

Opportunity for All

Promoting Growth and Inclusiveness
in the Middle East and North Africa

*Catriona Purfield, Harald Finger,
Karen Ongley, Bénédicte Baduel,
Carolina Castellanos, Gaëlle Pierre,
Vahram Stepanyan, and Erik Roos*

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OPPORTUNITY FOR ALL
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**Catriona Purfield, Harald Finger, Karen Ongley, Bénédicte Baduel,
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Groupings and Abbreviations

Throughout this paper MENA refers to Middle East, North Africa, Afghanistan, and Pakistan.

Countries within the region are grouped using WEO income thresholds for advanced, emerging market, and low-income countries into

MENA Advanced Economies (MENA AD): Bahrain (BHR), Kuwait (KWT), Oman (OMN), Qatar (QAT), Saudi Arabia (SAU), and United Arab Emirates (ARE),

MENA Emerging Markets (MENA EM): Algeria (DZA), Egypt (EGY), Iran (IRN), Iraq (IRQ), Jordan (JOR), Lebanon (LBN), Libya (LBY), Morocco (MAR), Pakistan (PAK), Tunisia (TUN), and West Bank and Gaza (WBG).

MENA Low-Income Countries (MENA LIC): Afghanistan (AFG), Djibouti (DJI), Mauritania (MRT), Sudan (SDN), Somalia (SOM), and Yemen (YMN). Syria (SYR) has been excluded in many cases due to lack of reliable data.

Executive Summary

As the global economy continues to grow, policymakers in the Middle East and North Africa (MENA) region are at a critical juncture. Regional growth has been uneven since the global financial crisis due to a range of factors, resulting in stagnant incomes, inadequate job opportunities (particularly for young people and women), and ongoing frustrations over the quality and accessibility of public services.

The inclusive growth and job creation agenda has moved to the forefront of national dialogues in recent years. Ostry et al (2014) have demonstrated that inequality and an inability to sustain economic growth often represent two sides of the same coin, and making growth more inclusive can also make it more sustainable. Yet much work remains as countries move toward implementation of pro-inclusive growth policies that will be critical to the economic success of the region. A 2014 conference in Amman—co-hosted by the Jordanian government, the Arab Fund for Economic and Social Development, and the IMF—laid the foundation for a policy discussion in the Arab world focused on fairness and inclusion. Four years later, in January 2018, representatives and experts from more than 20 countries in the region convened in Marrakesh to discuss their experiences in pursuing policies aimed at promoting “opportunity for all” and ensuring that no one is left behind.

This paper seeks to pave the way for further operationalizing the inclusive growth agenda by exploring the key issues the MENA region faces in its efforts to promote inclusive growth. Given that many reforms are already underway in the region and the intention of the paper is to chart a future course for policies to enhance inclusive growth, the paper intentionally emphasizes the key areas where faster and deeper progress is needed. It also underscores the need for policies to be tailored to country-specific

circumstances since “one size” cannot fit all, especially in a region as diverse as MENA.

The paper lays out the central facts for understanding the primary challenges countries in the region must address to create more jobs, lift growth, and make growth inclusive. It highlights various obstacles such as the insufficient level of private-sector job creation, the small size of the private sector, and the severe obstacles the region’s large pool of young people and women face in finding jobs. It makes the case for three key policy priorities—level the regulatory playing field so private sector firms and SMEs can grow and create the jobs necessary to employ the region’s youth when the public sector no longer has the capacity to be the employer of first resort; leverage trade and technology to generate a large internal regional market to be better positioned to compete internationally in the face of rapid technological progress that is fundamentally changing markets; and adopt comprehensive policies to improve skills, flexibility, and employability of workers in the face of technological advances (such as artificial intelligence) that are changing the nature of work.

The paper also considers how specifically the MENA region can make growth become more inclusive. Currently, factors such as family circumstances, gender, age, or location often prove to be obstacles for many citizens who are seeking access to essential public services and social safety nets, a problem that is compounded by corruption. The paper proposes several policy priorities aimed at broadening access to opportunity. These include improvements in governance, expansion of access to finance, expanding the coverage and generosity of social safety nets, especially to benefit the poor, and policies specifically targeted to enable excluded groups like youth, women, refugees, and rural populations overcome the obstacles they face.

Finally, the issues of government performance and accountability are explored in greater depth. The paper documents the significant skepticism and dissatisfaction many in the Arab world have toward governments’ provision of public services and their handling of issues like income inequality. In many cases, the skepticism is not unfounded, given that many critical services are inefficiently provided and are of low quality; that tax collection is often too low to provide adequate funding for social spending, infrastructure, and other inclusive growth priorities; and that spending often benefits the wealthier segments of society more than the poor. The paper therefore makes the case for creating space for higher infrastructure and social spending by reorienting spending away from generalized subsidies, by tackling wastage and corruption, and by widening tax bases and making them more equitable.

