المنتدى العربي الثاني للتنمية والتشغيل

نحو حماية إجتماعية وتنمية مستدامة

The Second Arab Forum for Development & Employment

Towards Social Protection & Sustainable Development

المملكة العربية السعودية - الرياض ٢٣-٢٥ ربيع الآخر ١٤٣٥ / ٢٤-٢٦ فبراير ٢٠١٤

Working paper on

Investment Climate Supporting Job Opportunities

Mr. Peter Mousley

Investment climate supporting job opportunities

Abstract: This short note on "Investment Climate and Jobs" draws on the analysis of recent flagship reports prepared by the World Bank together with other seminal academic work and data drawn from the World Bank Enterprise Survey and Doing Business databases and provides an overview of key issues in the investment climate and the role these factors play in entrepreneurship, the life-cycle of firms and their demand for labor. It highlights some of the current recommendations deriving from the Flagship reports' analyses as to the policy priorities to be addressed in the MENA region, if governments are to help augment the job creation contribution of the private sector. This includes the importance of ensuring a level playing field for firm competition, reinforcing the considerable policy and legal reforms to the investment climate that have been undertaken in the region with greater attention to the accountability and fairness of their implementation and complementary initiatives to support "Gazelle" type firms which generate the bulk of new sustainable jobs.

Keywords: *Investment climate, jobs, business constraints, finance, private investment*

DISCLAIMER: This is a draft working paper produced for the Second Arab Conference on Development and Employment, 'Towards Social Protection and Sustainable Development'. The findings, interpretations, and conclusions herein are those of the authors and do not necessarily reflect the views of the Kingdom of Saudi Arabia, The Arab Labor Organization, or the International Bank for Reconstruction/The World Bank Group and its affiliated organizations, or its Executive Directors, or the governments they represent. If you wish to cite from this document, please request the latest version from the authors.

I. INTRODUCTION

1. **The Challenge:** The *2013 World Development Report* (WDR13)[1]opened with an acknowledgement of one of the single most important challenges facing the world's economies – the need to generate an additional 600 million jobs over the forthcoming 15 years. This challenge is particularly pressing for the young and for females, who currently find themselves some of the worst-affected in terms of accessing labor market opportunities. Whereas the majority of these jobs are needed in Asia and Africa, there are significant job deficits in the MENA region, with some entrenched equity concerns that cut across gender and age.

2. The gap between job opportunities and available supply in the MENA region is substantial. Even during relatively robust periods of regional growth, such as the first decade of this century, where the growth rate in MENA was aboutfive percent, total employment creation amounted to less than 3 million jobs per annum.[2] This translates into rising levels of unemployment, given the numbers of new job entrants. An additional 1 million jobs per annum would be needed to bring unemployment rates from the current level of some 11% across the MENA region to the four to six percent levels experienced in fast growing emerging economies. The picture is made all the more challenging when looking at some of the other characteristics faced by policy makers seeking to generate jobs in MENA countries. Two-thirds of the population is under 24, one in four youth are unemployed and three out of four working age women do not participate in the labor force[3].The most internationally successful industry in the MENA region – hydrocarbons – provide very little of a direct solution to the job deficit, employing less than 2% of the region's workforce while accounting for approximately 50% of value added. Two other significant characteristics of the current problem include labor market inactivity and informality.

3. The unemployed in the MENA region havehigh inactivitylevels (in terms of job search activities) at 54% compared to other middle- income regions like Eastern Europe and Central Asia (36%) and Latin America (44%).[4]90% of the those working age persons in MENA that are inactive in the labor market are women[5]. One of the drivers of the

[1]World Bank 2012. World Development Report 2013: Jobs. Washington DC. World Bank
[2] MENA Notable Facts Data Sheet, May 2013, World Bank
[3] World Bank 2013, "Jobs for Shared Prosperity: Time for Action in the Middle East and North Africa", 2013
[4] MENA Notable Facts Data Sheet, May 2013, World Bank
[5] World Bank 2013, "Jobs for Shared Prosperity: Time for Action in the Middle East and North Africa", 2013

market inactivity is indicated by the fact that, more than in any other region of the world, the overwhelming majority (above 50 percent, on average) of the population would rather work in the public sector[6].This attitude persists among the young generation, in spite of changes in hiring rates in the public sector over time in non-oil countries. The phenomenon to a large extent an echo of past public sector labor policies and the public sector's continued dominance in the labor market, but to some degree also reflects the inability of the private sector to take the lead in job creation in these economies.

4. The growing size of the informal sector, likewise suggests constraints to the establishment of formal businesses that can create jobs and provide realistic opportunities for sustainable employment that can rival the attractiveness of the public sector. Informality is growing with more than a quarter of all output in the region being produced informally. Related to this, two-thirds of the workers do not have pensions, and self-employment accounts for approximately 28% of all employment[7]. This in turn points to an investment climate across the region that falls short in meeting the needs of an expanding labor market in the region.

II. THE LINK BETWEEN INVESTMENT CLIMATE AND JOBS

5. **The Importance of the Private Sector:** Given that 90%[8] of the world's jobs are generated by the private sector and some 66%[9] of developing country employment by SMEs, strategies to help firms – particularly SMEs - to establish, innovate and grow and to employ more workers in the process is the core of a job creation strategy. This is true world-wide. It is also important to understand where the largest employment growth is happening.Globally, the service sector leads in terms of growth of employment share, followed by manufacturing while agriculture is in the decline[10].

6. Another significant feature of job creation in MENA is that, despite the solid growth that occurred, at least up to the 2008 financial crisis, jobs outside of the public sector (which remained a leading source of employment within the region over this period) tended to be in lower value-added sectors such as construction. Moreover, in

[6] MENA Notable Facts Data Sheet, May 2013, World Bank
[7] MENA Notable Facts Data Sheet, May 2013
[8]World Bank 2004."World Development Report 2005: A Better Investment Climate for Everyone" Washington DC. World Bank
[9] International Finance Corporation 2013, "IFC Jobs Study: Assessing the Private Sector Contribution to Jobs Creation and Poverty Reduction", World Bank Group.
[10] Ibid.

contrast to other regions of the world, nowhere where data is available for MENA countries, does the *formal* private sector employ more than 20% of workers[11]. Thesecharacteristics, together with the relatively lower labor demand originating out of high growth, capital intensive resource sectors, have left the region with a growing gap between young job seekers entering the market on the back of a demographic bulge and jobs created. Government's role in this process is to design policies and foster an enabling environment that provides opportunity and incentives to entrepreneurs to take ideas to new, job-creating markets establish and grow firms and hire others in the process.

7. Jobs can be created in different ways. Governments need to remain cognizant of this and the extent to which a given investment climate impacts these different channels to job creation. Box 1below provides a useful definition of these channels.[12]

Box 1: Job Creation – The Different Channels Defined:

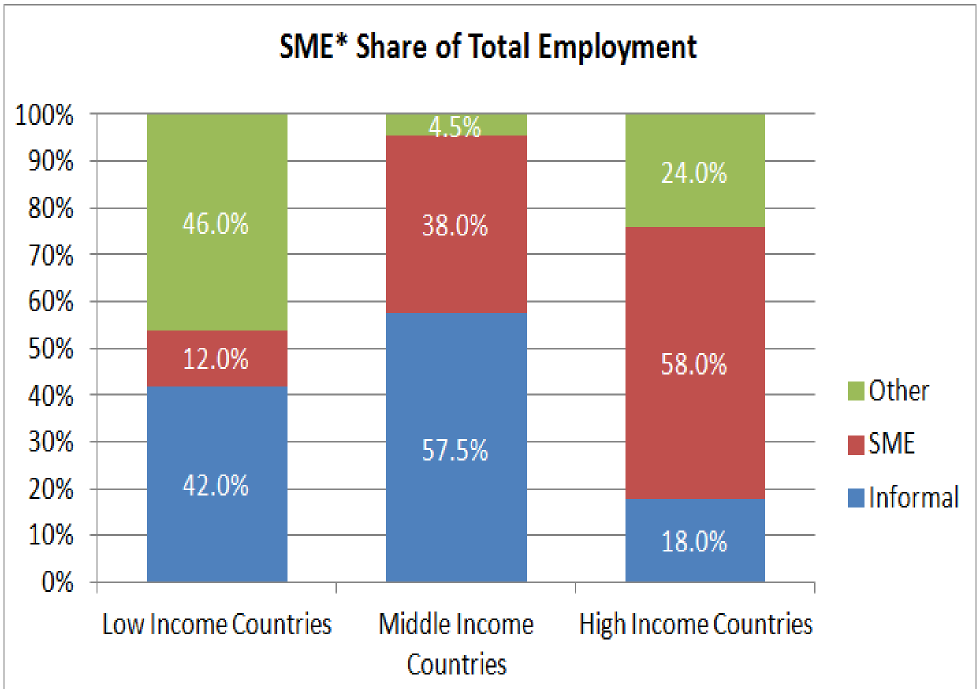
- ***Direct Jobs***: employment changes in given enterprises;
- ***Indirect Jobs***: employment changes in suppliers and distributors;
- ***Induced Employment***: Jobs resulting from direct and indirect employees spending more and increasing consumption;
- **Secondary *Effects***: Refer to job creation through benefits of improved access to infrastructure, such as access to more reliable power, allowing enterprises to produce more, and more efficiently.

