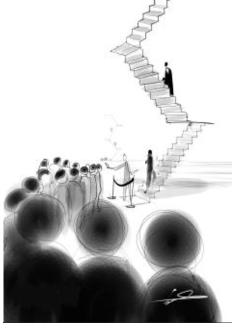

Jobs or Privileges

Unleashing the Employment Potential of the Middle East and North Africa

Summary

Problem

The Middle East and North Africa region faces high unemployment or jobs in low-productivity activities often in the informal economy.

Analysis

The private sector has not generated enough jobs as policies that restrict competition have limited the entry of new firms and prevented more productive firms from growing – the type of firms that create most jobs. These policies are often captured by few politically connected firms and result in privileges instead of an environment that enables all entrepreneurs to grow and prosper.

Solution

Encourage competition and reform policies that allow a few connected firms to dominate the most lucrative sectors of the economy. Sustaining the reforms requires institutions that promote equal opportunities for all entrepreneurs and transparent and open policy making.

What do privileges look like in the Middle East and North Africa?

- *71% of connected firms in Egypt, but only 4% of all firms, sell products that are protected by at least three technical import barriers.*
- *64% of politically connected firms in Tunisia are operating in sectors subject to restrictions on Foreign Direct Investment relative to only 36% of non-connected firms.*
- *45% of all connected firms in Egypt operate in highly subsidized energy-intensive industries such as cement or steel, compared to only 8% of all firms.*
- *64% of politically connected firms in Tunisia are in sectors requiring an exclusive license to operate relative to only 45% of non-connected firms.*
- *Firms in politically connected industries (i.e., with at least one connected firm) are 11-14% more likely to have acquired land from the government.*
- *An additional firm with a politically connected CEO reduces the average waiting time for a construction permit in an industry by 51 days.*
- *Firms in industries with at least one politically connected CEO are inspected by tax officials 4.6 times a year relative to 5.7 times a year for firms in industries without a connected CEO. In addition, the frequency of inspections by the municipality is about 20% higher for firms in non-connected industries.*
- *The variation of reported inspections across firms is significantly higher within connected sectors. This suggests that politically connected firms receive very few inspections while non-connected firms are inspected frequently.*
- *The entry of new firms into politically connected sectors is about 28% lower.*
- *Employment growth declines by about 1.4 percentage points annually when connected firms enter new, previously unconnected sectors in Egypt.*

Politically connected firms are identified in Egypt as firms managed or owned by businessmen controlling senior posts in the government or National Democratic Party and in Tunisia as firms *whose assets got confiscated after the revolution as they were owned by the Ben Ali family*.

PROBLEM

The lack of private-sector jobs in the Middle East and North Africa (MENA) has led to high unemployment, especially among young people and women, and to a large informal economy, concentrated in unproductive, subsistence activities. As a result, the region has a vast pool of untapped human resources.

- Only 19% of the working-age population has formal sector jobs in MENA relative to 27% in Latin America and the Caribbean and 40% in Eastern Europe and Central Asia.
- The share of employment in micro firms with less than five employees dominates the private sector, ranging from about 40% in Tunisia and Jordan to almost 60% in West Bank & Gaza and Egypt.
- The probability that micro firms grow beyond 10 employees 5 years later is only 2% in the West Bank & Gaza, 3% in Tunisia, and 12% in Lebanon.

ANALYSIS

Growth could have been much higher had MENA countries been able to absorb their fast-growing labor force into the higher-productivity activities.

- Real GDP per capita growth hovered around 2% over the last 20 years; 2-4% lower than in South or East Asia.
- Growth was driven by an increase in the share of the working-age population rather than labor productivity.

Are the fundamentals of job creation different from other regions?

They are not: startups and more productive firms create more jobs in MENA as elsewhere.

- Micro-startups – firms less than 5 years old and with less than 5 employees – accounted for 92% of net job creation in Tunisia from 1996-2010 and 177% in Lebanon from 2005-2010.

Few firms either entering or exiting the market coupled with slow productivity growth has limited MENA's pool of startups and more productive firms that are the engines of job creation.

- For every 10,000 working-age persons, on average, only 6 limited liability companies were created annually in MENA; the average among all worldwide was 26.
- After 35 years in operation, firms in Tunisia and Egypt barely increase their productivity while firms in Mexico, India and Turkey increase their productivity 2-3 fold.

Distorted Dynamics

These factors holding back job creation are rooted in a policy environment that favors a few dominant market players and insulates them from competition. For example,

- Removing restrictions on foreign direct investment (FDI) into service sectors in Jordan would increase the entry of foreign firms which, in turn, would create jobs in domestic firms.
- In Morocco, more competition, equal and predictable treatment by tax administrations, less corruption and obstacles in the judicial system, and lower cost of finance would raise job growth among young firms.
- Eliminating energy subsidies to industry in Egypt (which amount to US$7.4 billion or 3% of GDP in 2010) would increase competition and job creation: despite lower wages in Egypt only 562,000 people work in labor-intensive manufacturing firms relative to 886,000 in Turkey.
- Ending large variation in rule enforcement would raise competition and innovation: over 50% of surveyed firms regard regulatory policy uncertainty as an obstacle to firm growth in MENA.

Avoiding the Pitfalls of Industrial Policy

Efforts to stimulate private sector growth and jobs in MENA have often taken the form of active industrial policies. But there is limited evidence of success and several instances of policy capture by a few, connected firms. A comparison with East Asian countries highlights several critical differences in policy design:

1. Broader consensus on a common strategic growth vision.
2. Evaluation systems to assess the performance of policies and public officials.
3. Support was linked to verifiable performance guaranteeing equal access for all firms.
4. Industrial policy provided incentives for firms to compete in international markets.
5. Far-reaching public sector reforms creating a merit-based public administration.

Privileges instead of Jobs

Policies in MENA have often been captured by a few politically connected firms. This has led to a policy environment that created privileges rather than a level playing field, and undermined private sector growth and job creation. These privileges insulated firms from domestic and international competition and subsidized their operations via preferential and sometimes exclusive access to cheap inputs (credit, electricity, land, and so forth). These policies undermine competition, equal opportunity for all entrepreneurs and result in lower efficiency, innovation, and job creation. The quantitative impact of privileges during the Mubarak and Ben Ali regimes in Egypt and Tunisia are summarized above. Many of these policies are still in place.

The available qualitative evidence points to similar mechanisms of policy privileges in other MENA countries.

SOLUTION

The road to more jobs in MENA countries is paved not only with better supply-side policies (e.g., education) but, crucially, does also require significant reforms to stimulate labor demand by moving from a system of privileges to one where all firms and new entrepreneurs compete on an equal basis. Therefore, governments should reform all policies that unduly constrain competition.

One critical aspect of this reform agenda is to create institutions that safeguard competition. Such institutions include, but are not limited to, an independent competition authority; appropriate procurement laws, or an accountable and highly competent public administration. Another component, just as important, is to ensure policy making is transparent and open, with a mechanism that encourages citizen participation. Finally, this report provides a decision-making guide which governments can use as a framework when designing and implementing policies.

For references and detailed analysis and policy recommendations, refer to the complete 2014 World Bank Regional Report: "Jobs or Privilege: Unleashing the Employment Potential of the Middle East and North Africa".