

Job Creation and Social Protection :

Exploring the Barriers and Opportunities

Abstract:

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. Added to this are outdated and ineffective social safety net structures that are not promoting livelihoods and resilience for the poor across MENA. Thus making it harder for the vulnerable to break the cycle of poverty and gain higher levels of human capital. This paper will examine the most pressing barriers to exclusion that have produced unemployment, address the risks linked to weak social insurance systems and safety net mechanisms, and provide policy recommendations for countries to overcome these barriers.

Table of Contents

Foreword

I. Introduction

II. Situation Analysis of Employment and Social Protection in MENA

- i. Labor markets in MENA: Inefficient and Inequitable
- ii. Who are the most affected by the low-productivity equilibrium in labor markets?

III. Barriers to higher productivity equilibrium

- i. Growth
- ii. Lack of dynamisms in the private sector
- iii. A regulatory environment that reinforces the status quo in the labor market
- iv. Skills gap and asymmetric information in job search

IV. The way forward: Available policy options for the current challenges in employment and social protection

- i. Policy options

Foreword

Securing access into the labor market continues to be a challenge across the Middle East and North Africa (MENA) region. Vulnerable groups such as women, children, and the poor still face many disadvantages that are based on factors beyond their control including access to quality public services, notably education and health. This has had an impact on their skill level and whether they will have the necessary expertise to enter the formal labor market. In turn, labor market distortions also lead skilled labor to aspire for employment in the public sector, at the expense of the most productive sectors of the economy.

Acknowledging and addressing current market distortions and barriers leading to exclusion are important steps towards improving citizens' resilience to poverty and lowering levels of unemployment and underemployment.

The Second Annual Forum on Development and Employment provides the opportunity for Arab leaders to discuss some of the most pressing barriers to exclusion that have produced unemployment, and address the risks linked to weak social insurance systems and safety net mechanisms.

The Forum seeks to emphasize how the current regulatory environment, by protecting certain markets and a few privileged insiders, stands in the way of a dynamic and job-creating private sector. The rules need to be adjusted in order 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 would ultimately lead to higher labor demand. The current incentives that affect decisions about where to work and when to hire also need to be addressed. These efforts would include: (i) creating a balanced public sector labor market to enable efficient labor flows; (ii) easing employment regulations, coupled with a strong and well-targeted social safety net and social insurance to protect the unemployed, would facilitate entry and mobility; and (iii) an education system better aligned 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.

This gathering of Arab leaders is the ideal platform to create a joint understanding of the challenges in the MENA region and how they can best be addressed.

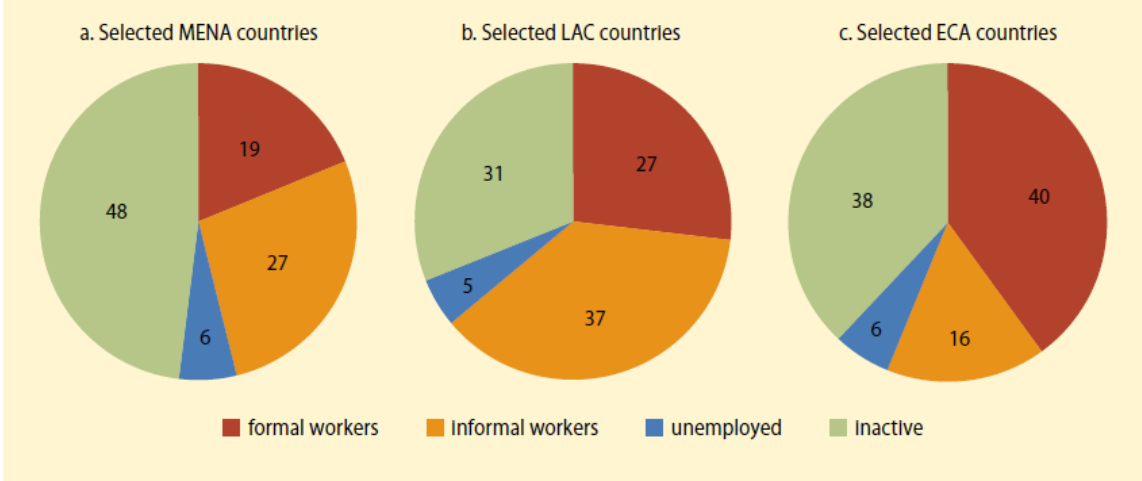
Inger Andersen
Regional Vice President
Middle East and North Africa
The World Bank

I. 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. Added to this are outdated and ineffective social safety net structures that are not promoting livelihoods and resilience for the poor across MENA. Thus making it harder for the vulnerable to break the cycle of poverty and gain higher levels of human capital.

There are several underlying distortions preventing a more productive use of human capital and leading to a widespread sense of unfairness and exclusion. MENA has a large share of untapped human resources and in the pre-Arab Spring period, many governments tended to rely on a redistribution system that promoted (a) a minimum standard living by providing universal subsidies of basic consumer goods, and (b) public employment in response to demand for secure jobs by the middle and upper classes. As a result, unemployment, and inactivity, are more prevalent in MENA than in other middle-income regions (figure O.1), as a high proportion of the working-age population, particularly women, is inactive or experiences high unemployment.

