Joseph in Lebanon. The university was able to generate a successful cluster of service industries that targeted export markets by creating a private technology park and launching a seed capital fund dedicated to investing in early-growth Lebanese companies (see box 7.8).

High-skilled diaspora networks

Another strategy for stimulating innovation is to encourage the transfer of knowledge by leveraging highly skilled diasporas, which the MENA region has in abundance (see World Bank 2011). Some of the examples of successful firms illustrated in box 7.6 involved diaspora returnees, who took advantage of local high-skilled labor and their knowledge of global markets to create successful export-oriented businesses. But diasporas do not necessarily need to relocate permanently in the home country. Transfer can occur through "diaspora institutions," which can be formal or informal networks of practice that domestic actors can tap

BOX 7.8 Lebanon's Berytech Technology Park

In Lebanon, the Berytech Technology Park, initiated by the private University of St. Joseph, is a multisector park focusing on services: advertising, business coaching, accounting, management consulting, computer hardware and peripherals, and clinical research.[a] Berytech launched a seed capital fund (Berytech Fund)[b] dedicated to investing in early-growth Lebanese companies whose business is in information and communication technology (ICT) in exchange for equity ownership. With over US$6 million under management, Berytech Fund stimulates high-tech growth by investing in early-stage technology companies, providing both the equity capital and the guidance needed to succeed. The fund invests from US$100,000 to US$1.2 million in any single investment—a range not generally served by formal venture capital funds—and helps secure additional financing if and when needed. Focus sectors include ICT, energy, agrofood (food processing), environment, health care and medicine, and media and communications.

Source: Aridi 2011.
a. http://www.berytech. org/component/option,com_wrapper/Itemid,392/lang,en/.
b. http://www.berytechfund.org/about.php.

into in various ways to solve business problems. The production structure in MENA countries relies heavily on micro and small enterprises: for these firms, the challenges of access to the know-how and networks they need to upgrade production and to be competitive in larger international markets can often be formidable. In this context, diaspora institutions can help reduce these costs and act as important agents of transformation. These institutions play a facilitating role, matching diasporas with local entrepreneurs who have the potential to grow but face constraints that require external expertise to resolve.

Diaspora engagements are about entrepreneurship and risk taking in expectation of higher-than-usual returns. As such, they can and should not be mandated, administered, or directed by the state. However, they can be nourished and supported through mechanisms that incentivize domestic firms to partner with diaspora experts, and they require the same conditions needed by other civil society initiatives to thrive: freedom of association and of information exchange across borders. An example is the nongovernmental organization (NGO) Maroc Entrepreneurs, which has become a successful platform for recruitment of diaspora talent abroad within the Moroccan private sector (see box 7.9).

Justifiable government interventions to support innovation

Even if incentives for innovation are aligned, market failures and other constraints may prevent firms from innovating, especially given the relative scarcity of role models. For instance, firms may not have the capacity to access global sources of knowledge easily or to identify and connect with the actors that can respond to their R&D needs. Institutions dedicated to generating knowledge and research, such as universities, may operate in isolation from the private sector, because they lack incentives or opportunities to collaborate. Finally, firms may have trouble obtaining risk-tolerant and forward-looking financing, such as venture capital.

However, the legacy of relations between the state and the private sector described earlier calls for strong caution toward any interventionist policy. If governments are committed to intervening, they should operate in a way that facilitates the process rather than leading it, share the risk with the private sector, and institute the appropriate governance structures to prevent capture of benefits by special interests. For this reason, the program designs will need to ensure that the performance of any institution can be monitored and that outcomes can be evaluated

BOX 7.9 Diaspora-led intermediation of talent and entrepreneurship

The NGO Maroc Enterpreneurs was founded in France by seven self-starting students of business administration to foster entrepreneurship, particularly in Morocco, and to link firms looking to recruit talent in Morocco with high-skilled graduates. A decade after its foundation, the organization is still run mostly by volunteers but now counts a network of about 3,000 students and 7,000 Moroccan graduates in economics and business, with offices in London and Paris. The organization offers business training and every year has a business plan competition for graduating students. The authors of winning projects are matched with experienced Moroccan businessmen as mentors. The government can facilitate these spontaneous initiatives by its openness to partnering with such organizations on specific activities but should not direct them.

Source: Kuznetsov and Morgandi 2008.

regularly. Selection criteria should be public and, where possible, the subject of consultation with relevant stakeholders; in addition, programs should systematically publish information on beneficiary firms and the subsidies that they receive, as well as allowing independent access to data and surveys to evaluate interventions. When feasible, impact evaluations should be built in at the start of any intervention.

Public-private venture capital funds

Some governments have been able to jumpstart venture capital for start-up enterprises. However, as these financing schemes can be captured easily by vested interests, the participation of the private sector is a first important element for ensuring that risk taking is directed toward investments where the potential for success is highest. External monitoring mechanisms are also important. Highly skilled diaspora networks can sometimes provide a check and balance on some of the more sophisticated institutions, such as venture capital funds, by acting as authoritative agents with specialized knowledge on the selection of promising projects for government cofinancing.[2]

Competitive funding schemes with diasporas

A second example of the role that governments can play is facilitating matches of innovation agents with domestic actors in search of innovation. Competitive funding schemes have proven to be effective catalysts of innovation. In the medium term, contests that encourage collaborative innovation efforts could become a very important source of funding for national R&D. They should involve participation of international partners and rely on international peer review. The main objective of such funding schemes is to provide an opportunity for dynamic and entrepreneurial individuals and organizations to develop their own projects in collaboration with each other and with international players. The science and technology ministries of Mexico and the Russian Federation have implemented such competitions.

Linking universities to local knowledge producers and the private sector

Rather than intervening in targeted firms, governments should pursue reforming the governance of universities (the main generator of talent pools) to help them become active participants in the innovation process. The following section describes the lessons learned from the study of world-class research universities in developing countries and discusses their relevance for universities in MENA.

Research universities promote innovation in three ways: first, by preparing talent for innovation (teaching); second, by engaging in research; and third, by commercializing research that is valued by markets, through the creation of patents, studies, and technical assistance. Because of demographic pressure and the expansion of tertiary education in the Arab world, universities have focused resources mainly on the first mission (teaching), less on the second (research), and not at all on the third (creating commercial value).

Just as the region needs role models of knowledge-based firms, it also needs examples of new and effective research universities capable of producing knowledge valued by markets. The paradox of the best research universities is that "everyone wants one, no one knows what it is, and no one knows how to get one" (Salmi 2009, 15) (see box 7.10).

The alignment of talent, abundant resources, and favorable governance is necessary to creating the enabling environment for innovation. At a minimum, this convergence implies the existence of national science or innovation policies with links to higher education policy, clearly defined roles for research universities, and cooperation with dynamic companies. With the exception of Morocco, Tunisia, and some GCC states, most MENA countries seem to lack these elements (see Nour 2011, 409; Arvanitis 2007, 36). Regarding university governance, an appropriate regulatory framework, strong and inspiring leadership, and adequate management significantly influence the ability of research universities to prosper (Altbach and Salmi 2011, 331). Autonomy in a wide array of domains is also essential for (1) mobilizing supplementary resources from nonpublic actors; (2) determining attractive wage packages to attract the best staff; (3) boosting the international dimension of study programs; (4) using English as a teaching language to enhance the possibilities of recruiting high-level academics; and (5) innovating in curriculum and pedagogy (Altbach and Salmi 2011, 334). Despite the reform processes mentioned earlier, most of the public institutions of higher education in MENA are still unable to address most, or any, of these issues autonomously.[3] To give but one example, in Morocco public institutions of higher education can act on points (2) and (3) on their own initiative (no incentives are being provided), while points (4) and (5) are still overlooked by the relevant authorities and point (2) would require a systemwide reform that might prove difficult, if not outright

BOX 7.10 Common characteristics of successful research universities

The main findings from a study of 11 world-class universities in nine countries are relevant for MENA (see Altbach and Salmi 2011). The study determined that successful research universities share common characteristics that distinguish them from other institutions of higher education and therefore call for a tailored policy response:

- They are part of a differentiated academic system in which they are recognized as quality leaders and supported accordingly.
- With the exceptions of Japan and the United States, they are overwhelmingly public institutions.
- They are cost-intensive as adequate staffing and infrastructure are both expensive and necessary for success. Therefore, they also need an appropriate, and sustained, budget.
- They can potentially generate significant income through tuition fees that students are willing to pay, through intellectual property and other innovations that can be sold to the corporate sector,

(continued next page)

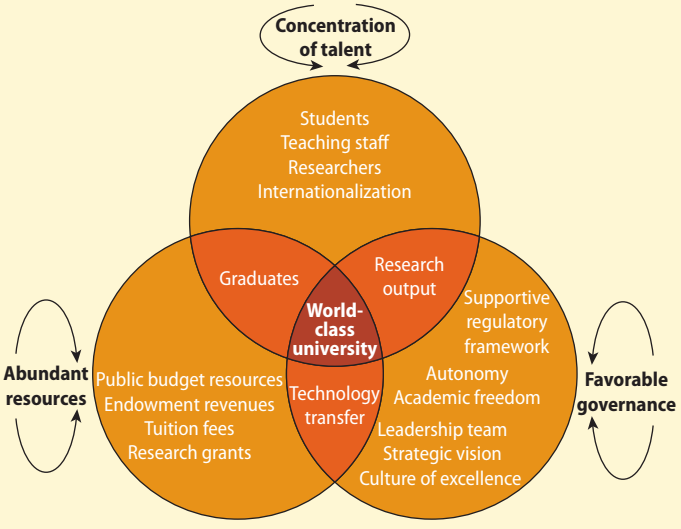
BOX 7.10 Common characteristics of successful research universities *(continued)*

and—in some countries—through the management of an endowment generated by fund raising.
- Their success is stronger when strong ties exist between them and nonuniversity research institutes.[a]
- Building a successful research university takes time—possibly several decades—and it is a complex process that requires constant attention, adaptation, and fine-tuning.[b]

The study also defines a theoretical framework presenting the key factors behind the success of these premier universities (see figure B7.10.1).

Source: Salmi 2009.
Note: World-class university.
a. Altbach and Salmi 2011, 24–25.
b. Altbach and Salmi 2011.

FIGURE B7.10.1 Characteristics of a world-class university



impossible. For an example of how to enhance university autonomy, see box 7.11.

Sustaining low-skilled entrepreneurs and promoting the potential of the highly skilled

Fostering entrepreneurship with a tailored approach

The distribution and characteristics of entrepreneurs, discussed in chapter 1, suggests that few of the highly educated—those most likely to create the greatest returns from entrepreneurship—are actually becoming entrepreneurs. A combination of constraints and lack of incentives may prevent them from making that choice. In contrast, the same profiling exercise showed that the less educated have a high propensity for entering subsistence self-employment, that the productivity of their enterprises tends to be low, and that subsistence self-employment is still highly correlated with poverty.

BOX 7.11 Enhancing university autonomy: The case of Shanghai Jiao Tong University

Despite a context different from MENA's—that is, one in which private-public partnerships are facilitated by the government's power over "private" companies—the reform process of China's Shanghai Jiao Tong University (SJTU) is a good illustration of concrete measures that enhance autonomy. To strengthen its international reputation, the SJTU embarked on a reform program that focused on four goals:

- Strengthening international publications by requiring students of the graduate school in science and engineering to publish in a journal covered by the *Science Citation Index*, as well as by providing incentives for such publications.
- Encouraging applied research and technology transfer through (1) the commercialization of patents through the dedicated SJTU technology transfer center; (2) the creation of an information platform on patents; (3) the authorization for staff to invest and gain a commensurate personal reward for any commercialized innovation; and (4) the investment in social sciences to promote the development of consulting services to the government and local organizations.
- Using research resources for talent development by increasing research funding and by promoting higher education and research standards at all educational levels, including multiplying partnerships with industry. The latter take the form of joint research undertakings, student internships in partner companies, and supervision of postgraduate students by experienced, active, engineers.
- Promoting internationalization through bilingual (Chinese and English) courses and through the participation of its students in study tours, university exchanges, internships, and jointly supervised PhD programs. The university is actively engaged in the development of dual degree programs and joint institutes with other institutions of higher learning around the world.

Source: Liu, Wang, and Cheng 2011, 50–55.

These facts suggest that two types of entrepreneurship interventions may be useful in MENA, if focused on two specific target groups. The first are interventions that facilitate entry of the highly skilled into entrepreneurship. The second are interventions that assist the existing stock of low-skilled entrepreneurs in upgrading their skills and that reduce constraints to investment and growth.

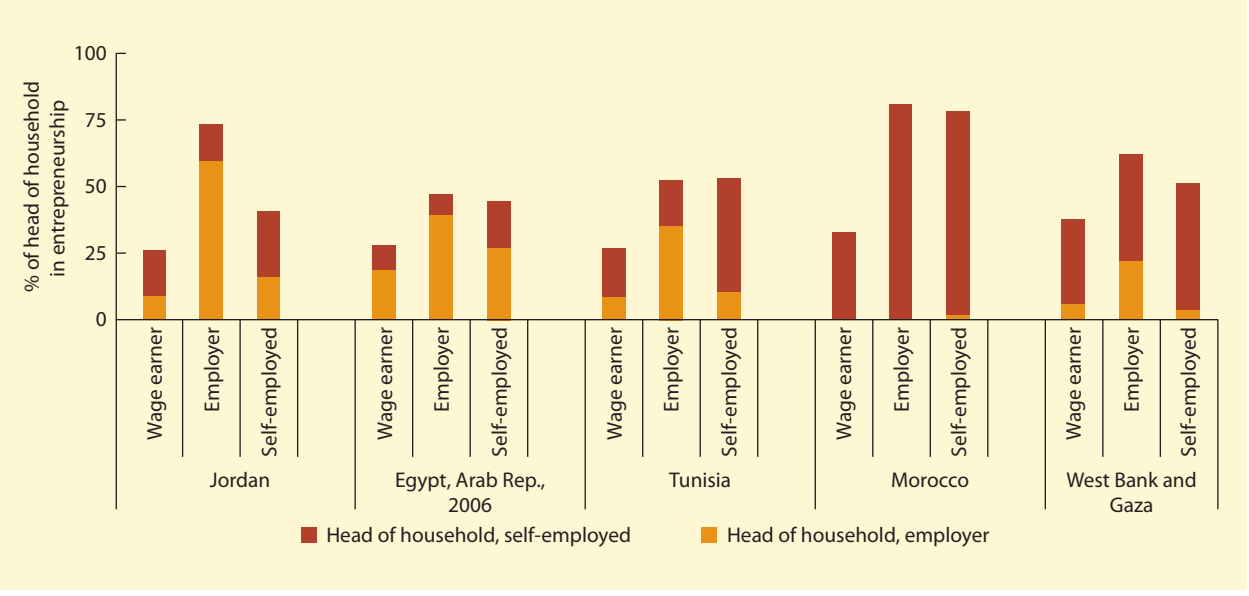
Facilitating entrepreneurship for more educated individuals

In addition to reforming the investment climate and improving access to credit for start-ups, a number of well-targeted and implemented policies can help promote entrepreneurship among the most productive segment of the active population, the high-skilled individuals. For instance, entrepreneurship training (which remains relatively rare in the region) can help build essential skills and reduce the risk of failure.

Improving the climate for start-ups

According to economic theory, individuals may engage in entrepreneurship if the endeavor is likely to be profitable enough to offset the opportunity cost of not working in the wage sector, which for high-skilled individuals offers relatively high returns. Thus all the factors that increase the costs of setting up and running a business or that affect the chances of a business to grow are likely to influence the entrepreneurship decision of the highly skilled population. Today in MENA most entrepreneurship cases seem to follow a strong intergenerational pattern: 72 percent of the young (non-household-head)[4] employers in Jordan live in households whose head is either an employer or is self-employed (figure 7.1). Similarly, more than three-fourths of

FIGURE 7.1 Share of employed individuals whose household head is an entrepreneur, by work status, selected economies in MENA, 2006–10



Source: Based on Arab Republic of Egypt's Labor Market Panel Survey (LMPS) 2006, Jordan's Labor Market Panel Survey (LMPS) 2010, Morocco's Household and Youth Survey 2009, Tunisia's Labor Force Survey 2010, and West Bank and Gaza's Labor Force Survey 2008.
Note: MENA = Middle East and North Africa. Individuals considered are all employed non-household-head people under 40 years of age.

young employers and the self-employed in Morocco live in households headed by entrepreneurs; these shares are much lower for wage employees.[5]

The overall perception from opinion surveys in MENA countries is that some of the core inputs to setting up a business—such as permits, credit, and, above all, training—are difficult to access. The constraints are perceived more strongly in non-GCC countries and decrease slightly as education and income increase (figure 7.2), but they remain high. High start-up and operating costs are more likely to affect the decision of those who may not want to work informally or of those who may have a higher profit threshold, such as the highly educated group.

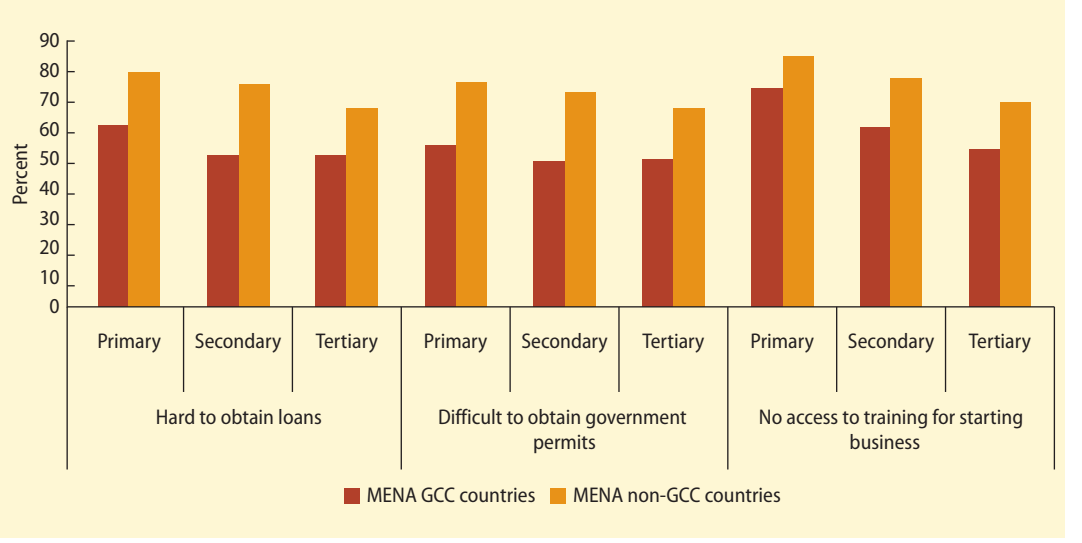
For instance, broadening access to professions, as discussed earlier in this chapter, in countries where these are still highly restrictive and opaque is an important avenue for increasing entrepreneurship among the highly educated.

Potential of entrepreneurship training

In addition to improving the business environment and access to credit, specific training is another way to foster entrepreneurship among the highly educated. Many interventions have focused on education and training, based on the evidence that some entrepreneurial traits and skills are strongly related to business setup and success[6] and that these traits can be taught. Some are implemented through school curricula for relatively early intervention,[7] while others cover those who are already in the labor market. Skills of interest include basic business and managerial skills, financial literacy and capability, and vocational and life skills. In addition to this main intervention, counseling and mentoring are often provided.[8]

According to a recent inventory of interventions for youth employment, only a small number of existing active labor market programs in MENA focus on entrepreneurship

FIGURE 7.2 **Main constraints to starting a business in MENA, by level of education, 2011**



Source: Gallup World Poll Survey 2011. See appendix for more information on the survey.
Note: MENA = Middle East and North Africa; GCC = Gulf Corporation Council.

promotion (table 7.2) (Angel-Urdinola, Semlali, and Brodmann 2010). Of the existing programs, only two have been rigorously evaluated; only one program out of those reviewed is found to target women; and microfinance programs are less common in MENA than in the rest of the world.

An example from which many lessons can be drawn is the business plan competition for Tunisia, a combination of entrepreneurship training and customized coaching focused on graduating university students (see box 7.12).

The program was found to have positive impacts on the acquisition of cognitive and noncognitive skills, as well as on the propensity for entering self-employment, which started from a very low base. In addition, the program confirmed the important role that both the business climate and the incentives in the labor market play in whether an individual enters into self-employment. In fact, the Tunisian graduate youth who participated in the business plan competition mentioned access to finance as a top constraint to their entering into self-employment, and this perception did not change over the course of the training. The study also underscored that high wages in the formal public sector continue to act as a disincentive to take risk: the impact evaluation found that the training had no effect on the participants' preference for the public sector as an employer of choice.

Importance of work experience in entrepreneurial success

The profile and history of entrepreneurs suggests that while tertiary-educated individuals should be incentivized to set up firms, incentivizing the entry of first-time job seekers may not be optimal. Only a few inexperienced individuals are likely to enter into entrepreneurship. Most entrepreneurs have accumulated experience and know-how (and probably also capital) before transitioning into self-employment. Figure 7.3 shows that in the case of Egypt and Jordan, about 30–40 percent of the entrepreneurs ages 25–46 were already involved in entrepreneurship a decade earlier, either as heads of their business or as unpaid family members. Another large share of the entrepreneurs (25–45 percent) previously worked as wage workers, especially in the informal economy. Comparing employers

TABLE 7.2 Programs promoting entrepreneurship in MENA

Program name	Economy	Target group	Component
Injaz al Arab	Jordan; Egypt, Arab Rep.; Tunisia; Lebanon; West Bank and Gaza; Morocco	School students (grade 7 to university)	Private firms' volunteers provide job skills and financial literacy training to students in public schools
Achievement	Egypt, Arab Rep.	Youth	Private sector volunteers share experience and provide entrepreneurial training
Textile merchandiser program	Egypt, Arab Rep.	Unemployed youth	Provide textile merchandise (vocational training) skills training as well as life skills
Positive youth initiative	Egypt, Arab Rep.	Unemployed youth	Vocational training through apprenticeship and grants provided for business setup
Microcredit youth lending program	Egypt, Arab Rep.	Youth	Group-based microcredit
Microcredit program	Egypt, Arab Rep.	Youth	Microcredit and business training
Entrepreneurship Training for Women Artisans	West Bank and Gaza	Women	Entrepreneurial training and access to funding
Know about your business	Syrian Arab Republic	Youth	Business education
Graduate entrepreneurship program through IT	Tunisia	Unemployed university graduates	Entrepreneurial and IT training
Youth microfinance initiative	Yemen, Rep.	Youth	Entrepreneurship training and microfinance
Turning theses into enterprises	Tunisia	University students	Business training, coaching, and financial prize for business plan competition winners
Microcredit	Morocco	Rural households	Microfinance

Source: World Bank Youth Employment Programs Inventory.
Note: MENA = Middle East and North Africa; IT = information technology.

BOX 7.12 Entrepreneurship training in Tunisia

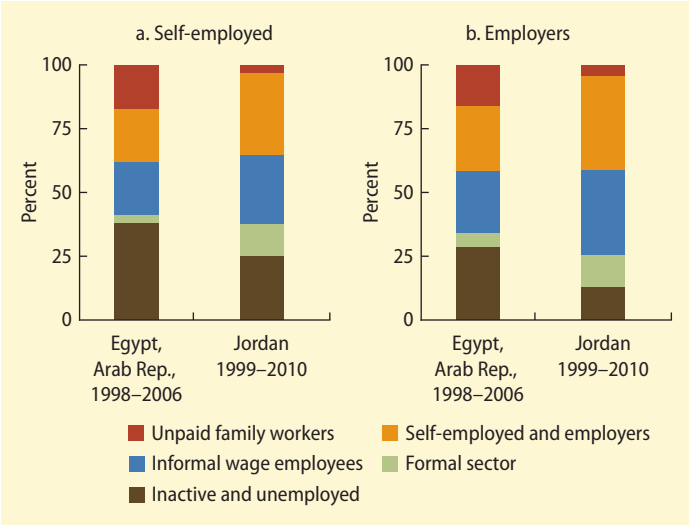
In 2009, Tunisia introduced an entrepreneurship track into the applied undergraduate curriculum, which entailed training in business and entrepreneurship as well as coaching. Students could choose the entrepreneurship track as an alternative to the standard curriculum. As a graduation requirement, students had to prepare and submit a business plan instead of a traditional undergraduate thesis. Of 1,800 eligible students, 1,702 applied in the first year. Given capacity constraints, half the applicants were randomly selected for the newly established entrepreneurship track, while the other half were assigned to the standard curriculum.

The rigorous evaluation by Premand et al. (forthcoming) of this entrepreneurship program is the first attempt to take an experimental approach to quantifying the effectiveness of business training among a sample of university students. Results show that beneficiaries of the pilot program were 61–88 percent more likely on average to be self-employed compared with graduates from the control group. The program was also effective in fostering business skills, expanding networks, and affecting entrepreneurial traits and behavioral skills, as well as raising graduates' sense of opportunities and optimism toward the future. Participants entering entrepreneurship training placed a lower value on agreeableness (the literature regards placing a lower value on agreeableness as an important quality for success in business professionals or managers), but the entrepreneurship track increased extroversion. This finding suggests that different behavioral skills may be shaped by different types of training or activities.

Source: Premand et al., forthcoming.

FIGURE 7.3 Transition matrix of self-employed and employers ages 25–46 in the Arab Republic of Egypt and Jordan, by work status, 1998–2006 and 1999–2010

percent



Source: World Banks staff, using the Arab Republic of Egypt's Labor Market Panel Survey (LMPS) 1998–2006 and Jordan's Labor Market Panel Survey (LMPS) 2010. See the appendix for more information on these surveys.

in the top and in the bottom wealth quintiles for Jordan and Morocco also shows that the high-earning employers stand out not only for having higher education but also for being older than the low earners. This finding could be related to the long time it takes for an entrepreneur to reach success but perhaps also to the fact that more successful entrepreneurs have more experience.

According to the evidence, then, governments should be cautious about promoting entrepreneurship as a short-term measure for reducing the unemployment of first-time job seekers. Instead, the government could help young people acquire work experience early on and then encourage the better-performing individuals to shift from wage employment to entrepreneurship. That way, these new, highly productive entrepreneurs can create the jobs that will absorb unemployment.

Improving the productivity of subsistence entrepreneurs

Most studies of the investment climate focus on formal enterprises, and relatively less is known about constraints to (largely informal) subsistence entrepreneurs in MENA. A number of programs have been implemented around the developing world, however, to promote low-scale entrepreneurship; and the barriers that they try to reduce usually include the lack of generic business skills or experience and the lack of start-up or working capital.[9]

Access to microcredit

Expansion of access to credit can benefit microenterprises. An impact evaluation of a microfinance program in rural Morocco (Crépon et al. 2011) showed only mild effects of credit expansion on start-ups. In contrast, however, expansion of access to credit had important effects on existing entrepreneurs, who cut back their spending on consumption and nondurable goods in order to finance the expansion of their businesses. For most subsistence entrepreneurs, the main challenge may not be entry but business growth. The positive effect of releasing credit constraints is also documented by De Mel, McKenzie, and Woodruff (2008a, 2008b), who show that providing cash or in-kind transfers to small retail firms in Mexico had positive effects on profits, but the effects were higher for the firms that were more credit constrained.

Tailored training in essential business skills

A second set of policies can help foster skills in existing microenterprise owners. Informal enterprise owners can benefit from training in basic accounting, literacy, and numeracy but also from workshops for technological upgrading of production and IT skills. Such skills may also lead to better labor market matching by facilitating the search for wage-labor opportunities. However, the lack of a developed market for provision of these skills implies that appropriate design is crucial to incentivizing providers to offer only relevant and work-time-compatible trainings. Demand-driven approaches, such as for example, the provision of training vouchers, have

yielded promising results in other contexts, notably Kenya and Uganda (Van Adams 2001).

Business environment, infrastructure, and access to technology

A broader set of policy interventions is likely to have important spillovers on the welfare of this group of largely poor entrepreneurs. First, improving the formal business environment is crucial to enabling the transition of (subsistence) microentrepreneurship to wage employment, as many microfirms are created just because wage jobs were lacking. In addition, regulations that discourage formality may undermine employment growth and productivity-enhancing investments.

Second, many of the constraints that microentrepreneurs face relate to the geographic location where the working poor live and operate. Infrastructure and transportation networks are crucial for improving access to markets where product demand is higher, as well as for access to the digital infrastructure that spreads information on prices and demand opportunities. Transportation is also important because it allows individuals to connect directly to markets and reduces dependence on intermediaries.

Finally, a number of organizational technologies can improve the efficiency and specialization of microentrepreneurs, allowing them to benefit from economies of scale. For instance, agricultural cooperatives can be an important vehicle for acquiring high fixed-cost goods such as machinery needed to process and market products. The legal framework needs to be in place to allow these entities to operate. Table 7.3 provides examples of programs developed to address particular constraints affecting small-scale entrepreneurs.