Source: IFC Jobs Report, p.23

8. It is also important to understand the source of jobs within the private sector. Chart Ibelow highlights that fully 95.5% of employment in middle income economies derives from the SME and informal sector. The SME share of employment increases to 60% in the high income, as compared to the 38% in middle income countries.

[11] World Bank 2013, "Jobs for Shared Prosperity: Time for Action in the Middle East and North Africa", 2013
[12] International Finance Corporation 2013, "IFC Jobs Study: Assessing the Private Sector Contribution to Jobs Creation and Poverty Reduction", World Bank Group, p 23

Chart I



*Where SME is defined as an enterprise with fewer than 250 employees. Source: Meghana Ayyagari, Thorsten Beck and Asli Demirgüç-Kunt *Snmall and Medium Enterprises Around the Globe* (Washington: World Bank, 2005)

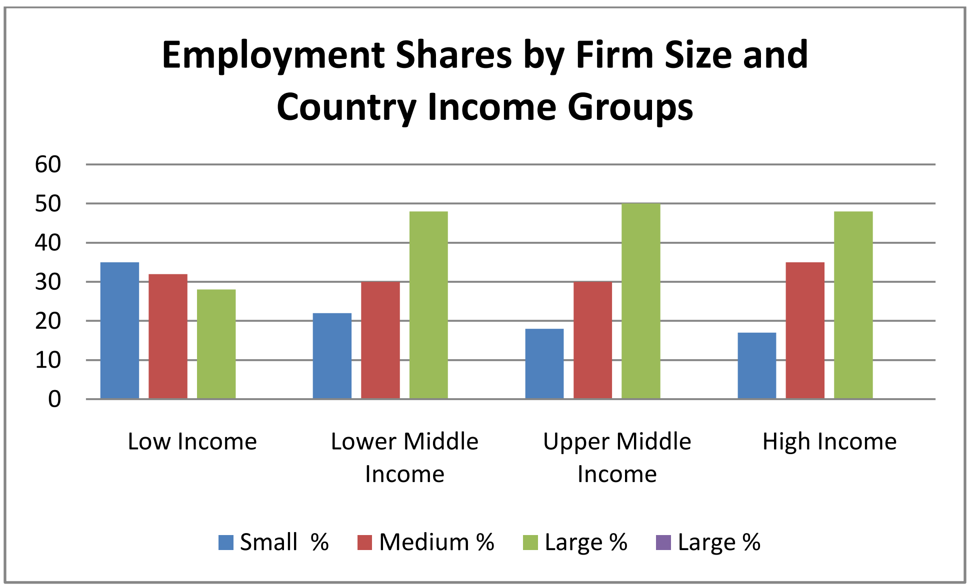
9. The above chart was based on a definition of SMEs up to 250 employees. It demonstrates the importance of a growing SME sector in formalizing economies as they move towards higher income levels. It is also very significant to note the size of the informal sector in the middle income country category. This amounts to 57.5% of the employment in the private sector and represent a huge body of working people looking to achieve more sustainable, better quality jobs.The SMEsector provides the most probable entry point from informal to the sorts of formal businesses that have the capability of generating better quality job growth. In view of this, support to the SME sector needs to be a priority area of any government effort to create jobs. What are the key considerations in designing a policy framework to achieve this outcome?

10. Drawing in evidence from World Bank enterprise surveys which provides more disaggregated information on firm size[13], provides the following picture of formal employment characteristics across country incomes groups and firm sizes. It can be seen in Chart II below that in middle to high income countries; it is the larger firms (with

[13] World Bank enterprise surveys categorize small firms with employment levels between 5-19, medium 20-99 and large equal/greater than 100.

employment levels greater than 100) that are home to the largest share of jobs. Only in low income countries does the bulk of employment reside in the small enterprise sector.It should be noted that the enterprise surveys exclude firms with less than five employees and are based on weighted estimates from the survey data, so the chart indicates more of a pattern than precise figures.That being said, there is a prima facie case to be made to foster firm growth as a source of job creation and to target the needs not just of new entrants into the formal private sector as noted earlier, who are likely to be small, but to also look to see how to tailor policy in order to build a robust enabling environment for firm growth at the higher end of the scale. This then gives rise to the question as to which type of firms are most likely to grow and move beyond survival businesses into larger more dynamic enterprises.

Chart II



Source: Enterprise Survey Database, IFC Jobs Report

11. The source of new jobs requires also an appreciation of the likeliest sources of new demand for workers. From this dynamic perspective, much of the literature focuses on the role of small and medium sized firms as the principal driver of new job creation[14]. And each year, as new firms get formed and registered, they bring with their birth new jobs. However this is too much of a "snap-shot". Many of these start-ups fail to grow or go out of business relatively soon. Further research[15] conducted on the so-called

[14] Birch, D. 1979, "The Job Generation Process: Final Report to the Economic Development Administration", Cambridge, MA.
[15] "Gazelles as Job Creators: A Survey and Interpretation of the Evidence", Small Business Economics – An Entrepreneurship Journal, February 2009.

"gazelle" firms (younger, rapidly growing firms) encompassing some 20 studies of North American and European countries concluded the following:

- Gazelle –type firms generate the bulk of new jobs;
- Gazelles tend to be younger firms;
- Gazelles can be of all sizes, although smaller is over-represented. Larger "Super Gazelles" also play a significant net job creation role where they exist;
- Gazelles are not limited to IT and high-technology industries. Evidence is that they exist in all industries.

12. What counts, according to this analysis, are those firms that "survive" and then – most significantly - grow. In support of this, recent analysis points to the age of a firm being the key determinant of likely job growth[16]. More specifically, it is the surviving subset of young firms that grew the most that offered relatively the best net job creation performance. These "young firms" are not necessarily small. In fact the analysis of US market concludes that, when controlling for age, there is no systematic inverse relationship between firm size and net growth rates[17]. To what extent are these findings applicable to the Middle Eastern economies? And if so what does this imply in terms of the actions to be taken by governments seeking to strengthen investment climates for business growth and employment? Before proceeding to these questions, a clearer understanding of the term "investment climate" is required.

13. **Defining Investment Climate:** What are the factors that comprise the "enabling environment" that helps todetermine the life cycle of a firm, including: (i) whether or not(and how) an entrepreneurial idea gets to market; (ii)how a businessperson establishes a firm; (iii)when s\he invests in its growth and hire others in the process; (iv) how and when s\he exits, if eventually the firm cannot succeed? Clearly profit has a central place. But what are the factors that a businessperson needs to take into consideration and address when deciding to risk an investment, deploy assets, and take on market obligations to realize this profit. There is no definitive list of what comprises the "investment climate", but the World Development Report of 2005, entitled *"A Better Investment Climate for Everyone"* proposed that this comprises the set of policies, laws, regulations and practices supplied by a government to manage costs, risks and barriers to entry that impact firm entrepreneurship, investment and ultimately productivity and job

[16] "Who Creates Jobs? Small Versus Large Versus Young", Haltiwanger, J.C.; Jarmin, R.S.; J. Miranda; NBER Working Paper 16300
[17] Ibid, p. 2.

creation capacities. A good investment climate is not just about "generating profits for firms…but improving outcomes for society…"[18].