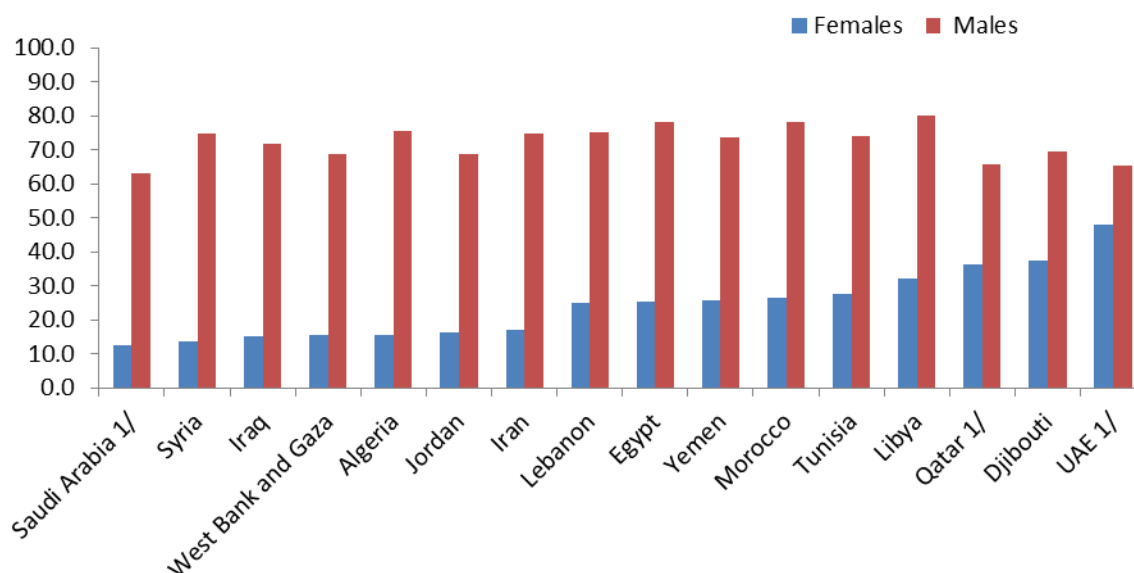
FIGURE O.1 Composition of the working-age population in MENA and two other regions, 2010



Source: World Bank, 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.

In 2010, 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 in MENA is persistently higher than in other regions and overwhelmingly impacts youth and women. In Egypt and Tunisia, the highly educated are more likely to be unemployed. However, in most countries, the majority of the unemployed are still medium- or low skilled individuals. Among the 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 is small, employing no more than 20 percent of workers.

FIGURE O.2 Labor force participation rates by gender (last year available, 2009–10)



Source: World Bank, based on ILO-KILM 2012, the Kuwait 2009 Annual Statistical Abstract on “Unemployment in Kuwait: Facts and Figures”, the Oman Labor Statistics 2009; the Saudi Arabia 2009 Saudi Manpower Survey; and the UAE LFS 2009.

Note: 1/ Refers to national, nonimmigrant population

What follows for those with limited employment and income opportunities is alarmingly low progress on human development outcomes, which are exacerbated by the absence of social safety nets that provide the means for protection against financial shocks and destitution and enhance human capital accumulation. A large share of the region’s population hovers close to the poverty line and exhibits low resilience to shocks. As many as 15-17 percent of Egyptians, Iraqis, Syrians, and Yemenis have per capital consumption levels of no greater than \$0.50 per day above the US \$2 per day poverty line (in purchasing power parity terms). More than a quarter of children in the bottom income quintile in Egypt, Morocco, and Syria are chronically malnourished. Children, at the age of 16-18, in the poorest quintile in Egypt and Morocco are more likely to have dropped out of school than to have continued studying.

Recent economic and social transitions in MENA have refocused attention on the need for greater social inclusion, livelihood and resilience. Although sustained growth in many MENA countries has reduced poverty and fostered a growing middle class, economic progress has yet to reach many families who face persistent risk of poverty. In Jordan, for example, close to a third of the population has experienced poverty in at least one quarter of year. Even though the official poverty estimate is 14.4 percent, nearly 18.6 percent of the populations, including middle-income groups, have experienced spells of poverty. The case is similar in other countries around the region including Egypt, Yemen, and Tunisia where poverty and vulnerability rates have continued to climb. The Arab Spring’s demand for democracy and voice carries unprecedented opportunities for transforming the system of privilege into one of protection, promotion, and inclusion.

This background paper for the Second Arab Forum for Development and Employment builds on a number of World Bank publications across various disciplines. The purpose of the

paper is to provide the context of employment and social protection in the Arab World as a starting point for discussions on the various aspects surrounding the main challenges and the way forward. Section II provides situation analysis of employment and social protection in MENA. Section III presents the main barriers to higher productivity equilibrium. Finally, section IV concludes by presenting the way forward and available policy options for the current challenges.

II. Situation Analysis of Employment and Social Protection in MENA

Labor markets in MENA: Inefficient and Inequitable

The MENA region has a large share of untapped and inactive human resource that is not participating in productive economic activities. For the limited jobs available, many qualified workers desire working in the public sector where overall productivity is low. Combined with low mobility and a large wage gap across sectors, it indicates that labor markets are inefficient in allocation of talent and function at a “low-productivity equilibrium.” Labor markets are also inequitable: securing a job in a competitive market where jobs are scarce is largely correlated with “unearned” circumstances, such as gender and parental characteristics.

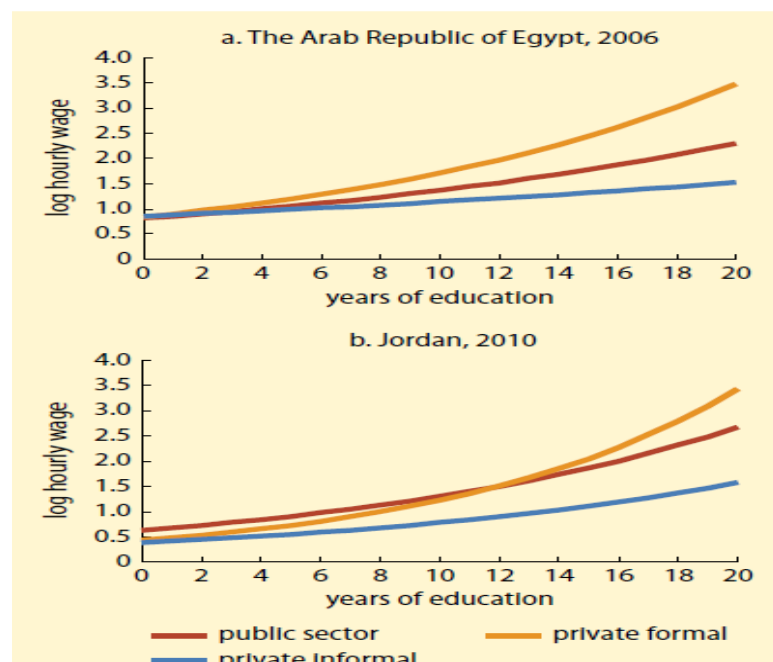
Inefficient allocation of human capital

A number of symptoms indicate that labor markets in MENA do not allocate human capital to obtain its highest return:

(1) Wage differentials persist across sectors and individuals that cannot be explained by differences in human capital:

In many MENA countries, returns to education (especially primary and secondary education) are high in the formal public and private sectors and very low in the informal private sector. Figure O.3 plots the expected wage of an average worker by years of education and employment in the formal public and private sectors and the informal private sector in Egypt and 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 informal private sector.