Despite these significant challenges, there is reason for optimism. With action and commitment to the principles and reforms that emerged from Amman

and Marrakesh, the MENA region can capitalize on the opportunities provided by the strengthening global economy and provide a better, more equitable, and prosperous future for its citizens. The region's highly educated and tech-savvy youth—in many countries over half of 18–34-year-olds owned a smartphone (Poushter 2016)—have tremendous potential to spur growth if given opportunities and jobs. The region's women are another huge source of untapped potential. Reducing the gender gap in labor force participation to double (rather than triple) the average for emerging market and developing economies would have doubled GDP growth in MENA over the past decade—a gain of US\$1 trillion in cumulative output. These estimates hint at a bright prosperous future that could be ignited through policy reforms that promote higher, more inclusive, growth.



Introduction

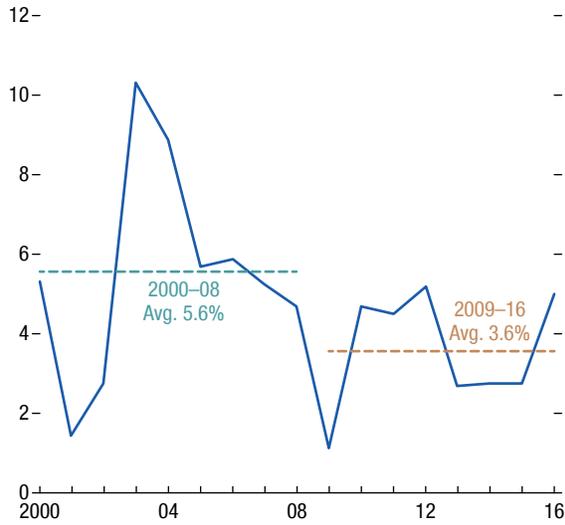
Despite a period of robust growth in the mid-2000s, the Middle East and North Africa (MENA) region has experienced lackluster growth for much of the past decade. Growth was hard hit by the global financial crisis and has since been affected by a series of factors: the slowdown in trading partners' growth, the fall in oil prices from 2014, protracted regional conflicts, as well as a longer-term trend of stagnant or declining productivity in countries across the region.

Countries across the MENA region have placed job creation and inclusive growth at the heart of their reform agendas in recent years, and certainly since 2011. And there has been progress—though not enough. Although regional GDP growth ticked up in 2016, the average growth rate since 2009 has been one-third slower than the average during 2000–08, and less than half its 2003 peak (Figure 1.1).

On the surface, regional indicators of poverty and inequality appear modest. Income inequality—measured by the Gini coefficient—ranges from a low of 0.28 in Algeria to a regional high of 0.44 in Djibouti, generally below peers (Figure 1.2). The middle class represents a significant share of populations, but where data are available, its expansion has been slower than in other regions (IMF 2014a). The reported rate of extreme poverty (living on \$1.90 a day) is low (Chapter IV).

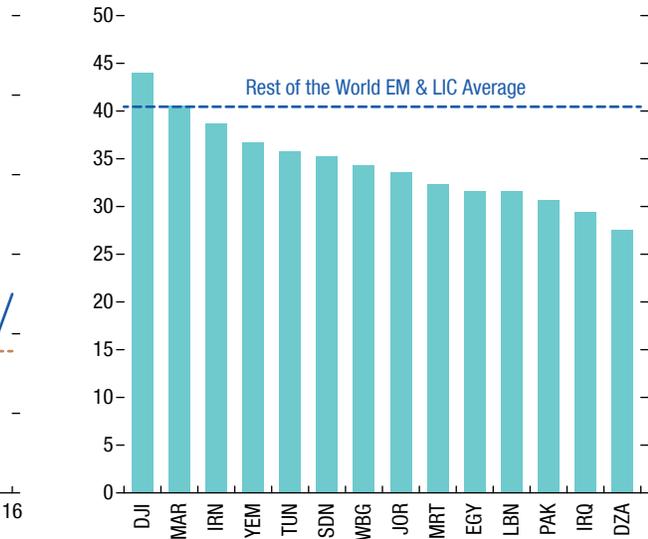
However, persistently weak growth has left per capita incomes near stagnant, and the income gap with other regions is widening. Average income per person grew by only 0.8 percent per annum from 2013–16, which further exacerbated the problem of income inequality that had emerged with peers in the previous decade (Figure 1.3). Meanwhile, the lack of jobs and access to affordable high-quality public services, finance, and technology are hampering access to

Figure 1.1. MENA Real GDP Growth
(Percent change)



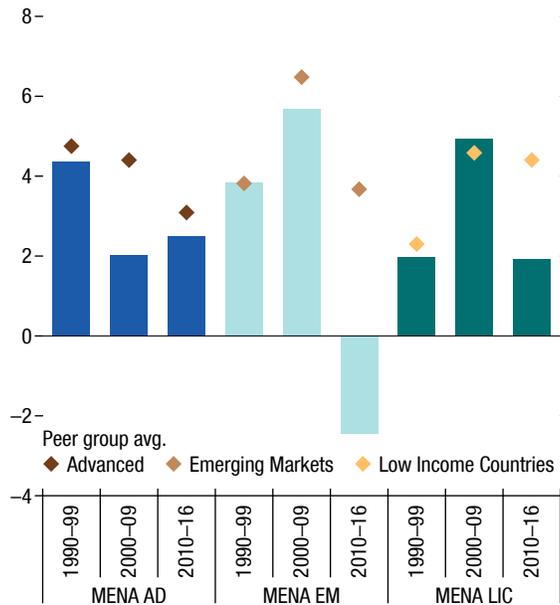
Sources: National authorities; and IMF staff calculations.
Note: The regional average is weighted by purchasing power parity adjusted GDP.