14. What does this mean? First that the investment climate has a public good role – it needs to serve society as a whole not just businesses – this includes labor and consumer, as well as business person. And the business person is not just the large and connected one, but also those medium and small firms that offer the majority of jobs, as seen from the Charts above. To achieve this, an investment climate needs to facilitate job creation, lower prices and broaden the tax base. Within this tripartite framework, the following Table I sets out the borderline of areas in the investment climate where the government can find its principal role and those aspects more directly determined by market and firm forces:

Table I

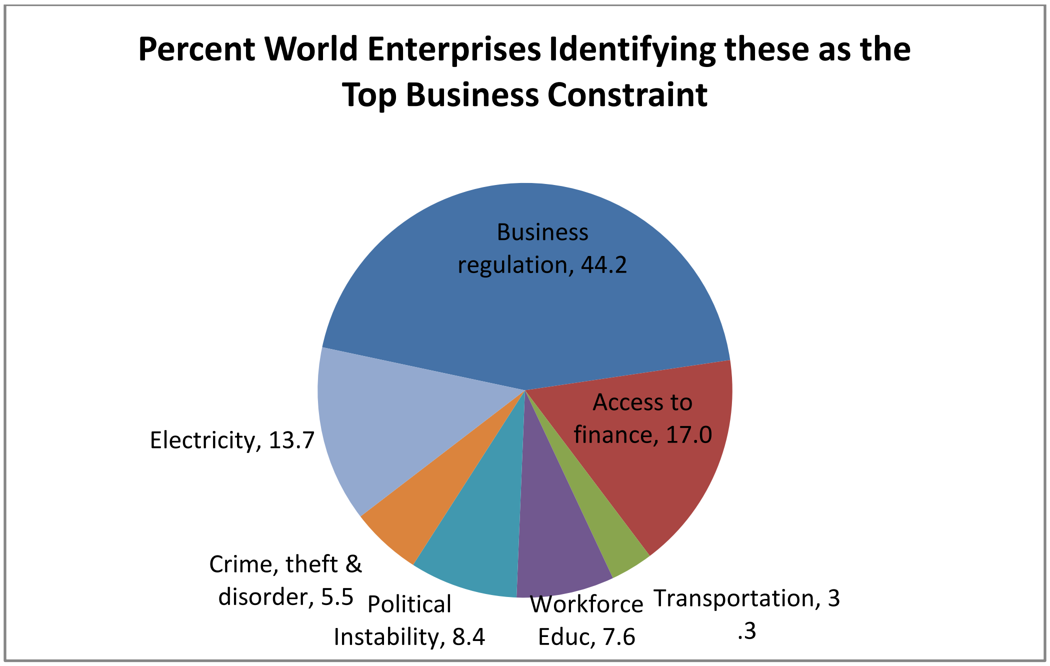
Government Roles in Fostering Environment for Private Investment		
	Government has Strong Influence	**Government has Less Influence**
Costs	Corruption, Taxes, Regulatory burdens, infrastructure and finance costs, labor market regulation	Market determination of prices Distance to input and output markets economies of scale
Risks	Policy predictability and credibility, macro-economic stability, property rights, contract enforcement, expropriation	Consumer and competitor responses, external shocks and natural events, supplier reliability
Barriers to Competition	Regulatory barriers to entry and exit, competition law and policy, functioning finance markets, Infrastructure	Market size and distance to input and output markets Economies of scale

Source: World Development Report, 2005

[18] WDR 2005, page 20

15. To what extent are these different aspects of the investment climate viewed as significant constraints to businesses? Drawing on a data set of enterprise perceptions drawn from some 45,000 firms interviewed to date through the World Bank enterprise survey work, a composite set of constraints that comprise "business regulations" are seen by 44.2% of respondents to amount to the largest constraint to business. This is portrayed in the Chart III below:

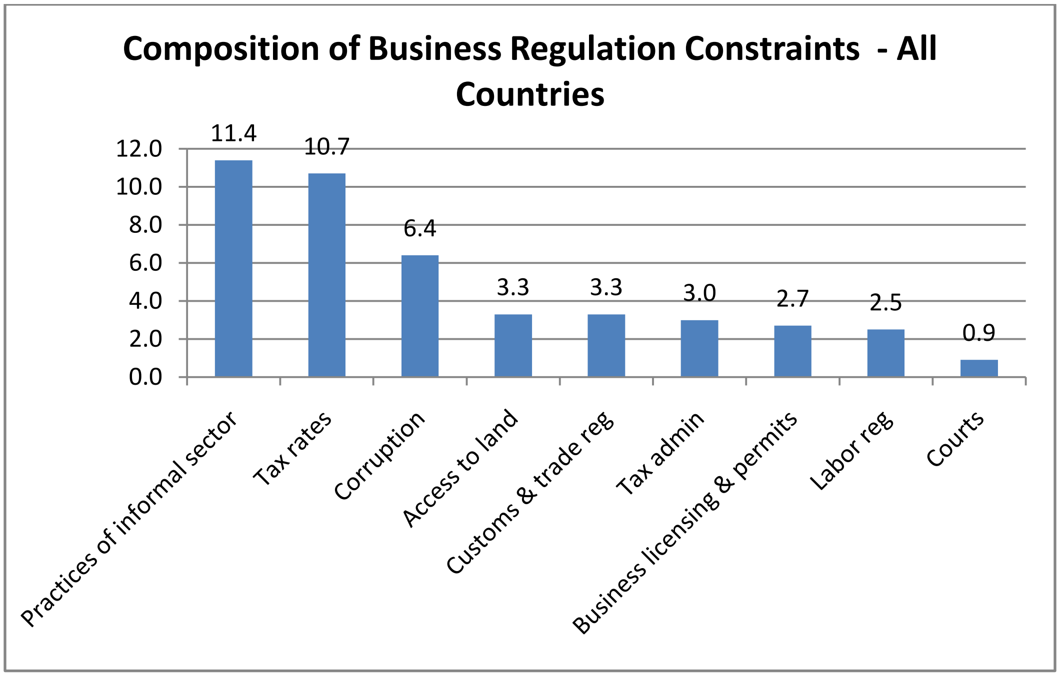
Chart III



Source: World Bank Enterprise Survey Database

16. In terms of what comprises the category detailed above as "business regulations", this is portrayed in the following Chart IV, where it can be seen that among the subset of items, tax rates and administration (13.7%), informality (11.4%), and corruption (6.4%) rank as the most significant worldwide.