FIGURE O.3 Expected wage by years of education in the Arab Republic of Egypt, 2006, and Jordan, 2010



Source: World Bank, using the Jordan LMPS 2010 and the Egypt Labor Market Panel Surveys (ELMPS) 2006; $E(w|Yrs\ of\ edu) = \exp(C + \beta_1\ Yrs\ of\ Edu. + \beta_2\ Experience + \beta_3\ Experience\ squared)$.

Note: Estimations based on Mincer model. Sample includes wage earners in urban areas working between 30 and 60 hours per week.

(2) Workers' mobility from low-productivity to high-productivity employment is very limited:

Low mobility across different types of employment, especially toward better quality jobs, indicates that labor markets do not arbitrage the allocation of human capital effectively across job opportunities. 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 in them for long periods and to those who do not to queue for an opening

(3) Geographical differences in labor market outcomes persist:

Stark and persistent differences in unemployment rates across geographical areas indicate that geographical mobility has a limited role in evening out differences in labor market outcomes within a country—resulting in labor market segmentation and isolation. This phenomenon is exacerbated when better jobs are concentrated in particular regions. For example, public sector jobs are often concentrated in the main metropolitan areas.

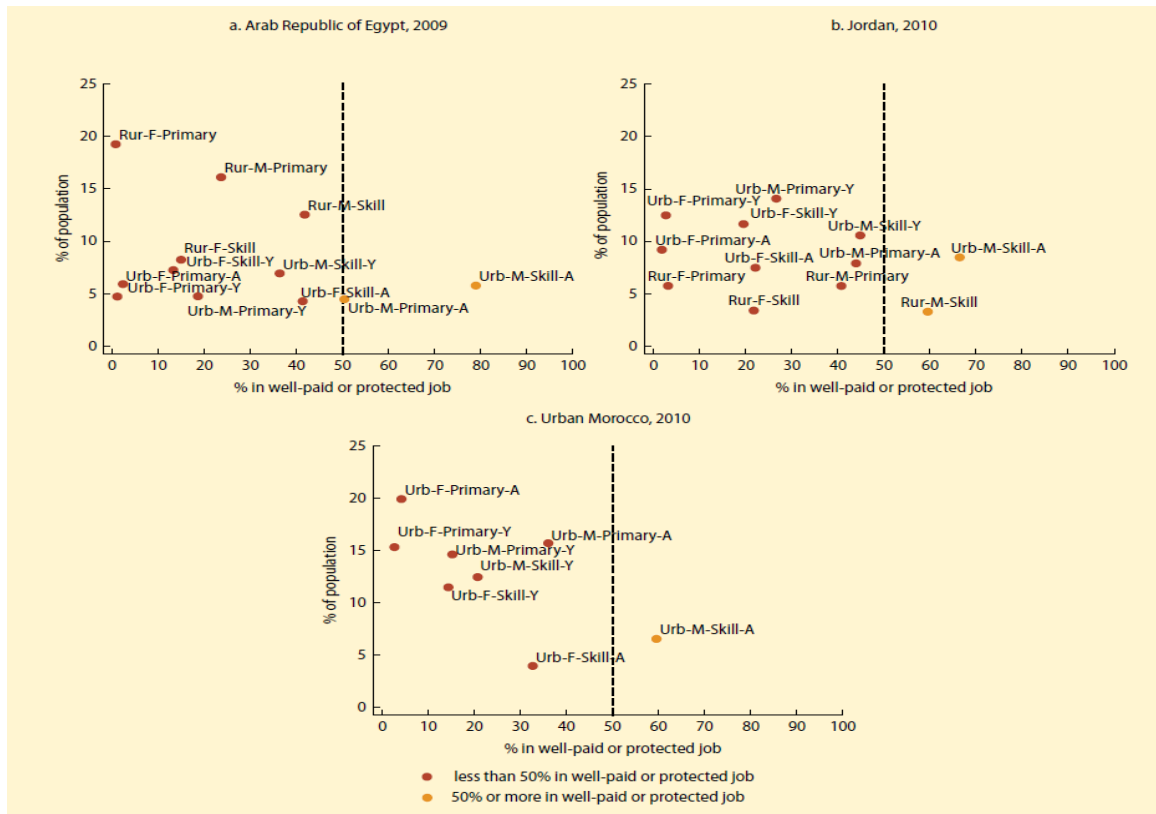
Inequitable distribution of job opportunities

For a large share of the population, “protected” good jobs in the region are inter-linked with the “success” of securing employment in the public sector or through informal networks in the private sector. These jobs agglomerate, for many households, around one earner. To many, this success constitutes a de facto safety net that makes labor market reform more politically difficult. Few workers can achieve success through high-paying self-employment. However, the perceived risk, privilege in access to mentorship, networks, and credit, influences the likelihood of pursuing or finding higher-productivity jobs.

(1) Uneven distribution of scarce jobs across groups and geographic regions

Figure O.4 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.4 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, many young people, women, and rural, low-skilled workers are significantly less likely to have such a job, while the opposite is true in the case of prime-age men.

FIGURE 0.4 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: World Bank, 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.