TABLE 7.3 Programs for small-scale entrepreneurs in various developing countries

Main constraints	Types of intervention	Basic component	Examples
Limited skills to start up a business	Vocational training	Skills training in particular areas of vocation, such as carpentry, tailoring, and baking, for example	Uganda NUSAF Program, Malawi Apprenticeship Program, India Self Help Group
Limited knowledge to operate a business	Business training	Education on business planning, cost calculation and price setting, market analysis, marketing, customer relations, and business practice, for example	Tunisia business training and planning, business training for microcredit clients (Ghana, Peru, Tanzania)
Limited knowledge to make use of capital and smart investment decisions to grow a business	Financial training	Education on the concept of inflation, interest rate, investment, profit maximization, portfolio, and accounting, for example	Financial training for existing business owners (Bosnia and Herzegovina, Indonesia)
General lack of career plans and inability to manage skills, time, and money	Life skills training	Promotion on positive life perspectives, general problem-solving skills in life, and sound decision making	Social assistance programs in Chile and Nicaragua
Limited access to credit to start, invest, and expand businesses	(Micro) credit, subsidies	Provision of loans or grants for business operation	Microcredit in Bangladesh, India, Pakistan, and Tanzania, among others
Risk averseness, high discount factor	(Micro) insurance, saving	Provision of institutional support to purchase insurance or open a savings account for the future	Microinsurance in Malawi, savings account
Limited experience and social capital	Counseling, mentoring	Hands-on advice for business operation, application of knowledge, guidance on financial products and credit, and linkage to the existing market and network	Graduation model in Argentina and Chile, on-site visit and counseling in the Dominican Republic

Source: Cho and Honorati 2012.
Note: NUSAF = Northern Uganda Social Action Fund.

Global lessons on the design of entrepreneurship programs

The meta-analysis of a recently developed global inventory of entrepreneurship promotion programs around the world sheds light on some of the design features that could enable these programs to work better but also reveals some of their limitations as a policy tool.[10] Programs in MENA are likely to yield better results if they combine entrepreneurship interventions with opportunities for broader access to credit—especially for credit-constrained groups, which can include existing entrepreneurs. Adding counseling improves the effectiveness of training programs, but the evidence is more mixed in the case of counseling and financing. The efficacy of training programs has also been demonstrated to rise with the skills of the participants: high-skilled workers learn faster.

Approaches specifically targeting women may yield better results than generalized programs that also try to include women (Attanasio, Kugler, and Meghir 2011; Field et al. 2010; Field, Jayachandran, and Pande 2010).[11] According to the inventory mentioned earlier, these interventions are still rare in MENA countries. Credit for young people, however, has been particularly successful only in countries where youth unemployment was not high, which is not the case across MENA economies.[12]

To conclude, caution remains warranted when applying any of these approaches, given the dearth of evidence from within the region. In this context, establishing a strong evaluation system—a rigorous impact evaluation would be best—will be essential.

Realigning the incentives for employment and productivity

This chapter reviews a number of policy options that could unleash the repressed potential of the private sector in MENA to create more employment, and more employment of better quality, along the whole spectrum of firms.

Boosting labor demand requires catalyzing the process of creative destruction, which is the core driver of the growth of labor productivity. Reforms that can facilitate this process include reducing adjustment costs and barriers to entry and exit. Facilitating firm exit—while potentially increasing short-run job losses—will be crucial for job creation in the long run as it ensures that resources are reallocated toward their most productive uses and because it encourages entry by reducing the costs of failure. It will also be important to create the conditions for incumbent firms to invest and grow, given MENA's limited dynamism. Enhancing transparency in public administration and increasing institutional accountability are important for ensuring equal opportunities and reducing the scope for corruption.

Addressing structural constraints to the provision of credit, currently limited for firms of most sizes, will allow firms to invest and help them grow. Promoting trade would not only alleviate demand constraints, which prevent firms from scaling up, but also serve as a disciplining mechanism as firms would have to innovate to become and remain globally competitive.

In spite of the complex political economy of energy subsidies, removing them is likely to pay a triple dividend in job creation: it will reduce the relative costs of labor, it would immediately incentivize investments in more energy-efficient (and likely relatively more labor-intensive) production, and it would free up fiscal space that can be used to lower labor taxes and further reduce the (relative) cost of labor.

This chapter also discussed the potential of innovation policies, in light of the effort that many governments are making to actively upgrade the quality of their production systems. While the importance of innovation is widely appreciated, innovation is typically led by the private sector. However, market failures in innovation may persist that would leave a role for governments to play: appropriately aligning incentives for innovation is crucial. This goal may require facilitation of knowledge diffusion, for example, by creating forums where innovating agents and firms could meet, as well as by enabling firms to trade freely across

borders. Reforming university governance is also likely to help realign the incentives for creating positive and tangible spillovers to the private sector.

Similarly, increasing the rate of participation in entrepreneurship among the current and growing stock of highly educated individuals will require the general improvement of the investment climate for this option to become more attractive. However, at the margin, specific programs could release some of the immediate skills-constraint to entry. In addition, it is important to address the problems faced by the very large but unnoticed segment of the private sector—the mostly informal microentrepreneurs, who cannot be absorbed into the wage market in the short term but who would benefit from a range of cross-sectoral policies to improve their productivity.

Notes

1. See World Bank (2002) for a discussion on designing competition authorities.
2. An example is Fundación Chile, created as a nonprofit corporation by the Chilean government and the conglomerate ITT in 1976. Fundación Chile became the key player in Chile in renewable resources. This foundation is, for instance, widely credited with turning Chile (a country with no native salmon population) into the world's second-largest salmon producer.
3. Please refer, for example, to the 2009 Arab Knowledge Report classification system (see Mohammed bin Rashid Al Maktoum Foundation and UNDP 2009).
4. Data limitation does not allow us to capture the profession of the parents of young entrepreneurs who have left their household.
5. Data limitations allow us to detect only the work status of entrepreneurs who are not household heads, thus, those who are relatively young.
6. For example, Ciavarella et al. (2004) using data from the United States find a strong relationship between some attributes of personality (conscientiousness, emotional stability, openness, agreeableness, and extroversion) and business survival. Crant (1996) also points to personality as a predictor of entrepreneurial intentions.
7. Organizations such as the Kauffman Foundation and Junior Achievement, for example, focus on promoting entrepreneurship curricula as a part of primary and secondary education, while a number of interventions including microcredit and training programs target those who are already in the labor force.
8. The provision of counseling is particularly prevalent among programs in the Latin American and Caribbean region, such as Chile's Solidario and Argentina's Jefes y Jefas.
9. See the *World Development Report 2013* on jobs for a comprehensive review of the evidence (World Bank 2013).
10. Building on Cho and Honorati (2012), the metaanalysis focuses only on studies with rigorous impact evaluation and identifies 37 interventions around all regions, including the two from the MENA region. Since meta-analysis identifies the extent to which different settings of studies—different design, outcomes, and methods of analysis, among others—affect reported results, this is particularly useful for synthesizing multiple studies with variations in multiple aspects like the studies on entrepreneurship programs. In addition, World Bank (2013) provides a comprehensive review of the evidence.
11. For a comparison, note that programs targeting only youth do not necessarily improve the effects on youth.
12. Whether the labor market is favorable to youth is measured as the ratio of the youth unemployment rate over that of adults. Compared to adults, if the youth unemployment rate is high, the labor market is considered less favorable to youth.

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Regulatory Framework of the Labor Market: Overcoming Segmentation

8

Main findings

- To remove segmentation in their labor markets, countries with the most restrictive regulations could consider reforming the regulation of wages and especially contracts.
- A reform of the overly generous employment terms in the public sector to align risks and returns with the private sector would entail large fiscal gains and improve the allocation of talent to where it is most productive.
- In the private sector, more lenient but enforceable contract regulation could be combined with unemployment insurance to protect workers' incomes during periods of joblessness.
- A more transparent and actuarially fair social insurance system could contain fiscal costs better than the current system, while increasing coverage.
- Policies that encourage women to work go beyond immediate labor market regulation and need to target the underlying determinants of women's access to economic opportunities.

Segmentation in MENA's labor markets

How can the countries of the Middle East and North Africa (MENA) overcome segmentation and achieve a dynamic labor market, one that gives all groups an equal chance and allows the labor force to move to the highest-productivity sectors? While the solutions will have to be specific to each country in the region, given that conditions differ widely, they will likely involve political decisions about the minimum wage, wage agreements, and public sector wage scales. They will also involve decisions about the regulation of contracts: hiring and dismissal procedures and working hours, in both the private and the public sectors. Finally, they will involve decisions about particular aspects of the social insurance system.

These decisions need to rest on a broad social consensus involving all affected citizens. Chapter 5 suggests two fundamental preconditions for overcoming the labor market segmentation in MENA, which apply to

all countries in the region. First, policy makers and citizens need to know what is happening in their labor market and how they are affected individually. Access to reliable and inclusive information therefore must be ensured. This requirement is discussed in more detail in chapter 10.

Second, it is important that citizens can make their voices heard in an inclusive debate about political options. This means not only strengthening the institutions that represent traditional social partners (trade unions, employers, parliament, and the government) but especially establishing mechanisms to represent the new social partners (youth, women, the unemployed, and informal workers): their voices are essential for making socially optimal decisions on key elements of labor market regulation.

Only an inclusive social dialogue can, for example, set a minimum wage that protects workers without harming the job entry chances of others. Only an inclusive social dialogue can negotiate collective wage agreements that balance inequality concerns with the entry chances of inexperienced youth or design a social insurance system that covers the entire workforce. An inclusive social dialogue can go as far as involving social partners in the governance of the social insurance system, as in Germany, where a diverse group of employee and employer representatives self-administer the social insurance system. There, representatives are elected by all those covered by social insurance. This form of governance can in principle enable smooth reforms, because all social partners have a direct insight into potential strains on the system. The Jordanian Social Insurance System (see case study in chapter 10) and the Tunisian pension funds also have clear roles for both employers and employee representatives in the governance of the system, albeit with less direct insight and access to information.

Once these two important preconditions for successful consensus building are met, the recommendations will differ by country. The following sections explore some options.

Strengthening basic labor market institutions

A small group of countries—including the Arab Republic of Egypt and the countries in the Gulf Cooperation Council (GCC)—would benefit from expanding essential labor market institutions. In these countries, the traditional social partners such as trade unions and employer representatives are not organized and diverse enough to hold a tripartite dialogue in which all stakeholders have equal standing. Other social partners are nonexistent, weak, or just emerging (Egypt). In line with this social landscape, which favors a "laissez-faire" environment, minimum wages or collective wage agreements either do not exist or are not based on a broad social consensus.

Two essential institutions that merit strengthening in all countries of the region are labor inspection and employment services. Strengthening employment services is discussed in chapter 9. Evidence on labor inspection is currently available for Algeria and Tunisia. Both countries have developed these institutions with the official mandate of enforcing labor market regulations and establishing a presence in different parts of the territory. In Algeria, experts point out that labor inspectors officially intervene only reactively, at the express request of a complainant (Musette and Mohamed-Meziani 2011), similar to the model in northern European countries. In Tunisia, the mandate for labor inspection also covers managing labor disputes and reconciling the workers' and unions' dialogue with the employers.[1] Tunisian labor market experts rate poorly the performance of the national labor inspection institution, whose coverage is limited to large formal sector firms, with smaller and informal firms operating under the radar. This situation contributes to strengthening the informal sector and thus to segmenting the labor market. The insufficient quantity and quality of human resources are frequently cited as the main causes of low performance and, together with the broad mandate and discretionary

powers of labor inspection institutions, have contributed to the reputation of these institutions as "labor police" (Boughzala 2011). Addressing this negative perception and improving the capacity of labor inspectors would entail strengthening the labor inspection functions and removing excessive mandates and discretionary powers from the legal codes.

Overcoming segmentation in wages

The initial statistics presented in chapter 5 are consistent with weak enforcement of minimum wages in several MENA countries, which can discourage hiring or divert it to the informal sector, thereby circumventing the official minimum wage.[2] Overall, a move to less restrictive (but enforced) regulation would be better than regulation that invites circumvention and informality and would prevent the majority of the workforce from operating outside the regulatory framework.

In view of this possibility, some countries—including Algeria, the Islamic Republic of Iran, Jordan, Morocco, the Syrian Arab Republic, and the Republic of Yemen—might want to review their minimum wages carefully and adjust them downward to meet market realities. A somewhat lower minimum wage, agreed to in an inclusive social dialogue and well enforced by all partners, could be a substantial improvement over the status quo. Successful downward reform of minimum wages is rare, and since it might come at high political costs, its pros and cons should be weighed carefully. The experience in the Netherlands offers some lessons in this regard (see box 8.1).

Among the countries in MENA whose minimum wages merit revision, the Dutch example could be particularly relevant to Algeria, Jordan, and Morocco. The institutions in these countries are powerful enough to hold a tripartite social dialogue and could embark on a public debate along similar lines. A public pact or accord between social partners for a reform of the minimum wage or its indexation would be credible.

In a small group of countries (Algeria, Tunisia, and, to a lesser extent, Jordan) opening up the dialogue on collective wage agreements would likely result in a

BOX 8.1 Wage reform in the Netherlands, 1980s

In the Netherlands, social partners—trade unions and employer representatives—normally negotiate collective and minimum wages autonomously. However, the state has traditionally set statutory wage policy and retained the right to intervene with wage freezes in extreme cases.

During the late 1970s, the country suffered an unemployment crisis that needed a strong strategy for job growth. The government announced a freeze on public wages and on the minimum wage. Unions suffered membership losses, organizing less than 30 percent of Dutch workers in the early 1980s (Ebbinghaus and Visser 1999), and ultimately voluntarily agreed to a de facto wage freeze in exchange for employers' negotiating working time.

In 1982, trade unions and employers signed the historic Wassenaar Accord and committed themselves to wage increases below inflation and productivity growth. Indeed, real wages fell in the following years. The two main motivations for this were, first, to get the Dutch economy back on a course of industrial profitability and, second, to retain autonomy as social partners and reduce government intervention. In 1984, the indexation of public sector pay and social transfer payments was abandoned; wage formation remained below price and productivity increases, coincident with substantial employment increases. In 1993, a new bipartite agreement pledged the continuation of a "responsible wage development."

Source: Visser and Hemerijck 1997.

downward adjustment for wage floors for graduates. Although these countries have relatively well-organized traditional social partners, the political dialogue does not yet sufficiently include new partners. Consequently, the collective wage agreements of the past represent only formal "insiders" but are binding for youth and women.

Overcoming segmentation in labor contracts

Most countries in the region would benefit from greater flexibility in firing rules, combined with better security in incomes (the so-called flexicurity policy). This process would involve the moderation of employment protection legislation and an increase in social protection to buffer the cost of a transition between jobs. These changes would mean a moderate but not excessive protection against dismissal and well-designed unemployment insurance and assistance. The country-specific design and mix of these two depend strongly on the political feasibility in the country, and one nation's recipe for success may fail in another. A few lessons from international experience merit consideration, however.

Strict employment protection usually manifests itself through either high severance pay or high administrative burdens on firing. For example, high severance pay can make firing so costly that employers are reluctant to make contract hires that include severance pay and prefer to hire informally or use more precarious temporary contracts. One way to ease the burden of severance pay is to convert the one-off severance charge at termination into a severance savings account or fund that accumulates over time and receives contributions from both employers and employees. The contributions can be set at a small percentage of the current annual salary, rather than the last (and likely higher) annual salary at termination. The severance account could then follow an employee from job to job and be awarded upon retirement. Both the Colombian *cesantía* model and the Austrian workers' capitalization fund bear features of this approach.

The other potentially high barrier to firing—administrative charges—needs careful review country by country. The Tunisian labor code, for example, requires employers that dismiss an employee for economic reasons (such as productivity gains) to submit an application and receive the approval of a third party, the Commission des Licenciements (layoff commission). Changes to this rule could involve replacing the discretionary power of the commission with a published list that spells out the criteria for the layoffs that require consultation with (but not approval of) the commission. All layoffs not listed would then be free from the obligation for consultation.

Moving toward less stringent employment protection in hiring can also be beneficial. Labor markets with relatively liberal hiring policies, on the one hand (for example, policies that allow temporary and fixed-term contracts), and protective firing policies that exclusively burden open-ended contracts, on the other hand, are segmented. New job market entrants end up (and get stuck) in unprotected temporary contracts, while established insiders benefit from open-ended contracts. Inspired by the experience of southern Europe, notably Italy and Spain, where open-ended contracts mandate high severance pay and such clauses are not likely to be removed in the short run, recent empirical literature has developed the model of a single open-ended contract to overcome the dualism of fixed-term versus open-ended contracts. This type of contract gradually accumulates the severance pay charge that the (old) open-ended contract provided upon signing. Evidence from Bentolila, Dolado, and Jimeno (2011) and Costain, Jimeno, and Thomas (2010) shows that this model could be beneficial if firing costs as such cannot be changed. The marginal increase in severance pay would be minimal from a contract extension under this model, compared to a discrete switch from temporary to open-ended hiring.[3]

Overcoming segmentation in social insurance coverage

Perhaps the most critical task in addressing the segmentation between labor market insiders and outsiders is to develop effective reform programs that rapidly increase access to social risk-management tools. Indeed, both the coverage and the scope of social insurance need to be revised in most MENA countries, where economic development has yet to be reflected in broad-scope social insurance programs. Most other middle-income, modern market economies offer unemployment insurance (UI) and maternity benefits. The case for increasing MENA's coverage from its current level of 33 percent is based on the negative consequences of excessive exposure to uncovered social risks (old age, disability, death, and work injury) and on the associated productivity gains and improvements in social cohesion that would be achieved.

Designing incentive-compatible social insurance

Strategies for expanding social insurance in MENA should start with eliminating gaps in legal coverage and then adapting social insurance rules (in particular for pensions) to create stronger incentives for individuals and firms to participate and contribute over long career paths. The improved incentives should be designed with financial sustainability in mind. Specific, possibly subsidized, coverage extension programs—aligned well with the core design of a reformed social insurance system—should complement traditional interventions. Reforms should also allow (voluntary) entry to those who either lack access to social insurance through formal jobs or who cannot pay the full cost of participation in social insurance.[4]

For example, the self-employed, the workers in agricultural cooperatives, and the employees of small firms are often unnecessarily excluded from legal coverage in MENA. In the context of contributory systems, any expansion that does not address the need for a close (that is, actuarially fair) relationship between the contribution of an individual and the expected benefits will further undermine the financial sustainability of the scheme, especially pensions. Redistribution in the context of social insurance benefits can be justified, but it should be transparent and explicitly directed at improving the social position of targeted groups. In particular, the use of (even implicit) subsidies should be restricted to helping individuals with low savings capacity (informal workers in particular) enroll in low-threshold social insurance programs that extend coverage beyond formal employment. This last step is especially hard, as it will require a leap beyond the conventional wisdom that individuals must have a formal job to participate in social insurance.

Promoting greater transparency and efficiency

A review of the spending efficiency of the social insurance system, including labor taxes and contributions, will help balance the economic efficiency and employment losses of contributions to social insurance with the benefits of the protection offered. Egypt, the Islamic Republic of Iran, Lebanon, and Tunisia have a "tax wedge"[5] exceeding that of the Organisation for Economic Co-operation and Development (OECD), and Morocco follows closely behind. However, these countries do not achieve the high degree of social insurance coverage and services typically offered in OECD countries. An in-depth survey of the system, following the money spent, would help identify bottlenecks. Greater transparency is needed in both collection and spending, including parafiscal (that is, levies or fees other than taxes, but still going to the state; quasi-taxes) and "voluntary" contributions.

At the same time, social insurance contributions need to be aligned with the long-term financial sustainability of social insurance systems to ensure that the desirable reduction in high contribution rates corresponds with reforms on the benefit side. Achieving this balance is easier said than done. The same

political economy forces that contributed to the current equilibrium are likely to skew choices in favor of pursuing reform through increases in contribution rates, rather than restricting early retirement, reducing income replacement generosity, or inducing longer contributory paths through other measures.

Designing unemployment insurance to mitigate rigid employment practices

Most MENA countries should consider unemployment insurance as an alternative to legislating rigid employment protection (and severance pay). Effectively protecting income during job transitions can sustain a more dynamic labor market with simultaneously increased job creation and destruction and more frequent transitions across the current insider-outsider divide. This report has shown how excessively rigid labor regulations increase the segmentation between insiders and outsiders. In a broader sense, any regulation that increases the costs of discontinuing unproductive employee-employer matches constrains the labor market's efficient allocation (and reallocation) of production workers and therefore also constrains the expansion of economic activities and employment. Paradoxically, the enemy is not the destruction of (unproductive) jobs per se but rather that the social consequences of layoffs are borne solely by employees.

Unemployment insurance is a mechanism by which firms and workers share the social costs of increased labor market dynamism and the associated frictional unemployment (that is, the period between jobs when an individual is searching for employment, or transitioning from one job to another, often in a context of imperfect or incomplete information) without restricting the forces of creative destruction. In other words, it is a tool for simultaneously decreasing legislated employment protections but increasing income protection for periods of frictional unemployment. A shift from legislated employment protections to unemployment insurance would then promote less dualistic labor markets; in fact, the vision of accelerated net job creation through the parallel acceleration of creative destruction and job creation is really a reflection of increased flexibility in formal employment.

Unemployment insurance savings accounts (UISAs) may be a new institution that is especially useful in reducing the barriers around formal employment in MENA. Unemployment insurance in a broader sense may rely on two types of mechanisms: risk pooling and individual savings of various kinds, both of which mean that the risks remain with the individual. Risk pooling is its traditional core mechanism, whereby the contributions of the employed pay for the benefits of those laid off. A limitation of risk pooling is that it relies on the ability of institutions to unfailingly verify unemployment status. In the absence of such institutions, moral hazard (the risk that individuals will claim unemployment benefits while informally employed) could cause the collapse of the unemployment insurance system. Initially used in Latin America, unemployment insurance savings accounts address this challenge by combining mostly mandatory savings ("saving for a rainy day") with a degree of risk pooling to make resources available during periods of job search. The UISA design allows an unemployment insurance mechanism to prevail even in a weak implementation environment, as those who attempt to abuse the system can "steal" only their own savings. Any unused savings should be paid out to the UISA "owner" upon retirement (Robalino, Vodopivec, and Bodor 2009). The desirable incentive effect has been working in Chile (Reyes, van Ours, and Vodopivec 2010), and the experience of Jordan's UISA scheme (introduced in 2011 and soon to be available) could provide lessons for other MENA countries as well.

Public versus private sector segmentation

Gains from reforming public sector employment

There is evidence that the public sector crowds out some private employment, induces queuing for coveted public jobs, and

allows "double dipping." Chapter 5 presented evidence of this phenomenon for five diverse countries in the region, representing the Maghreb (Algeria, Tunisia), Mashreq (Egypt, Jordan), and the Gulf (United Arab Emirates).

Most countries in the region would benefit from reviewing the risks, returns, and extent of employment in the public sector. Such a review would address the very heart of employment arrangements in the public sector and prompt a debate on both the effectiveness and the financial sustainability of public sector activity.

Practical steps toward change

A recent review of the experience of public sector reform suggests the following practical steps (see Manning et al. 2012):

- *Identify core and noncore public sector activities and employment.* Most countries conduct the former through civil servants. This first step is necessary for the MENA region if it is to achieve a separation of functions between the government (responsible for policy and legislation) and the private and nongovernmental organizations (NGO) sectors (as providers of employment, health and environmental services, utilities, and the like).
- *Contract out noncore activities to private and third-party providers.* Noncore activities rely on skills that do not need to be nurtured within the public sector or on services that can be bought. This second step will help reduce crowding out of the private sector. The public sector can thus be a legitimate source of revenue for the private sector in areas where public funding is justified.
- *Decentralize decision making to regional or local offices where possible.* Decentralization helps reduce the workload of the central office and alleviates any bottlenecks associated with central approval and clearance. Empirically, it has been shown to foster innovation, as problems detected locally can often be solved locally. For example, the Tunisian employment agency recently began decentralizing budgeting and procurement to local offices.
- *For the career-based core of civil servants, revisit the incentives set by salaries and employment terms.* Essentially, this process means maintaining merit in appointment and promotion. Current public sector recruitment in MENA is modern and transparent on paper but in reality presents major limitations. Evidence from Egypt and Morocco, for example, shows that the majority of new magistrates entering the judiciary come from families where one parent already holds this position. Moreover, the disconnect between regulation and implementation needs to be overcome. In response to the meritocracy challenges in the region described in chapter 6, the public sector should take the lead in demonstrating transparent and fair practices. To that end, the hierarchies in command and control, which are far steeper in the civil services throughout MENA than in other parts of the world, should be flattened. Hierarchies can have a negative impact on civil service culture, as well as a detrimental effect on innovation and creativity.

Given the significant size of the public sector in most MENA countries, any reform needs to recognize the importance of public workers as a political constituency. Public servants are citizens, they vote, and they are unlikely to want to let go of privileges any more than other parts of society. In the Gulf states, Jordan, and Lebanon, public servants represent more than 30 percent of the labor force—a very powerful and vocal political constituency.

Inducing youth to aspire to jobs outside the public sector will require changes in other sectors of the economy. The attractiveness of the public sector comes primarily from its risk-return package but is also a function of the unattractive terms offered by the informal and small business sectors. The barriers in the private sector are explored in detail in chapter 4.

Removing the segmentation limiting women's participation in the labor force

Policies that encourage women to work and increase their attractiveness to employers go hand in hand. Labor force participation reflects a combination of individual choices and reactions to market conditions. Chapter 2 discusses evidence that a share of the women who do not participate in the labor force actually would like to work. In this spirit, policies that target the underlying determinants of female access to economic opportunities and touch on more than the immediate labor market regulations—such as time constraints, access to inputs, and market and institutional failures as priorities for intervention—can promote a better alignment between individual aspirations and actual opportunities for women. Since more than one factor may be in play, a package of interventions is typically needed.

Reducing the mismatch between labor market requirements and what women learn in school

Although it is important to reduce the mismatch between labor market requirements and what is learned in school for young men, this is particularly critical for women in the region, because to a greater extent than men, young women choose the humanities and social sciences for their higher education. These disciplines are better suited to the increasingly rare public sector jobs, but they are not oriented toward the skills that the private sector is seeking. One of the most efficient ways of acquiring work-relevant knowledge and professional skills for excelling in the job market is to apply theories learned in class to real work settings through on-the-job training or internships. Equally important, policies encouraging on-the-job training for women can also help change employers' attitudes toward female workers, challenging the prevalent stereotype in MENA that female workers are not as productive as male workers. In Jordan, for instance, a pilot program provides employability skills training and a short-term incentive for firms that employ young women. Early results suggest that such incentives do work (see box 8.2).

Encouraging women to participate in lifelong learning

Active labor market policies (see chapter 9) can address specific labor market problems and provide training, place individuals in new jobs, and help the job seekers overcome information problems by communicating their abilities to employers. Where these policies focus on specific sectors or occupations, they can address the information problems that arise from gendered networks. These measures could include providing information about wages and qualifications for a given occupation and engaging experienced workers as mentors for younger workers of the same (underrepresented) sex. In MENA, women are, however, severely underrepresented as beneficiaries of active labor market policies, partly due to insufficient female targeting but maybe also to lack of flexibility in program schedules. Many programs are conducted during working hours or require full-time participation. It may be difficult for a young woman with children to participate in programs with such strict schedule requirements. Training programs should attempt to provide flexible schedules. Moreover, cultural restrictions sometimes require female teachers and classes for women only, although in practice the majority of programs are coeducational (Angel-Urdinola, Semlali, and Brodmann 2010).

Ensuring safety in travel to work and in the workplace

Women in MENA countries report that the lack of safe and reliable transportation constitutes a main constraint to their ability to work (World Bank 2011). This constraint is relatively inexpensive to address and could significantly increase female employment. Several countries around the world (Egypt, Japan, and Mexico, for example) provide public transportation for women only so that women can travel safely. Moreover, the private sector as well can undertake measures

BOX 8.2 Jordan NOW: The New Opportunities for Women pilot program

Despite low employment rates, the majority of recent female graduates in Jordan want to work: 93 percent say they plan to work, and 91 percent say they would like to work outside the home after they are married. Yet only 17 percent of women aged 20–45 work in Jordan, compared with 77 percent of men. This gap also holds among the more educated; with community college graduates, it starts immediately on graduation and widens thereafter. The Jordan New Opportunities for Women (Jordan NOW) pilot program is rigorously evaluating the effectiveness of two policies to aid young female graduates in their entry into the workforce with short-term wage subsidies and employability skills training. *Short-term wage subsidies* give firms an incentive to risk hiring young female graduates and an opportunity to overcome stereotypical perceptions of women as employees. The subsidies also give young women more confidence in approaching prospective employers. The subsidy has a value equal to the minimum wage for six months. *Employability skills training* supplements the technical skills graduates learn in community colleges. Students in the NOW pilot received 45 hours of instruction in team building, communications, presentations, business writing, customer service, resume writing, interviewing, and positive thinking.

Just over half the trainees (62 percent) completed the courses. Unmarried women were more likely to attend. Employment rates among graduates who received vouchers alone or vouchers plus training are between 55 and 57 percent, compared with 17 and 19 percent among those who received training alone or received neither training nor vouchers. In all groups, employment effects were higher for unmarried women. Financial empowerment (measured as the proportion of women who have their own money and can decide how to use it) also increased significantly for all who received vouchers, training, or both. Follow-up surveys will determine whether the employment effects of job vouchers are sustained and will explore the link between marriage and work, given the early findings that married women are less likely to attend the training, less likely to use the vouchers, and less likely to be employed.

Source: World Bank 2011.

to ease mobility constraints for women, such as providing buses to take women from their homes directly to the workplace. In addition, it is important to institute policies that protect women at work and make the population aware of the legal consequences, in addition to losing one's job, of harassing females.