Chart IV

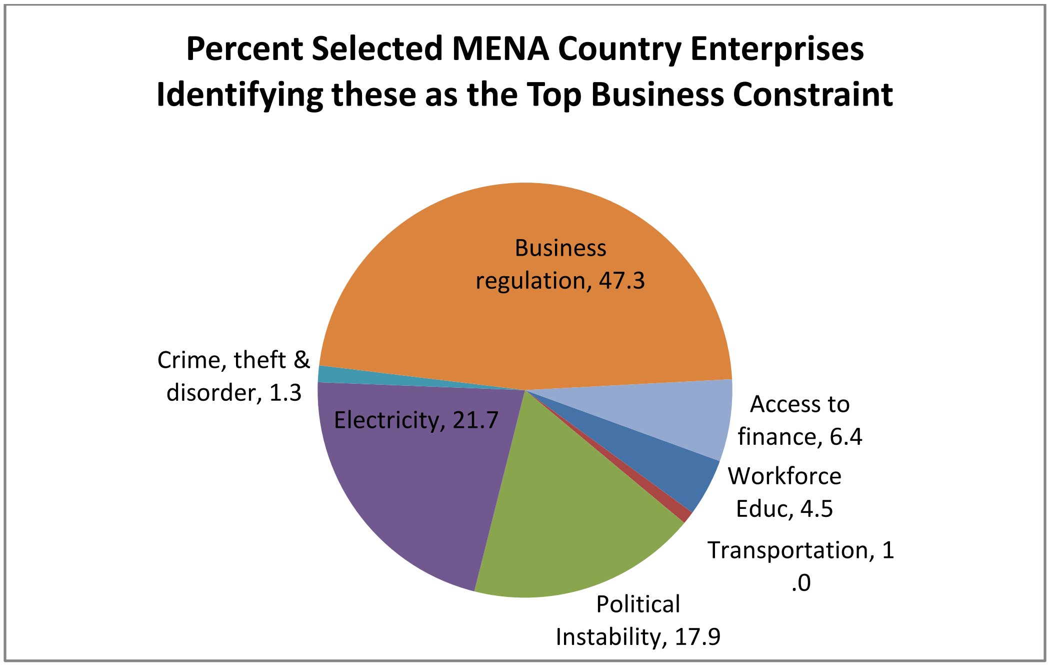


Source: World Bank Enterprise Survey database

17. It is notable that, when the same graphs are generated for the subset of MENA countries, as shown below in Charts V and VI, business regulation constraints remain high on the agenda in the selected sub-set of MENA countries[19], just like the rest of the world. However, political instability and electricity overwhelm these types of constraints, relative to access to financeand workforce education which are more often the greater constraints in other regions of the world. Looking at the subset of business regulation constraints, the same issues dominate but their order differs with MENA enterprises ranking corruption as the highest constraint (11.2%), followed by informal practices (9.8%) and tax rates and administration at 9.1%. Access to land is also seen as significantly more of a constraint in MENA than in the rest of the world with 6.6% businesspersons from the region ranking it as a major constraint versus 3.3% when the sample is worldwide.

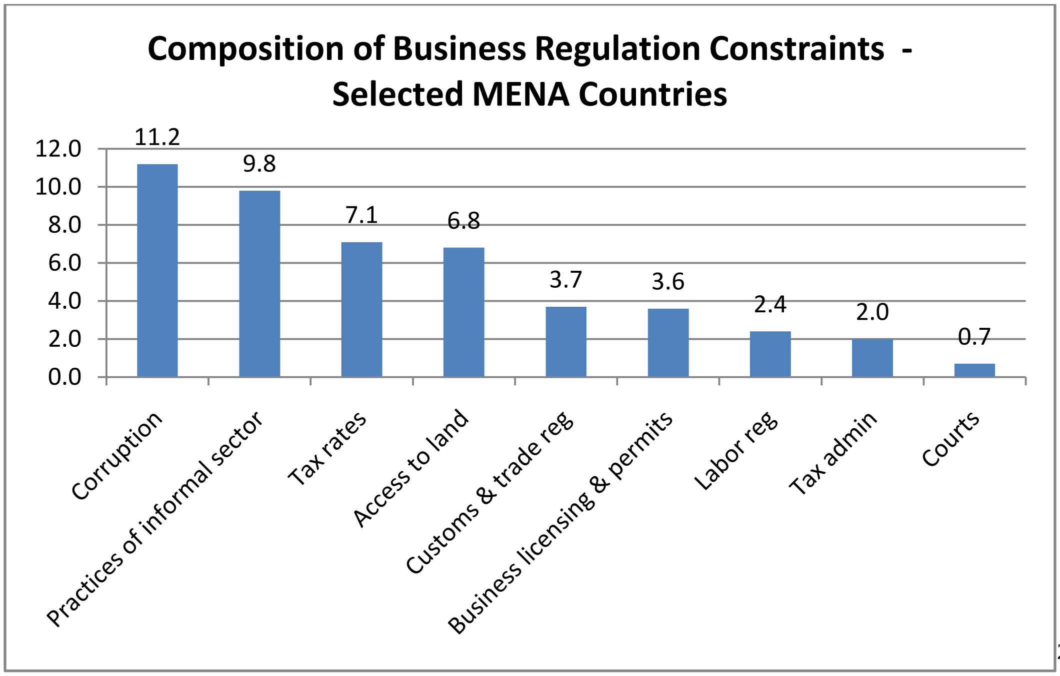
[19] Data is from Egypt, Iraq, Jordan, Lebanon, Palestine, Syria, Yemen Enterprise Surveys

Chart V



Source: World Bank Enterprise Survey database

Chart VI



[20]

Source: World Bank Enterprise Survey database

18. It is also important to recognize that, while these aspects of the investment climate pertain to all sectors and sizes of firms, the impact can differ , depending on the cost structures, specific industry risks and barriers to entry[21]that characterize the sector or firms of a particular size. For instance, power supply is a bigger cost and competitiveness driver in manufacturing than services. And small and medium firms systematically rank access to finance and tax administration as bigger constraints to their businesses than larger firms. The following Table[22] summarizes – at an international level of aggregation – how different sized firms, country income groups and sectors perceive their constraints environment:

Table 2

Constraint	A2F	Electricity	Informality	Tax Rate	Skills
Firm size					
Small	**1**	**2**	**3**		
Medium	**1**	**2**	**3**		

[20] Data is from Egypt, Iraq, Jordan, Lebanon, Palestine, Syria, Yemen ESs
[21] WDR 2005
[22] See IFC Jobs Study, pp 38-39

Large	**3**	**1**			**2**
Country Income					
Low	**2**	**1**		**3**	
Low-Middle	**1**	**3**	**2**		
Upper-Middle	**1**		**3**	**2**	
High	**3**			**1**	**1**
Industry					
Manufacture	**1**	**2**	**3**		
Retail	**1**	**3**	**2**		
Services	**1**		**3**	**2**	

Source: IFC Jobs Report, 2013

19. The differences, occasioned by firm size, national income levels and industry specifics often require of government more targeted efforts to ensure that the investment climate is tailored also to address these different features and constraints and provide incentives that take into account the context within which a country's businesses are striving to invest and grow.

20. **The Link to Jobs:** How does this tie to the jobs agenda? The more hostile the environment is for the private sector, the less likely firms are going to be to take the risk to innovate and invest and, by this measure, grow and create jobs. Political and macro-economic stability, transparent, predictable and efficient laws and regulations and their effective and accountable implementation are all well understood factors that impact the private sector investment decisions. But that being said, there is no fixed relationship between investment levels and job creation. We have all heard talk of "jobless growth" and the extent to which jobs accompany growth depends on a range of other considerations impacting relative factor market prices, such as technology transformations, labor market rigidities and skills gaps. There is also the evolving body or research on the impact that firm size and age has on employment creation, as referenced earlier. What is the contribution of the investment climate to this complex agenda? The following section investigates this question further, taking a narrower look at that realm of investment climate that is defined about as "business regulations" and "access to finance". Analysis of infrastructure and skills is being undertaken in companion notes.

III. LESSONS LEARNED WORLD WIDE FROM INVESTMENT CLIMATE CHANGE AND REFORM

21. The relevance of the investment climate to job creation is generally accepted in principle, but the specifics of aspects of the investment climate that are most relevant to jobs, and the degree and conditions under which it is indeed relevant, is a matter of debate. The debate arises from the definition of what constitute the components of the investment climate, the relative significance of these components to job creation, and under what conditions they tend to be significant.

22. As already noted, there is no single definition of the investment climate. Stated broadly, the investment climate includes all policy areas that affect the incentives of businesses and entrepreneurs. This includes macro-economic policy and political stability as well as areas directly related to business transactions including business entry, trade, exit, finance, and other areas typically measured in Doing Business reports, Investment Climate Assessments, and other analytical frameworks. Crucially, especially in the MENA region, this also includes the consistency and predictability of the investment climate over time and across investors and businesses (regardless of size, location, and relationships) that can be affected by corruption or privilege, which are also aspects of the investment climate. So, investment climate represents a broad agenda, hence the difficulty in pinning down its overall effects on job creation.

23. The question of the significance of a particular aspect of the investment climate to job creation is further complicated by the fact that it depends on other conditions in the political and economic environment and the state of all other aspects of the investment climate. For example, while business entry reforms may be of great significance for formal job creation in a stable, growing economy with a large informal sector on its way to formalization, it has little significance in the context of a predatory state where formalization exposes businesses to corrupt inspections, tax collectors, and regulators. It is unlikely any amount of business entry reform would be enough to overcome the disincentives to formalize given these sorts of threats and, this being the case, policy makers cannot expectsuch reforms to make inroads towards increased formal job creation. In short, context is key and it is difficult to generalize lessons on investment climate approaches and priorities across countries. That said, this section of the paper will present available evidence, analysis, and findings on the significance of the investment

climate to job creation with the purpose of illuminating some points on what has been found to work, what has not, and what we have yet to learn.