Though these jobs are scarce 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. 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. Although the current unbalanced equilibrium acts as a (very inefficient) safety net, which has kept income inequality fairly low in MENA when compared to other regions, it sustains relatively high reservation wages. In other words, lowest wage for which an individual is willing to work in MENA is comparably higher among both women and youth in a large segment of the population. This may explain, 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.

(2) High returns and low productive public jobs

Perception for finding good-quality jobs also affects the low-productivity equilibrium. 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 the young generation, in spite of changes in hiring rates in the public sector over time in non-oil exporting countries. 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.

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 and are at higher risks of living in poverty because of various factors they overwhelmingly face disadvantages that push them to inactivity, unemployment or informal low paying work. Moreover, welfare policies and untargeted SSNs that can promote economic opportunity and help the vulnerable overcome poverty, such as income support, services that build human capital, and cash transfers, have a limited impact due to low coverage, poor targeting and inefficient generosity. As a result, these groups are placed at a double disadvantage. The following sections explain the specific extent of disadvantage for each of these groups.

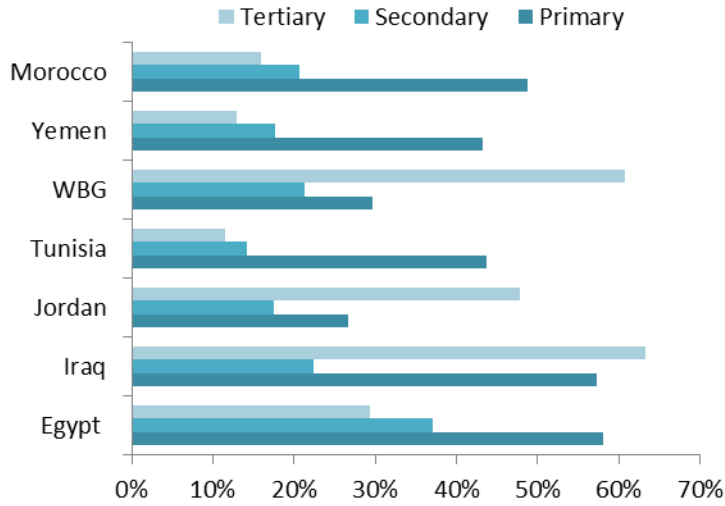
Youth and children

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. High joblessness and slow education to work transition are the two dominating factors for youth's exclusion from the labor market.

(1) 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 0.5 and 0.6 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.

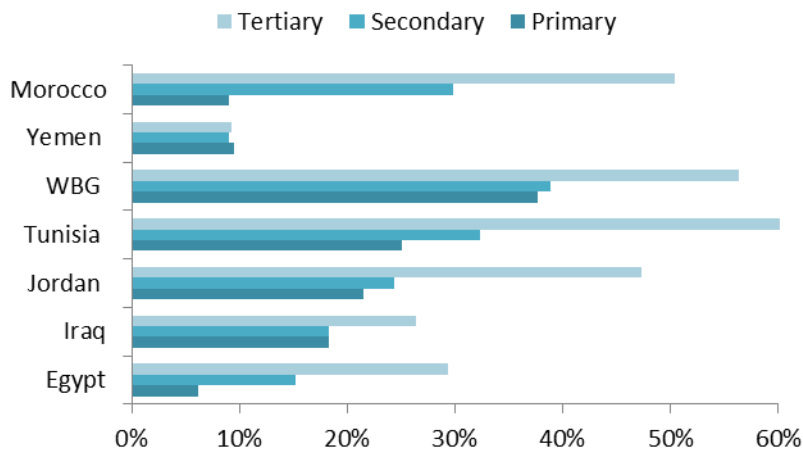
FIGURE O.5 Youth NEET rates in selected MENA countries by education level, individuals ages 15–24, 2008–10



Source: World Bank, 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).

FIGURE O.6 Unemployment rates in selected MENA countries by education level, individuals ages 15–24, 2005–10



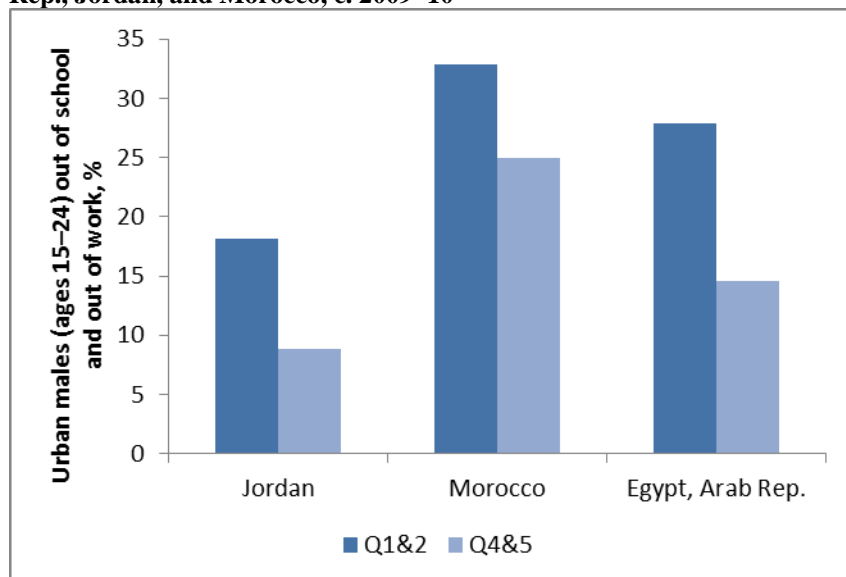
Source: World Bank, based on the Republic of Yemen HBS 2005; the West Bank and Gaza LFS 2008; the Tunisia LFS 2010; the Jordan LMPS 2010; the Iraq HSES 2006; the Egypt SYPE 2009; and the Morocco LFS 2009.

Note: MENA = Middle East and North Africa. Data refer to those who are unemployed.

Moreover, for a large portion of out-of-school youth, inactivity is more prevalent than unemployment. 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.