Addressing legal bottlenecks

Labor regulation does not always take into account women's key role in the household. In particular, legislative restrictions pertaining to part-time work should be revisited, as they can discriminate against female workers who cannot consider full-time work because household chores. Relaxing such constraints would give women more opportunities for paid employment.

Laws that govern property rights and inheritance, especially land, are disadvantageous for women in several countries and thus limit access to economic opportunities. Several property laws allow brothers to inherit land rather than sisters or require brothers to inherit double what a sister inherits. Moreover, laws that make the husband the head of household can drastically reduce a woman's ability to enter contracts, register property in her name, or join the workforce after she marries, because in some countries the husband's permission might be needed for the woman to travel or work. Maghreb countries have already made important progress in reforming these aspects of their legal systems, but much remains to be done in the region.

Finally, maternity insurance needs to be carefully crafted to minimize the risk of disadvantaging women in the labor market. Jordan, for example, recently abolished employer-paid maternity benefits and introduced maternity insurance paid by the social security system to increase women's

economic participation and protect their rights and entitlements immediately after childbearing. Specifically, the law "will limit excuses and justifications presented to dismiss the employment of women in cases of marriage, pregnancy or maternity leave. As a matter of fact, maternity insurance shall encourage employers to employ women and as a result promote their role in the labor market" (SSC 2011). Box 8.3 explores implementation challenges of this new law.

Providing affordable care for children

Women spend more time on child care than men. This greater demand on women's time constrains their economic opportunities. In many countries, improved child care opportunities for women have been the key to their participation in the labor force. A developed child care education industry could be economically important because the child care industry itself also creates jobs (mainly for females) and allows parents, mainly young mothers, to be economically active. Child care service can be provided directly by the state (including local governments) or by the private sector or NGOs, usually with public subsidies and regulation. It could also be provided locally through so-called community mothers who receive training and then care for children in their own homes. High-quality early childhood development programs have positive effects on the welfare of future generations; they have been shown to prepare young children for success in school and eventually in life. Colombia's Hogares Comunitarios program, which provides subsidies to designated homes operating as community child care centers, has significantly increased mothers' participation in the labor market as well as hours worked (World Bank 2011). Employers can also provide day care.

BOX 8.3 Stakeholders' perceptions of Jordan's new social insurance law on opening up employment opportunities for women

A forthcoming qualitative research study sought to capture perceptions of the ease or difficulty with which Jordan's new social insurance law could be implemented. Approximately 141 women and men in 24 focus groups, as well as 40 employers, were interviewed in early 2012. Most men and women who were aware of the law viewed the changes positively and believed that, given the right circumstances (such as the nature of the particular job and changes in employers' and family members' mindsets), it could increase women's employment. They thought that changes in the way maternity benefits were paid were a positive step toward equality for women in the labor force. However, both men and women participating in the focus groups suggested that employers might not view the law favorably and expressed concern over employers' compliance with the law and the implications for hiring practices. This perception was reflected in employers' comments. Most were aware of the law, but they were largely divided on its usefulness to employers, and many were uncertain how to implement its provisions. The participants made a number of recommendations with respect to the law and its implementation:

- *Public awareness*. Improve public awareness of the law; clarify the provisions of the law and disseminate any changes to employers, employees, and the general public.
- *Dialogue and consultation*. Strengthen dialogue between the Social Security Cooperation, employers, and employees to clarify the rationale and provisions of the law; include employers, employees, and civil society in consultations on any review of the law and its implementation.
- *Implementation*. Clarify the payment mechanism for maternity insurance during maternity leave and facilitate processes for payment to reduce the burden on the recipient during this time (for example, direct bank deposits).
- *Monitoring and safeguards*. Implement a strong monitoring system and equitable and clear enforcement of the law to facilitate implementation.

Source: Brodmann et al. 2012.

In rural areas, employer-provided day care is likely to work best in places where a large number of employees are clustered. India is experimenting with child care options for rural women in the informal sector and in a public works program (box 8.4).

Redesigning parental leave policies to maintain incentives to hire women

There are deeply rooted norms and beliefs about who does housework and provides child care within the home. It is important to start off with policies that work around these norms rather than trying to change them. Parental leave policies can either reinforce social norms around child care or try to work toward more nuanced social norms. Providing maternity leave, for example, allows a woman to take some time off to be with her children and also enhances her prospects for participating in the economy. The expectation that a woman should at all times be the primary household care provider is reinforced when paternity leave is not provided. Although there is certainly nothing wrong with the woman caring for the children, it is very important that children have opportunities for substantial bonding with fathers as well, which paternity leave could allow. Starting off by providing both maternity and paternity leave and making paternity leave mandatory in the medium term will likely be "transformative" by giving men incentives to take on more child care duties and fostering more nuanced norms around care. Moreover, paternity leave will likely decrease employers' reluctance to hire women, as men would also have the right to paid leave. A factor that determines the effectiveness of parental leave in opening additional labor market options for women is the question of who pays. When the costs are borne only by the employers, their incentive to hire women is reduced. Public subsidies or equal amounts

BOX 8.4 Expanding child care options in India

In India, Mobile Creches (a nongovernmental organization) is experimenting with models for providing child care services for women employed in the rural informal sector and in public works programs. Thirty-one day care facilities were set up around New Delhi on public construction sites in partnership with contractors, who provide child care facilities in addition to sharing other costs. These centers responded to the expectation that women would represent a large proportion of those taking up public works programs: this figure reached 80 percent at some sites. The day care programs include a nutritional component by providing meals during the day and tracking the nutritional status of children over time; they have also integrated health services (for example, immunizations and regular doctor visits). To provide access to child care for women working in the informal sector in resettlement colonies in Delhi, Mobile Creches also helped create home-based centers and community-based programs by identifying and training local women to provide these services. Together with Pradan, another Indian NGO, Mobile Creches also built a group of centers in remote rural areas in the states of Jharkhand and Bihar following discussions with local women about the child care constraints they faced in accessing income-generating activities (specifically, yarn production) in their communities. These centers follow a community-based model, relying on employers as well as the broader community for their management, contribution of food materials, and training and selection of teachers.

Similar efforts have been undertaken in the Indian state of Gujarat by the Self-Employed Women's Association, a trade union for poor, self-employed workers in the informal sector. It has set up day care centers for members' children up to age six. This service not only provides education and nutrition for the children but also reduces the working days women have to miss to take care of their children—an especially important contribution, because few of them are salaried workers.

Source: World Bank 2011.

of maternal and paternal leave could help address this issue.

Increasing women's capacity to start and run their own businesses while increasing their capacity to access credit

Female self-employment is compatible with prevailing social norms in the region, and policies that encourage and support female entrepreneurship could increase female participation in the labor force. Training in entrepreneurial skills, mentoring, business plan development, and business start-up assistance are all important measures, and such services should increasingly target women. Several MENA countries are experimenting with "microcredit plus" models, combining credit with training in business skills and efforts to facilitate access to markets. Because women use credit less than men do, however, lenders have little or no information about women's potential repayment capacity and are unwilling to extend them credit even if they are creditworthy. Women's lower ownership of assets in MENA also limits their ability to offer collateral. Microcredit schemes, in a variety of forms, are the most common way of addressing the information deficit problems for entrepreneurs. In group lending, individuals (who typically lack collateral) band together to obtain a loan; although the loans go to individuals, the liability for repayment falls on the entire group. Regular group meetings allow lenders to overcome the information problem. In Egypt, for example, post office branches are being used as outlets in some of the poorest 1,000 villages to offer microenterprise loans to disadvantaged women who lack collateral. A randomized impact evaluation has been designed to assess the effectiveness of this program.

Providing rural women with market access through infrastructure upgrades and access to technology

Upgrading and expanding rural roads can increase the labor supply for women as well as for men in rural areas, making it easier to access markets, expanding economic opportunities, and raising household income. Through the use of the Internet and mobile phones, markets can also be brought closer to women, who can more conveniently connect with potential buyers and get information about prices. In India, a program run by an NGO, the Foundation of Occupational Development, organized groups of women to market their products directly and increase their profit margins by providing them with access to cell phones and the Internet. Also in India, the Self-Employed Women's Association trade facilitation center created an online outlet so that women could sell textile and handicraft products to improve quality and reduce delivery times (World Bank 2011).

How much do labor regulations matter for job creation compared to private sector regulations?

As chapter 5 showed, labor regulations matter for employment, especially when excessively restrictive. But private sector regulation also matters: a good investment climate and regulations that foster competition in the product markets are good for employment.

According to a recent and growing empirical literature, labor market institutions and product market regulation interact: liberalization of the product markets has more pronounced effects on employment in labor markets that have higher collective-bargaining coverage. However, the rigidity introduced through collective bargaining also seems to retard upward trends. Real wages increase less with higher competition in product markets when the unions are powerful (Griffith, McCartney, and Harrison 2007).

The interaction between labor market and product market regulation is complex. Fiori et al. (2007) show that employment gains from reducing barriers to entry in product markets are larger when labor market policies are restrictive. In this sense, deregulation of product markets and labor markets can be "substitutes." That is, countries in which it is politically difficult to deregulate the labor market might achieve the same outcome by concentrating on deregulating the product markets.

At the same time, liberalizing product markets can reinforce labor market deregulation but not necessarily vice versa. Fiori et al. (2007) find that product market deregulation has led, over time, to a decline in workers' bargaining power. In this sense, product and labor market deregulation can be considered "complements." Therefore, when assessing the total employment effect of deregulating product markets, one needs to consider both its direct effect and the induced effects on labor market policies and institutions. In particular, the recent literature indicates that labor market deregulation does not affect the setting of product market regulation. This finding suggests that deregulation and liberalization policies are best phased in, starting with the private sector and product markets and then letting the labor market follow or move in parallel.

Towards more dynamic labor markets

MENA countries would generally benefit from moving toward less restrictive labor market regulation, which would be easier to enforce than the legal status quo. Overly restrictive regulations include, for example, high minimum or collective wage requirements in several countries, which people try to circumvent through informal work relationships. They also involve rigid dismissal rules that reinforce labor market segmentation among newcomers such as youth and women, who are less likely to obtain jobs with formal, protected contracts. Finally, a reform of employment terms in the public sector is necessary and would result in large gains.

More lenient dismissal rules and wage policies could be combined with unemployment insurance and incentive-compatible social insurance to protect workers' incomes and also cover periods of joblessness. A more transparent and efficient social insurance system could contain fiscal costs better than the current system, even with higher coverage.

Policies to encourage women to work should go beyond immediate labor market regulation and target the underlying determinants of women's access to economic opportunities, such as social norms, time constraints, access to inputs, and child care. Since more than one factor may be at play, a package of interventions is needed.

Notes

1. See http://www.cnudst.rnrt.tn/cgi-bin/wwwi32.exe/[in=C%3a/sources/appli/jort.06/affiche.in; http://www.cnudst.rnrt.tn/jortsrc/2010/2010f/jo0872010.pdf.
2. Breaking the minimum wage rule usually entails the denial of social insurance, because registration in the social insurance program could cause the employer's violation of the minimum wage law to be discovered.
3. The impact of single open-ended contracts on equilibrium unemployment is debated. See Bentolila, Dolado, and Jimeno (2011) and Costain, Jimeno, and Thomas (2010).
4. For an in-depth discussion, see Gatti et al. (2012).
5. A tax wedge is the difference between the before-tax and the after-tax wages: that is, the income tax rate. In this report, this includes social contributions and labor taxes paid by the employer and is not the classical "tax wedge," which also takes into account taxes paid by the employee.

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Educational and Training Systems: Realigning Incentives for Skills That Matter and Making Employability Count

9

Main findings

- The reform agenda for educational and training systems needs to build on timely information on education and labor market outcomes. Such information is essential not only to formulate policy but also to guide young people's decision making and realistically shape their expectations.
- To close the skills gaps equitably and efficiently, educational and training systems need to replace the current logic of selecting students with a logic of fostering learning.
- A renewed public-private partnership in education and skills development can also provide incentives and information for employers to play a prominent role in education and training.
- Transparent intermediation and skills certification mechanisms are needed to effectively match talent to opportunities in the private sector.
- Active labor market programs need to be refocused to provide second-chance options to the most vulnerable who face challenges in successfully integrating into the labor market.

The Road Not Traveled education flagship report (World Bank 2008) presented a policy road map for educational and training systems in the Middle East and North Africa (MENA): good governance and incentives for accountability were the trigger for the reforms needed in the region. Results—i.e., relevant learning outcomes—rather than inputs should drive policy making and lead to effective public accountability and demand-driven programs and curricula. Although the Arab Spring ushered in a political climate favorable to progress in this long-term program of reform, it is obvious that these reforms will not come easily or quickly. They will require strong and consistent leadership, the engagement of all stakeholders, a focus on governance, sustained and predictable financing over the long term, and robust monitoring and evaluation (M&E).

This flagship report focuses on a specific dimension of that comprehensive reform program advanced back in 2008: building employability and making it count in the labor market. It examines specific issues related to the transition from education to work. The central message is that skills gaps and mismatches reflect the inability of educational and training systems to transform heavy investments by young people and their families into tangible labor market outcomes. In addition, unmeritocratic job-matching mechanisms exacerbate the difficulties that young people encounter in acquiring the skills to be employable. Such mechanisms prevent young people from cashing in their employability capital and successfully mastering the transition from education to work.

Instituting reforms that address these challenges and yield more responsive and innovative educational and training systems is urgent. Realistically, however, such reforms, no matter how successful they become, make a necessary but insufficient contribution to solving problems related to the transition from education to work in MENA. The lack of relevant skills among first-time job seekers and the absence of a level playing field for accessing jobs create a low-level equilibrium trap, in which neither the private sector nor the educational and training systems appear to have the capacity, information, or incentives to do things differently. For this reason, it is essential to foster competition in the private sector and realign incentives for hiring in the public sector. Furthermore, financing mechanisms in the educational and training systems will also need to change in response to increased dynamism in the private sector resulting from reforms.

Overcoming skills gaps, mismatches, and unmeritocratic hiring practices

From the specific perspective of educational and training systems, long-term policies for meeting the challenges in the transition from education to work need to focus on three fundamental goals:

- *Closing the information and knowledge gaps.* This requires monitoring and evaluating the quality of education on the one hand and reforming assessment and certification systems on the other. Addressing knowledge and information failures, gaps, and asymmetries will allow employers to better communicate what they require from the educational and training system, and will enable educators to improve quality and to better assess and certify learning. Closing these gaps will also lead families and students to make more informed decisions and build realistic expectations for the transition from education to work, and it will permit all stakeholders to have more systematic, accurate information about what education and training are accomplishing. This increased transparency can lead to more solid accountability across all the institutions and actors involved.
- *Replacing the "logic of selection" with a "logic of learning."* The ultimate challenge for education in the 21st century is paradoxical: to design a race that everybody can win and in which there are multiple ways to win. This challenge will be met only when governments decide to make maximizing opportunities for all citizens, particularly for youth, a top priority. Hence, educational and training systems—particularly at the secondary level, including technical and vocational education and training (TVET)—should become more inclusive and more focused on learning and less on selecting and exclusively rewarding the academically able while leaving the rest behind (OECD 2012; MEC-IFIIE 2012). Policy priorities should thus shift toward preventing students from dropping out and leaving school early and find alternative training itineraries for everyone to acquire relevant skills and competencies for a successful transition from education to work.
- *Making employability count through a renewed partnership between the private sector and the educational and training systems.* A new, more effective public-private

partnership (PPP) framework in education and skills development in MENA would yield the right incentives and necessary information for employers to play a prominent role in education and training. A common language and incentives are needed to correct the signaling failures from both sides. Public and private intermediation also has a role in providing employers access to a larger pool of candidates and thus improving the efficiency of the job-matching process. Efficient private and public intermediation systems could also mitigate young people's concerns that they will not succeed in the second transition from employability to employment because of factors they regard as beyond their control.

Timely and publicly available data that inform policy making and guide stakeholders' decisions are important because they simultaneously cut across all reform efforts and provide the "glue" that makes them cohere. These long-term policy areas respond to the employability and employment barriers identified in chapter 6. Education and skills have low quality and relevance for three reasons: (1) the private sector and the educational and training systems operate in isolation; (2) the public sector continues to be the main *client* of the educational system; and (3) a logic of selection prevails over a logic of learning in educational systems. In addition, hiring practices are driven by privilege rather than competition. Learning rather than selection should be the objective of an inclusive educational and training system that provides opportunities to all students and equips them with the high-quality, relevant skills for success in a dynamic labor market. Making employability count depends on the ability of the private sector to signal which skills are needed and contribute to providing them. Efficient and transparent intermediation between labor supply and demand—through public or private employment services, for example—could mitigate young people's concerns that they will not succeed in the second transition from employability to employment because of factors they regard as beyond their control.

In addition, the region needs to find policy solutions that provide young school leavers with second-chance options in case the transition from education to work fails and to help those who are particularly vulnerable, such as low-skilled youth or women, integrate into the labor market. Such second-chance options outside the educational and training system include tightly targeted active labor market programs (ALMPs). Figure 9.1 summarizes these points.

This chapter addresses both long- and medium-term policies as well as short-term measures with high potential for innovation and relatively low implementation difficulty that are generally applicable throughout MENA. A suggestive country-specific list of priority policies and measures based on inputs from education policy makers in MENA is presented in the annex to this chapter and reprised in chapter 10. The chapter will make periodic reference to some of these policy options and measures to identify which are already high on the priority list of MENA countries.

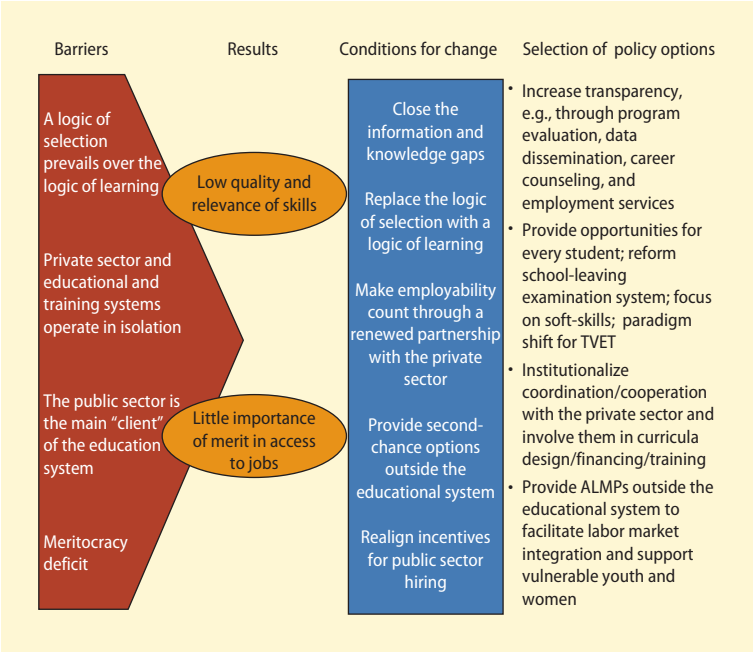
Closing the information and knowledge gaps

Closing the information and knowledge gaps related to skills supply and demand and to learning outcomes will help set the right incentives for producing relevant skills and enable both educational institutions and employers to communicate more effectively. Closing the data gap on skills is therefore crucial to closing the skills gap itself. Data are needed to inform the dialogue and decision making of stakeholders on students' choices in upper-secondary and tertiary education and, more generally, on expectations—from employers but also from students and their families—of the educational and training systems (Sondergaard et al. 2011).

Improving quality through monitoring and evaluation

A first step is to establish M&E systems (including national systems to assess student

FIGURE 9.1 Linking the barriers to the transition from education to work to long-term policies



performance, tracer studies, and more sophisticated classroom-based evaluation instruments) and to use the resulting data to make policies and improve institutions. In addition to strengthening the measurement of learning outcomes, a parallel effort is needed to build the capacity to use the data to improve results in schools (box 9.1). The availability of data and a more transparent policy for its dissemination will lead to more solid accountability mechanisms, more informed and participative stakeholders, better grounds for new partnerships among stakeholders, more realistic expectations and aspirations among students, and a better sense that reform policies and measures are worthwhile and have high potential to achieve their goals.[1]

National assessments that provide evidence for developing policies and improving schools differ from public exams. Usually administered to samples of students, these assessments are designed to establish baselines and measure learning progress. Most educational systems in MENA lack sufficient evidence on student performance, although ironically the region has never lacked for student testing. MENA students have to sit for numerous public examinations, and, as explained in more detail in chapter 6, the entire educational and training system in some countries seems to revolve around those examinations. Student achievement is therefore thoroughly examined in MENA but rarely for the purpose of improving the quality of education: rather, it is used only for academic selection and student placement in upper-secondary and tertiary education. The lack of evidence-based policy formulation and implementation is one of the factors that explain why many efforts to improve the quality of education have not been very successful, why education is not at the forefront of public agendas, and why so little public debate has taken place on how to improve the quality and relevance of education. This limitation, together with the lack of a critical mass of human resources to conduct education research, is hindering the region's capacity to transform its low-performance educational systems into high-performance systems that offer more dynamic support for integrating Arab countries into the 21st-century global and knowledge economy.

BOX 9.1 The Arab Regional Agenda on Improving Education Quality and the Regional Network for Education Research Initiative

The Arab Regional Agenda on Improving Education Quality seeks to enhance learning outcomes for all in the Arab world by improving the quality and relevance of the education services available. To achieve this goal, the organization will tie existing and new partners and institutions (public and private) into a coherent, more effective regional network. Directed by the Arab League Educational, Cultural, and Scientific Organization, located in Tunis, the organization maintains five regional programs housed at five centers across the region, each targeting a crucial area for improving the quality of education: (1) evaluation of learning achievement; (2) professional development for teachers; (3) early childhood development; (4) curriculum innovation and information and communication technology in education; and (5) entrepreneurship education.

The organization will build capacity and strengthen institutions both regionally and in individual countries. Its regional strategy is to create a strong knowledge base and foster collaboration through a network of experts, programs, and specialized institutions. In countries, it will build the capacity to use assessment and evaluation to improve learning outcomes, focusing on school and classroom factors.

International collaboration is the key strategic principle of this regional agenda, under the assumption that collaboration is the most effective way to get results within a country. Building regional capacity will make it easier to develop the required institutions and critical mass of experts and specialists, which would take far longer and require greater investment to develop inside each country individually. Regional learning will accelerate because countries will have multiple institutional venues for exchanging experiences, accessing knowledge, and obtaining technical assistance.

The organization was officially launched in Tunis in January 2012. A number of regional and international organizations have already joined this innovative network: the World Economic Forum, UNESCO–Beirut, the Islamic Development Bank, Microsoft, Intel, Injaz Al-Arab, Queen Rania Teacher Academy, and the Arab Resource Network.

The Regional Network for Education Research Initiative aims to build national and regional capacity in MENA for using empirical evidence in the formulation, implementation, monitoring, and evaluation of education policies aimed at educational improvement. In support of that goal, the World Bank endowed the Jordan National Center for Human Resource Development with a three-year Institutional Development Fund. Additional funds were provided through a partnership with the Islamic Education, Scientific and Cultural Organization.

Through a series of workshops, seminars, online discussions, and mentoring visits, the regional network has enhanced the capacity of educational research institutions, researchers, and policy makers from seven MENA economies (Dubai, Jordan, Lebanon, Oman, the Syrian Arab Republic, Tunisia, and the West Bank and Gaza) to analyze, present, and discuss data and evidence related to student learning and performance and to understand the factors that determine and explain differences in learning achievements. It has also strengthened the capacity of participating countries to formulate evidence-based policies and programs aimed at tackling student learning and performance issues. The regional network has also reached other goals:

- It was instrumental in bridging the gap between education researchers and policy makers. During several workshops, local researchers presented policy notes on selected education issues to policy makers; the researchers also validated their approach to policy analysis and the immediate impact of their recommendations.
- A virtual network of researchers from seven countries was established to facilitate and encourage the exchange of ideas, technical assistance, and reports and related documents among participants. Establishing the virtual network proved challenging owing to the participants' lack of experience with this type of collaboration, but the identification of a "champion" team (West Bank and Gaza) helped overcome this obstacle.

The contemporary drive to set up national student assessment systems—and for increased participation in international testing programs such as the Programme for International Student Assessment (PISA) or the Trends in International Mathematics and Science Study (TIMSS)—reflects the global consensus that, in addition to the assessment *of* learning, countries must invest in assessment *for* learning, because such investment is the foundation for meaningful and sustainable improvement in the quality of education (Greeney and Kellaghan 2008, 2009). It is not enough to have the capacity to measure learning outcomes; what really makes the difference is whether countries also have the capacity to use information about learning outcomes to improve quality and enhance equity, the capacity to communicate the information to the wider public, the capacity to learn from the results, and the capacity to make policy choices based on the results.[2]

Although more and more countries in the region participate in international testing programs—particularly TIMSS—and some have set up their own national assessment systems, policy makers and practitioners still lack the capacity for analyzing the data. Until very recently, countries have generally been reluctant to disseminate student assessment data systematically; however, momentum is also building toward greater regional collaboration in a field where all MENA countries face the same issues and challenges (as shown in box 9.1).

The turning point may have arrived in September 2010, when 18 MENA countries, represented by their ministers of education, met in Doha and signed the Doha Declaration on Improving Quality of Education in the Arab World.[3] The declaration contains the following agreements, among others:

- Establishing quality national standards for all dimensions of the educational system, particularly for teachers and other education professionals.
- Establishing national monitoring and evaluation systems based on objective data and quantitative and qualitative indicators to measure student learning and school performance. These data will then be used by teachers to improve their performance, help decision makers in making well-informed choices, and inform the community on the outcomes of the resources allocated to schools.
- Building capacity of human resources in the field of quality and its monitoring and evaluation, and providing them with the necessary competencies to design and develop assessment mechanisms and tools as well as advanced methods of data analysis.
- Disseminating a culture of quality, evaluation, and accountability in education, where the data on the functioning and outcomes of the educational system are made publicly available to all stakeholders.
- Establishing a joint Arab evaluation system and regional research program on the quality of education, developing benchmarks and regional databases through the collaboration between the Arab Observatory for Education and the ministries of education and other specialized institutions.

Implementing these agreements could be transformational for education quality in the MENA region.

Reforming assessment and certification systems

A high-quality educational system requires a high-quality assessment and certification system. Such a system clearly sets the rules of the game for all stakeholders—including employers and public and private education and training providers—and has the capacity to produce accurate information on the skills and competencies of graduates to reduce asymmetric information in labor markets and improve mobility.

Over the past several decades, many countries have worked on developing National Qualifications Frameworks (NQFs) as a way to ensure the high-quality recognition of learning at all levels (ILO 2010).[4] NQFs are "frameworks in which all the qualifications offered in a particular country (or region) are

organized according to level …. NQFs show how different qualifications relate to each other [and] are thus designed to enhance horizontal and vertical mobility within a country's or region's education and training system" (King and Palmer 2010). NQFs have the potential to bridge the gap between learning and certification—that is, between skills development as such and the certified value of the acquired skills in the market. They introduce more transparency and therefore more complete and nuanced information to learners, teachers, and employers about what graduates know and are able to do. Because NQFs focus on defining learning outcomes, they can become a critical driver of competency-based curriculum reform. This clarity also enables employers to understand specific qualifications more easily and helps improve communication and understanding between the private sector and the educational and training systems.

Referencing national work to a regional qualifications framework is one way to assess the qualifications acquired in a given country in the context of the skills-specific labor demand in several other countries. A regional framework also promotes awareness of the quality and relevance of postbasic education. Internationally harmonized national frameworks can be important instruments for bridging the asymmetry of information across national borders and fostering international labor mobility. A good example is the European qualifications framework, which some MENA countries in the Mediterranean are considering as a reference for their national systems (Leney 2009). A more integrated regional approach to qualifications may speed up and add value to national processes while heightening the transparency of qualifications systems throughout the region.

National and regional frameworks clearly add value by enhancing the employability of graduates (especially in key sectors), increasing the mobility and portability of qualifications, and improving the formal and legal visibility and transparency of credentials. Yet these initiatives in MENA face important political constraints. Conflicting agendas within the region reinforce the lack of political leadership, key stakeholders in relevant sectors are not involved, and technical leadership and expertise are lacking within institutions.

Moreover, despite the promising potential and the worldwide trend favoring national frameworks and related transnational approaches to qualifications, regional frameworks appear to take a very long time to set up (at least a decade in most cases), are difficult to implement, and (more important) are challenging to amend or refine (Young 2005). King and Palmer (2010) suggest that there are "other ways to ensure quality and skill recognition than an NQF." To be sure, instead of the top-down approach of national qualifications, in some countries a bottom-up approach—one that is sector based instead of system-wide—could work better. In fact, both could be undertaken in parallel, because setting up a national framework is presumably, by definition, a long-term process. Traditional approaches such as collaboration between the government and employer associations in a particular sector in setting occupational standards, defining required competencies, and identifying assessment and certification mechanisms could also work well in MENA. This approach has the added value of bringing together, for a much-needed institutionalized dialogue, sector employer associations, chambers of commerce, trade unions, public authorities, and education and training providers (CEDEFOP 2009; Psilos and Gereffi 2011).