Do Investment Climate Reforms Create Jobs – The Evidence

24. The empirical evidence demonstrating a positive effect of investment climate reforms on jobs is mostly related to reforms of business transactions – primarily business entry, but less is available on business exit and taxation. In the case of business entry, this may be due to the relative ease of collecting job evidence on these business transaction-related reforms which are more immediately observable and quantifiable.

25. **Business entry:** Business entry reforms are focused on simplifying and modernizing procedures for registering new or existing businesses. Evidence of the effect of business entry reforms on job creation is available from empirical studies on the effects of business entry reforms in Portugal and Mexico where an increase of 21.7% and 2.8% in formal employment were observed respectively from the reduction of number of procedures and time to register a business and the creation of "one stop shops"(in Portugal the cost of registration was also decreased by 10.1%)[23]. Other studies were able to show only an increase in number of registered firms, as in Columbia where business entry reforms were found to have resulted in an increase of 5.2% in registered firms and in India where firm registration increased by 6%, but not on job creation[24]. Another cross country study associated a decrease of 61% in days required for registration with a 0.4% increase in formal jobs[25]. On the other hand, a reform program in Peru that reduced: (i) registration time drastically from 160 to 1.6 days; (ii) inspections by authorities from 5 to 1, and; (iii) costs by 60% showed no effect on business registration or jobs[26].

26. The range of results from these studies, from strong to little or no effect on job creation, reflects the dependence of the efficacy of these reforms on their specific design and on the broader context. The degree of effect on firm registration and job creation is likely commensurate with the degree to which other factors of the investment climate continue to act as constraints despite the reforms in business entry. This leads to the conclusion that while a common entry point for investment climate reform, business entry reforms are best implemented in conjunction with reforms of other aspects of the investment climate.

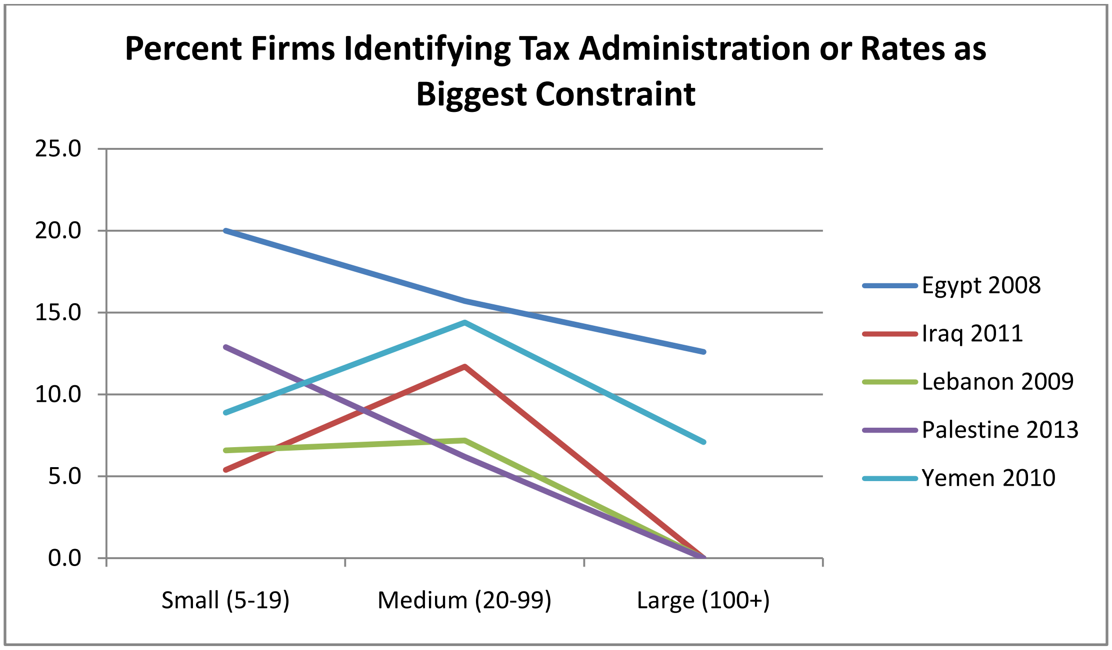
[23] IFC Jobs Report, 2013
[24] Ibid
[25]Parra-Peña, Rafael Isidro, and MassimilianoSantini. 2013. "Investment Climate reforms and Job creation." The World Bank.Mimeo.
[26] Ibid

27. **Business exit:** Business exit reforms focus reducing the complexity of bankruptcy proceedings and the time to discharge a bankruptcy. There is limited evidence of direct effects of business exit reform on job creation; however one cross-country study of 15 developed countries in Europe and North America showed that a 21.6% decrease in the time to discharge a bankruptcy was associated with a 1.5% increase in the rate of self-employment.[27] While the developed context of this study limits its utility, the results are nonetheless important in that the study empirically confirms the deterrent effect of business exit complexity on entrepreneurship. This finding is particularly relevant in the MENA region due to the relatively poor ranking of MENA economies on this issue in Doing Business, where nine of the seventeen countries referenced in table III below rank in the lowest fourth and third quartiles of the 189 countries surveyed with only three countries in the first quartile (Bahrain, Qatar and Tunisia). This suggests a need for reform in this area.[28]

28. **Taxation:** The tax regime is one of the key factors in investment decisions. The tax structure and rates and the consistency and degree of complexity in the administration of a tax system will affect participation in the formal economy and the structure, employment and size of formal firms. In World Bank enterprise surveys, taxation is more often identified as a business constraint by small and medium enterprises rather than large ones, so it is a particularly important issue for promoting small business (see Chart VII below). It is also a barrier to formalization. For example, in a study of the informal sector in Palestine, 47% of informal enterprises surveyed (firms with at least one paid worker besides the owner or premises outside the home) cited payment of taxes as a reason for their informality, with an even higher percentage 64%, citing the lack of benefits from formality as the reason[29]. Among formal firms, one study of a tax reform program in Brazil that benefitted exclusively micro and small, unskilled labor intensive businesses showed a 12% increase in employment in the eligible firms as a result of simplifying the taxation process, reducing the tax burden by 8% on eligible firms, and restructuring the taxes to incentivize employment and reduce labor costs.

[27] Ibid
[28] Doing Business 2014
[29] Informal sector survey by Palestinian Central Bureau of Statistics on behalf of the World Bank, 2013, unpublished.

Chart VII



Source: World Bank Enterprise Survey database

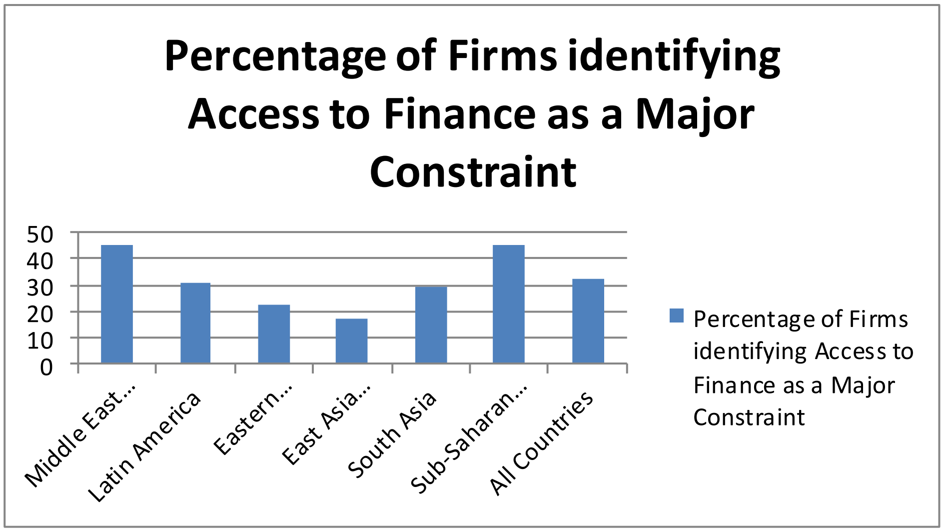
29. **Investment promotion:** Investment promotion activities, often undertaken through the establishment of an investment promotion agency or intermediary, provide facilitation for investors, advocacy for investment promotion, and information and outreach to target investor markets, particularly FDI. While attribution can be difficult, a number of studies of investment promotion activities showing the positive effects of investing in investment promotion on FDI and in some cases on consequent associated employment. A study of investment promotion activities in 124 countries showed that sectors targeted by investment promotion agencies benefitted from 155% more FDI and had a 68% increase in employment over non-targeted sectors.[30] While not making the final link to job creation, numerous other studies have demonstrated the high leverage of investment promotion activities on levels of FDI.[31]

30. **Access to Finance[32]:** Across the world, a firm's access to finance is one of the highest rated constraints to firm growth. Chart VIII indicates that, together with the sub-

[30]Parra-Peña, Rafael Isidro, and MassimilianoSantini. 2013. "Investment Climate reforms and Job creation." The World Bank.Mimeo.
[31] IFC jobs study
[32] Access to finance, while being included as part of the definition of "investment climate" is nevertheless a substantial agenda in and of itself. The note can only touch upon some of the key issues.