Once in the labor market, individuals with low levels of human capital accumulation are at the highest risks of being unemployed or in poor-quality jobs. The figure O.7 shows that poor young men are more likely to be out of school and out of work than non-poor young men.

FIGURE O.7 Share of Young Urban Males out of School and out of Work, by Family Wealth, in Egypt, Arab Rep., Jordan, and Morocco, c. 2009–10



Source: Authors' calculations based on data from the following household surveys: SYPE, Egypt 2009; LMPS, Jordan 2010; and MHYS, Morocco 2010. For full descriptions, see appendix A.

Note: Q = income quintile (1 = lowest, 5 = highest).

(2) Slow transition to work and unequal access to basic services

High youth joblessness can be interpreted mainly as the result of a slow, incomplete transition from school to work. Many children in MENA are likely to have poor access to social services such as schools and are more vulnerable to poverty. Children and youth's risk of poverty and rate of access to social services depend, to a large extent, on circumstances beyond their control, such as their location at birth, their gender, and their parents' wealth and education. Growing up in a poor household and in rural areas limits the opportunity to accumulate key human capital. For instance, a child in rural Upper Egypt is 3.4 times less likely than a child in urban Lower Egypt to attend primary school.

Even when children gain access to social services such as health care, education and are able to break the poverty cycle, there are still dynamics that limit their access to the labor market. 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.

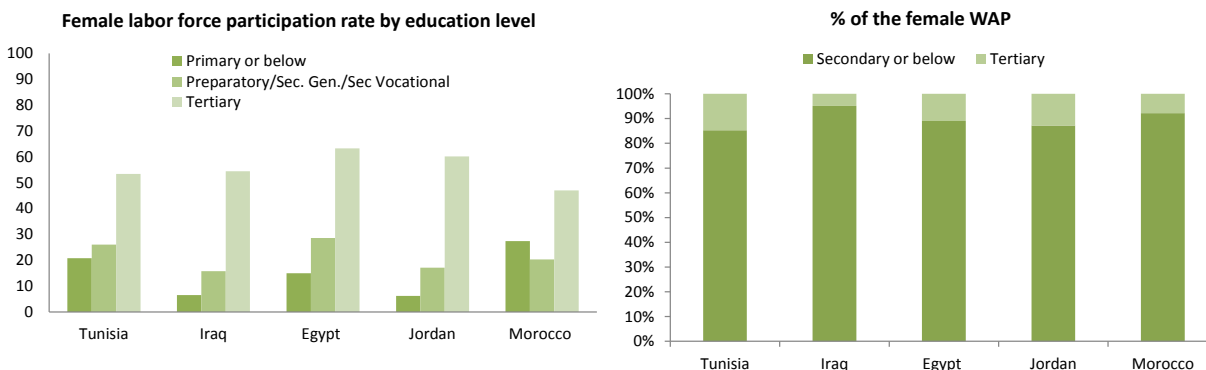
Women

Women have 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.8).

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. The same data also show that, after marriage, women's decision-making power is substantially reduced.

Some of the main factors hindering female labor force participation in MENA are weak support systems (such as public transportation and child care services), lack of empowerment, educational disadvantages, and wage discrimination as well as gender segregation in various industries.

FIGURE O.8 Female participation in the labor force in five MENA countries, by education level, various years, 2005-10

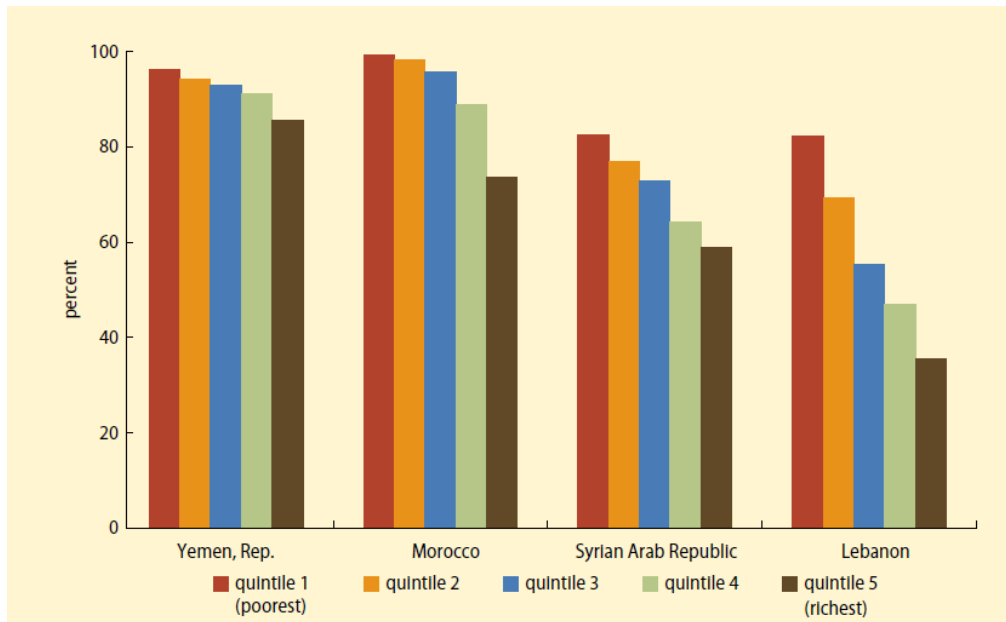


Source: World Bank, based on the Iraq HSES 2006, the Morocco YHS 2010, the Egypt LMPS 2006, the Jordan LMPS 2010, and the Tunisia LFS 2010.

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 (figure O.9). Informality is a complex phenomenon; yet one segment of the informal workforce displays the lowest chance of accessing desirable jobs and the highest chance of being poor: unskilled rural workers, defined as those with a primary education or below who live in rural areas.