Short-term measures for MENA

This agenda described so far definitely focuses on long-term policies, involving a focus on results rather than on inputs, a drive for transparency, and a regional and international dimension for benchmarking and collaboration. In this context, however, it seems useful to identify short-term policies and measures with high innovation potential and relatively low implementation difficulty that MENA countries could adopt.[5]

Design, develop, and strengthen national systems of student assessment

Some countries in the region, notably Jordan and Tunisia, have made very important progress in developing national systems of student assessment over the past few years. As discussed in box 9.1, additional initiatives such as the Arab Regional Agenda on Improving Education Quality and the Regional Network for Education Research Initiative are highlighting the potential of international collaboration as an incentive for more countries to set up their assessment systems, make relevant use of the data collected, and take steps to disseminate the findings more transparently.

Refine the quality assurance function in the educational system

Institutional changes that strengthen the separation between policy-setting functions and evaluation and oversight functions are needed to ensure the institutional autonomy of governmental bodies or agencies in charge of nationwide evaluation of learning outcomes. Some MENA countries implemented similar reforms long ago—among others, Jordan, through its National Council of Human Resource Development, and Lebanon, through its Education Center for Research and Development.

Invest in school and career counseling and guidance

Promoting career counseling and guidance functions within schools and universities should facilitate placing students in internships and jobs. International evidence shows that career counseling is particularly cost effective in helping students identify the best match for their talents in the current labor market.[6] Continuing to professionalize the career counseling function could be coupled with strengthening the counseling role of teachers and trainers as part of their professional development (box 9.2).

BOX 9.2 Career counseling and guidance: The example of Sweden

Sweden has invested in career and educational guidance throughout its entire school system. This investment has succeeded partly because of the development of high-quality education for counselors. The national curriculum states that counseling is compulsory and that "student guidance officers and vocational guidance staff should inform and guide pupils prior to the next stage of their education and vocational orientation." The activities and roles of the counselors differ, depending on the type of school, but all activities have the common goal of helping an individual obtain more knowledge about his or her own capacity, increase self-confidence, and form personal goals within education and working life. Information about current opportunities and promising fields within the labor market is shared. Pupils receive counseling both individually and in group sessions in primary, secondary, and upper-secondary schools. Counselors usually work within the schools, although some municipalities offer career guidance through an external guidance center instead of within each single school.

Quality counseling requires trained counselors. In Sweden, counselors are prepared through a three-year university program leading to a BA degree. Participants in this program learn to support individuals in exploring, articulating, and developing their interests and capabilities as well as their knowledge about themselves in relation to society, education, and working life. The educational requirements for counselors who serve in vocational education programs vary; sometimes a teacher provides counseling, and at other times a degree in counseling is required.

In addition to counseling, career fairs are arranged regularly in cooperation between local employers and upper-secondary schools. The fairs provide general information about various educational tracks, professions, and labor market opportunities and usually offer personal career guidance. Fairs are often an opportunity for students to connect directly with employers and arrange for summer jobs or internships.

Source: International Program Office for Education and Training 2010.

Improve labor market information and graduate tracking

The collection of data on numbers, skills, and wage evolution of graduates of TVET institutions, universities, and certification programs should be improved to facilitate career decision making and enhance efforts to promote investment. This measure will provide job market and career guidance for young people, criteria for program creation or withdrawal for TVET providers, and accurate information for employers on the labor market results of different institutions and programs in specific sectors.

Replacing the logic of selection with a logic of learning

Increasing the avenues of success available in educational and training systems is a critical goal in transforming a selection-oriented system into a learning-oriented one. Multiplying the number of viable options for students is in itself a powerful, inclusive policy, with high potential for innovation and quality improvement in education.

Providing opportunities for developing meaningful skills

The first long-term policy option is to design alternative training itineraries for every student, so that each acquires relevant skills for a successful transition from education to work. Implementing this policy in secondary education and especially in postbasic or upper-secondary education requires strengthening and rebalancing the links between general and vocational tracks and introducing new, blended training programs. It also requires greater emphasis on developing core knowledge and cognitive skills, in part through reclassifying some TVET schools as general education secondary schools and increasing the share of the common secondary curriculum required in TVET schools while redefining the very nature of that curriculum.[7]

The demands of the 21st-century labor markets give priority to skills and competencies that both go beyond and cut across the traditional divide between general and vocational education (World Bank 2005; Griffin, McGaw, and Care 2012). In addition, deferring student selection and specialization is becoming more common as secondary education systems expand and become more inclusive. The global trend over the past 50 years or so has been toward upgrading specialized vocational programs to postsecondary and tertiary levels at the same time that vocational and specialized training elements are being incorporated into the secondary education curriculum to keep them relevant and to retain students (World Bank 2005).

Reforming the secondary-school leaving examination

Responding simultaneously and effectively to growing student diversity and rapidly changing labor market demands requires finding the right mix of cognitive, soft, and job-related skills. According to the evidence, routine skills are increasingly less valued as countries get richer (Autor, Levy, and Murnane 2003). The key policy question for the school curriculum then becomes, which curriculum prepares students best for an uncertain, rapidly changing future? The answer necessarily implies balancing the short-term demands of the labor market against the long-term employability potential of graduates. The global trend is toward outcome-based and competency-based curriculum reforms in postbasic education (CIDREE/DVO 2008; CEDEFOP 2009): these curricula have the potential to create a more challenging, demanding, motivating, and inclusive learning environment for students. One of their key goals is to give students more choice and more autonomy as learners. They also imply clearer student expectations about the daily routines and activities in the school and about the teaching and learning process.

Outcome-based and competency-based curriculum reforms have very important organizational implications for schools, requiring sweeping transformations in the ways in

which schools are organized, all the way from the timetable, the use of space, and the teaching and learning materials to external partnerships. Finally, these curriculum reforms lead to a much more sophisticated assessment regime, one which, for a start, is clearly aligned with the competency approach. Such a regime would obviously enhance and promote the relevance of the curriculum, although it is also true that assessment will become more complex, time consuming, and potentially more bureaucratic. Schools and education policy makers alike need to be aware of those risks and ensure that they take concrete actions to address them.

Reform of the secondary-school leaving examination system is perhaps the most critically needed educational change in MENA. Transforming that system from an exclusively selective mechanism into one that promotes inclusion and learning could trigger dramatic changes in postbasic education in the region. For one thing, the competency-based curricula now being developed and implemented to some extent in most countries in the region provide a strong case for national public examinations to reflect and prioritize the evaluation of competencies. The introduction of more aptitude-oriented and higher-order cognitive elements into the examination instead of—or at least in addition to—rote memorization questions would send a strong message to schools, teachers, and students that the priorities for learning outcomes are changing.[8] In this way, examinations could realize their considerable potential as instruments for closing the huge gap in perceptions of education quality: many employers and other stakeholders regard quality as the inculcation of 21st-century skills, achievable by all, whereas some influential stakeholders still regard it as the development of an elite of academically able pupils who can score 99 in a Tawjihi-like examination (that is, a general secondary examination also used to regulate admission to higher education).

Any attempt to reform public examinations in MENA needs to acknowledge from the outset, however, that public confidence in education currently relies to a great extent on these Tawjihi-type examinations and that the public regards them as a central institution in society and widely believes them to be a fair, meritocratic instrument for allocating further educational opportunities. Students and other stakeholders participating in focus groups in Jordan highlighted these points quite effectively and convincingly. Most mentioned that the Tawjihi exam plays a large role in determining one's future, and, given that admissions policies across all universities and colleges in Jordan are directly based on Tawjihi grades, students' choices about their postsecondary education are very limited.[9] It is not surprising then that initiatives to reform examinations are raised continuously in public debate but resisted systematically by some stakeholders (the Arab Republic of Egypt is the most salient example). Consensus appears extremely difficult to build, although the changes brought about by the Arab Spring could provide a favorable political climate for complex reforms in the examination system.[10]

Investing more in disadvantaged students and schools

To level the playing field for all individuals and to ensure that the proportion of young people who are unskilled and excluded from further education is as low as possible, greater investment is needed in disadvantaged students and schools. Chapter 2 presents strong evidence that a large share of young people in MENA are excluded from educational and training systems at some point during their school lives and, because of lack of skills, they cannot access quality employment. More inclusive policies are needed in education and training to prevent the exclusion of those vulnerable and disadvantaged because of early school leaving or school failure and to identify conditions in which second-chance programs effectively provide routes back into education—and therefore employment—for these young people. Such policies are needed throughout the region. Some education policy makers in Morocco

and the Republic of Yemen consider them a top priority (table 9A.1).

A report from the Organisation for Economic Co-operation and Development (OECD) (2012) on the quality and equity of education emphasizes that governments should invest more in disadvantaged students and schools "to ensure that everyone gets a fair chance" and identifies a number of concrete measures in that direction. First, grade repetition should be eliminated; this widespread practice is costly and ineffective;[11] yet its academic benefits are slight and short lived. Second, student tracking and streaming policies should be avoided, at least until the end of compulsory education (usually the start of upper-secondary school), because they harm students who are moved down to lower tracks without raising student performance as a whole. Focus group participants in Jordan noted that early tracking there, which is usually done based on teachers' recommendations and grades and not on personal aspirations or desires, limits students' choices too soon in their school lives. The best evidence of the advantages and potential gains of delaying tracking comes from Poland, one of the success stories of secondary and TVET reforms in the 2000s (Jakubowski et al. 2010; World Bank 2011). Third, school choice has to be managed to avoid segregation; for example, financial incentives could encourage the best schools to take vulnerable and disadvantaged students. Finally, a research review of the most successful inclusive policies and measures in European schools has identified innovation in student grouping arrangements and parental and community participation in schools as the two most powerful interventions for improving learning outcomes among vulnerable, disadvantaged, and at-risk students in general (MEC-IFIIE 2012). See also box 9.3 on financial and nonfinancial approaches to overcoming the equity challenge in tertiary education.

Reforms that enable learning to prevail over selection—eliminating grade repetition, providing alternative curriculum options and pathways to prevent students from dropping out, introducing soft or 21st century skills, or introducing innovative student grouping arrangements—always risk triggering the resistance of some stakeholders. Those stakeholders include some parents and teachers who see reforms as a risky watering down of standards that lowers the bar for what counts as serious, demanding, academic, traditional education. Once again, only the systematic dissemination of data on learning outcomes and therefore a better-informed and evidence-based public debate on education can address and mitigate this risk.

A paradigm shift for TVET

Another major option for opening up avenues of success for young people is the modernization of TVET. MENA's challenge is to raise the capability of the TVET system and provide students with the skills required in the knowledge economy while offering inclusive alternatives to nonacademic individuals. Traditionally, TVET has played two roles in educational systems (ETF and World Bank 2005). First, it has been an instrument for preventing or offsetting the risks of social exclusion that result from high rates of early school leaving and school failure. In this common, "low-prestige" role, TVET is an alternative for those who fail academically or cannot be accommodated by higher education. Second, TVET is used as part of active labor market policies to combat youth unemployment and, to a lesser extent, retrain workers affected by economic restructuring. In the 21st century, a third and increasingly important role for TVET is to support the development of a knowledge-based economy by helping workers adjust to accelerating technological change and contribute to the competitiveness of enterprises. With the exception of a small number of schools (see the example in box 9.4), TVET systems in MENA have mainly provided a second-choice, lower-quality alternative to general education, with limited opportunities for lifelong learning. The task for TVET today is to combine a remedial role with the

BOX 9.3 Mechanisms for overcoming the equity challenge in tertiary education

According to recent research, the most effective policies for promoting equity and increasing opportunities for disadvantaged students in tertiary education are those that combine financial aid with measures to overcome nonfinancial obstacles. Strong evidence shows that well-targeted and well-managed financial aid can be instrumental in reducing financial barriers to tertiary education. A combination of three methods can help students from disadvantaged groups overcome financial obstacles to tertiary education: (1) no tuition fees or low fees; (2) scholarships and grants; and (3) student loans. With the exception of the West Bank and Gaza, tuition in MENA is already low in most public tertiary educational institutions. One of the main challenges for governments in the region is to ensure that existing scholarship and grant schemes are effectively targeted and managed to support students from the lowest quintiles and girls as a matter of priority. Experience from the 60 or so countries with student loan programs—mainly in North and South America and in Asia and the Pacific—indicate that, when interest rate subsidies are kept at a reasonable level and repayment mechanisms operate efficiently, these programs are one of the best ways of promoting financial sustainability and equity at the same time. The Australian income-contingent student loan system, in particular, illustrates the advantages of an approach that conciliates efficiency in loan collection and fairness in the distribution of the payment burden.

Many countries have successfully implemented outreach and bridging programs to secondary schools whereby universities build partnerships with K–12 institutions and reach out to students at a very young age to encourage them early on to think about attending university. In the United States, Texas provides automatic admission into the University of Texas, the state's flagship public university, for the top 5 percent of all high school graduates in the state. In a number of countries, Brazil and India, for example, affirmative action programs help increase opportunities for tertiary education for students from underprivileged ethnic groups. A recent evaluation of the preferential admission program at UNICAMP, one of Brazil's top public universities, reveals that the Afro-Brazilian students admitted under that program have the same completion rate as other students. The Ford Foundation has provided funding to a number of universities in Sub-Saharan Africa and Latin America in support of retention programs targeting underprivileged groups at risk of dropping out.

Finally, Colombia offers a good example of the integration of financial aid and nonfinancial measures for promoting equity. The Colombian Student Loan Agency, the first such institution established in the world (1951), has recently implemented a "comprehensive strategy" that involves participating tertiary educational institutions in a partnership in which loan beneficiaries receive not only financial aid to pay the cost of their studies and living expenses but also academic and psychological support to increase completion rates. A recent impact evaluation has shown that the probability of dropping out is four times less for beneficiaries of student loans than for other students.

Source: Salmi and Bassett, forthcoming.

BOX 9.4 Don Bosco in Egypt

The Don Bosco Institute, run by the Italian Silesian Brothers, is a successful example of a private, fee-paying model for TVET. Rather than produce old-fashioned second-chance diplomas, the institute offers three- and five-year diploma courses that provide a path to employment, decent pay, and career progression—the very elements lacking in most public TVET institutions. The institute's credibility and trustworthiness lie in its consistent production of workers who can actually perform the activities corresponding to their certificates, so that the certificates effectively guarantee quality. This outcome comes about not just because relevant curricula are taught but because the institute's trainers are recruited based on their technical and pedagogical instruction and practice.

Source: UNDP 2010.

provision of cutting-edge skills, sometimes even within a single institution.

The first step in carrying out that paradigm shift is to strengthen demand for TVET institutions and programs by diversifying provision modes in upper-secondary and tertiary education. This step implies opening up pathways from secondary-level TVET to tertiary education to ensure that significant proportions of TVET graduates have a real chance of taking those pathways (which, again, also calls for a reform of the examination system, as discussed).

Thus, a lifelong learning approach for modernizing TVET will demand reform in the articulation between tertiary education and TVET. Such reforms could expand TVET graduates' options for higher education by developing a system of quality community colleges, technical institutes, and polytechnics; setting incentives to enlarge the private tertiary education sector; and creating distance teaching universities and virtual campuses. Miller-Idriss and Hanauer (2011), however, point to a clear political-economy constraint: "Higher education throughout the region is challenged by a high degree of centralization, a lack of incentives for improvement, and limited mechanisms for reform or for evaluating reforms." In such an environment, it is even more difficult for tertiary institutions to channel students' strong demand for programs aimed at public sector jobs toward more widely employable degrees that better respond to the demands of an emerging private sector. Many countries in the region still compel private institutions of higher education to mirror the curricula of their public counterparts. While private institutions have greater freedom in staff management, the curriculum restrictions nonetheless represent a major impediment to responding to any emerging market needs.

A second step in modernizing TVET is to encourage students to enroll and graduate by improving the quality of vocational training courses at the upper-secondary level, including work-based training, and by making the different upper-secondary pathways equivalent in certification. Priority quality improvements cover a wide range of issues, such as curriculum development, teacher and trainer development, better testing and outcome measurement, M&E, updating standards for qualifications, and accreditation mechanisms (King and Palmer 2010).

Critical to improving the quality of TVET are better qualifications and greater diversity in the mechanisms for delivering those qualifications. Initial and continuing TVET qualifications, either delivered through formal education and training or by nonformal courses, should be well articulated to help individuals market their skills. The limited alternatives for delivering TVET services should be expanded by exploring and developing e-learning and other options for expanding access to those services and improving their quality (OECD 2009a).

A paradigm shift for TVET, both the medium-to-long-term measures and the appropriate short-term changes (see below), are a priority for the whole MENA region. These measures include curriculum reform (Lebanon), addressing and altering the financing of TVET (Egypt, Jordan, Oman, and the West Bank and Gaza), and accrediting and incentivizing private providers (Jordan, Saudi Arabia).

Short-term measures that MENA countries could adopt

Establish a two-step examination system

Establishing a two-step examination system, with a secondary graduation exam followed by a university entrance exam, would separate the criteria for leaving or graduating from secondary school from the criteria for entering university or other institutions of higher education. The high stakes of the examination would be diminished, and a greater proportion of students would have a better chance of succeeding at graduation.

Placing more weight on secondary school grades, class rank, school attendance

records, and other indicators of student work during the upper-secondary years would also reduce the pressure on the last year of upper-secondary education and minimize the advantages implicit in private tutoring. Even more important, it would diversify student assessment instruments and, as a result, amplify the range of skills that can be used to qualify for graduation and further education. Even countries where the national examination has traditionally performed a double function (graduation and university entrance) have moved to minimize the high-stakes and high-risk nature of the exam. For example, the French Baccalauréat involves testing some of the common subjects (French, history) one year earlier, placing more emphasis on a dossier of the student's work in some modalities of the examination, and introducing a subject called *travaux pratiques encadrés*, which consists of group work to develop soft skills such as teamwork, problem solving, and leadership.

Offer all general secondary and TVET students the opportunity to take the same level of examination

Allowing all students to take university entrance exams has worked well in advanced and high-performing educational systems. In France, for instance, diversification of the Baccalauréat examination led to the creation of a "technical" and a "vocational" Baccalauréat. In the 1980s, in just over a decade, the modalities of the examination increased from 4 to about 38. The tremendous inclusive impact of this diversification was part of a policy goal to increase the share of Baccalauréat graduates to 80 percent of the age group (Eckstein and Noah 1996).

Abolish the selective nature of the leaving exam and reduce the rigidity of tracking arrangements

Abolishing the selective nature of the ninth-grade leaving exam and reducing the rigidity of tracking arrangements in upper-secondary education would break the association of TVET tracks with failure or low ability and facilitate a more inclusive transition from lower- to upper-secondary education.

Regulate private tutoring

Among other measures, public school teachers should be prevented from privately tutoring students in their schools. It is very likely that families invest excessively in private tutoring because tutoring and cramming do in fact help, owing to the nature of the exams. If the exams were more rigorous and relevant in the sense of testing real problem solving, then tutoring might not help as much; or if it did help, it would actually add value to young people.

Prioritize and invest in programs to prevent students from dropping out and leaving school early

National, regional, and institutional programs that prevent students from dropping out and leaving school early should be supported. In addition to regulatory changes to prevent uncertified youngsters from leaving the school system, it is critical to promote innovation in schools and training centers oriented toward implementing inclusive practices (OECD 2012; MEC-IFIIE 2012).

A renewed partnership between educational and training systems and the private sector

Making employability count depends on the ability of the private sector to signal which skills are needed in the labor market and to help provide those skills. Efficient and transparent intermediation between labor supply and demand, for example, through public or private employment services, could help allay young people's concerns that they will not succeed in the transition from employability to employment because of factors they regard as beyond their control.

Communication between educational and training institutions and the private sector

Involving the private sector in education and training must shift from a focus on "consultation" to a focus on "engagement." Such engagement can be facilitated and promoted only if, as discussed, information gaps and failures are addressed, the right incentives are in place—including financial ones—and an institutionalized dialogue takes hold among public education authorities, employers, and other key stakeholders. In other words, if TVET is to become a credible and respected option for students and their families, employers must also perceive it as credible, and this perception relies on much more than just consulting and informing them. Long-term goals of this nature demand concrete measures and interventions to promote and eventually institutionalize the private sector's engagement in education and training and, more specifically, in TVET. From the perspective of public education authorities, the long-term policy goal is to balance regulation with innovation. This balance can be achieved by reforming the governance and financing of TVET while creating the space, incentives, and enabling environment for innovation to flourish in both public and private providers. Moreover, beyond TVET itself, a better-functioning partnership between educational and training systems and the private sector should also help address the low-level equilibrium trap that appears to be behind the meritocracy deficit described in chapter 6.

The first policy option to pursue is formalizing and institutionalizing communication and coordination channels between educational and training institutions and the private sector. Developing and enhancing these channels—with an emphasis on the skills to be incorporated into the curriculum—call for governance reforms that bring key stakeholders into the strategic decisions and management of TVET policies and services. Such reforms also include the development of accountability mechanisms and decentralization to ensure efficiency, relevance, and quality in TVET service delivery.

Chapter 6 presents evidence from MENA on the difficulties and constraints that prevent TVET governance bodies—notably TVET councils—from successfully involving and engaging employers. A good part of the reason for those failures is the marginal role that employers are given in such bodies. Streamlining existing bodies to strengthen their collective voice and to better articulate employers' views on skills is crucial. It is also necessary to reinforce employers' role in a national governance agency that focuses on employment, skills, and qualifications and reports to the central government (and, if applicable, to regional or local administrations with some autonomy in education and training). Coordinating bodies in specific sectors can also help strengthen employers' voice and promote their engagement. Specialized sector entities like the Enterprise-Trainers Partnerships in Egypt are a good example in that regard. El-Ashmawi (2011) points to four core functions for these sectoral bodies, around which consensus is growing: (1) to provide labor market intelligence on a sectoral basis; (2) to support the development of occupational standards; (3) to promote quality service provision in the sector; and (4) to train teachers according to set standards.[12]

Expanding private provision of TVET through incentives, partnerships, and contracts

The second long-term policy option is to expand private provision of TVET through tax incentives, public-private partnerships, and performance-based contracts. It entails providing equipment, training trainers, and developing strong links among public and private TVET providers and employers in curriculum development. An example of such an initiative comes from Egypt, where a TVET project funded by the European Union has developed close collaboration among Siemens, the University of Heidelberg, and vocational training centers. Another example comes from Jordan, where several private firms collaborate with the Vocational Training Corporation to

establish model centers through PPPs (most notably in the tourism sector with funding from the U.S. Agency for International Development).

Also in Egypt, over the past few years a number of international donors, in cooperation with the government, have invested in pilot reform programs to improve the attractiveness of TVET by creating more powerful links with the private sector and therefore more possibilities for employment. The most important of these is the Mubarak-Kohl Initiative, which is currently being implemented in a number of schools following the dual system[13] and the Alternance education initiative introduced by the European Commission–funded TVET Reform Program (with its Enterprise-Trainers Partnerships, in which businesses partner with providers of education and training) (El-Ashmawi 2011). Another very innovative example (this one from Tunisia) is presented in box 9.5. These pilots have certainly provided the foundation for a more ambitious approach to systemwide reform. The governance reforms suggested above are a necessary condition for moving from innovative pilots to systematic reform.

Efficient and transparent intermediation

The predominance of informal networks for job search and hiring limits the efficiency of the job-matching process and introduces inequities, given that access to employment depends strongly on personal connections.

BOX 9.5 Tunisian Association for Communication and Technology

Following the events of the Arab Spring, a Tunisian business association formed to ensure progress on the offshoring agenda: the Tunisian Association for Communication and Technology (TACT, l'Association Tunisienne pour la Communication et la Technologie). TACT promotes three objectives: to make Tunisia known for its offshoring services; to operate in a think-tank capacity as a source of ideas on offshoring for the government; and to help international companies locate offshore departments in Tunisia.

The TACT pilot program is a public-private partnership involving four ministries of the government of Tunisia (technology, economic development and foreign investment, education and vocational training, and higher education and research), public and private engineering schools, and the private sector. Training is carried out by EsprIT, a private university located in Tunis.

Two hundred unemployed university graduates with a background in information and communication technology (ICT) were selected to take part. An estimated 30,000 ICT graduates are unemployed, of whom 17,000 are newly graduated. ICT graduates rapidly become "offshore-ready" through training that lasts 10 months and includes a 6-month curriculum with four 180-hour units of instruction in ICT fundamentals, ICT "environments," languages (English and French), and communication. This curriculum is complemented by four months of on-the-job training, six weeks of which cover a fifth module (with training in finance, computer science, project management, or another topic). The 10-month program allows a trainee to pass a series of certifications: one or more IT certifications (in Java, .net, and so on) and in language (the TOEIC or TOESL).

TACT functions as a charitable trust, offering all managerial and administrative services related to this program free of charge. When candidates are accepted into the program, the government pays 3,000 Tunisian dinars (TD) (US$1,985) for tuition and the cost of certification exams. Microsoft intends to contribute to the program by paying for the certification programs; in addition, thanks to the government's recognition of the program, participants retain the Amal (Arabic for *hope*) monthly allowance of US$133 paid to support job seekers over the 10 months of training. Candidates also receive a free laptop (valued at US$462) that they may keep.

TACT has established this program on a results basis. It accepts the full tuition of TD 3,000 from the government only when students are placed in positions in the offshoring sector.

The evidence on employment barriers presented in chapter 6 calls for more formal job-matching systems and mechanisms to permit more equitable, merit-based access to jobs. The public sector has a role to play in providing formal and open intermediation between job seekers and employers, as well as in enhancing the skills of unemployed workers and adjusting them to the needs of the private sector through selected ALMPs (see, for example, Angel-Urdinola, Semlali, and Brodmann 2010; Angel-Urdinola, Kuddo, and Semlali 2013; Wazzan and Zovighian 2013).

Although most MENA countries provide some form of intermediation through public employment services, several challenges and shortcomings reduce their efficiency and service provision. Public employment services in MENA focus too strongly on expensive training and employment incentives rather than on providing more cost-effective assistance with job searches, including counseling. The last not only achieve employment results similar to other interventions at a significantly lower cost but also address the information asymmetries between job seekers and prospective employers, thereby reducing the importance of privilege in access to jobs.

Public employment services assist prospective employers by posting vacancies, conducting database searches for job profiles, or prescreening job applicants and matchmaking. Most often, however, the approach of public employment offices is rather passive; they expect employers to post vacancies and do not actively build links with the local employer community or market their services. Both public employment services and employers use a variety of other recruitment channels, including personal contacts, advertising, applicant initiative, and references from schools, consultants, and existing employees. In addition to offering incentives to employers to increase vacancy notifications, the employment service can register vacancies advertised elsewhere, and it need not limit itself to longer-term jobs. In many instances, temporary or part-time employment contracts can be regarded as an intermediate state between full employment and unemployment. Repeated temporary placements often lead to a permanent job, and consequently it is in the interest of public employment services to handle short-term work.

For MENA countries, a closer partnership with private service providers, training and educational institutions, employers, and communities might be useful for ensuring that programs respond to market conditions. Various methods can achieve this goal, including extensive outreach by local office staff, job fairs, an aggressive marketing campaign, and regular labor demand surveys (World Bank 2010).

Given that private recruitment agencies are still at an early stage of development in MENA, governments need to ensure proper regulation so that all rights are enforced, thus enhancing social acceptance for this form of work.[14] Private employment agencies are often equated with temporary work agencies that facilitate short-term contracts and labor. They do, however, also perform job-matching services, particularly for employers with medium- and higher-skill requirements (like, for example, headhunter services).

To improve the effectiveness of delivering public employment services, Angel-Urdinola, Kuddo, and Semlali (2013) propose the following reform options:

- *Develop PPPs.* Public employment services in the region will need to develop partnerships with the private sector to deliver training and employment services to the stock of unemployed (notably youth), promote participation in internships and on-the-job training, and develop demand-driven programs tailored to the needs of the private sector. These partnerships should assure the delivery of concrete results. One common mechanism for doing so is to introduce result-based contracts, whereby providers of employment services are remunerated based on their demonstrated capacity to connect beneficiaries to available internships and jobs.
- *Promote entrepreneurship, on-the-job training, and life skills training among job seekers.* Service provision in the region should find a better balance between (costly) interventions

that are cumbersome to scale up (notably wage subsidies, vocational training, and entrepreneurship promotion) and more cost-efficient interventions, such as labor market intermediation, the provision of soft-skills training, and employment counseling services, and entrepreneurship awareness programs that encourage experimentation and learning among university graduates.

- *Improve governance and accountability.* Most countries in the region need to develop a clear framework (and allocate resources) to monitor and evaluate the efficiency and effectiveness of existing employment programs. For example, they could develop clear legal frameworks for M&E, develop results-based (not output-based) labor market information systems (LMIS) (see box 9.6), and promote a culture of program evaluation and auditing.
- *Strengthen institutional and regulatory frameworks.* Countries in the region need to improve institutional capacity to deliver employment services by reducing fragmentation in the system. Institutional coordination should be promoted across relevant agencies as well as between central and local agencies (given that the needs of the unemployed vary across localities).

Short-term measures that MENA countries could adopt

- *Design and implement a communication strategy.* A communications strategy could

BOX 9.6 Introduction of a labor market information system in the United Arab Emirates

A labor market information system (LMIS) is a set of institutional arrangements, processes, and tools for the collection, integration, analysis, policy formulation, and dissemination of labor market information. Such a system assists in minimizing the information gaps that lead to mismatches and distortions and signal information on supply and demand for skills to the various stakeholders that formulate and implement human resource development, employment policies and programs, and private sector decisions. An LMIS also allows policy makers to (1) monitor developments in the labor market; (2) monitor the underlying shifts in the workforce, the skills dynamics in an economy, and how educational and training systems can respond; (3) develop targeted and evidence-based policy interventions; and (4) assess the impact of policies on the labor market.