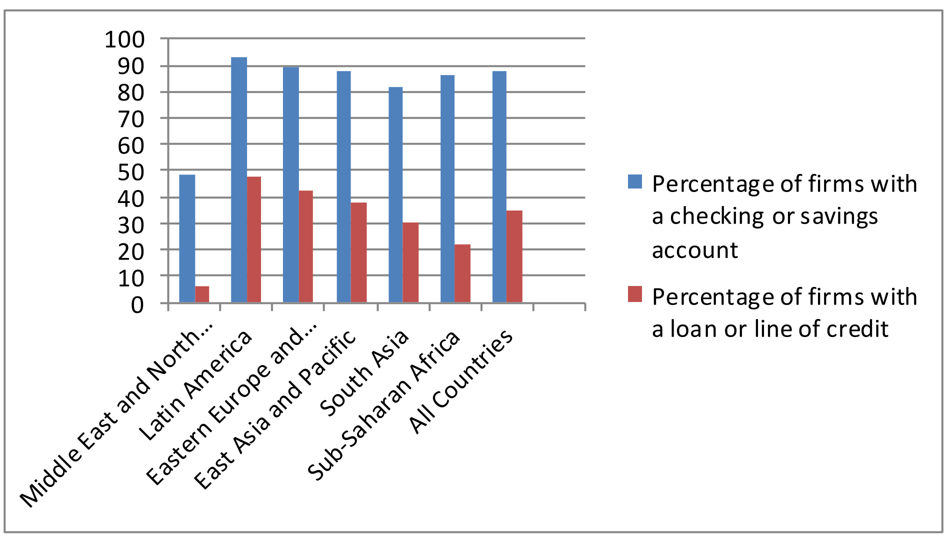
Saharan Africa region, MENA is the region with the largest percentage of firms (44.9%) highlighting access to finance as a constraint. Equally striking is Chart IX where, in terms of financial inclusion measures (bank accounts, loans, lines of credit etc.), the MENA region is seen to be the lowest in comparison to all other regions. To what extend does finance impact job creation?

Chart VIII



Source: World Bank Enterprise Survey database

Chart IX



Source: World Bank Enterprise Survey database

31. As noted in the *IFC Jobs Report*[33], it is difficult to directly attribute job creation to access to finance. There isevidence for the role that financial development can play in capital accumulation, productivity growth, innovation and entrepreneurship which, in turn, are key to enterprise growth and job creation. For finance to serve this purpose both access and cost factors need to be considered. In terms of access, key issues to address include risk considerations of the party seeking finance (e.g. collateral considerations), potential discrimination (gender, minority, or age related), lacuna in the contractual or informational framework (i.e., that gives rise to adverse selection and moral hazard issues between borrower and lender) and availability and suitability of financial products to the needs of the private sector (including length of the financing term;products beyond lending, including equity finance, guarantees and insurance products; and the availability of Islamic products).

32. The pricing of these different instruments is another consideration, which in turn is a function of both broader macro-economic fiscal and monetary considerations, the overall level of development of the financial sector, including the aforementioned access issues. Whereas it is not generally seen to be government's role to directly provide credit and financing to the private sector, policies to help develop the functioning of the financial sector do fall within the scope of government action. This includes actions to foster greater information exchange between lender and borrower through the facilitation of credit bureaus and credit scoring methodologies, strengthening of collateral regimes and enforcement arrangements. Active policies to improve access to finance are especially important for SMEs and microenterprises which tend to face greater challenges in obtaining access to finance and often require specialized products.

33. Modernizing the financial infrastructure is a therefore a key consideration in this respect. Elements of the financial system such as the payments andcredit information systems, movable asset registries are important aspects of the business enabling environment. In addition government policies should foster bank competition and ensure effective regulatory for banking and non-banking financial institutions.

34. One specific area for attention concerns the provision of finance for start-ups and immediately thereafter during a firm's initial growth spurt, where availability of the right type of funding can be especially crucialto the success of an entrepreneur's efforts to commence business and sustainably grow. New firms, as discussed earlier, are a major source of employment creation and, as noted in the recent *Global Financial Development*

[33] See Chapter 7, IFC Jobs Report, 2013

Report, 2014[34], it is the smaller and younger firms that face the greatest constraints to access to finance due to the aforementioned market imperfections such as information asymmetries and related high transactions costs. The availability of early stage financing in the form of angel investing and venture capital are critical to nurturing the growth of start-ups.

35. **Other investment climate reforms:** There is more limited evidence on the effects of other types of investment climate reforms such as property registration, trade logistics, inspections, permits, and secured transactions, but that is due to the limited studies rather than conclusive evidence to the contrary. In many cases, investment climate reforms are implemented as a package of reforms, possibly during a period of broader governance reforms and economic development, so attribution can become quite difficult. Nonetheless, an evaluation of some of these reform packages has also shown positive results.

36. More targeted reforms related to certain sectors, such as special economic zones for manufacturing sector, have had mixed results with some successes alongside conclusive failures. More work will need to be done to identify the determining factors of success for SEZs and similar sector-targeted initiatives.

IV. CURRENT STATUS OF INVESTMENT CLIMATES IN MENA REGION

37. **Review of key measures:** The most recent 2014 Doing Business rankings for MENA countries is summarized below:

[34] See Chapter 3, Global Financial Development Report 2014: Financial Inclusion, The World Bank, 2014

Table III: Doing Business Rankings for 2014 and 2011 Comparator

Indicator	SB	CP	Elect	PR	GC	PI	PT	TAB	EC	RI	Overall 2014	2011 Ranking
Country												
Algeria	164	147	148	176	130	98	174	133	129	60	**153**	**136**
Bahrain	99	4	52	32	130	115	7	81	122	27	**46**	**28**
Djibouti	127	157	144	133	180	182	66	60	163	147	**160**	**158**
Egypt	50	149	105	104	86	147	148	83	156	146	**128**	**94**
Iraq	177	84	46	100	176	128	65	179	141	185	**165**	**166**
Jordan	117	111	41	104	170	170	35	57	133	113	**119**	**111**
Kuwait	152	133	59	90	130	80	11	112	119	94	**104**	**74**
Lebanon	120	179	51	112	109	98	39	97	126	93	**111**	**113**
Morocco	39	83	97	156	109	115	78	37	83	69	**87**	**114**
Oman	77	69	58	21	86	98	9	47	107	72	**47**	**57**
Qatar	112	23	27	43	130	128	2	67	93	36	**48**	**50**
KSA	84	17	15	14	55	22	3	69	127	106	**26**	**22**
Syria	135	189	82	82	180	115	120	147	179	120	**165**	**114**
Tunisia	70	122	55	72	109	52	60	31	78	39	**51**	**55**
UAE	37	5	4	4	86	98	1	4	100	101	**23**	**40**
WB&G	143	131	87	122	165	80	62	123	88	189	**138**	**135**
Yemen	114	101	116	61	170	138	129	128	85	126	**133**	**105**

Source: Doing Business 2014, "Understanding Regulations for Small and Medium-Sized Enterprises", World Bank Group Publication, 2013.