FIGURE O.9 Informality rate by quintile of per capita consumption in selected MENA countries, 2011

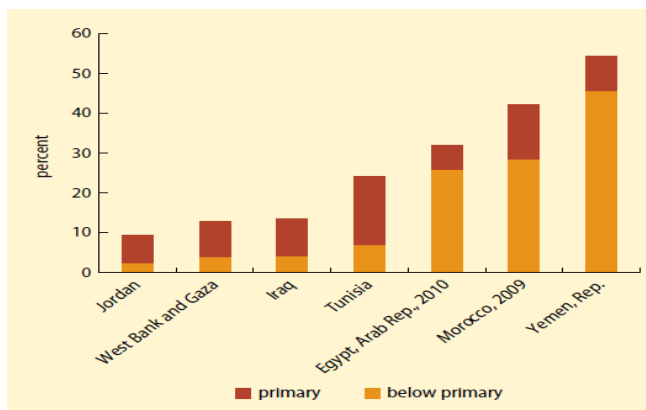


Source: Angel-Urdinola and Tanabe 2012.

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).

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.10). 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.

FIGURE O.10 Unskilled rural workers as a percentage of the working population, 2006–10



Source: World Bank, 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.

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. The lack of social security coverage leads to the working poor being highly vulnerable to poverty without effective coping strategies.

(1) Vulnerable households spend a high share of total expenditures on essentials

This implies that households cannot easily scale down their expenditures during shocks, and thus they can easily move into poverty. For instance, between 2005 and 2008, 55 percent of Egyptians experienced at least one episode of poverty or near-poverty (Marotta et al. 2011).

(2) Many suffer from a high probability of irreversible loss of human capital during shocks

In face of a major shock, households rely on their own income, savings, assets, as well as on informal safety nets (such as private support from family and neighbors) because few have access to formal safety nets. As many as 15 percent of households in Iraq and Morocco reported suffering at least one major shock during the previous 12 months, but only about 1 percent of these shock-affected households reported receiving help from formal safety nets.

III. Barriers to higher productivity equilibrium

MENA is a region with an extraordinary heterogeneity in socioeconomic characteristics, institutional development, and natural resources; yet MENA countries share significant trends in economic performance. These include solid growth rates in the 1960s and 1970s resulting from investments in infrastructure, education, and health, accelerated accumulation of production factors, and increased productivity linked investments in physical and human capital. With the plummeting of international oil prices in the 1980s the foundations of growth 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. By the 1990s, reforms across MENA varied 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 pro-cyclical 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 1996 and 1999 to around 5 percent between 2000 and 2008.

Despite the recent extended stretch of solid growth, there have been barriers to higher productivity equilibrium. These include: (i) growth; (ii) lack of dynamism in the private sector; (iii) a regulatory environment that reinforces the status quo in the labor market; and (iv) skill gaps and asymmetric information in job search.

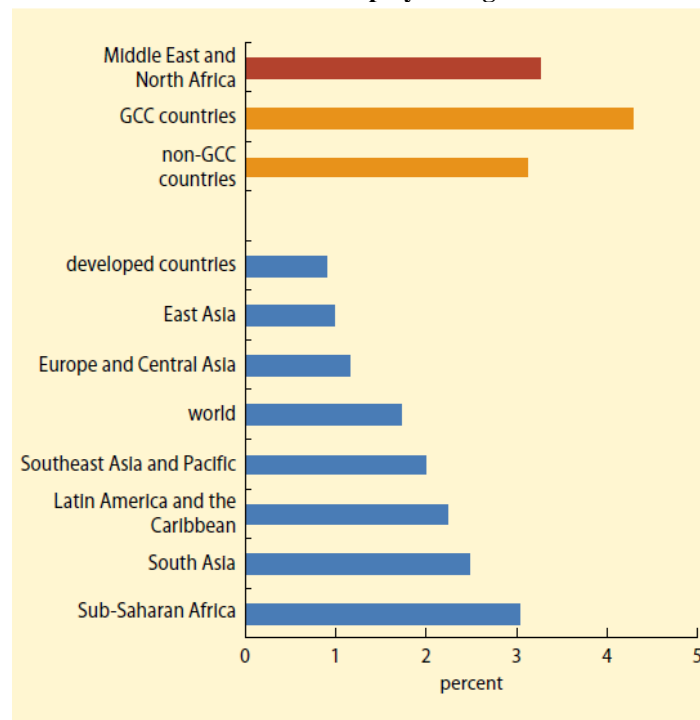
Growth

Disappointing employment outcomes

Employment outcomes in the region continue to be of concern on two main fronts:

- (1) The number of jobs created is not sufficient to absorb the increasing number of new entrants into the labor market: the “youth bulge” has meant that even though there have been increases in jobs that supply is not meeting the increasing demand (figures O.11 and O.12).

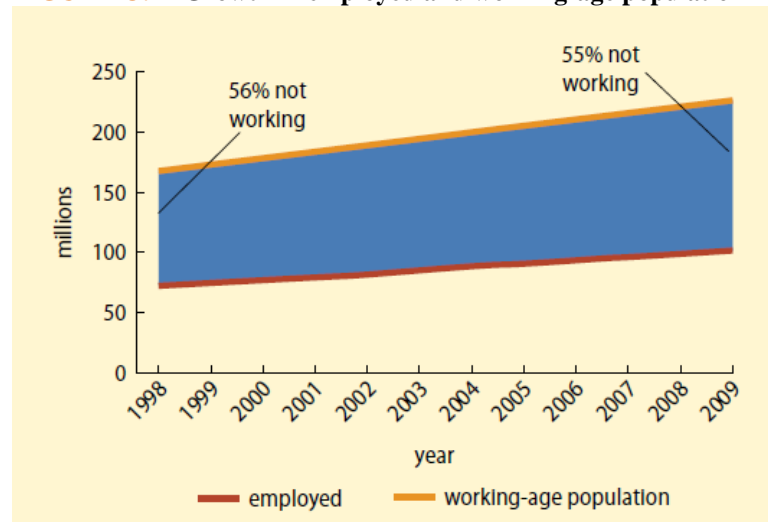
FIGURE O.11 Total annual employment growth in selected regions of the world, 1998–2008



Source: ILO-KILM database.