The World Bank has been supporting some MENA countries in the development of LMIS. In the United Arab Emirates, the LMIS collects information on all aspects of the labor market, including unemployment and employment, vacancies, types of employment, wage data, productivity, and the like. Data are collected either from administrative records (such as foreign labor registries, social insurance registries, civil service records, and so forth) or from survey data (mainly a labor force survey, last administered in 2009). The data are then put into a data "warehouse" at the Ministry of Labor, and the LMIS Unit uses business intelligence software to analyze and report on the data. Custom reports are generated and provided to senior government officials and other stakeholders. The cornerstone of the LMIS is a set of 23 key labor market indicators developed specifically to respond to policy priorities in the United Arab Emirates. The policy priorities include "emiratization," flexibility, demographics, protection, and productivity. In addition, the LMIS is governed through a multiagency steering committee that includes the major providers (and users) of data. Memoranda of understanding are established between the Ministry of Labor and other agencies to ensure timely sharing of information. The dissemination of labor market information is done through a communications strategy that recognizes the various stakeholders involved and provides information relevant to each group. In the medium term, the ministry is looking to strengthen the job-matching functions by matching nationals' applications with labor applications for foreign labor. In addition, the ministry intends to develop occupational projections (by occupation, skills, industry, and the like) to aid in signaling across supply and demand.

explain the merits of TVET as a lifelong learning subsector and contribute to removing the stigma associated with TVET paths in MENA. Such strategies must explicitly target employers in addition to students, families, and public opinion. In Egypt, for example, ad hoc awareness campaigns that were not conducted in the framework of a communications strategy triggered mixed results at best. In 2007, the Industrial Training Council partnered with the Federation of Egyptian Industries under the sponsorship of the Ministry of Finance to commission a large media campaign to promote a positive attitude toward industrial employment. The campaign was complemented by pre-employment training for youth to increase the likelihood of matching vacancies in private firms as well as by some monitoring and evaluation. Acceptance of vocational training among young people was less than 2 percent in the precampaign survey. As the campaign rolled on, 10 percent of inquiries (from among 1,100,000 callers) expressed a willingness to be employed on production lines. Of these, 110,000 were interviewed, and 87,000 (8 percent) became employed (UNDP 2010). In Jordan, a communication strategy is being developed through a consultative approach with all stakeholders, relying heavily on market research for perceptions and attitudes that can help tailor the awareness campaign.

- *Reform, relicense, and empower sector skills councils to increase employers' engagement and investment in skills development.* In the United Kingdom, for instance, the Leitch Review of Skills proposed to deliver more economically valuable skills by allowing public funding for vocational qualifications only when the content had been approved by the sector skills councils (Leitch 2006).
- *Promote business engagement in the classroom and in the management of TVET training centers.* Private sector representatives should have the opportunity to participate in classroom settings (for example, as visiting lecturers or adjunct teachers). Going beyond that, Morocco has adopted a process of delegated management, whereby the vocational training minister signs a contract or memorandum with an industry group that then manages a public training center and, in so doing, defines the skills to be delivered, designs the training program, includes internships and job placements in the program, and involves professional staff from the industry in evaluation. Morocco has four such centers in three sectors (fashion, aeronautics, and automobile).
- *Achieve sustainable, effective, and equitable financing of TVET.* Public funding should be continued for TVET systems, partly through increasing the number and amount of scholarships as an additional incentive to create demand. While the promotion of that new partnership between the educational and training system and the private sector mostly involves governance-related reforms, alternative financing incentives and mechanisms will also be needed so that the educational and training system can respond to a more dynamic and engaged private sector. Thus, sufficient and predictable financing will be needed to create demand for TVET, to attract higher-caliber students, to sustain training programs and qualifications consistent with local and regional labor market trends, and to ensure high-quality practical training in private companies.
- *Provide incentives for accreditation of private institutions.* Accreditation of training institutions needs to be encouraged through policies such as tax incentives to the private sector for engaging accredited organizations.
- *Encourage early intervention.* Early in an unemployment spell, employment services should intervene to provide job search assistance and counseling through high-contact density between job seekers and employment counselors.
- *Reorient public employment services toward the private sector labor market.* In some countries in MENA, public employment services focus on job matching in the public sector. These efforts

and resources should be directed toward the productive private sector. Innovative financial and career incentives for job seekers could be explored to encourage them to give up waiting for a public sector job and actively search in the private sector. The use of employment subsidies could be explored for helping bridge the gap between market wages and job seekers' reservation wages.

- *Create more opportunities to support job seekers.* Job-matching services, career guidance, and counseling could be scaled up, and services could be provided to a larger and more diverse group of job seekers. Innovative ways to better target youth and women in job matching and training could be explored to ensure their equitable access to the programs. Women and youth form the bulk of MENA's unemployed and inactive; yet publicly provided services do not target these groups systematically. Such targeting, coupled with a means test, would ensure that programs reach those most in need.
- *Regulate and coordinate with the private sector.* If the private sector finances, manages, and implements employment services, the primary role of public agencies would be to ensure proper regulation and policy coordination among public and private providers, which balances security with flexibility.

A role for active labor market policies

Young first-time job seekers who have difficulty in mastering the challenging transition to work as well as particularly vulnerable groups, such as low-skilled youth or women, need special services outside the educational and training system. The following policy options focus on ALMPs—active labor market policies—and highlight some of the same priorities as identified above: the importance of counseling, matching supply and demand, and strengthening soft skills in training curricula. In addition to training or entrepreneurship support for those with medium or high levels of skills, temporary wage subsidies or public works programs can help them gain work experience and obtain temporary income support. In discussions with education policy makers from MENA, providing second-chance options outside the educational system through ALMPs is high on the list of medium-to-long-term measures in Jordan, Oman, and Saudi Arabia, whereas Jordan, Tunisia, and the West Bank and Gaza prioritize investing in entrepreneurship and coaching as a short-term measure (see table 9A.1 in the annex).

Provide comprehensive ALMPs

A package of services for young job seekers with medium-to-high skills, including job counseling, matching services, and training in soft skills, should be provided. Most ALMPs targeting young people in MENA focus only on providing job-related skills, and very few provide on-the-job training, let alone individualized case management (Angel-Urdinola, Semlali, and Brodmann 2010). International evidence shows that comprehensive programs that target youth through PPPs are successful in increasing employability. Several countries in Latin America have moved from in-classroom training to a package including workplace training and additional services such as counseling, mentoring, and job search and placement assistance, as well as training in soft and life skills.[15] A well-known program is the Chilean government's Chile Joven program, which offers comprehensive employer- and demand-driven training programs to unemployed youth. This program's success led to customized replications of the model in several other countries. Impact evaluations in Argentina, Chile, and the Dominican Republic indicate that program participants display a 10–21 percent greater likelihood of finding employment than similar young people who did not attend the program. Earnings among those who find employment after the program are also higher than among young people who find employment but did not participate in the program (World Bank 2006).

The evaluations identified the following key success factors: (1) PPPs and training programs that offer practical experience linked directly to an internship with a private employer previously identified by the training institution; (2) training that provides youth not only with technical skills but also with soft and life skills; (3) a program that provides flexible schedule alternatives, such as evenings and weekends, to ensure that youths who work or care for children during regular business hours can attend; and (4) the regular monitoring of successful programs so that they can be improved continuously (Angel-Urdinola and Semlali 2010).

Invest in entrepreneurship training and coaching

Many aspiring entrepreneurs in MENA have had little formal education or training when they enter the entrepreneurial labor force. The knowledge and skills that many currently use in their businesses have likely been acquired from prior experience or from relatives in family enterprises. Chapter 7 showed the importance of prior work experience to transition successfully into entrepreneurship; however, aspiring entrepreneurs still need to strengthen business know-how (such as numeracy and financial management skills), as well as to facilitate access to credit and appropriate technology. Paying for training and other services, as well as finding and selecting quality training, can be problematic. Governments can bridge the gap through targeting prospective entrepreneurs early and linking them with relevant sources of knowledge and support (see box 7.12 in chapter 7 on Tunisia's business plan competition).

Subsidize wages and social security contributions for women and young people

Wage subsidies can be a means for improving opportunities and the employability of youth and women. Employers are reluctant to hire young workers without experience, particularly females, because employers generally have even less experience working with women and might regard them as less committed to staying employed. Wage subsidies to private firms sometimes encourage employers to risk hiring new entrants, and several evaluations from Europe show a large beneficial impact on employment (OECD 2005). Evidence suggests that wage subsidies can work to the advantage of women and youth (Galasso, Ravallion, and Salvia 2002). Subsidies are particularly effective when combined with other programs, such as on-the-job training, counseling, and job search assistance (Kluve 2006). See examples from Jordan and Turkey in box 9.7.

There are a few caveats. Although wage subsidies have seemed cost-effective in countries such as Argentina and Poland (Cunningham, Wuermli, and Sanchez-Puerta 2010), in other countries they have often shown a negative cost-benefit balance because of deadweight loss, substitution, and displacement effects (Calmfors 1994). To be effective, wage subsidies have to be targeted well and be limited in duration; employers' obligations also have to be enforced. It is important to ensure that the subsidy goes to those employers who would not have hired young workers in the absence of the additional financial incentive.

Provide labor-intensive public works and training in job-specific skills

By providing market-relevant skills and generating local infrastructure, public works can relax some of the constraints to market access that rural workers face and generate effects that last beyond the program's duration. Aside from temporarily employing unskilled and semiskilled workers at low wages on labor-intensive activities to create new community infrastructure, public works programs can also serve as a temporary safety net, ensuring income in times of shock (such as natural disasters or macroeconomic crises). For example, the Egypt

BOX 9.7 Wage subsidy programs in Jordan and Turkey

Jordan's training program to increase participation of women in the workforce

The World Bank's Jordan NOW (New Work Opportunities for Women) pilot combined two interventions aimed at reducing the barriers to entry into the labor market for young women: a short-term wage subsidy and training in employability skills. The soft-skills training was designed and implemented jointly with a local Jordanian nongovernmental organization in the fall of 2010. From a group of 1,347 women who had recently graduated from community colleges in Jordan, about 600 girls were randomly selected to participate in the nine-day-long (45-hour) training course. Following discussions and feedback from private sector firms on the lack of soft skills among young entrants into the labor market, the course was designed to cover a series of basic employability skills. These included effective communication and business writing (for example, making a presentation and writing business reports and different types of correspondence), team-building and teamwork skills (such as exploring characteristics of a successful team and how to work in different roles within a team), time management, positive thinking and how to use this skill in business situations, excellence in providing customer service, and résumé and interviewing skills. Sessions were based on active participation and cooperative learning rather than lectures, with games, visual learning experiences, group exercises, and active demonstrations used to teach and illustrate concepts.

A year after the soft-skills training courses ended, the World Bank conducted a follow-up survey to assess the impact of the interventions. Countless numbers of participants gave strongly positive feedback about the skills training: that the experience opened their minds and gave them a much better grounding for getting a foothold in the labor market. The results of the survey back up this feedback to some extent: training helped boost these recent graduates' self-esteem—about one-quarter fewer women in the training group indicated that they are severely mentally depressed compared with the control group. However, there are indications that the challenges faced by young female entrants in the Jordanian labor market are far more serious: on the whole, soft-skills training had no sustained impact on employment. Neither did it affect any other dimensions of employment: salary, weekly hours worked, labor force participation, and total time employed.

Subsidizing social security contributions for youth and women in Turkey

In Turkey, a subsidy designed for new youth and women hires between July 2008 and June 2009 consisted of 100 percent of employers' social security contributions (at the legal minimum wage) in the first year, with a 20-percentage-point decline per year in the subsidy in the following four years. An evaluation of a similar program piloted in selected regions of Turkey between January 2004 and December 2005 found that employment among youth and female workers in provinces that benefited from subsidies grew by 1.7 percent per month, whereas the growth rate was 1.1 percent per month in provinces that did not benefit from the subsidy (in other words, subsidies contributed to a 63.0 percent increase in employment growth rate in beneficiary provinces). Based on the results of this pilot experience, the effects of a similar program implemented nationally could have contributed to a net creation of approximately 163,000–235,000 new jobs. Unfortunately, Turkey was hard hit by the financial crisis, which undermined the program's impact. Programs like this, while attractive for promoting employment among targeted groups, could be expensive. Estimates from the Turkish Treasury indicate that generating one extra job for those benefiting from the program could cost US$12,000–17,000.

Sources: Jordan NOW baseline, midline, and endline surveys; staff calculations; Angel-Urdinola and Semlali 2010.

Social Fund for Development created jobs and provided new community infrastructure and services as part of the government's safety net and poverty reduction strategies. The Republic of Yemen Social Fund for Development has implemented a labor-intensive work program since 2006 that serves as a poverty alleviation mechanism in urban areas for many unskilled workers arriving from rural areas (Del Ninno, Subbarao, and Milazzo 2009). For an example from India, see box 9.8.

Although public works seem to have a positive impact on employment outcomes only in the short run, they have the potential to generate effects that endure beyond the life of the program by developing infrastructure and providing market-relevant skills (Dar and Tzannatos 1999; Betcherman, Olivas, and Dar 2004). Infrastructure development may unleash productive capacity, lower the cost of doing business for micro and small enterprises, and raise their access to wider markets and customers. Box 9.9 explores the links between infrastructure development and employment in MENA.

A review of public works projects in several countries over the past 20 years shows that a number of design features are critical to their effectiveness: they need to have clear objectives, they should create valuable public goods, and they should have predictable funding (Del Ninno, Subbarao, and Milazzo 2009).

Invest in early childhood development and home-based work for women

"Workfare" programs need not always involve public works. Instead of providing new infrastructure, for example, the work can supply an underprovided public service, such as child care. This type of workfare is not necessarily temporary and not reserved to the unskilled, as an example from South Africa shows (box 9.10).

This type of workfare can be financed through the demand side, because there are service users. For example, a new pilot program in Tunisia (Bedaya) explores the potential for combining a program such as the one in South Africa with child care vouchers for poor working women. The vouchers, a benefit from the Ministry of Social Affairs, could be used to pay for the newly established child care centers. The centers can redeem the service vouchers at the ministry against cash revenue. While this program actively creates new jobs, especially for qualified women (as child minders), it is not workfare in the traditional sense. The child care managers act like entrepreneurs and need to attract enough clients or service users to make their centers profitable.

BOX 9.8 An employment guarantee scheme to build infrastructure in rural Maharashtra

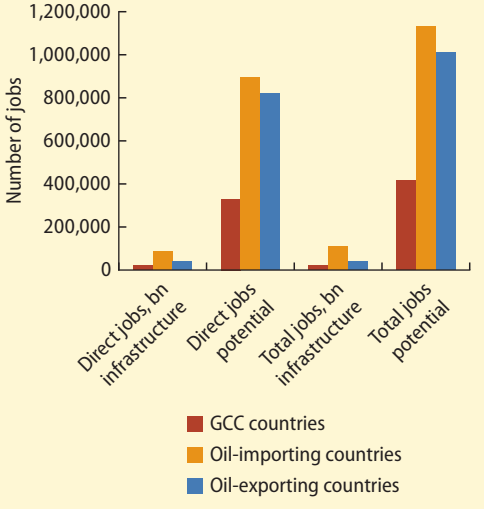
India has a long history of using employment guarantee schemes to provide income relief to the poor and build needed infrastructure. Introduced in the 1970s, the employment guarantee scheme of the Indian state of Maharashtra is one of the largest public works programs in the developing world. It guarantees employment to all adults older than 18 years of age who are willing to perform unskilled manual work at piece rates. The scheme has succeeded in targeting the deserving segment of the population and building rural infrastructure. In 2004, the Indian government enacted the National Rural Employment Guarantee Act, which guarantees 100 days of employment in public works to rural people and is projected to cost 1–2 percent of gross domestic product.

Source: OECD 2009b.

BOX 9.9 The impact of infrastructure investments on employment

Investment in infrastructure could be a natural "early gains" measure for creating jobs in MENA (see also the discussion in chapter 10). In the short run, every US$1 billion invested in infrastructure has the potential to generate around 110,000 infrastructure-related jobs in the oil-importing countries (OIC), 26,000 jobs in the economies of the Gulf Cooperation Council, and 49,000 jobs in the developing oil-exporting countries (OEC) (see figure B9.9.1). The region could therefore generate 2.0 million direct jobs and 2.5 million infrastructure-related jobs just by filling current domestic infrastructure gaps.

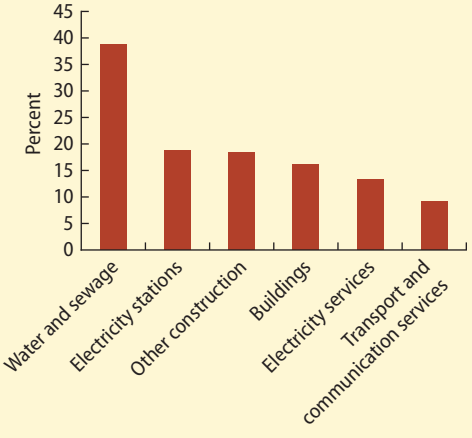
FIGURE B9.9.1 Estimated jobs creation through infrastructure investment per billion U.S. dollars of investment in MENA, 2009



Note: GCC = Gulf Cooperation Council; bn = billion.

The potential of such programs varies by sector and country. Because of per capita income differences, US$1 billion in infrastructure investment would generate more than six times as many jobs in a sector in Djibouti as in Lebanon, but Lebanon would find it considerably easier to finance the investment expenditure. Spending on construction of roads and bridges would generate more than twice as many direct jobs as the same amount of spending in any other sector because the work is more labor intensive. To reflect the variation across sectors, figure B9.9.2 shows the estimated cost of creating one direct job in various sectors in Egypt in 2009. Sectors also differ in their propensity to generate indirect jobs. It depends on the extent to which the sector requires inputs from other sectors to produce its output.

FIGURE B9.9.2 Cost of creating a direct job in road and bridge construction relative to other sectors in the Arab Republic of Egypt, 2009



Apart from quick wins, the long-term employment effect of infrastructure investment could be significant. Estache et al. (2012) find that infrastructure investment resulting in one percentage point of additional growth could create 9 million additional jobs in MENA in the course of 10 years, or a little less than 1 million jobs per year.

Source: Estache et al. 2012.

BOX 9.10 Supporting early childhood development and home care services in South Africa

A public works program in South Africa set out to provide temporary jobs, skills, and early childhood accreditation to 19,800 young unemployed (mainly female) persons over five years. The goal was to combat unemployment while investing in the future generation through early childhood development and home-based care programs. Youth are hired at a minimum wage, receive training, accreditation, and designated jobs providing services for the very young in their communities. Training and employment include various levels: (1) qualifications corresponding to accreditation of teacher aides and kindergarten teachers; (2) direct and immediate creation of work opportunities in targeted early childhood development sites in very poor areas; (3) on-the-job training and certification for early childhood development support staff, such as vegetable and legume gardeners, cooks, and administrators; and (4) short-term, three-month employment opportunities in auxiliary tasks for 3,000 unemployed parents through existing schools and local authorities.

Source: Antonopoulos and Kijong 2011.

Skills as drivers of success in the labor market

Building employability and making it count in the labor market are essential conditions for efficient and equitable labor market outcomes. Young people and families in MENA invest heavily in education and training; yet the majority of youth cannot reap the appropriate individual returns from such investments. Several constraining factors intervene, including the low quality and relevance of their skills and the limited importance of merit in gaining access to a job. From a social perspective, returns to investments in education are low in MENA, partly because the number of good employment opportunities in the private sector is limited and partly because so many young people choose to queue for jobs in the public sector. High youth unemployment—both involuntary and voluntary—is a result of this low-productivity equilibrium.

Meritocracy in access to education and hiring, the availability of multiple pathways in education, and the provision of second-chance options are key elements in developing a productive workforce. A meritocratic society signals market demands more clearly to educational and training systems. As a result, it creates demand for the "right" skills in the "right" areas and reduces the mismatch between what the market needs and what the educational and training system produces. Promoting meritocracy reinforces the conditions for reform identified here: closing stakeholders' information and knowledge gaps; valuing learning and problem solving in more inclusive educational and training institutions; involving employers in education and realigning incentives for public sector hiring; and improving the efficiency of job matching while also providing second-chance options through active labor market programs.

Citizens' demand for agency and dignity in MENA underlines the importance of involving civil society in crafting and implementing policy solutions. The policy options outlined in this chapter are certainly not new. Most will take a long time to implement properly and bring about measurable results; yet the first step forward is the most crucial one to take. But, to be sure, success will require more than technocratic solutions. It will require a society that is ready for change, that is ready to provide real opportunities for future generations, and that has leaders in the public and private sector alike who are prepared to make a real commitment to building employability and making it count in the labor market.

Annex

TABLE 9A.1 Selected short- and medium- to long-term educational policies and measures for MENA

	Early gains/short-term measures	Medium-term to long-term measures
Egypt, Arab Rep.	1. Integrate databases into a national education management information system 2. Update curriculum standards to enable a more ambitious curriculum reform in secondary education and vocational education and training (VET) 3. Complete the National Qualifications Framework (NQF)	Establish and develop a national system of student assessment Address the financing gap for technical and vocational education and training (TVET) Transform TVET from a second-rate option into a life-long learning (LLL) system
Jordan	1. Reform the examination system (Tawjihi), mainly by establishing a two-step examination system, with a secondary graduation exam, followed by a university entrance exam, and by switching the focus of the exam to higher-order skills and competencies 2. Complete the modernization of the curriculum 3. Design alternative training itineraries for every student, so that each acquires relevant skills for a successful transition from education to work 4. Design and establish tracer studies for both technical and vocational education and training (TVET) and tertiary education graduates 5. Regulate private tutoring 6. Expand private provision of TVET through tax incentives, public-private partnerships, and performance-based contracts 7. Invest in early childhood development and home-based work specifically targeted to women 8. Invest in entrepreneurship training and coaching	Formalize and institutionalize communication and coordination channels between educational and training institutions and the private sector Provide second-chance options outside the education system through active labor market program (ALMPs)
Lebanon	1. Open new channels between TVET and tertiary education and reform the university entrance examination 2. Complete the NQF in partnership between the public and the private sector 3. Strengthen counseling and guidance services in all schools 4. Reform the curricula of TVET	Formalize and institutionalize communication and coordination channels between educational and training institutions and the private sector Develop a reformed national system of student assessment
Morocco	1. Reform the examination system (Baccalauréat) and evaluation of student performance as a whole so that the focus is on skills and competencies 2. Create a Labor Market Information System 3. Systematically carry out tracer studies for graduates	Formalize and institutionalize communication and coordination channels between educational and training institutions and the private sector Establish and develop a national system of student assessment
West Bank and Gaza	1. Reform the secondary-school leaving and university entrance examination (Tawjihi). 2. Develop the Education Management Information System and the Labor Market Information System 3. Invest in counseling and guidance services 4. Achieve sustainable financing for TVET 5. Invest in entrepreneurship training and coaching	Establish and develop a national system of student assessment
Tunisia	1. Refine the quality assurance function in the education system, strengthening the separation between policy-setting functions and evaluation and oversight ones 2. Reform the examination system (Baccalauréat) and evaluation of student performance, as a whole, so that the focus is on skills and competencies 3. Invest in entrepreneurship training and coaching 4. Strengthen and professionalize counseling and guidance services, particularly in VET 5. Regulate private tutoring	Create a comprehensive information system that is used as the key policy tool for labor market–related decision making

(continued next page)

TABLE 9A.1 Short-and-medium-to long-term educational policies and measures for MENA *(continued)*

	Early gains/ short-term measures	Medium-term to long-term measures
Oman	1. Create a labor market information system 2. Systematically carry out tracer studies for graduates 3. Continue the process of establishing a professionalized service of counseling and guidance for all schools 4. Ensure public funding for VET 5. Design and implement a communication strategy that explains the merits of TVET as a life-long learning subsector and contributes to removing the stigma associated with TVET 6. Invest in early childhood development and home-based work specifically targeted to women 7. Invest in entrepreneurship training and coaching	Improve the collection of data on numbers, skills, and wage evolution of graduates of secondary and TVET institutions, universities, and certification programs to facilitate career decision making and to enhance efforts to promote investment Design alternative training itineraries for every student so that each acquires relevant skills for a successful transition from education to work Transform VET from a second-rate option to an LLL system Provide second-chance programs through ALMPs
Saudi Arabia	1. Create a labor market information system 2. Systematically carry out tracer studies for graduates 3. Provide incentives for the accreditation of private institutions in TVET	Formalize and institutionalize communication and coordination channels between education and training institutions and the private sector Transform TVET from a second-rate option into an LLL system Provide second chance options outside the education system through ALMPs
Iraq	1. Establish a two-step examination system with a secondary graduation exam followed by a university entrance exam 2. Place more weight on secondary school grades, school attendance records, and other indicators of student work during the upper secondary years 3. Develop the national system of student assessment 4. Finalize a long-term education strategy that is based on quality data.	Strengthen and rebalance the links between general and vocational tracks and introduce new, blended training itineraries Continue progress toward a competency-based curriculum reform
Yemen, Rep.	1. Improve the collection of data on numbers, skills, and wage evolution of graduates of secondary and TVET institutions, universities, and certification programs to facilitate career decision making and to enhance efforts to promote investment 2. Prioritize and invest in programs to prevent vulnerable students from dropping out and leaving school early	Formalize and institutionalize communication and coordination channels between education and training institutions and the private sector Transform TVET from a second rate option into an LLL system Continue progress toward a competency-based curriculum reform

Source: Feedback collected by the report team from Ministry of Education/Higher Education officials on reform priorities (World Bank Course on Strategic Choices in Education Reform, Muscat, Oman, June 18, 2012).
Note: MENA = Middle East and North Africa.

Notes

1. Table 9A.1 shows that creating management information systems and integrating existing data or conducting new surveys is high on the list of priorities in many MENA countries.
2. Concrete examples from selected countries on how to use assessment data to design better policies can be found, for instance, in Greeney and Kellaghan (2009) and in World Bank (2011).
3. The full text of the Doha Declaration can be found in the following link: http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/EXTGC/0,,contentMDK:22711414~menuPK:6130053~pagePK:2865066~piPK:2865079~theSitePK:6130003,00.html.
4. Many countries have created or are in the process of creating NQFs. East and South Asian countries such as Australia, Hong Kong SAR (China), Malaysia, the Philippines, Singapore, and Sri Lanka have NQFs that the International Labour Organization deems "established" (ILO 2010); the same goes for many members of the European Union (such as France, Ireland, Romania, the United Kingdom, and others) and for a good number of countries in other regions. In MENA, Egypt, Jordan, Lebanon, and Tunisia have established NQFs (Leney 2009).

5. See the annex to this chapter for details on suggestive country-specific short-term policies and measures.
6. For example, evidence from a United States–wide sample of high school students suggests that guidance and counseling services improved the quality of students' educational and occupational decisions and educational performance (Lapan, Gysbers, and Sun 1997). For young women, such counseling may have positive externalities on the community. For example, a study in India found that women who received three years of career and recruiting services had higher employment rates than women who had not received the service; among girls ages 5 to 15, the service increased the probability of school attendance (Jensen 2010).
7. The need to design alternative education and training itineraries for every student is high in the list of education policy priorities in Jordan and Oman, among other countries (table 9A.1).
8. Well-known and highly influential national public examination systems such as the French Baccaluréat, the German Abitur, or the British General Certificate of Secondary Education have evolved in that direction and have indeed been used as a tool for implementing curriculum reform in those countries (Eckstein and Noah 1996).
9. A young university graduate claimed: "We are forced into disciplines, it is never a choice." And a mother said: "When we have a Tawjihi student at home, for us it is a 'horror' because this will determine their future."
10. In consultation with officials from ministries of education from a large number of MENA countries, the need to reform the examination system, such as the Tawjihi or the Baccalauréat, was among the top policy priorities in Iraq, Jordan, Morocco, Tunisia, and the West Bank and Gaza. The issue has also been a recurrent focus of policy and public attention in Egypt (table 9A.1).
11. For instance, the OECD report shows that in Belgium, the Netherlands, Portugal, and Spain, the direct costs of grade repetition account for nearly 10 percent of the annual spending on primary and secondary education.
12. Formalizing and institutionalizing communication and coordination channels between education and training institutions and the private sector is a key medium- to long-term policy priority, for example, in Jordan, Lebanon, Morocco, Saudi Arabia, and the Republic of Yemen (table 9A.1).
13. A dual system combines apprenticeships in a company with vocational education at a vocational school.
14. International instruments that provide guidelines for regulating private employment services include Convention 181 of the International Labour Organization as well as the accompanying Recommendation no. 188.
15. For example, a life skills training to improve employability in the Dominican Republic, called Juventud y Empleo, integrates life skills education to help young people become more effective employees and citizens. Among the topics taught are self-esteem, teamwork, communication skills, work organization and service skills, job search skills, and knowledge related to risky behaviors (reproductive health, drug use, violence, and others) (World Bank 2006).

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Spotlight 1

An Overview of Policy Options and Their Sequencing

The chapters in part 3 (7, 8, and 9) have presented an array of recommended policy responses for opening pathways to more jobs in MENA. They covered the private sector business environment, labor market institutions, and education and skills. Although there are regional trends, ultimately each country needs its own policy response, which will vary with the degree and number of constraints.