Key: SB: Starting a business, CP: Dealing with construction permits, Elect: Getting electricity, PR: Registering Property, GC: Getting credit, PI: Protecting investors, PT: Paying taxes, TAB: Trading across borders, EC: Enforcing contracts, RI: Resolving insolvency.

38. As can be seen from the above table, using the Doing Business methodology, the MENA region has a best performing UAE with an overall ranking of 23, followed by Saudi Arabia at 26 and Qatar, Oman and Bahrain ranked at 48,47, 46 respectively, Tunisia at 51st place and Morocco at 87. The remaining countries from the region included in this estimation all place after 100. With the exception of some of the GCC countries, Morocco and Tunisia, all countries have experienced declines in their rankings since 2011. This is not surprising given the events of 2011 and uncertainties that have ensued across the region. That a number of countries have maintained moreorless parity in rankings, given these circumstances is laudable. But despite a number of years of measurable improvement in investment climate measures – a period during which a

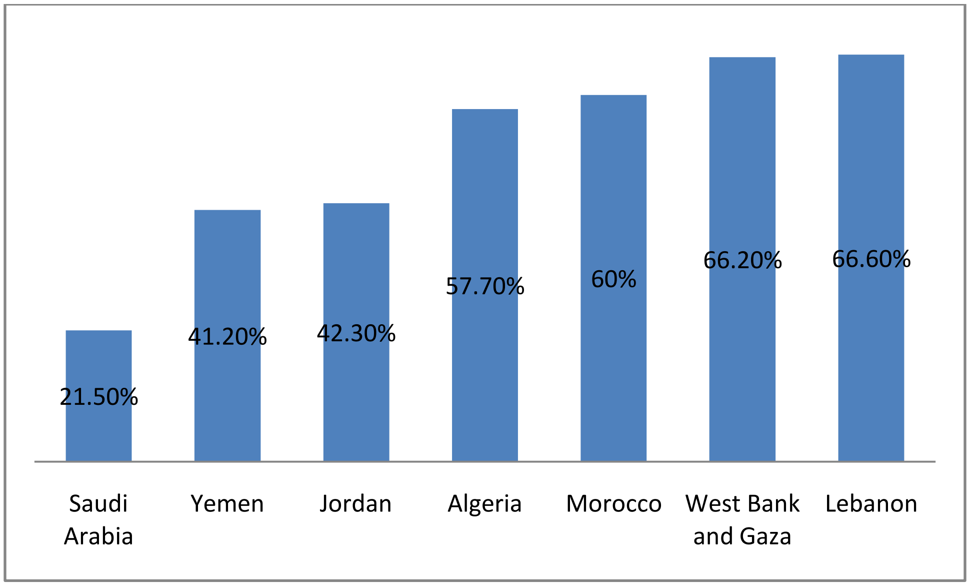
number of MENA countries simplified business regulations and reduced restrictions to trade and investment– nevertheless the return in terms of investment and job creation was relatively limited, when compared to results in other countries in other regions. The question is why? Some explanation of this is likely attributable to key areas where there was no substantial progress – in particular in terms of reforms required in access to finance and contract enforcement. But this is not the full picture.

39. The 2009 World Bank flagship study on the private sector in the MENA region, *From Privilege to Competition*, first sought to answer this question. While concluding, as noted above, that the investment climate reforms in MENA were overall not far behind other regions in the world (as was the case at the time of its publication in 2009), the report saw the region lagging in the way these rules and regulations are enforced, in the consistency and transparency in the implementation of rules and regulations and saw part of the solution to lie in the manner in which these regulations, while improved, needed to be implemented. Uncertainty and discretion in the implementation of regulations that govern the business environment result in an uneven playing field that favors incumbent firms over new entrants, dampening the potential positive effects of reforms on new business entry, investment decisions, and associated job creation.

40. This condition is portrayed in the Chart X below where significant percentages of enterprise survey respondents across the region indicated a perception that regulations were not being interpreted consistently and predictability by authorities. This reinforced earlier analysis contained in the *"From Privilege to Competition"*[35]report that pointed to the significant problems created for businesses as a result of policy uncertainty and weaknesses in policy implementation. Graph XI (reproduced from the report) highlights in yellow the aspects of the investment climate particularly susceptible - in the eyes of business - to uncertainty and poor implementation.

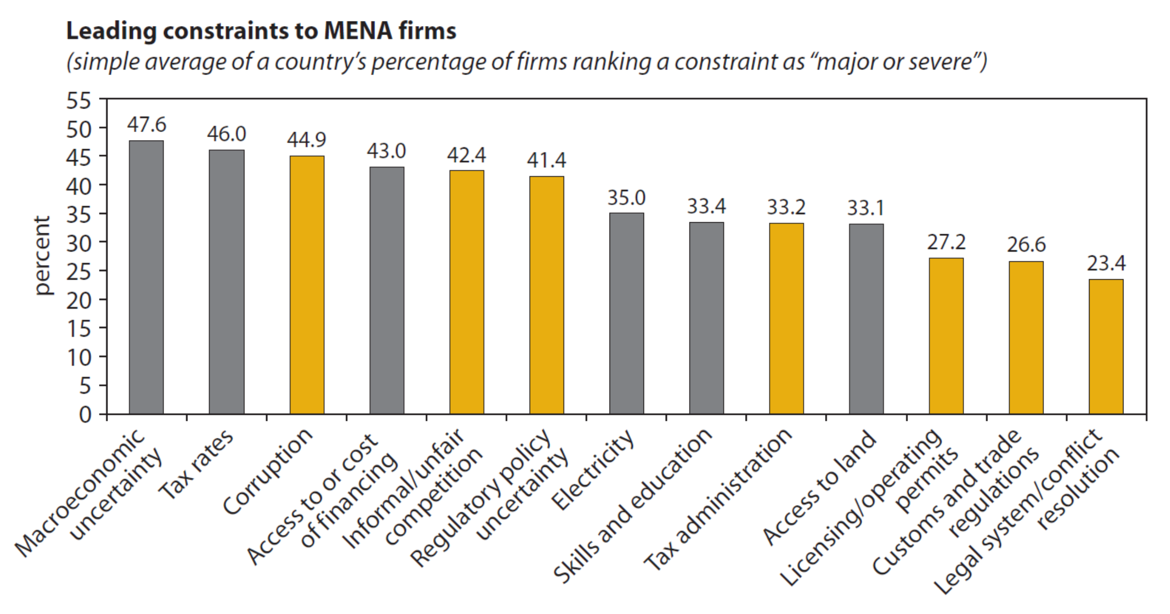
[35] "From Privilege to Competition: Unlocking Private Sector Growth in the Middle East and North Africa", World Bank 2009.

Chart X: Percentage of firm respondents disagreeing that regulations are interpreted consistently and predictably



Source: Jobs for Shared Prosperity, World Bank, 2013

Chart XI



Note: Constraints related to policy uncertainty and policy implementation are highlighted in yellow.

Sources: World Bank Enterprise Surveys of Algeria, Egypt, the Islamic Republic of Iran, Jordan, Lebanon, Morocco, Oman, Saudi Arabia, Syria, West Bank and Gaza, and the Republic of Yemen economies, various years.