Note: GCC = Gulf Cooperation Council.

FIGURE O.12 Growth in employed and working-age population in non-GCC MENA countries, 1998–2009



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

- (2) Jobs were created in relatively low-value-added sectors, and public employment continued to account for a substantial share, especially in Gulf countries.

An unfinished reform agenda

Although implementing sound fiscal and monetary policies will continue to be a prerequisite for sustained economic growth in MENA, leveling the playing field of the business enabling environment as well as the individual access to labor market are equally important. However, at structural level, a number of specific factors continue to inhibit change in labor markets or firm entry:

- (1) 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 non-resource tradable sectors by increasing uncertainty. Thus reducing development prospects in more dynamic sectors of the economy, which are not capital intensive and have a higher potential for creating employment.
- (2) Pro-cyclical and discretionary fiscal policies, which rely on costly universal energy and food subsidies and result in a lack of high, sustained investment.
- (3) 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.

Lack of “dynamisms” in the private sector

Lack of playing field and distorted input prices

The private sector in MENA displays little dynamism a measure of average firm entry, age, human-resource characteristics, and density. The MENA region has the world's highest average firm age, the highest average age of its chief executive officers, and one of the lowest firm densities in the world.

- (1) The persistence of informal networks in access to capital, market opportunities, and regulators are key barriers to growth of firms and, as a result, firm demand for jobs. The

slow growth of firms and limited capacity to generate employment are linked to the business environment. Firms in MENA countries complain about inconsistent and unpredictable policy implementation. 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 for innovation.

- (2) Input prices are distorted and create an anti-labor bias. For example, energy subsidies, which are common and substantive in the region, increase the relative cost of labor in relations to the cost of energy and thereby limit labor demand in the short run. 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 total energy subsidies (Abouleinein et al, 2009).

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

Labor markets in the region contend with a relatively heavy public sector. The design of social insurance systems covers a small minority of workers, while the lack 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 and the role of public employment

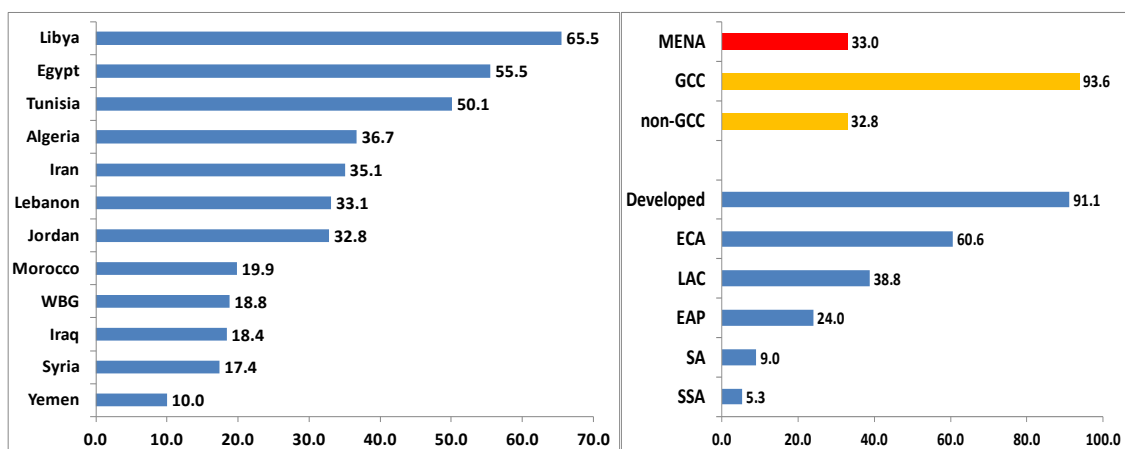
- (1) Important wage rigidities contribute to unemployment, queuing and informality. In addition, wages, contract duration, working hours, and dismissal procedures define the employment relationship. Dismissal (from the formal sector) however, remains more difficult in MENA than in any other region of the world.
- (2) The public sector has traditionally employed anywhere between 14 and 40 percent of all workers. Employment conditions in the public sector access to social security, higher wages, and generally low pressure to be productive, compete with and may even crowd out employment conditions in the private sector.
- (3) "Double dipping" occurs as a result of extremely low risk of dismissal, and relatively low demand for productivity.

Effects of financially unsustainable social insurance systems

The design of the pension systems constitutes a barrier to mobility in labor markets in the region.

- (1) Pension systems in MENA are relatively new, having recently evolved from covering only civil servants (figure O.13). The coverage is still limited, leaving about 60 percent of the labor force without protection against old-age risk. Additionally, no legal coverage instruments are available for self-employed and agricultural workers in many countries, including Djibouti, Iraq, Morocco, Syria, and West Bank and Gaza. No pension schemes exist for agricultural workers in Algeria, Iran, Iraq, Libya, West Bank and Gaza, and Yemen.

FIGURE O.13 Share of the labor force contributing to social security (%) in MENA and other regions of the world



Source: Gatti et al. (2012) from ILO-KILM.

Note: coverage in GCC countries in ILO-KILM has limited representativeness, and is essentially limited to Bahrain.

- (2) A number of features in the design of social insurance schemes in MENA contribute to the low participation (coverage) rates and include: limited legal coverage; short minimum vesting periods which promote gaming of the system; early retirement provisions which distort incentives to participation; and the use of average wages in the last few years of service as a basis of calculating benefit amounts, which makes these schemes more expensive. These flaws exacerbate the financial unsustainability of 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.
- (3) The provision of pension schemes in the public sector and their limited capacity in the private sector discourage labor from moving to private employment and strengthen the segmentation between the public and private employment sectors. With a large share of the private sector engaged in low-value-added production, 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.
- (4) Unemployment insurance, another form of social insurance, is limited in availability across MENA despite its ability to cover the risk of temporary income loss when a person loses a job thus providing no income protection for the unemployed in mitigating the effects of sudden job loss and preventing more people from slipping into poverty.