Table S1.1 summarizes the policy options discussed in part 3 grouped by main constraints in each of the areas. Table S1.2 provides a list of indicators across countries that could be considered as a proxy of the extent of particular constraints in each economy where data are available. Of course, this table cannot fully demonstrate the complexity of each constraint, but it might help prioritize possible policy options.

TABLE S1.1 **Policy options by context**

Policy area	Constraints	Priority policy actions
Business environment	Discretion and corruption in business environment	• Substantive simplification of business regulations to reduce room for administrative discretion and corruption in countries with poor rankings in individual indicators • Make information on regulations, procedures, decision criteria, and anonymized enterprise data fully public • Increase accountability of public administration and sanction abuses
	High entry barriers and low competition	• Reduce discretion of licensing process and reduce costs of entry in product markets through unnecessary licenses • Reduce state monopolies in product markets (for example, regulations prohibiting de jure or de facto private or foreign presence in specific sectors) • Make competition authorities fully autonomous from executive • Simplify regulations for microenterprises to encourage registration and to enable credit access
	Low access to credit for firms	• Develop private credit registries and reform collateral regimes to include small borrowers • Increase bank competition (including through privatizations) • Revise regulations to enable entry of microfinance institutions and nonbank financial institutions to reach microfirms and low-income consumers
Labor market	Distortionary subsidies	• Remove energy subsidies and subsidies to crops with low labor intensity • Develop targeted social safety nets to counter price shocks in low-income households and to assist displaced workers • Provide technical and financial assistance to subsidy-dependent producers and industries to transform production technology
	Labor market, public sector, and social insurance	• Reform labor code to ease dismissal procedures, costs, and design unemployment insurance systems • Develop in-depth assessment of financial flows in social insurance, especially in pension system • Public sector: outsource noncore activities, decentralize decision making, and, most important, align the risks and returns of the wage package with the private sector
Skills	Skills constraints	• Start with basic skills and ability measurement (standardized tests) • Radically reform TVET for higher quality • Reform secondary school exit exams together with university admission • Foster strong link between private sector and education in TVET • Establish quality assurance system, especially in HE

Note: TVET= Technical and Vocational Education and Training; HE = higher education.

TABLE S1.2 **Overview of constraints by country and policy area**

	Ranking on constraints in the business environment					Ranking on constraints in the labor market			Ranking on skills constraints
	Ease of doing business (1)	Regulation quality/ implementation (2)	Control of corruption (3)	Getting credit (4)	% aged 15+ with loan in past year (5)	Energy subsidy as a % of GDP (6)	% of employment in public sector (7)	Constraining labor market regulations (8)	% of firms reporting skills as a constraint to business growth (9)
Egypt, Arab Rep.	High, 110	Moderate, 47th percentile	High, 22nd percentile	Moderate, 78	Very high, 3.65	6.9% in 2009	High, 27% of employment	High, (rigid hiring and firing laws)	High, (ICA: 50.1)
Jordan	Moderate, 96	Moderate, 57th percentile	Moderate, 50th percentile	High and worsening, 150	High, 4.47	6.0% in 2011	High, 34% of employment	Moderate	Moderate (ICA: 32.6)
Lebanon	High, 109	Moderate, 54th percentile	High, 22nd percentile	Moderate, 78	Low, 11.27	0.1% in 2009	Low, 16% of employment	Moderate	High (ICA: 55.5)
Morocco	Moderate, 94	Moderate, 50th percentile	Moderate, 40th percentile	Moderate, 98	High, 4.3	3.9% in 2009	Low, 11% of employment	High (severance payments: 26 weeks of salary)	Moderate (ICA: 30.9)
Syrian Arab Republic	High, 134	High, 19th percentile	Very high, 4th percentile WGI	Very high, 174	Low, 13.4	—	Moderate, 28% of employment	Moderate (considered 8th most constraining among 19 by employers ICA)	High (61% employers find skills obstacle to growth; over 50% have difficulty recruiting the skills they want—3rd highest) (ICA)
Tunisia	Low, 46	Moderate, 53rd percentile	Moderate, 42nd percentile	Moderate, 98	Very high, 3.18	2.5% in 2011	Moderate, 22% of employment	Low/High (very flexible for first 3 years of contract; very rigid after 4 years)	Moderate
United Arab Emirates	Low, 33	Moderate–low, 62nd percentile	Low, 72nd percentile	Moderate, 78	—	—	Very high for UAE nationals (92% of employment)	High for nationals, low for expatriates	High for nationals (lack of specialization in private sector required fields)

Notes: Rankings: red = very high; yellow = moderate; green = low. (The notes below show the data sources and threshold levels of the business environment, labor market, and skills constraints in MENA countries.) GDP = gross domestic product; ICA = investment climate assessment; — = not available; WGI = World Governance Indicators; UAE = United Arab Emirates.

Column 1: *Ease of doing business rankings*. Source: *Doing Business 2012* (World Bank 2011). World average ranking for middle-income countries: 100.9. Thresholds are set as follows: 1–49 = low; 50–100 = moderate; >100 = high.

Column 2: *Regulation quality indicator*. Source: World Governance Indicators (2010 data). Thresholds: bottom 33 percentiles = high; 33–66 percentile = moderate; 67 + percentile = low constraint.

Column 3: *Control of corruption indicator*. Source: World Governance Indicators (2010 data). Thresholds: bottom 33 percentiles = high; 33–66 percentile = moderate; 67 + percentile = low constraint.

Column 4: *Getting credit ranking*. Source: *Doing Business 2012* (World Bank 2011). This indicator assesses the institutions, regulations, and financial infrastructure in place to enable credit. Thresholds for constraints are set according to global country rankings: 1–49 = low; 50–100 = moderate; >100 = high.

Column 5: *Percentage aged 15+ with loan in the past year*. Global Findex (2011). World average: 9.05%. Thresholds are set as follows: 0–50% of world average = high constraint; 50–100% of world average = medium constraint; above world average = low constraint.

Column 6: *Energy subsidy as % of GDP*. Source for all countries but Jordan: Silva, Levin, and Morgandi (2013). Data are mostly for 2009. For Jordan, data are from IMF (2012). Thresholds: <=1% = low; <=3% = moderate; >3% = high.

Column 7: *Percentage of employment in public sector*. Lebanon Employer-Employee Survey (2010). Public sector includes only employees in public administration. Thresholds: under 20% = low; 20–25% = moderate; over 25% = high.

Column 8: *Labor market regulations*. Authors' estimates conducted as part of this study based legislation analysis (see chapter 5).

Column 9: *Skill constraints*. Percentage of firms reporting that skills of workforce are a constraint to their business, from Investment Climate Assessment surveys (2005–10).

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The Road Ahead

PART 4

I know that I am only dust under the steamroller of fate, but I have to do it. It is my duty as a human being. If I don't speak up, I will stay all my life crouching, kneeling, crooked. I want to raise my head, express myself.

— Abdelaziz Belkhodja, *The Return of the Elephant*

The Political Economy of Inclusion

10

Main findings

- The political-economy equilibrium in the region has diluted the implementation of technical solutions that could remove the barriers to job creation, many of which have been widely known.
- In many cases, a system of rents accruing to ruling coalitions has provided incentives to maintain barriers to entry in the private sector and withhold access to finance. At the same time, the limited space for voice and pluralism and restricted access to data have reinforced the status quo.
- Moving towards a more inclusive development model is essential to sustained and quality job creation.
- The aftermath of the Arab Spring presents opportunities and challenges. Newly elected governments face pressure to deliver results, but might do so with inefficient policies such as scaling up subsidies and public sector jobs without significantly changing the "rules of the game."
- Comparable experiences with regime transition elsewhere indicate that shifting to a model of broader-based growth is feasible.
- Several tested approaches exist to produce measurable gains in job creation in the short run and build credibility, without compromising the feasibility of the acutely needed structural reforms.
- Investing in data to promote openness and transparency and leveraging the role of new social forces for a more inclusive social dialogue can help build a shared vision for reform.

A complex legacy

During the colonial period (mid-nineteenth to the early twentieth century), France and Great Britain influenced the diverse political institutions in the Middle East and North Africa (MENA), largely through their spheres of influence and the control exercised in their colonies, mandate states, and protectorates. After the colonial period, a rapid metamorphosis in the region's political landscape took place. Proto-democracies, military rule, and monarchies old and new proliferated and experienced numerous political upheavals, including civil and international wars, foreign invasions, coups d'état, and revolutions, both peaceful and bloody.

Despite the wide variety of political forms, the longevity of individual political regimes

in most countries is remarkable. How can such political longevity within countries be reconciled with the diversity of political systems in countries in the region? What are the implications for economic outcomes?

The framework introduced by North et al. (2009) studies different types of social order and how these orders affect the appropriation and distribution of economic rents (that is, special privileges) (see box 10.1). In this interpretive framework, countries in MENA generally align with the "rentier state model," as defined by the literature specific to the region (Beblawi 1990).

Within this model, two typologies of countries emerge, based on their main source of rents (Luciani 1990). The first group of countries is characterized by easy access to rents accruing directly to the state, most commonly from natural resources. As these states do not need to collect revenues from taxation, the pressure from citizen-driven accountability is attenuated. While these states have little incentive to diversify their economies or open up their political systems, they face significant challenges in job creation because of the capital-intensive nature of extractive industries and other challenges documented in the vast literature on resource-rich economies.

The second group comprises countries that are resource poor. There, elites benefit from rents derived from their apex positions in organizations that control certain sectors of the economy. These economies are more diversified than those with natural resources and tend to rely on a larger dominant coalition.

A characteristic of rentier states is their ability to secure consensus by sharing part of these rents, especially through subsidies and public employment. The high degree of interventionism required to keep this order in place strongly affects the dynamics of the private sector. In fact, several studies suggest that the combination of oil rents, remittances, and foreign aid lessens the pressure for market reforms.[1]

BOX 10.1 Social orders and economic management

The framework advanced by North, Wallis, and Weingast (2009) and extended by North et al. (2009) provides an interesting lens through which to view political structures around the world. The authors map societies to different types of social order, defined as the means by which a society is organized to maintain coordination and cooperation among its constituent individuals. Many countries solve the problem of coordination (and control of coercive capacity) by creating a dominant coalition. Members of the coalition (the elites of the society) receive special privileges or "rents" as a reward for their membership. These elites normally control vast patron-client networks and military, political, economic, or social organizations, from which they derive rents. To protect and maintain the value of elite rents, the dominant coalition (usually through state organizations) provides third-party enforcement against any shirking or rebellion in elite-controlled organizations that might adversely affect elites' rents. The dominant coalition must also limit the ability of nonelites to form new organizations that could compete with elite organizations and drive down elite rents.

This model of social order—which North et al. (2009) term a "limited-access order"—differs from a model in which citizens can form new organizations, with little restriction. In these open-access-order systems, impersonal institutions constrain the government from using the state's coercive capacity—military or police—illegitimately (that is, to intimidate political opposition parties or to retain power, for example), and the government seeks control by supporting a broad array of economic and social organizations. To obtain and sustain an open-access order, a large number of individuals must have the right to form political, economic, and social organizations. The state guarantees legal protection to these organizations, as well as the rights of forming new ones within certain minimum requirements. Moreover, the institutions that govern the formation of any new organization are guided by impersonal rules.

The Arab Spring may contribute to altering this trajectory by opening up political systems, which would enable social and economic systems to become more open and inclusive and experience more economic growth, poverty reduction, and creative destruction.

Historically, the political-economy equilibrium in MENA yielded policies that have led to several unproductive outcomes:

- Highly uneven regulatory playing fields for firms, including discretionary access to credit
- Significant labor market rigidities
- Access to jobs based on personal networks rather than on objective signals of ability
- Generally limited access to information and civil liberties

All of these outcomes were—and have the potential to remain—significant barriers to employment growth in MENA. Their secondary legacy is an unorganized citizenry that may at first struggle to use new liberties, such as those acquired in post–Arab Spring nations. This chapter reviews the consequences of these policies from a political-economy perspective and examines the alternatives for change.

Revisiting the political economy of private sector dynamics

This section revisits key features about the interactions between the state and the private sector—the experience of privatization, enforcement of regulation, and limited access to credit—and explicitly links them to some of the political-economy incentives that prevail in rentier states as well as to the types of exclusion and social divides that this model perpetuates.

Elite capture of public benefits

Following decolonization and independence, most of the countries in MENA adopted the (then common) development model of state-led industrialization. As rents from natural resources were depleted in the region's relatively resource-poor countries (for instance, the Syrian Arab Republic, Tunisia, and the Republic of Yemen), several governments embraced policies to increase the role of the private sector and reduce the fiscal losses. In North Africa, the first wave of market-oriented intervention in the 1990s was intended to attract foreign direct investment in the energy sector to increase revenue generation and forestall the taxation of citizens in a period of fiscal constraint. The second wave corresponded to internationally backed structural adjustment programs aimed at reducing government losses from state-owned enterprises, mainly through privatizations.

According to the (still-emerging) literature on this period, economic liberalization was part of a long-term strategy of power preservation. Rulers used economic reforms to consolidate power, reconfigure ruling elites, and get buy-in from the upper-middle classes by allowing access to greater consumption (Dillman 2001; Heydemann 2007; and Kienle 2001). Among others, Kaufmann (2011) claims that the gains from privatization were captured by elites, as observed in Eastern Europe following the collapse of the Soviet Union. At the same time, MENA governments proved unable to break away from their traditional sources of political support in the public sector. Unlike their Asian counterparts, MENA economies enjoyed only a limited political space for imposing the reforms that could effectively increase private sector–led development and reduce rent seeking (see Esfahani 1994, for an example from the Arab Republic of Egypt). Privatization in all countries occurred at a very slow pace and in a piecemeal fashion owing to its unpopularity among workers and among those concerned about political stability (Posusney 2003).

Many retrospective analyses have argued that one consequence of these reforms and of the way in which they were implemented was to reinforce inequities in labor and product markets. The earlier regime of industrialization allowed governments to provide rents to a broader base of citizens, for instance, by subsidizing loss-making enterprises and granting monopolies. Instead, the new phase

of privatization and overall downsizing of the public sector increased the polarization of winners and losers in the reform process. As noted in earlier chapters, weak or absent competition policies and an unfavorable investment climate limited the positive impact of reforms and prevented economic restructuring from yielding increased investment or the entry of new actors in liberalized markets.

Liberalization did have some successes. The history of liberalizing wireless telecom utilities in MENA in the early 2000s (described in box 7.5) illustrates the potential of liberalization for harnessing investment and creating jobs. Interviews with sector experts shed light on the specific political economy of this success story. At the time of reform, mobile telecommunication had a small consumer base and represented a small revenue source for state-owned incumbent firms, which lacked sufficient incentives to invest in this new sector. For this reason, opening up competition faced lower resistance than in other sectors. However, to date, public telecoms have resisted the liberalization of international voice communication, which has historically represented a large source of their revenue in a market where domestic communication has dropped in cost due to competition from mobile providers. Experience in other regions has shown that in a competitive environment, international communication would see a dramatic reduction in profit margins for all providers, at the expense of incumbent firms.

Enforcement of regulations and discretion

Starting in the 1990s, many countries in MENA have made significant strides in reforming business regulation. As a result, numerous measurable aspects of their business environments have substantially improved, and some MENA countries have ranked among the top reformers in the world. Improvement in these indicators signals positive changes, but qualitative and quantitative evidence on the de facto implementation of regulations suggests that discretionary enforcement has continued to dominate, limiting the positive effects of reforms (see chapter 4).

For example, the discretionary enforcement of complex procedures is an important up-front fixed cost for firms desiring to enter a new sector or to grow. It disproportionately affects young and emerging enterprises while favoring incumbent firms, which in turn limits competition and creates rents for incumbents. Recent anecdotal evidence offers a glimpse of how regulations were used to control rent distribution in Tunisia before the Arab Spring. Cassarino (2011) reported that discretionary enforcement of regulations and overzealous tax enforcement were mechanisms for maintaining "the threshold beyond which autonomous private initiatives could not prosper without the prior approval of the ruling party." Interviews with key stakeholders from the labor movement and in economic think tanks in Egypt and Tunisia, conducted as background for this report, confirm this assessment.

Rent seeking is pervasive in democracies and nondemocracies alike, and it is not unique to MENA. Depending on the mechanisms for accountability, rent seeking can result in different types of economic distortions (Fisman and Gatti 2006). For example, Keefer (2007) argues that rent seeking in China was kept at bay by the institutionalization of rules within the Communist Party cadres to ensure that elites, while benefiting from rent seeking, were accountable for delivering their end of the bargain, namely, economic growth. Many, including Keefer (2007), suggest that the lack of accountability mechanisms among rent-seeking elites in MENA led to stagnation in the private sector in the region (Olsen 2000). Although rent seeking was entrenched, rent-seeking elites were never certain that they could appropriate rents indefinitely. In response to that uncertainty, incumbent firms probably invested at a relatively lower rate and skewed their investment choices toward activities with low value added and fast returns and away from longer-term investments

with higher returns, such as investments in innovation. Interestingly, some countries used export processing zones to capture the growth potential from export industries driven by foreign direct investment, without losing their grip on domestic economies and control over domestic rent distribution. According to case studies in Jordan and Tunisia, the special policy environment (virtually free of red tape and at times anchored in international agreements) in export processing zones greatly facilitated their export performance, because these zones offered greater stability to foreign investors and allowed exports to thrive.

Discretionary access to credit

With the sole exception of Sub-Saharan Africa, firms in MENA, small and large, have the lowest access to credit in the world.[2] Just as important, banks in the region have highly concentrated portfolios focused on large enterprises. For example, countries not part of the Gulf Cooperation Council (GCC) have the highest ratio of top 20 loan exposures to total equity (World Bank 2011). Standard and Poor data showed that in 2006 in Egypt, for example, more than 50.0 percent of loans were held by state-controlled banks; using data from the Central Bank of Egypt, the World Bank (2006) concluded that 0.5 percent of total borrowers received more than 50.0 percent of total credit given to the private sector (see also Keefer 2007).

Access to credit can be skewed and limited for many reasons, including the lack of properly developed accounting and auditing systems in firms, high rates of tax evasion, limited development of legislation that would allow firms to collateralize their assets, and the very limited depth of nontraditional sources of financing, such as financial markets (World Bank 2011). At the same time, the strong concentration of credit could be seen as an instrument for limiting entry and rent seeking to an elite group, particularly in countries where banks were traditionally state owned. Under this interpretation, the limited development of policy instruments for improving credit access could be an endogenous outcome of the political-economy equilibrium described earlier.

Organized labor: Partners in and challengers of the status quo

Traditionally, unionization has been low in MENA. The data and literature suggest that union representation has been largely limited to workers in the public sector and in privatized public enterprises, but it has rarely been present in the rest of the private sector. Forteza and Rama (2006) estimated that about 16 percent of the workforce in MENA countries was unionized during 1970–99, a percentage well below that of industrial countries (37 percent) and slightly below Latin America (18 percent). Cherkaoui and Ali (2007) estimated that unions covered about 5 percent of the workforce in Morocco. According to survey data, in 2006, about 22 percent of Egypt's labor force was unionized; in 2009 in Jordan, 6 percent of workers in the public sector and 11 percent in the private formal sector were unionized.

Since independence, labor unions have been a unique social force within the architecture of Arab political regimes. The relationship between organized labor and central governments followed a rather similar pattern across countries in the region, as organized labor acted as an explicit partner in state-led industrialization and modernization (table 10.1). As an Egyptian scholar and labor activist defined it during a series of qualitative interviews conducted for this survey,

> The rule of the unions is, usually, to provide a direct and regulated way to solve the workers' problems. This was not the case in Egypt, since workers had no representation in these structures. Unions were only a bureaucratic figure to stabilize the political and economic regime, after the revolution of 1952. The way workers used to solve their problems was by getting around [them], or in [the] worst case scenario by quitting their jobs.

TABLE 10.1 Historical structure of unions in selected countries in MENA

Country	Structure	Affiliation
Morocco	Three unions	Loose party affiliation
Jordan	Single union	Not affiliated
Egypt, Arab Rep.[a]	Single union	Party affiliated
Tunisia[a]	Single union	Party affiliated
Algeria	Single union	Party affiliated
Syrian Arab Republic	Single union	Assimilated to single party
Iraq[a]	Single union	Assimilated to single party

Sources: Gobe 2008; Paczynska 2006; Posusney 1997; Posusney and Cook 2002; Zakaria 2006.
Note: MENA = Middle East and North Africa.
a. Describes the setup before the revolution in the Arab Republic of Egypt and Tunisia and regime change in Iraq.

For instance, in Tunisia, the state-sanctioned tripartite organizations covered all sectors of the economy: white- and blue-collar workers were organized through the Union Générale des Travailleurs Tunisiens, the business class through the Union Tunisienne de l'Industrie, and rural workers through the Union Nationale des Agriculteurs Tunisiens. Similarly, since Nasser's time, Egypt had followed a corporatist structure, exemplified by the fact that the Ministry of Manpower also served as head of the national trade union's confederation. Jordan maintained a single official union, while Morocco's model stands as unique with three official unions, each linked to one of the main traditional political parties, often competing for workers' support (Posusney 2003).

The special role that unions played in the state architecture granted them a somewhat more liberal treatment than that reserved for other civil society organizations, which were often repressed. In many countries, labor unions claimed a special legitimacy, because their birth often predated independence. Yet, following independence, unions were reconstituted and progressively subjected to government control in one form or another. In exchange, their members were guaranteed what could be seen as a privileged distribution of government rents, through higher salaries, nonwage benefits, and protective labor legislation (Gobe 2007).

Despite these controls, labor unions represented the main and sometimes the only (managed) outlet for popular participation. The history of labor market reforms in Egypt and Morocco during the decade of liberalization in the 1970s illustrates the leading role that unions played in shaping labor legislation and the governments' reluctance to embrace sweeping reforms, even when under pressure from domestic and international investors. During these reforms, unions obtained important concessions such as legal space for public expression, the right to strike (granted for the first time), and only mild changes to severance conditions for the existing stock of workers (Paczynska 2007; Zakaria 2006). More recently, unions played an important role in Tunisia and Egypt in the months preceding the Arab Spring revolutions in 2010 and 2011.[3]

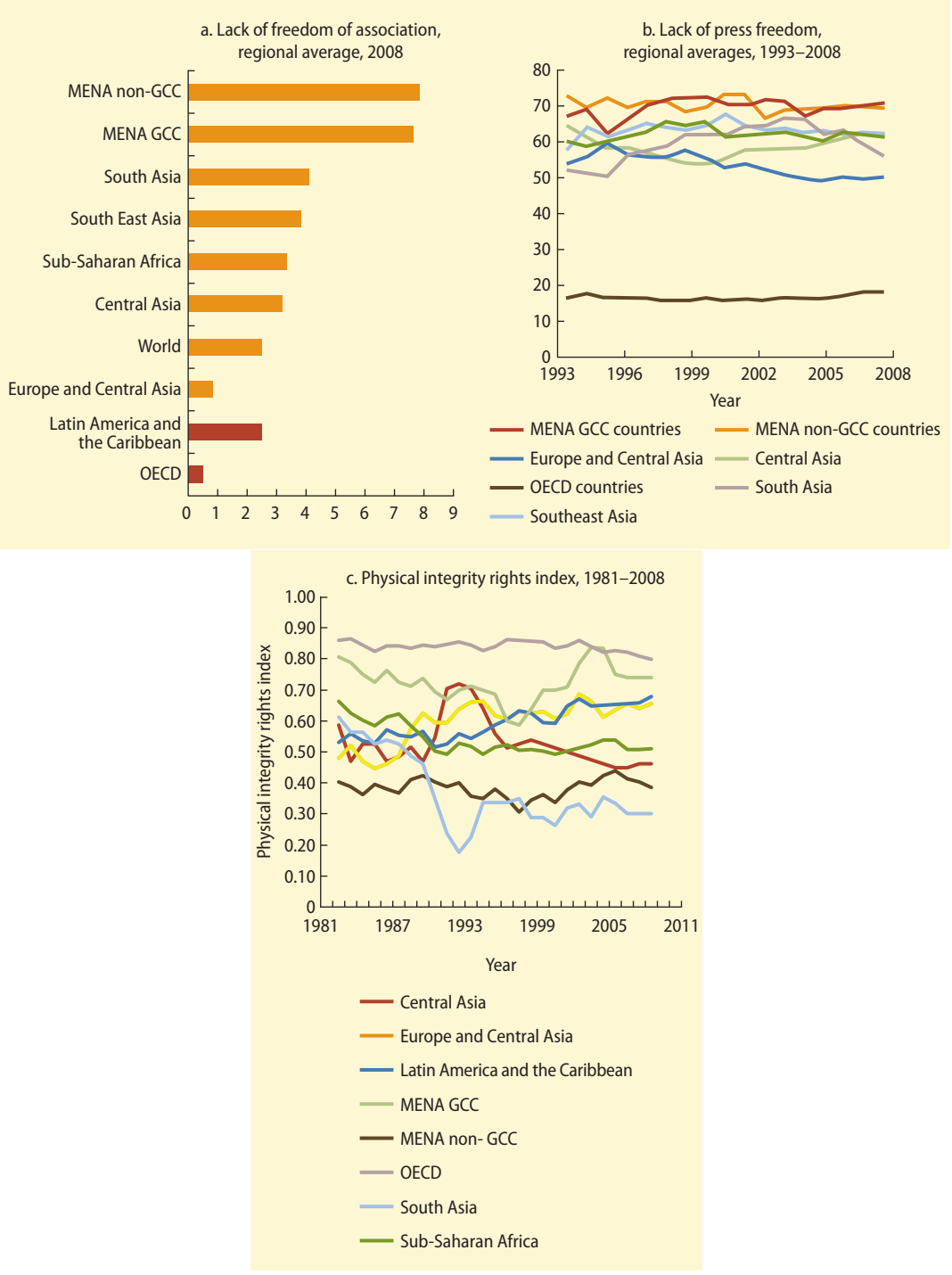
Limits on civil society and access to information

Freedom of association, freedom of speech, and other civil liberties are key pillars of accountability in a society. Without data and information, however, civil society's ability to hold governments and institutions accountable is severely limited. In 2008, MENA ranked second to last in "freedom of association" and freedom of the press, and non-GCC countries in the region scored among the world's lowest on citizens' rights of physical integrity[4] (figure 10.1).

In addition, citizens' lack of access to relevant data could remain a major roadblock to inclusive development in MENA. Access is limited partly by explicit legislative provisions and partly by limited capacity (which is itself a product of a prolonged lack of access to data).

Table 10.2 illustrates how nearly all countries in the region either do not produce or rarely share statistical data in a way that can be used for independent analysis or policy making. Even data sharing between ministries and the national statistics offices is often limited to a few specific datasets in most MENA countries.

FIGURE 10.1 **Civic freedom indicators for world regions and OECD countries, various years**



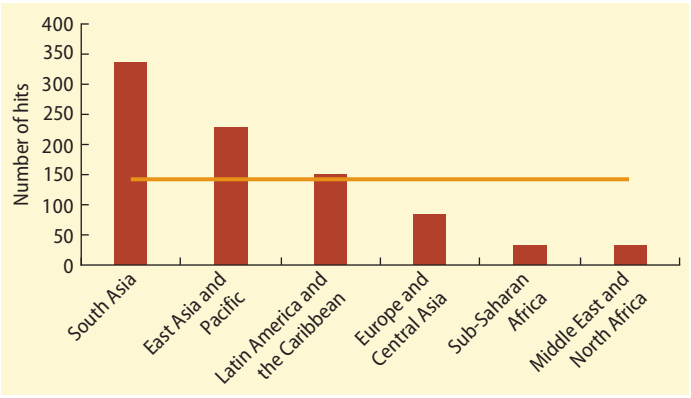
Source: Based on CIRI Human Rights Dataset and Reporters without Borders 2012.
Note: OECD = Organisation for Economic Co-operation and Development; MENA = Middle East and North Africa; GCC = Gulf Cooperation Council. Physical integrity index is calculated as a two-period moving average.

TABLE 10.2 Access to and quality of survey data in MENA

Survey data access	MENA countries
Economies with no survey data for studying living standards or that conducted surveys but have not released the data even in aggregate form	Algeria, Bahrain, Kuwait, Libya,[a] Saudi Arabia, Oman, and Qatar
Economies that have systematically collected nationally representative household data (at least since the 1980s in the case of the Arab Republic of Egypt, the Islamic Republic of Iran, Jordan, Morocco, and Tunisia). Data access policies vary strongly. Tunisia published the anonymized microdata from its labor force survey online following the revolution. Access to microdata in the Islamic Republic of Iran is officially permitted but in practice is ad hoc. The remaining countries share data only in exceptional cases, or provide only subsets of data.	Egypt, Arab Rep.; Iran, Islamic Rep.; Jordan; Lebanon; Morocco; Syrian Arab Republic; Tunisia; and United Arab Emirates
Economies that relatively recently started regular collection of microdata and grant access relatively freely. Iraq and West Bank and Gaza publish the data and the methodology on the Internet.	Djibouti; Iraq; West Bank and Gaza; and Yemen, Rep.

Source: Scott and Yemtsov 2010.
Note: MENA = Middle East and North Africa.
a. Libya recently conducted a household budget survey and turned to international agencies for help in the analysis of its results.

