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Jobs for Shared Prosperity

Time for Action in the Middle East and North Africa

EXECUTIVE SUMMARY

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

The MENA region has a large pool of untapped human resources, with the world highest unemployment rate among youth and the lowest female labor force participation. At the same time, desirable jobs - defined as high paying job or with social insurance coverage - are few: private employment is overwhelmingly of low value added and the public sector still provides the majority of formal jobs. High wage differentials, low mobility, and stark and persistent geographic differences in employment outcomes underscore the inefficiency with which labor markets in MENA allocate human capital. Moreover, access to desirable jobs is predominantly tied to circumstances beyond individual control, such as gender, location at birth, and parental education rather than individual effort. These inefficiencies and inequities are exacerbated by the fact that some of the most coveted jobs, such as those in the public sector, provide high individual returns, but are not necessarily associated with the

highest social productivity. Gallup's recent polls show that the overwhelming majority of youth would rather work in the public sector. In this way, the incentives that workers face keep MENA labor markets in a low-productivity equilibrium: To increase the chances of securing a public sector job, young people choose higher education degrees that are not relevant to the private sector. Those who can afford it then 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, this model of labor market success is unsustainable.

Many barriers contribute to this equilibrium. The process of *creative destruction*, which led to *technological upgrading in fast-growing East Asian and Eastern European economies*, is limited in MENA's private sector. Few well established firms operate in a regime of privilege and limited competition, while

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

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

With no feedback mechanisms from firms and a legacy of state-led industrialization, the main focus of education systems continues to be the production of future employees for the public sector. While the MENA region has the highest percentage of firms in the world complaining of inadequate skills, the incentive for education and training systems to cultivate relevant skills and competencies are muted. Moreover, a rigid tracking system and restrictive university admission policies promote a logic of selection — manifested in rigid tracking in secondary education and high-stakes examinations — rather than of quality of education. This is reflected in MENA's disappointing performance in international assessments such as PISA and TIMSS when compared with countries with similar GDP levels. When formal skills are of limited value, other factors - such as personal networks - become more prominent in

determining hiring and can further promote the inequitable distribution of job opportunities.

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

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

Most of these policy recommendations are well known and broadly shared. This begs the question: Why have these reforms not happen yet? What could finally trigger the reform process?

MENA countries face a complex legacy. Pre-Arab Spring, governments tended to rely on a system of rent sharing among constituencies of support from a relative minority, as well as on universal subsidies of basic consumption goods. There were many aspects to this equilibrium: (i) public employment responded to the demand for guaranteed secure jobs by middle

and upper classes; (ii) access to credit was concentrated on an extremely small set of well-connected firms; (iii) restrictions on the right of association strongly limited the role for civil society organizations; (iv) and lack of access to data prevented an informed dialogue within the polity.

The powerful demand for democracy and voice of the Arab Spring carries unprecedented opportunities to break this system of privilege and move towards a new and more inclusive model of development.

However, it also carries challenges – governments are under tremendous pressure to deliver results rapidly, which might push them towards populist, fiscally costly measures that continue to reinforce current divides. Long time outsiders might see the current political transformation as the opportunity to finally become the new insiders, thus generating a mere alternation of elites. Moreover, there is evidence that it is difficult for new governments to embrace ambitious reform agendas, something that could be particularly daunting in the midst of the current drop in growth and fiscal revenues.

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

And, if not now, when?