Lack of poverty targeted social safety nets

- (1) Fragmented SSN programs in MENA rely on poor targeting schemes such as categorical and geographical targeting. As a result, the wealthy tend to constitute a significant share of social safety nets beneficiaries. This results in high leakages, with only a quarter of untargeted SSN beneficiaries in the average country coming from the poorest quintile, while about 15 percent are from the richest quintile. The poor targeting, accompanied

with high fragmentation of SSNs among many small programs and low coverage, do not provide an efficient safety net to protect those without income opportunities against financial shocks and destitution. As a result, job losses become extremely costly for the poor.

Skills gap and asymmetric information in job search

A major determinant of skills-mismatch in the MENA region is the asymmetry of information for perceived market demand. This, in part, results in incentive to cultivate skills that are not necessarily in demand.. In particular, school-to-work transition period illustrates the skill distortion for the youth. Many youth in MENA need to undergo a “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

MENA countries have significantly expanded access to education, with substantial growth in enrollment in secondary and tertiary education. 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. Three key factors rooted in the incentives prevalent in MENA’s training, and educational systems contribute to these outcomes:

- (1) Logic of selection rather than learning: this is manifested in ridged tracking in secondary education and high-stakes examinations-dominates educational systems instead of a “logic of learning.”
- (2) 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. 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.
- (3) Perception of the public sector as the main client of education and training: the fact that governments continue to play an important role in providing jobs in MENA and that public sector jobs are still the most coveted by youth distorts incentives for skill formation.

A meritocracy deficit in the labor market

Education credentials are widely perceived to play a minor role in employers’ hiring decisions. When formal degrees have limited signaling value, other factors (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.

Limited role of formal labor intermediation

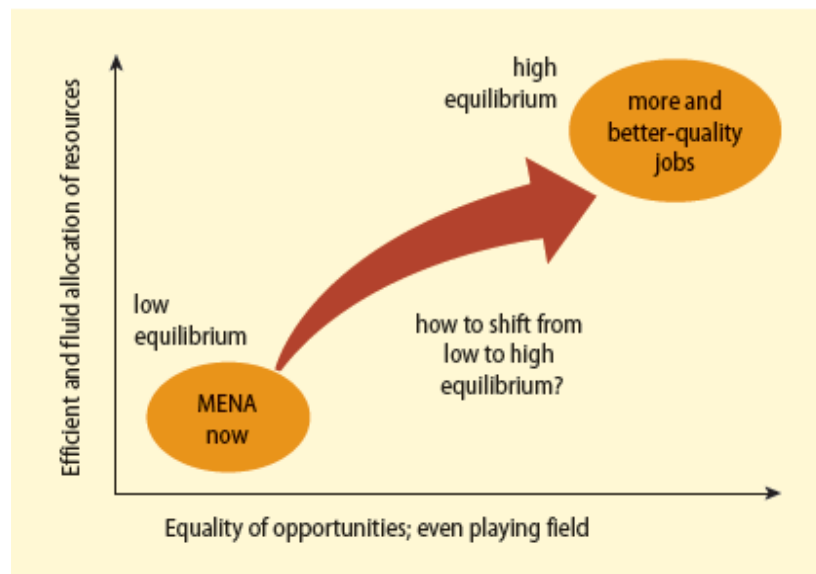
The widespread use of informal networks is a sign of information asymmetry and of signaling failure. Information asymmetries in labor markets can be overcome, to some extent, through intermediation services, and public and private employment agencies can play an important role in job matching.

IV. The way forward: Available policy options for the current challenges in employment and social protection

The employment challenge in MENA is structural. The rules that govern the distribution of growth dividends – including limited competition in the private sector and restrictive regulations of labor markets- have also limited economic growth and employment creation.

Similarly, a medium terms 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.14 Towards more and better quality jobs in MENA



Policy options

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, 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.

Let skills flow into productive private sector jobs by realigning employment conditions in both the private and the public sectors, and by rethinking labor regulation. Lower the barriers holding women back 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. 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 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.

A new labor market approach is needed that can reduce information gaps in the job search process, improve quality of relevant skills, and partner with the private sector in school-to-work transition.

The main challenge that the region faces is not further investment at the household level in education and skill attainment; rather, it is 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. Meritocracy signals market needs 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 feedback as a basis for reform and as a way to empower users.

Strengthen the resilience of disadvantaged groups by improving social insurance schemes and equalizing the ability to access labor markets

Growing up in a poor household and in rural areas is largely associated with poor human development outcomes. This largely pre-determines many future earning, education and health outcomes in adulthood. This is because the process by which children and young adults attain desirable education and health, for example, depends to a large extent on circumstances beyond their control (wealth, location at birth, gender etc.). Once in the labor market, individuals with low levels of human capital accumulation are at the highest risk for unemployment or accepting poor-quality jobs.

While there is no single solution, better results can be achieved through action on the following agenda items: (i) Recognize the need of adopting social safety net (SSN) programs that have a strong impact on poverty reduction and equity by prioritizing interventions that are better

targeted at the poor and vulnerable and promote investments in human capital; (ii) adopt best international practices to ensure professional and transparent management of social security reserves while examining the effectiveness of SSN resources, to determine reform measures that can be undertaken to improve targeting mechanisms; (iii) engage citizens in the dialogue on reform programs, and study the potential for reforms in energy and other universal subsidies, and the benefits that come about from these reforms in terms of freeing up fiscal resources to allow for reductions in the relative cost of labor and increasing its demand; (iv) ensure the financial sustainability of the programs' design, by appropriately aligning contribution rates, vesting periods and benefits; (v) broaden the scope of existing programs to provide mitigation against crisis situation and social risks of different sources for more effective and remedial actions; (vi) gradually eliminate the different treatment to workers in different sectors of activity, notably public service and private sector and provide basic social security programs to all workers; and (vii) ensure profitability of social security schemes within each country and across countries.