FIGURE 10.2 Number of publications on labor markets with data from six world regions in the EconLit Directory, 2010



Source: EconLit, 2010 data.
Note: Data capture the number of hits for "labor markets" and "region" on Econlit (database of the American Economic Association).

Moreover, technical limitations sometimes prevent countries from sharing data with users,[5] as the dissemination of data requires proper documentation of the microdata, cataloguing, platforms, and the technical skills to respond to criticism and questions, which countries lack. In fact, when accurate data, in raw or capably processed form, rarely reach citizens, they cannot develop informed opinions about political decisions. In fact, there is evidence that microdata on MENA are used relatively little in key research areas such as labor markets and social protection. As shown in figure 10.2, MENA has the least publications in these areas worldwide (Angel-Urdinola, Hilger, and Ivins 2011).

Consequences of limited data for social dialogue

Through lack of access to data, many citizens and social partners in MENA have been unable to make their voices heard in the public debate and in the related political decisions that affect their interests. As a result, political consensus often rests on the exclusion of those without a voice.

In labor market regulations, for example, choices regarding the regulation of work hours, types of contracts and their protection, wages and their elements, and social insurance and its contributory base affect many people and need to be discussed and settled in a public and legitimate debate. A well-studied example in the empirical literature is the dynamics of wage bargaining, in which trade unions allow only employed members to vote

on wage agreements (a common practice in most countries). The unemployed, who would usually benefit more from a wage reduction that could lead to an increase in jobs, cannot vote. Consequently, such negotiations rarely result in stagnating or lower wages, even if this outcome would improve the overall labor market (see, for example, Benassy 1995; Gaertner 1981). This division between insiders (employed, voting union members) and outsiders (unemployed, nonvoting) is particularly insidious if the unemployed are largely first-time entrants into the job market. Some youth activists in MENA have already recognized and voiced this particular concern (Cheikhrouhou 2012).

Challenges and opportunities in the post–Arab Spring

Chapters 7 through 9 highlighted the importance of moving towards broad-based growth as an essential precondition to sustained job creation. Will the Arab Spring be followed by opportunities to untangle the web of privilege that has so far hindered this process? An in-depth analysis and interpretation of the Arab Spring are beyond the scope of this work, but the following section documents both the opportunities and the risks inherent in fostering a more inclusive development model.

Post–Arab Spring governments in MENA face important changes. In some countries, democratic elections transformed the political landscape. Citizens are embracing new liberties, forming associations and parties, and developing alliances of parties. At the same time, new (and existing) governments are under tremendous pressure to deliver results in a context of high institutional uncertainty. For instance, in Tunisia, the number of labor strikes in both public and private enterprises has risen steadily since the Arab Spring.[6]

There is a risk that governments will respond to this heightened pressure with populist measures that alleviate political pressure but are costly and do not constitute a step toward more inclusive growth. Those who are not benefiting from the current redistribution of rents and economic benefits will likely continue to pressure governments. The persistent risk is that these outsiders want to become the system's new insiders without changing the rules that excluded them in the first place: in other words, they seek to become the new elites.

Prima facie evidence reveals the extent of these pressures on governments since the beginning of the Arab Spring. For example, several countries have resorted to bulk hiring of groups of job seekers queuing for public employment in specific sectors (Morocco, Tunisia) or have created permanent posts for all temporary employees (Egypt). In Tunisia, there has been discussion of lowering the standards and moving away from merit as the main criterion for hiring certain categories of public workers. The government in Morocco recently incorporated a wave of unemployed graduates, setting aside the traditional entry examination because of concerns over social unrest. Egypt implemented only the popular part of a legislated pension reform (an increase in the minimum pension) without addressing less popular elements essential to ensuring fiscal balance. As the Arab Spring unfolded, nearly all governments in the region offered important wage increases for public sector workers, often coupled—in resource-rich countries—with one-off cash transfers to all households or to households of public employees (table 10.3). Although these measures clearly responded to rising consumer prices, they did not ultimately target the most needy.

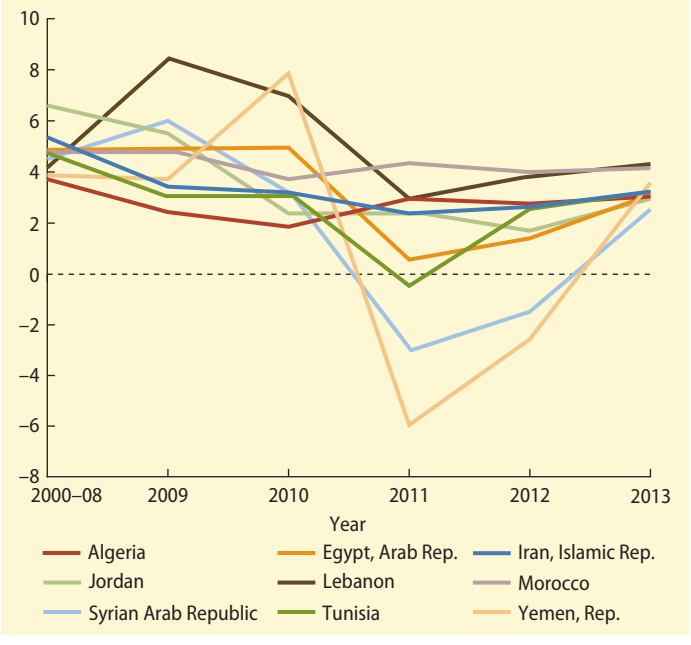
In the midst of a slump in gross domestic product and fiscal revenue (figure 10.3), such measures are fiscally unsustainable, and continue to preserve rules and incentives that keep current expectations and attitudes in place. For example, based on rigorous evidence from a randomized impact evaluation, an entrepreneurship training program in Tunisia improved participants' move from wage to self-employment but did not change the young participants' aspirations for a public sector job (Premand et al., forthcoming). If the terms and conditions of public sector employment remain the same, young graduates will

TABLE 10.3 Extraordinary policy measures implemented during the Arab Spring in MENA, 2011–12

	Special salary increases in public sector	Special financing in food subsidies/price controls	Special tax cuts	One-off Transfers	Bulk expansion of public sector hiring
GCC					
Bahrain	Y	Y	Y	Y	Y
Kuwait	Y	Y		Y	
Oman	Y	Y		Y	Y
Saudi Arabia	Y			Y	Y
United Arab Emirates		Y			
Qatar	Y				
Developing oil exporters					
Algeria	Y	Y			Y
Iran, Islamic Rep.				Y	
Syrian Arab Republic		Y		Y	
Yemen, Rep.	Y	Y	Y	Y	Y
Oil importers					
Jordan	Y	Y	Y	Y	
Lebanon				Y	
Egypt, Arab Rep.	Y	Y		Y	Y
Tunisia	Y	Y	Y	Y	Y
Morocco	Y	Y		Y	Y

Source: World Bank 2012b.
Note: MENA = Middle East and North Africa; GCC = Gulf Cooperation Council; Y = yes; [blank] = no.

FIGURE 10.3 Growth in GDP forecast for non-GCC countries in MENA, 2000–13



Source: World Bank 2011.
Note: MENA = Middle East and North Africa; GCC = Gulf Cooperation Council; GDP = gross domestic product.

continue to have an incentive to queue (see chapter 2). Similarly, interviews with leaders of the emerging labor movement conducted for this report in Egypt and Tunisia reveal that their members often aspire to a more inclusive but still public sector-centered social contract, with no acknowledgment of the fiscal unsustainability of this model. Extending public employment would indeed respond to these demands, but it would not reduce segmentation in labor markets or promote more inclusive growth.

Enabling a broad reform process: Examples of successful transitions

Part 2 of the report explained in detail the many reforms that would need to take place to bring countries to a higher-productivity path. This section highlights reforms from outside the region that have at least in part moved toward a more inclusive growth model, with a particular focus on the reform process.

Including broad-based change in the political agenda

Prototypical reform processes usually start by bringing the reform topic into public debate and onto the political agenda, followed by actions to generate buy-in among stakeholders and build a consensus of approval.

This dynamic can be heightened in electoral periods in which political parties must compete with different agendas and lead debates around their reform topics. A popular and relevant combination of agenda items is crucial for scoring an election victory. One relatively recent example is the landslide win of the Turkish Justice and Development Party (AKP) under Tayyip Erdoğan in the early 2000s, backed by a broad reformist agenda (box 10.2).

Citizen discontent is another frequently used channel for bringing items into the political debate, independent of a country's

BOX 10.2 Structural reforms under broad-based politics: Turkey's Justice and Development Party in the 2000s

Turkey's fast and equitable growth performance over the past decade is often attributed to the bold reforms and prudent policies implemented by the country's ruling Justice and Development Party, democratically elected for a third consecutive term in a landslide victory in June 2011. The party's success in balancing the requisites of macrostability and inclusive growth under its leader, Recep Tayyip Erdoğan, contains important insights for governments in MENA, as the gains from bringing together diverse collective interests behind a reformist agenda were significant.

The traditional support base of the AKP comprised the small- and medium-sized entrepreneurs in the Anatolian heartland. Yet the party's commitment to macrostability, market-driven development, and the democratization of Turkey also drew endorsement from the well-organized, Istanbul-based big businesses. This enhanced support from employers was instrumental in consolidating structural reforms initiated in the aftermath of Turkey's financial crisis in 2000–01, including particularly challenging reforms in banking and public financial management.

Beyond the big cities, the AKP government has promoted expansion of the economy's centers of dynamism by establishing regional development agencies, stepping up regional investment supports, and maintaining close relations with attendant business organizations. Beneficiaries were an array of smaller but rising Anatolian firms.

Particularly relevant in this regard is the AKP's broad public appeal. Erdoğan's socially conservative yet solidarity-oriented rhetoric attracted wide segments of Turkish society that had felt excluded by the country's top-down modernization experiment led by secular elites. Building on this popular momentum, AKP leaders emphasized social justice and inclusive growth. At the local level, AKP-run municipalities implemented social aid programs, at times relying on the party's extensive grassroots organization. This strategy was complemented at the national level by increased spending on health and education, high agricultural subsidies, and improvements in the quality of public services.

A broad electoral coalition also entails policy compromises, as illustrated by Turkey's enduring labor market challenges. The few changes include a 2003 law that provided a legal context for temporary contracts, the introduction of a modest unemployment insurance scheme, and, more recently, targeted incentives provided to employers' social security premiums and new programs for vocational training as part of the government's policy mix to counter the global crisis of 2008–09. On the whole, however, the Erdoğan government avoided dramatic shifts in labor market arrangements that could upset its social partners. As a result, Turkey's labor regulations remain relatively rigid, with strict employment protections guaranteed under high severance payments. Minimum wages are also set consistently above regional averages. In addition, despite a mass privatization drive, the number of public employees increased through new recruits, and public salaries were raised in recent years. Currently, the government is finalizing a new employment strategy, which has been put together after wide

(continued next page)

BOX 10.2 Structural reforms under broad-based politics: Turkey's Justice and Development Party in the 2000s *(continued)*

consultations with related stakeholders and which will bring further modifications to the system.

An important lesson to be drawn from the AKP case is that a broad policy base does not necessarily ensure far-reaching reforms in all areas. It does, however, provide a necessary platform for social deliberation, from which sustainable solutions might follow. Turkey's remaining labor market woes, including low activity rates, a high incidence of informality, and a low participation rate among women, are primarily the result of structural constraints such as the country's industrial profile and accelerated rural-urban migration in the past decade. Given the delicate balance of collective interests upon which the AKP's electoral coalition rests, the party opted not to address these issues through radical, top-down reforms. Instead, it chose a more careful approach, involving repeated consultations and a series of policy experiments.

Source: Guven 2012.

form of governance. By way of illustration, Turkish citizens experienced growing discontent with the patronage politics of the ruling ANAP Party in the 1980s. The nascent debate was directed against state economic enterprises, public banks, and public sector contracts, and citizens urged the government to make this a part of its reform agenda.

Further, factors external to a government's current scope of action can be strong push factors and can shape both public debate and policy agendas. Many, including Duval and Elmeskov (2005) and Høj et al. (2006), suggest that big economic crises are associated with higher overall reforms. Crises often increase the costs of avoiding reform; for example, unaddressed labor market rigidities can slow labor market adjustments to a crisis (Forteza and Rama 2006).

Building stakeholder buy-in based on shared benefits of change

Building stakeholder buy-in on reform requires creating a strong narrative that stresses the importance of aggregate social gains. To return to the example of Turkey in the early 2000s, the AKP managed to package its reformist agenda in a way that attracted support from interest groups that did not traditionally support the party (box 10.3). That support was crucial to consolidating challenging structural reforms, especially in banking and public financial management, following Turkey's financial crisis in 2000–01.

Building buy-in also requires identifying and mobilizing segments of the population that would benefit from the proposed reform but either do not know it or lack the means to voice approval. This subject has been well researched in the context of labor market reform. For example, data from the Organisation for Economic Co-operation and Development show that employees with limited skills, the unemployed, and youth have higher rates of approval for increasing contractual flexibility in the labor market, suggesting that labor market reform would be more likely if outsiders represented the majority of the labor force (see Bentolila, Dolado, and Jimeno 2011; Dolado, Jansen, and Jimeno 2002). This effect can combine with the aforementioned external "crisis" effect. Saint-Paul (2002) found that reforms occur at a "tipping point" when unemployment is rising, not just when it is high, because the employed—the labor market insiders—are in danger of losing their jobs. It is important to note that these findings apply only when outsiders have the information to understand the consequences of specific policy designs and are equally represented.

Once stakeholders' buy-in is secured, actual approval of the reform package will

BOX 10.3 Lessons from Turkey's reform in the 1980s

During the 1980s, Turkey experimented with a variety of reforms, particularly fiscal and trade reforms. The variation in economic and political outcomes provides important lessons on what to do and what not to do.

Balance of achievements

Turkey succeeded in the structural transformation of its economy: the share of output for export rose from 5 percent in 1979 to 23 percent in 1989, and real output roughly doubled. Turkey's financial markets opened internationally, in stark contrast to the situation before 1980, and have since developed depth and sophistication. Even in areas where the program was judged a failure as of the end of 1991—for example, in reducing fiscal deficits, inflation, income inequality, and the size of inefficient public enterprises—the transformation of trade and finance fundamentally altered the context of the problems and changed the options available to the government.

Unbroken privileges

While the reforms of the early 1980s greatly reduced the importance of rent seeking, particularly with regard to foreign trade, patronage politics by the ruling ANAP Party became more widespread in the latter half of the decade. As individuals or firms with direct access to the government proliferated, the favors they managed to obtain led to growing resentment in the wider populace. Many people became disaffected by the ANAP's arbitrary distribution of rents. Traditional sources of patronage politics included state economic enterprises, public banks, and public sector contracts. The extrabudgetary funds created new avenues for rent redistribution.

Empowered technocrats

In retrospect, the failures of macropolicy in the latter 1980s can be traced to three forces. First, a broad consultative process was not institutionalized to cultivate popular support. Second, the top bureaucrats lacked autonomy from the politicians and hence were unable to counteract pressures that led to expansion of the fiscal deficit. Third, there were problems of coordination and conflict within the bureaucracy itself. The highly centralized policy apparatus created in the early 1980s proved useful in initiating and sustaining reform through its early stages. Yet insularity and lack of institutionalized links with interest groups increasingly turned out to be a disadvantage for coordinating policy and managing distributional conflicts under conditions of fully competitive politics. Political management of a reform process requires building coalitions with interest groups—developing each part of the reform package so that it contributes to the overall objectives of the program and at the same time satisfies the relevant groups enough for them to support it, even if other parts are not to their liking.

Speed of reform

A large portion of the reforms were initiated at two critical times when the government had a mandate for dramatic action: the 1980 balance-of-payments crisis and the postdemocratization honeymoon of 1983–84. Making reforms rapidly was important at these junctures. Later in the 1980s, as the democratic process became more routine, reforms succeeded when they were carefully prepared in consultation with the groups affected. Both crash programs and gradualism were thus appropriate, each under different circumstances.

Source: Adapted from Onis and Webb 1992.

depend on how the reform affects the interests of different constituencies. When losers from the reform are more organized and vocal, even reforms that bring aggregate gains can be blocked. This outcome often occurs when labor market reforms affect the benefits of unionized (and therefore vocal) workers, rather than the unemployed or informal workers, who are likely to benefit from more flexible labor markets but are not usually organized.

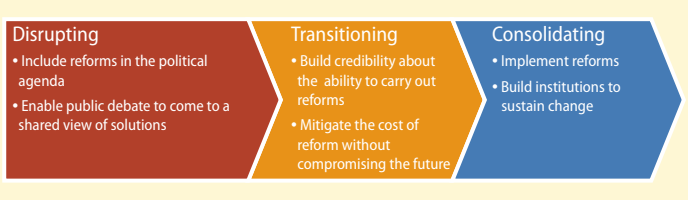
Policy makers adopt a variety of strategies to protect the rights of insiders while engendering change: (1) packaging reform so

that some of its elements satisfy the relevant groups enough for them to go along, even if other parts of the package are not to their liking; (2) focusing on strengthening nascent sectors or areas where incumbents are not already entrenched (such as highly innovative export sectors) to build a new constituency for change and create jobs without directly confronting vested interests; and (3) grandfathering—in other words, applying new rules to new entrants and securing agreement from the beneficiaries of the old rules, whose privileges remain intact. Turkey's experience in the 1980s illustrates the benefits of packaging reforms (trade and macro) to make them more politically acceptable. Export subsidies in the form of low-interest credit and tax rebates played an important role in building a pro-export coalition, which could in turn buy support for more conventional instruments such as exchange rate devaluation and import liberalization (box 10.3).

Reforming for broad-based employment growth in a post–Arab Spring MENA

Some of the necessary reforms for making the private sector, the labor market, and the skills systems move toward higher job creation will be costly to many groups in the short run, even though such reforms promise growth and benefits in the future. Behavioral evidence shows that people strongly prefer avoiding losses to acquiring gains (Tversky and Kahneman 1991). It is therefore important to accompany changes to the status quo with other measures that facilitate the transition to a new state: that is, measures that build the credibility of the new government and mitigate the future cost of reforms. Given the pressure that governments receive to repeat "more of the same," it is also important that these transitory measures also be compatible with the new midterm agenda. Figure 10.4 illustrates this transition process toward reform.

FIGURE 10.4 Lessons from successful transitions: Steps in enabling a broad reform process



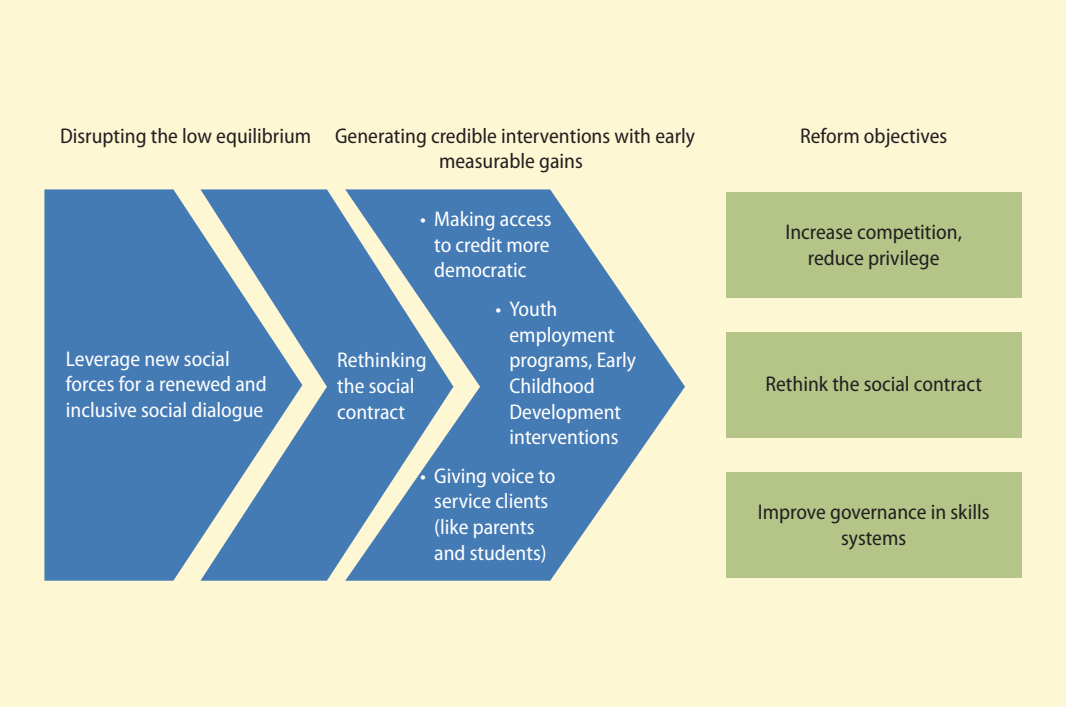
What follows is a nonexhaustive illustration of potential short-term actions that could facilitate the structural reforms highlighted in the previous section: (1) leveraging the new social forces for change; (2) improving access to data and information and freeing restrictions on political dialogue to allow a constructive and broad-based debate to take place; and (3) scoring early wins that generate credibility and mitigate the cost of reforms, without compromising midterm objectives. These short-term policy actions include both general approaches, which are conditions for change in all areas of the jobs agenda discussed in the report, and "low-hanging fruit" for each sector. Figure 10.5 provides a diagrammatic summary.

Leveraging new social forces for a renewed and inclusive social dialogue

A new political landscape is shaping the region, affecting both established social partners (trade unions, employers, legislative bodies, and government) and new social partners (civil society, youth, women, the unemployed, and informal workers). These new groups have not been part of traditional tripartite negotiations on issues such as wages and labor market policies. Similarly, the private sector in a number of countries is still unable to organize in independent associations and raise funding from members (World Bank 2009).

Having all stakeholders at the table will contribute to building a shared view of labor markets and barriers to private sector development. A number of measures could facilitate this inclusive process. Examples include reforming regulations on the rights of civil society organizations, workers, and

FIGURE 10.5 **Short-term policies and reform objectives**



employers to organize; opening up the dialogue on reforms to nontraditional actors (representative employer associations, nonunion representations, and so on); adopting new channels for large-scale communication and consultation; engaging organized labor and civil society as agents with concerns beyond the short term, something that political parties often cannot afford to do; and building national capacity for providing and analyzing information so that outsiders can offer substantive proposals and eventually build shared views on how to foster employment.

Improving access to data and information

Even in the political economy of MENA, difficult reforms can be achieved by using data and engaging in a national dialogue to arrive at a shared view of the issues and a negotiated solution. Social insurance reform in Jordan is one rare example (see annex).

This kind of feedback and learning can also be provided in joint international survey and assessment initiatives, such as those under way in the education sector (the Programme for International Student Assessment, or PISA, and the Trends in International Mathematics and Science Study, or TIMMS). The Russian experience shows that "breaking the monopoly" of the statistics office can be a driving force in improving data quality and access (box 10.4).

Without access to trusted data about the state of the economy, however, the ability of civil society and media to fulfill this function is extremely limited. Scientists need to be able to publish research results using data, without direct or indirect censorship or pressure, and journalists need to be able to access both statistical data and scientific results, interpret them, and present them to the wider public. Therefore, it is key that governments, especially their statistics offices, allow the public to have access to all relevant economic and sociodemographic data, at the anonymized

BOX 10.4 Data access in the Russian Federation

Over several years, the Russian Federation moved from maintaining the complete secrecy of its main household budget survey (HBS) toward posting survey data on the Internet in a downloadable form. The process started in 2001, when increased public attention to poverty reduction and monitoring forced Russia's statistical agency (Rostat) to engage with researchers and international donors to review its practices and procedures. By 2007, micro datasets from several years of HBS were available free from Rostat's website (http://www.gks.ru). Several internal factors combined to produce this change:

- A decade-long effort by Russian researchers (supported by donors) to collect public-access household survey data challenged Rostat's monopoly and helped build a critical mass of expertise outside the main government agency.
- A policy decision to move to greater transparency and performance-based budgeting was initiated by the Ministry of Finance in the late 1990s and accelerated by the financial crisis of 1998–99. The Ministry of Finance made "open access" a key dimension of performance indicators for Rostat.
- A parallel advocacy campaign targeted Rostat officials, making them aware of international practices and professional standards. The World Bank supported Rostat's exposure to international standards through study tours of data access practices and technical assistance for preparing anonymized microdata ready for dissemination, which reduced the cost of public access to Rostat data.

Source: Programmatic poverty assessment for Russia, cited in Scott and Yemtsov 2010.

individual level.[7] A number of approaches can help, as discussed below.

Limits on researchers' access to anonymized individual records can be reduced, along with contradictions within the law or between the basic statistical law and any derived decrees. Removing procedures that introduce a high degree of discretion in granting access to data, such as requiring personal authorization from the head of the statistics office or even ministerial approval, could eliminate bottlenecks. Tunisia is a recent successful example of overcoming legal and other barriers to data access. A June 2011 decree on access to information clearly indicates that anonymized individual data must be made available to the public by the national statistics office before June 2013.

To support evidence-based policy making, statistics offices need the capacity to carry out large-scale household surveys to provide data that are comparable over time, are representative at a sufficiently disaggregated level, and meet other standards. The exchange with experts and outside data users is critical to providing feedback and improving the quality of data. Statisticians inside the office and in academia need to work on the data to produce results and feedback for future surveys. When data are not accessible and their use is limited, statistical offices do not benefit from the feedback from data users and, in turn, have little or no incentive to improve measurement, precision, and survey design.

In this context, labor market observatories (LMOs), especially when independent from the government, can provide an external quality check and a trusted source of analysis and information (Rutkowski 2011). As issues of trust cannot be ruled out where data are concerned, appointing an independent institution to produce the relevant labor market statistics can be beneficial to all. LMOs can improve the quality of labor market information and enable labor market actors to make more informed choices. The role of an LMO is usually to use existing data more efficiently, to fill data gaps through new special surveys, and also

to help articulate evidence of employers' needs. Using the new and better data, policy makers can then tailor policies more closely to regional labor market conditions, and employment offices can match job seekers and vacancies more efficiently. Educational institutions can adjust curricula in response to changes in occupational demand, and students and job seekers can invest in skills that are in demand.

Some specific tools can improve the likelihood that LMOs will succeed and mitigate the risks of failure. Reporting arrangements are important. If LMOs report to regional authorities and not to the regional labor office, they naturally have a broader focus on the labor market rather than just unemployment. This arrangement also makes it possible for LMOs to evaluate the performance of the employment office. Selecting LMOs through competitive bidding can also ensure that the best capacity is mobilized. Box 10.5 illustrates the successful use of LMOs in Poland.

As the example of the LMO in box 10.5 shows, the quality and reach of dissemination are the keys to useful data. Dissemination should include existing surveys (survey summary reports) and administrative data, such as monitoring data on employment programs and vocational training. It should also include international benchmark surveys, such as PISA, TIMMS, the Progress in International Reading Literacy Study, and the

BOX 10.5 Labor market observatories in Poland

Poland established labor market observatories to improve the understanding of labor market performance and to produce much-needed information on regional and local labor market conditions and trends. This information was also intended to inform the allocation of budgets in local labor offices and employment programs. The country established 16 regional LMOs, 14 in a top-down procedure by the Ministry of Regional Development using European Union funds, and 2 in a demand-driven, bottom-up initiative of regional labor offices (RLOs). All LMOs operate under the RLO and are not independent (see table B10.5.1).

LMOs typically use a rich array of data to monitor the labor market: (1) administrative data from local labor offices on unemployment, vacancies, and active labor market programs (expenditures and participants); (2) data provided by the national statistics office, broken down by region, such as labor force surveys and employment and wage data; and (3) data from special-topic surveys (usually "sociological"). Currently, administrative data are underutilized compared to survey data. Data collection and monitoring of regional labor market conditions can be done in house or contracted out.

LMOs typically publish a variety of information: monthly bulletins (in paper and electronic versions), which include regular monitoring of both regional and local labor market conditions (such as trends in unemployment, the structure of unemployment, and trends in job vacancies) but no analysis; newsletters

TABLE B10.5.1 Main differences between the two types of labor market observatory in Poland

Bottom-up initiative	Top-down initiative
Regular activity of RLO	Temporary project (e.g., for 3 years)
Financed initially (mid-2000s) by RLO, then ESF	European Structural Funds
Objectives defined by RLO: Development of labor market diagnostic capacity of RLO	Objectives defined by the project: Output indicators (e.g., number of studies/workshops/publications)
Labor market analysis done in-house by LMO staff; surveys contracted out to research institutions	Analysis and surveys contracted out; LMO acts as a management unit
Research staff: 4–5 people Administrative staff: 5–10	Administrative staff: 5–10
Budget: €0.2 m per year	Project budget of €0.7 m–€1.0 m for 3 years

Source: Rutkowski 2011.
Note: LMO = labor market observatory; RLO = regional labor offices; ESF = European Structural Fund; m = million.

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BOX 10.5 Labor market observatories in Poland *(continued)*

(monthly or quarterly), which report on activities and signal upcoming events (workshops, conferences); and reports summarizing the results of special surveys. LMOs can also offer workshops and conferences for stakeholders on study design and results. Some LMOs issue biannual "labor market mismatch" reports, which assess the supply of and demand for labor by occupation. One LMO has an "occupational barometer," which is an assessment of labor shortages and surpluses by occupation done by local labor offices. LMOs disseminate their information on websites; in conferences for local experts, policy makers, and other stakeholders; and through the local media. Reports are sent to heads of regional governments, local labor offices, local education supervision bodies, and employer associations. They are also sent to other LMOs to share experience.