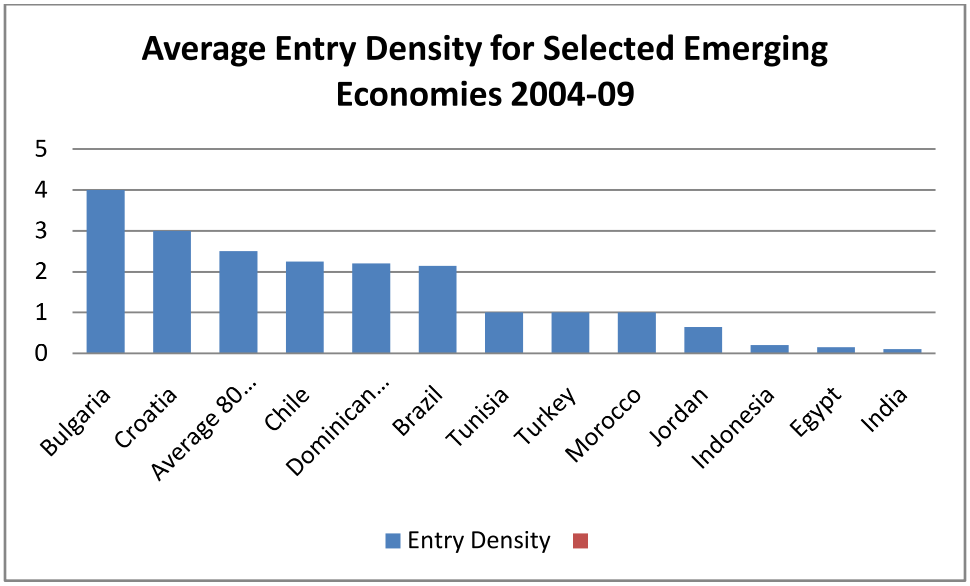
41. In addition to the above, further survey results also indicate that, notwithstanding the relatively competitiveness of business regulations in countries such as Jordan and Morocco, there are wide variations in waiting times across firms that result in uneven treatment of different businesses. These weaknesses in the investment climate inhibit enterprise risk-taking and depress investment and job creation.

42. Further ongoing analysis is serving to reinforce this proposition about implementation performance and its impact on the vibrancy and robustness of private sectors in the region[36]. In many MENA economies, it can be observed that large firms are often born large or those surviving small firms never get to grow significantly or may even contract. More specifically, thereis a lack of dynamism in terms of firm start-ups, growth and eventual exit – a process famously referred to as "creative destruction"[37]. This is reflected in the durability of an identifiable body of firms in different MENA countries and the trend in the region for firms not to diversify exports and seek out higher productivity goods. For instance, 33% of firms from non-GCC MENA countries export only one product to one destination accounting for some 33% of the export value of the countries in the region for which data is available. Some 12% of firms export four-plus products to four plus destinations and this sub-set accounts for 60% of export value, MENA substantially under-trades given its development level to the order of approximately 60-70%.[38]

43. The type of innovation (particularly product and market, as opposed to process innovation)that underlies strong export performance is one of the more predictable means to generate new jobs.[39] Moreover research suggests that firms most likely to innovate, to offer formal training, to use email and establish websites are those high growth firms that have the gazelle characteristics[40]. Conversely, privileged firms that appear not to grow – the outcome of being able to operate in a weak competitive environment with access to subsidized credit and\or privileged status in terms of their treatment within the prevailing regulatory environment –crowd out start-ups and the evolution of gazelle-type firms. This is strongly suggested by the following Chart XII which indicates that an average of 80 emerging countries significantly outperformed the best from MENA in terms of newly registered limited liability firms per 1000 working age people. And the best performers-which were Tunisia and Morocco – far outstripped GCC countries in this measure.

[36] "Jobs For Shared Prosperity", World Bank Publication, 2013
[37] "Capitalism, Socialism and Democracy, Joseph A. Schumpeter, 1942
[38] Ongoing World Bank research into MENA export performance,
[39] "What You Export Matters", D. Rodrik, R. Hausmann, J. Hwang, CID Working Paper #123, December 2005.
[40] Stone, A, and Badawy, L., 2011, "SME Innovators and Gazelles in MENA: Educate, Train, Certify and Compete", MENA Quick Note Series 43, World Bank.

Chart XII



Source: Jobs for Shared Prosperity, World Bank, 2013.

44. In addition to this low density of firm entry, there is a lack of exit volume, reflecting in part the overall weak insolvency regimes generally in place in the region, as noted earlier, For example the average annual exit rate for manufacturing firms in Morocco is 5.1%, significantly lower than, for instance, Chile or Columbia where the rate is more than twice, in the region of 11-12%.[41]In fact there is a developing bifurcation in the MENA region, with larger older and static businesses with fairly fixed or declining labor demand dominating the formal market and job growth happening not even in the SME sector, but the informal and micro-firm sector with little growth among those smaller firms that do survive. There is a missing middle in terms of new and dynamic SMEs that offer the better quality formal "good jobs"that governments seek to generate for their population.This contrasts with the firm dynamics in more competitive economies that operate with creative-destructive forces where firms grow and increase productivity or tend to exit the market.

V. CONCLUSION: POLICY OPTIONS AND EXPECTED OUTCOMES

45. This summary review of key analytical work and World Bank diagnostic assessments leadsback to Table I. Markets need to **"contestable",** in other words firms

[41] "Jobs for Shared Prosperity", p. 124

can enter and challenge incumbents on a level playing field. This requires that the barriers to entry are not stacked too high in favor of incumbents. The "**threat of entry"** is a critical ingredient if firms are to maintain urgency to innovate, improve productivity and grow. Analysis shows a strong positive correlation between productivity improvements of new entrants and incumbents.[42] In other words market dynamism - in terms of entry and exit- is good for both entrant and incumbent firm but even more significantly it is good for the wider economy and labor market, particularly the more skilled labor that innovative growth-oriented firms most demand. Leveling the playing field in terms by reducing policy uncertainty and improving the transparency, fairness and predictability of regulatory implementation and creating opportunity by fostering marketcontestability represent key objectives for government action if a stronger job creation performance is to be obtained from the private sector.

46. Determining how to proceed to develop a strategy towards this end and addressing constraints as identified above, covering business regulations and issues of competition and barriers that set entrants against incumbents, is a challenging political economy exercise. Identifying the optimal economic policies is not sufficient. This has to be allied to other political and social considerations that can have a significant impact of the success of any policy initiatives. Table IV below outlines some of the key considerations that would need to be taken into consideration in formulating a policy agenda.

Table IV

Criteria	**Variable**	**Description of Variable**
Relevance	Policy Priority	Do the actions focus on improvements which can have a measurable impact in support of private sector job creation?
Feasibility	Political Will and Institutional capacity	Does the political commitment for the policy exist? Who are the winners and losers and what are the compensation options? Beyond the reform champions, is there sufficient institutional capability to implement?

[42] This is the key conclusion of Chapter 4 of the "Jobs for Shared Prosperity" Report.

<table>
<tr><td></td><td>Sequencing</td><td>Are there sequencing considerations? Do certain measures better suit shorter or longer term timeframes?</td></tr>
<tr><td>Sustainability/ Cost</td><td>Budget and other resource Implications</td><td>Are there significant upfront or recurrent cost or revenue gain/loss considerations?

Is the reform financially sustainable?

Can gaps in institutional capacities essential for success be addressed in parallel with implementing the reform program?</td></tr>
<tr><td rowspan="3">Synergies and Impact</td><td>Demonstration</td><td rowspan="3">Do the planned initiatives have the potential to catalyze a broader alliance for reform in order to follow through or scale up? Three elements by which to assess this are:

(i) demonstration effects: does the initiative offer quick wins and tangible impacts etc to lock in commitment and maintain momentum;

(ii) linkages: to other stakeholders and capacity to scale up reformsor positive spilloversto other areas (eg where institutions created for one reform can – based on know-how gained – apply expertise and champion related or other reforms). Then there are knock-on effects where a reform initiative raises awareness and appetite to deal with related reform areas;

(iii) measurement: Can the policy impact be credibly measured. Do objective and broadly accepted benchmarks exist.</td></tr>
<tr><td>Linkages</td></tr>
<tr><td>Measurement</td></tr>
</table>

47. In conclusion, it also needs to be highlighted that investment climate reforms are often necessary, but rarely sufficient. An independent World Bank evaluation report[43] on its investment climate investmentsconcluded that where results had been disappointing, the principal cause was often traceable to a lack of implementation and insufficient attention to institutional and incentive framework within which the reform initiatives

[43] "Improving Investment Climates: An Evaluation of World Bank Group Assistance", The World Bank, 2006

subsisted. Moreover the report also underscored the need for an integrated package of mutually-reinforcing actions. Governments seeking to more effectively address the jobs challenge will need not only to augment the investment climate for new business entry and increased market competition andally this closely to improved implementation performance, but also effectively combine withprograms to address the principal binding constraints in the factor markets. This includes investments to improve infrastructure, actionsto develop finance and non-financial services and initiatives in support of labor force development through better targeted training and skills development, driven more closely by private sector demand requirements.

.