The actual use and appreciation of LMO data vary by type of user. Regional authorities find the data a valuable diagnostic tool that informs policy and raises awareness of regional labor market conditions. Local authorities find the publications useful but too complex to be effectively processed and used for policy purposes, and they consider them only loosely linked to the operation of the local labor office. Educational institutions find the data useful but too complex and not always relevant. Investors and employers are currently not very aware of the LMOs' work. Those who do use the data report favorably.

In Poland, the impact of LMOs on the labor market has been very positive. LMOs have become a platform for exchanging ideas, networking, and improving cooperation and coordination among stakeholders. Owing to improvements in the production and dissemination of information, employment policies are more closely aligned with the needs of local labor markets, public employment services are more responsive to the needs of employers, and investors and educational and training institutions are able to respond more effectively to local labor markets.

International Adult Literacy Survey, which are vital to signaling which skills are needed in the population at different ages. For the efficient use of data on individuals, researchers need an archive of household survey data with clear access criteria.

Dissemination of data can extend well beyond national boundaries, just as international educational benchmarks have spread. A regional data exchange can help unify standards and encourage peer review for better quality. At a more advanced stage, countries can also agree on standards for data sharing and dissemination and develop a monitoring mechanism for data access in the region, with periodic monitoring reports. The Program for the Improvement of Surveys and the Measurement of Living Conditions in Latin America and the Caribbean (MECOVI) initiative developed in Latin America in the late 1990s is one example (box 10.6).

Generating credible interventions with early measurable gains

The evidence shows that politicians in young democracies appear less able to make credible promises to broad groups of citizens: citizens are not sure if the new, inexperienced government can actually deliver on its promise; they are unable to hold the government accountable if it reneges on a reform promise; they are not sure if the government will gain from reneging at all; and those that benefit from a reform (winners) might not be sure of the power of the losers and whether the losers' influence might sway the government (Keefer 2007; Myerson 2009).

Under these circumstances, early and measurable gains could signal a young government's ability to deliver results and follow through with plans, despite a weak accountability structure or vocal opposition. At the

BOX 10.6 Improving statistical capacity through regional peer learning: The MECOVI project in Latin America

In 1996, the World Bank, the Inter-American Development Bank, and the United Nations Economic Commission for Latin America and the Caribbean jointly developed a program called the Improvement of the Surveys of Living Conditions (ISLC/MECOVI). The program was a response to the perceived poor quality typical of household surveys produced in the region. The capacity to produce policy-relevant data was limited, and datasets were rarely disseminated: statistical abstracts were usually all that was produced.

The project sought to engage countries at several levels. A limited set of countries received extensive support in a multiyear program to develop, implement, analyze, and disseminate surveys relevant to the policy discussions of the time and, most important, to welfare. A second and parallel effort supported regional workshops for all statistical offices on specific topics of interest (poverty lines, measurement of consumption and income, and the advantages of each in welfare analysis, for example). Third, two-week training courses were offered twice a year to bring data producers together with users to learn about developing policy-relevant surveys and basic analytical techniques. Finally, a database of all surveys available in the region was created and made accessible to researchers and policy makers.

When the program started, a key goal was to increase the access to data. Countries participating in the full program (4 originally, later expanded to 10) had to agree to a policy of public access to datasets. This position was very controversial in Latin America at the time. Interestingly, if one looks for data on Latin America today, many statistical offices offer the datasets on their websites and, instead of fighting users, are actively engaged with the research and policy-making community to improve the data and increase their use. While the message is still not universally accepted, the combination of providing incentives, of the demonstration effect (Peru's national statistical office made data publicly available and benefited from doing so), of the interplay between peers and counterparts, and of the long-term investment in increasing capacity in both surveys and analysis has paid off.

Source: Scott and Yemtsov 2010.

same time, governments must find a way to generate these early wins without compromising their capacity to undertake more significant structural reforms in the medium term. Both within and outside MENA, governments have made a number of innovative interventions that have relied on short-term, measurable gains and addressed the strong demand for inclusion, democratization, and accountability without compromising fiscal sustainability in the longer run. These interventions are compatible with a fiscally constrained environment such as the current one, and they target priority concerns for the region. These include:

- Reforms that facilitate women's transition into the labor force and that improve the employability of young people
- Interventions that fill infrastructure gaps with a view toward job creation
- Expansions of access to finance
- Changes that open up public services to citizens' participation

While the technical aspects of the broader reforms are discussed in more detail in part 2 of this report, the main lines of these interventions are summarized below.

Improving opportunities and employability through youth programs

New policy makers can choose from a rich array of tried and tested employment policies that target youth. These policies do not typically entail a political cost, and several are both sustainable and lay a good foundation for more difficult reforms later on. Examples of such policies include subsidizing the wages or social security contributions for women and young people; providing well-designed

active labor market programs; combining labor-intensive public works with training in job-specific skills for low-skilled workers; investing in early childhood development and home-based work; and helping youth create their own jobs through entrepreneurship training and coaching. To be demonstrably effective, these programs should have clear targets and be rigorously evaluated; and information on their outcomes should be accessible and broadly disseminated.

Facilitating female participation in the labor force

Early childhood programs targeting 0–3-year-olds are almost nonexistent in MENA, even though subsidized child care and preschool education represent a high-return public investment. A developed child care education industry could directly create a large number of jobs for women, while also allowing many more parents (young mothers) to be economically active. In addition, international evidence suggests that high-quality early childhood education and care help prepare young children to succeed in school and eventually in life. For example, they are associated with lower rates of grade repetition and lower dropout rates throughout a student's lifetime (Calahan and Tarr-Whelan 2006).

Filling important infrastructure gaps

Investment in infrastructure could be a natural "early gains" measure to create jobs in MENA because of its high labor content and its strategic role in connecting people to markets. The region could generate 2.0 million direct jobs and 2.5 million infrastructure-related jobs just by filling current domestic infrastructure gaps, according to a recent study (Estache et al. 2012). Apart from quick wins, the long-term employment effect of infrastructure investment in MENA could be significant: the employment response induced by infrastructure investment resulting in one percentage point of additional growth is expected to be 9 million additional jobs in the course of 10 years.

Democratizing access to finance

Given the severe restrictions on borrowing that many firms face, improving access to credit can be an important step toward lessening barriers to entry for firms and increasing employment, productivity, and general business development. The 2011 financial sector flagship report on MENA (World Bank 2011) laid out a clear road map for achieving the ultimate goal of democratizing access to credit. Although some of these interventions will take time, others could have an immediate effect on expanding access to finance for young entrepreneurs and small enterprises: (1) enacting laws to simplify borrowing and collateralization methods for small amounts; (2) permitting lenders to lend on the basis of personal evaluations and projected income streams; (3) permitting lending institutions to take deposits, if they can meet requirements that are practical as well as prudential; (4) supporting capacity building and product development for microfinance; and (5) ensuring that financial services effectively reach rural communities (WIEGO Network and World Bank 2008).

Opening up public services to citizens' participation

Improving the quality of social services is a visible intervention that can rapidly establish credibility for governments. When citizens can monitor the delivery of local services, the performance of service providers improves, and citizens' demand for greater inclusion is met in a highly visible way (Reinnikka and Svensson 2003). For instance, countries in other regions are allowing schools greater autonomy and are encouraging stronger local scrutiny from parents through the empowerment of parents' councils. In El Salvador, for example, giving parent committees a monitoring role and a budget led to measurable

BOX 10.7 Improving learning through parents' participation: Strengthening school councils in Morocco

A principal objective of the Programme d'Urgence of the Moroccan Ministry of National Education is to improve the quality of school life. Such improvement will require, among other things, reinforcement of supervision and monitoring and evaluation, especially of teachers. Past reforms in this area did not achieve the intended objectives. For example, for 2008, the Conseil Superieur d'Enseignement reported 80,200 days of unexcused teacher absences in lower secondary schools and 45,700 days in primary schools. A World Bank study in 2005–06 arrived at similar conclusions. A weak monitoring and incentive system for teachers did not help the situation. Efforts by school inspectors had limited effectiveness owing to geographic barriers and scarce resources, such as cars. The Conseils de Gestion (CdG)—that is, the official school management committees that include teachers, parents, and local stakeholders—were generally weak, and local stakeholders had little participation in school life.

New and innovative measures were needed to realize the Plan d'Urgence. The ministry therefore decided to explore the possibility of strengthening the CdG to serve as local guarantors of education quality. This action was inspired by international experience from El Salvador, which saw measurable improvements in learning achievement when school committees were empowered with a monitoring role and a budget.

A pilot experiment tested two ways of strengthening the CdG to determine which would yield the best results in learning and in pupil and teacher attendance. The ministry began planning a randomized pilot among lower-secondary schools that would include regular discussion forums, moderated by a local nongovernmental organization, in a first test group of colleges. The forums would formulate action plans to improve learning quality, and the CdG would be in charge of implementing the plans. Discussion themes could include, for example, pupil and teacher absenteeism, curriculum adherence, or infrastructure. The pilot also included a second test group, which would benefit from the forums in addition to the legal accreditation of the CdG as an association and a financial allocation to realize the action plan. A random sorting of colleges into one of the two test groups or into a control group would enable a rigorous impact evaluation.

In implementing the Plan d'Urgence, the ministry set forth several objectives for the pilot:

- *Discover mechanisms that offer effective incentives for teachers.* The pilot would test the extent to which the interaction with the local community could provide incentives through recognition and criticism of the teachers.
- *Prepare for decentralization in school administration.* The pilot would examine the extent to which the CdG could constitute a decentralized civic body of quality assurance.
- *Improve the quality of school life.* The quality forums under the leadership of the CdG would address all "quality" issues facing local schools.

The CdG pilot has been planned but has not yet been implemented.

Source: Grun 2009.

improvements in children's learning (Vegas 2005). A pilot project inspired by this experience has started in Morocco (box 10.7). Publication of data on performance and resource flows and the use of citizen scorecards for evaluating delivery are additional methods for increasing accountability.

Time for action in the Middle East and North Africa

With their natural resource wealth, young and increasingly well-educated populations, and strategic location near mature markets, countries in the Middle East and North Africa have tremendous potential. However, high and persistent rates of joblessness and low-productivity informal employment, along with a formal sector dominated by public employment, are clear indicators that the region is not making the most of its endowments. The great promise these countries hold has yet to be realized.

A comparative analysis of the region's employment dynamics suggests that the development model adopted by many

countries in MENA has failed to deliver enough good quality jobs—the kind of jobs that would have met the aspirations of the region's large youth cohorts. While the public sector played a key role in generating employment and raising living standards during the first decades after independence, demographics and global economic transformations now make a dynamic private sector the indispensable factor for sustained job creation. This report has shown in detail how the incentives for formal private sector job creation, productivity growth in firms, skills formation, and the efficient allocation of resources and human talent are stifled in MENA. Not only has this curbed the dynamism of the economy, but it has also produced inequitable outcomes that have been especially detrimental to women, young people, and the poor. The public sector and the state do have a vital enabling role to play, but this is a very different role from that seen in the majority of the region's countries at present.

Part of the underperformance in MENA is grounded in the complex political economy of the region, which also explains the inability of countries to embrace the reforms that could really change their development trajectory. In the years following independence, ruling elites consolidated their dominant position in society with a mix of limiting civil liberties on the one hand, and implementing populist policies on the other. The latter involved widespread fuel and food subsidies, and guaranteed public employment. During this time, elites were able to adopt economic strategies, such as enforcing policies only when it suited their aims, limiting openness to trade, and restricting access to credit and competition, which helped them secure large shares of the countries' economic rents. More importantly, this rent-seeking strategy held back the broad-based, inclusive growth process that is necessary to promote innovation and move the economy towards higher value added production.

The Arab Spring disrupted the political equilibrium in the region, and many countries are undergoing important and complex transitions. This presents a unique opportunity to break this system of privileges and move towards a new and more inclusive model of development. However, it also carries challenges. In particular, the new governments need to walk the fine line between responding to political pressure of different political groups—with risk of engaging once again in populist and fiscally costly policies without changing the rules of the game—and building ownership for reform. All of this in a context of high institutional uncertainty.

Many structural reforms will be needed to unburden countries from the legacies of the past and promote job creation. These include creating a level-playing field among firms, establishing a fair de facto investment climate, extending access to credit, rebalancing employment conditions between the private and the public sector, improving governance in educational and training systems and removing energy subsidies while protecting the poor and vulnerable.

The time for action is now. Global experience has shown that it is possible to produce tangible improvements in the lives of citizens in the short run without resorting to populist policies that might be harmful to the economy in the longer run. Improved social service delivery, short-term employment and skills development programs with well-designed temporary interventions for youth and the poor, and well-functioning social safety nets are but a few of the policies that can deliver early, visible, and measurable results. They can help new governments gain credibility, while a more open dialogue with the population, strengthened by open access to public data and information, builds consensus for the needed, longer-term structural reforms.

And if not now, when?

Annex Using data and dialogue to tackle a politically difficult reform: Social insurance in Jordan

An unsustainable social insurance system

The Jordanian pension scheme used to offer a very generous package, with early retirement at the age of 45, given a working period of 15 years for women and 18 years for men. Over time, more people opted for early retirement, with almost 80 percent of retirees choosing that option by 2008. In addition, there was no cap on pensionable salaries, allowing the rich and those who had some control over their stated salaries to earn extremely high returns on their contributions with large increases in the last few years before retirement. As a result, lower-income contributors and future generations were subsidizing the better-off.

Actuarial studies dating back to the 1990s identified these features as risks to the sustainability of social security. By 2026, Jordan's social security would have had to start liquidating the reserve funds to pay benefits, and by 2036, it would have exhausted all its reserves and would be in deficit.

A politically challenging reform agenda

The National Agenda of 2004 envisioned reforming social security by curtailing these unsustainable benefits; yet there was little appetite for reform, especially for early retirement, and little consensus on how this change could be accomplished. More important, the public had little or no understanding of *why* reform was needed. Although not unique to Jordan, lack of trust in the government made reform difficult. Reform of social security could easily trigger suspicions that the government wanted to cover up mismanagement problems or, worse, to signal a desire to use social security funds.

The Social Security Corporation (SSC) opted for raising public awareness about the sustainability of the status quo through a public awareness campaign, the National Dialogue on Reform. In early 2007, the SSC shared the results of its actuarial valuations with its main stakeholders, including the government at the highest policy-making levels and the tripartite structure of government, employers, and employees.

While the "need to do something" went down well among some (mostly in government), it did not go down well with those whose constituencies stood to lose—including contributors hoping to at least maintain their current level of benefits, if not increase them. Organized trade unions in particular actively resisted any attempt to tamper with the law. They questioned the credibility of actuarial reports, claiming that there was no problem to begin with or, if there was one, it was the fault of government and government should pitch in with the funds to fix it. It was clear that regardless of whether they understood the problem, many union organizers saw themselves as acting in the best interest of their constituencies, which meant resisting any change to the status quo. The common man or woman was more likely to be swayed by a mistrust of government and question the motives behind reform. The SSC was on the defensive.

A well-crafted public awareness campaign

At that point, the SSC decided to invest in a well-articulated public awareness campaign. The aim was to change the terms of the debate by attempting to get the messages across in simpler ways, to more people, and to cover more issues than just early retirement. The campaign was directed at universities, political parties, parliamentary blocs, municipal town halls, women's groups, youth and young entrepreneurs' associations, pensioners, nongovernmental organizations, and, not

least, the press. Methods to convey the message ranged from articles in the newspapers to TV interviews, public debates, and short documentaries. Many of the results were put in graphs and figures for policy makers and academics.

To address the issue of "credibility," the SSC offered Parliament the opportunity to identify any licensed actuary, firm, or individual to review the actuarial report, at the SSC's expense. While Parliament never took advantage of that offer, the offer itself helped bolster the credibility of the report.

In addition, to address arguments about "assumptions" about future demographic and behavioral factors, the SSC showed, in graphic terms, stylized examples in which individual workers contributed for the minimum vesting period required and then decided to retire and how much they would receive in benefits if, say, they lived an average lifespan. The results invariably showed that people would make more than they put in and potentially much more if they gamed the system.

To explain seemingly complex issues of financial sustainability in an intergenerational context, the SSC produced a simplified animation to show how, in the initial stages, contributions made by an expanding pool of employees far exceeded benefits paid to the few retirees. Then the animation showed that, as the system matured over time, the ratio of pensioners to workers grew, and illustrated the effects of increasing benefit payments and decreasing contributions. Next it showed the available pension funds gradually diminishing and the underlying assets disappearing one by one, ending with a big question mark around social security. Finally, in an attempt to convey the nature of a defined benefit pay-as-you-go system, the metaphor of a Jordanian olive tree was used. The olive tree in Jordan can last hundreds of years when each generation acts as a true custodian. Alternatively, olive trees can be cut down after just a few decades by a generation eager not just to enjoy the fruit of the tree but its wood as well.

The awareness campaign evolved over the first year into a National Dialogue Campaign over social security reform. The SSC had to commit itself up-front to clear policy goals as well as a clear process for articulating them. Only as the goals were spelled out and the SSC made itself accountable did the SSC improve its credibility.

Result: A new social security law

Through this strategy, the SSC was able to secure consensus for the reform. The main features of the new social security law included:

- Adjusting early retirement factors such as minimum age, minimum working period, and penalties for early retirement so that the incentives were to work longer
- Capping wages eligible for social security and capping new contributors at five times the average wage
- Introducing new protection schemes, all of which were designed to be self-sustaining, namely, a maternity insurance scheme (highly supported by women's organizations); an unemployment saving scheme (introduced to allay fears of those who used to see early retirement as an insurance against job loss); provisions for a health insurance scheme (actively demanded by both contributors and pensioners, not yet activated); and limited indexation of pensions to inflation (demanded by pensioners, not financed independently, but contained through limits)
- Reforming the management of both liabilities and assets

Reform winners and losers

Winners—youth, women, and workers in small enterprises. The social security reform package would yield clear winners by design. These were youth, who were guaranteed a sustainable pension system; women, who saw many of their grievances with the old law addressed; workers in small enterprises,

who wanted their coverage to become mandatory; and pensioners, who also had their pensions partially linked to inflation.

Potential losers—early retirees, the rich. The potential losers were in two distinct groups: those who would lose the ability to retire early and those whose salaries were above twice the national average (and mainly exceeded JD 5,000). Potential losers included some of the loudest voices in the country: organized labor and highly paid executives.

Compensation. While it was not possible to appease those groups, it was possible to address some of their demands. First, all of those who had accumulated the minimum number of years to qualify for early retirement by the end of 2010 were grandfathered into the old law. Second, a special provision was put in place to allow early retirement for those working in hazardous jobs through a higher employer contribution (this provision was very important for unions). Third, a defined benefit scheme was made possible for those making more than the allowed pensionable wages (this provision met the needs of executives who wanted firms to maintain the contribution on the full amount of their salaries). Together, these measures represented various forms of compensation that reduced the opposition of the losers, even though they all would have preferred the status quo to the reform.

Source: This annex summarizes findings from Razzaz 2011.

Notes

1. See, for example, Diwan and Squire (1993), Hoekman (1995), Shafik (1995), and López-Claros and Schwab (2005).
2. See chapter 4 and figure 4.1 (World Bank 2006, 97).
3. See, for instance, National Lawyers Guild (2011); and, for Egypt, Solidarity Center (2010).
4. The Physical Integrity Rights Index is an additive index constructed from the torture, extrajudicial killing, political imprisonment, and disappearance indicators. It ranges from 0 (no government respect for these four rights) to 8 (full government respect for these four rights). Details on its construction and use can be found in Cingranelli and Richards (1999).
5. For example, statistical agencies in Egypt, Lebanon, and Qatar maintain their survey and census microdata in Oracle/SQL databases. Because they do not use SPSS, Stata, or equivalent user-friendly software for data analysis, their datasets cannot be disseminated readily.
6. In February 2012 alone, 53 strikes were counted (African Manager 2012).
7. Note that concerns about anonymization are often not warranted. Datasets may contain two types of identifiers: (1) direct identifiers (such as name, telephone number, address, email address, social security number, and GIS coordinates); and (2) indirect identifiers (such as date of birth or age, sex, profession, income, and village or city of residence). A light anonymization procedure can quickly remove the direct identifiers. Indirect identifiers are a much more complex issue. In developed countries, a dataset that contains the date of birth, sex, and postcode of respondents makes it possible to identify a very high proportion of them simply by matching this file with other publicly available data files (such as a list of voters in the United States). In MENA today, no publicly accessible files can be used to match identities, so a light anonymization procedure would suffice.

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Appendix: Main Data Sources

Economy	Survey	Year	Description
Egypt, Arab Rep.	Labor Force Survey (LFS)	2010	Egypt's LFS 2010 was conducted by the Central Agency for Public Mobilization and Statistics (CAPMAS), with the goal of measuring the composition of the Egyptian civilian labor force, employment and unemployment levels, the characteristics of those who are employed, and the geographic distribution of the different individuals composing the labor force. The survey was conducted quarterly, using the population census as a sample frame, with a total sample size of 85,408 households per year.
Egypt, Arab Rep.	Survey of Young People in Egypt (SYPE)	2009	Egypt's SYPE was conducted by the Population Council and CAPMAS, with support from the Information and Decision Support Center and the National Center for Exams and Educational Evaluation. The sample was designed to be representative at the national level and for four administrative regions (urban governorates, Lower Egypt governorates, Upper Egypt governorates, and the frontier governorates). The sample size of approximately 17,000 young people, ages 10–29, was selected to provide estimates of key indicators related to adolescents and youth for the country as a whole and for the administrative regions and their urban and rural segments. The goal of the survey was to update the state of knowledge on youth and adolescents in Egypt on issues of health, education, employment, family formation, and civic participation.
Egypt, Arab Rep.	Egypt Labor Market Panel Survey (LMPS)	1998, 2006	Egypt's LMPS was conducted by the Population Council and CAPMAS with support from the U.S. Agency for International Development Egypt and the Ford Foundation. The LMPS 2006 is designed as a panel survey and follows the same households and individuals that were interviewed in the Egypt Labor Market Panel Survey of 1998 and re-interviews them. Individuals who split from the original 1998 households in the intervening period are also tracked and interviewed, together with their entire household. Of the 8,371 households interviewed in 2006, 3,701 were households that were interviewed in LMPS 1998; 2,167 were splits from the original households; and 2,498 were part of an entirely new refresher sample. The sample size is 17,364 individuals and 8,371 households. The surveys contain rich information about individuals' education, employment status, occupation, economic activity, firm size, wage, pension contribution, and the like.

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Economy	Survey	Year	Description
Iraq	Iraq Household Socioeconomic Survey (HSES)	2006–07	The Ministry of Planning and Development Corporation and the Central Organization for Statistics and Information Technology conducted HSES with the support of the World Bank in an effort to reduce poverty and promote social development. Providing essential data for understanding the nature and causes of poverty among Iraqi households, HSES is the largest household social and economic survey ever conducted in Iraq; it reached a total of 18,144 households. HSES provides information on education, labor, health, income, and expenditure in Iraq. It has a sample size of 17,822 households and 127,189 individuals.
Jordan	Jordan Labor Market Panel Survey (LMPS)	2010	Jordan's LMPS 2010 was carried out by the Economic Research Forum in cooperation with the National Center for Human Resource Development and the Jordanian Department of Statistics. For the first time in Jordan, detailed information about Jordanian labor market experiences and behaviors is available in the LMPS. It has a sample size of 25,969 individuals and contains rich information about individuals' education, employment status, occupation, economic activity, firm size, wage, pension contribution, and the decision making related to labor force participation. It allows for a much richer linking of individual characteristics with labor market outcomes.
Lebanon	Lebanon Employer-Employee Survey (EES)	2011	The Lebanon Employer-Employee Survey was conducted by the World Bank. It is a nationally representative household-based survey covering a sample of 1,841 households. The survey collects basic information such as age, education, and employment for the entire household; detailed information on employment (current and history), skills and training, wages, and work benefits for each individual in the household over 15 years of age who is either unemployed, self-employed, or a salaried employee; and the level of cognitive and noncognitive skills of workers.
Morocco	Morocco Household and Youth Survey (HYS)	2010	Morocco's HYS 2009–10, administered from December 2009 through March 2010, collected information from a nationally representative sample of 2,000 households across the country (1,216 households were urban and 784 were rural) on their demographic and educational characteristics, economic activities, migration, and social program participation. Data on household asset ownership were used to construct a household wealth index and classify households into welfare deciles. In addition to the household module, which collected information on all members, a separate youth module focused on young people, ages 15–29, in the 2,000 surveyed households. Consequently, information related to youth economic inclusion, community participation, and use of key public services was collected from 2,883 young individuals. The survey thus gathered information on understudied issues related to youth, such as labor force participation and intermediation, career choices and perceived employment opportunities, use of free time, and use of youth-oriented recreational and educational services that complement formal education.
Morocco	Morocco Labor Force Survey (LFS)	2009	Morocco's LFS 2009 was conducted by the Haut Commissariat au Plan, Direction de la Statistique, on a nationally and regionally representative sample (the sample size was 1 percent of the total population). The survey contains information on the size and structure of Morocco's labor force, including their demographic and educational characteristics, employment status, occupation, and economic activities.
Syria	Syrian Arab Republic Employer-Employee Survey	2009	The Syria Employer-Employee Survey is a nationally representative household-based survey, conducted by the World Bank. The survey collects basic information such as age, education, and employment for the entire household; detailed information on employment (current and history); skills and training, wages, and work benefits for each individual in the household over 15 years of age and is either unemployed, self-employed, or a salaried employee; and the level of cognitive and noncognitive skills of workers.
Tunisia	Tunisia Labor Force Survey (LFS)	2005, 2009, 2010	Tunisia's LFS 2005, 2009, and 2010 were conducted by the National Statistics Institute. This survey covers the entire country using the population census as a sampling frame. The sample size in 2010 was 549,015 individuals. The survey consists of a household module, a module for the employed labor force, and a module for the unemployed. The survey contains rich information on the size and structure of the Tunisian labor force, including individuals' education, employment status, occupation, economic activity, place of work, hours and days worked, reasons for and duration of unemployment, as well as prior employment.

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Economy	Survey	Year	Description
Turkey	Turkey Household Labor Force Survey (HLFS)	2010	Turkey's HLFS was conducted by the Turkish Statistical Institute (TURKSTAT), using as a sampling frame the Address Based Population Register System (updated every month) The survey covers the entire country population, sampling around 14,100 households each month, 12 times per year, and it contains rich information on economic activity, occupation, status in employment, and hours worked for the employed persons; it also informs on the duration of unemployment and occupation sought for the unemployed.
United Arab Emirates	Labor Force Survey (LFS)	2009	The United Arab Emirates' LFS 2009 was conducted by the National Bureau of Statistics. This survey collected information from a nationally representative sample of 11,024 households across the country and was conducted using the population census as a sampling frame. The survey contains information on the size and structure of the labor force of the United Arab Emirates, including their demographic and educational characteristics, employment status, occupation, economic activities, migration trends, and social program participation.
West Bank and Gaza	Labor Force Survey (LFS)	2008	The West Bank and Gaza's LFS 2008 was conducted by the Palestinian Central Bureau of Statistics, as a part of the Palestinian Labor Force Survey Program. This survey is conducted quarterly, and, in 2008, the total sample size was 30,180 households and 107,991 individuals ages 10 and older. The survey contains rich information on the size and structure of the West Bank and Gaza labor force, including the individuals' education, employment status, occupation, economic activity, place of work, hours and days worked, wages, pension contribution, and the like.
Yemen, Rep. of	Household Budget Survey (HBS)	2005–06	The Household Budget Survey 2005–06 was conducted by the Central Statistical Organization of Yemen. The HBS data contain information on household roster, economic activities, dwelling conditions, health, education, anthropometrics, income, durable goods, and consumption. One of the main objectives of the HBS 2005–06 is producing aggregates of the statistical indicators at the level of the urban and rural communities of each governorate to support economic and social development planning at the central and local levels. HBS 2005 contains observations on 13,136 households and 98,941 individuals.
World	Gallup World Poll Survey	2009, 2010, 2011	The Gallup World Poll Survey data are collected in more than 150 countries. The target population is the entire civilian, noninstitutionalized population, ages 15 and older, and samples are probability based and nationally representative (with some exceptions). A standard set of core questions is used around the world to measure global attitudes and behaviors, job creation, city prosperity, global migration, and well-being. In addition, supplemental questions might be asked in some regions. The typical World Poll survey includes at least 1,000 surveys of individuals per year; however, in some countries, oversamples are collected in major cities or areas of special interest.

ECO-AUDIT

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- 19 trees
- 9 million BTUs of total energy
- 1,591 pounds of net greenhouse gases
- 8,632 gallons of waste water
- 578 pounds of solid waste

In the aftermath of the Arab Spring, the question of jobs continues to be crucial for economic well-being and social cohesion in the Middle East and North Africa. *Jobs for Shared Prosperity: Time for Action in the Middle East and North Africa* uses a jobs lens to systematically analyze the dynamics of private sector, labor market institutions, and skills and training systems. It shows how several underlying distortions prevented a more productive use of human capital and led to inefficient and inequitable labor market outcomes, with an associated sense of unfairness and exclusion.

This report proposes medium-term policy options that could promote the robust and inclusive growth needed to tackle the structural employment challenge for the region. Just as important, it discusses the political economy mechanisms that could trigger this reform process.

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