Figure 1.2. Gini Coefficient for MENA Countries
(Percent, latest available value)



Sources: World Bank; and IMF staff calculations.

Figure 1.3. GDP Per Capita Growth
(Percentage change, in constant 2011 international dollars)



Sources: National authorities; and IMF staff calculations.

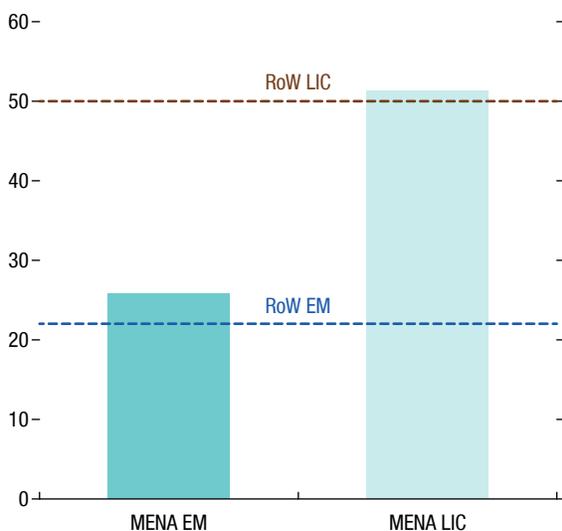
opportunity and preventing growth from benefiting all. For example, the 2017 Arab Youth Survey (ASDA'A Burson-Marsteller 2017) reveals that 35 percent of Arab youth see unemployment as the biggest obstacle facing the Middle East. The 2014 Arab Barometer survey shows that 70 percent of citizens think that “the government is doing bad or very bad at narrowing the gap between the rich and the poor.” Additionally, 60 percent think that “their government is not doing enough to improve basic health services.”

And the benefits of growth have not reached all. The United Nations Development Program shows 26 to 51 percent of MENA EM and LIC populations still live in poverty when measured in multidimensional terms (Figure 1.4). Poverty also runs higher in rural and disadvantaged areas (Chapter IV): almost 60 percent of the poor in Algeria, Egypt, Morocco, Sudan, and West Bank and Gaza live in rural areas (Food and Agriculture Organization, 2007). Poverty is rising sharply in countries in conflict: Iraq, Libya, Syria, and Yemen.

The good news is that the stronger global economy offers a window of opportunity for reforms. IMF projections show that global growth is the highest it has been this decade, having reached 3.7 percent in 2017, with the expectation that it will further accelerate in 2018 and 2019 (Figure 1.5). In the MENA region, growth is also expected to pick up. But at 3½ percent in 2018 and 2019, forecasted growth is well below the average of 5.6 percent achieved during 2000–08.

Figure 1.4. Population Living in Multidimensional Poverty

(Population weighted average, latest available, percent)

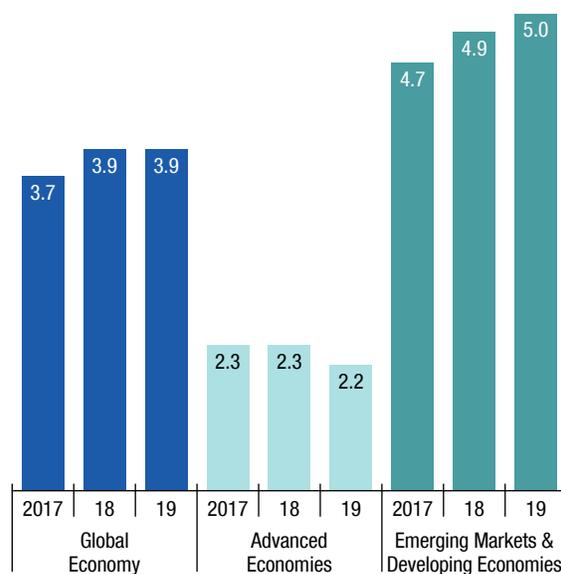


Sources: United Nations Development Programme, Multidimensional Poverty Index.

Note: MENA AD countries were excluded due to data availability.

Figure 1.5. Growth Projections

(Percent of GDP)



Source: WEO Update, January 2018.

Policymakers in the MENA region face the challenge of advancing reforms after years of low growth, hardship, and, in some countries, conflict. The central question facing countries in the region is how to scale up reform implementation in order to improve livelihoods and living standards—and how to do this in a sustainable way. Put more broadly: how can the region fulfill the aspirations of its youth, instill hope in the future, and increase public confidence in government service delivery and accountability?

In January 2018, representatives and experts from more than 20 countries in the region gathered in Marrakesh to discuss these questions. The “Opportunity for All: Promoting Growth, Jobs and Inclusiveness in the Arab World” conference, co-hosted by the Moroccan government, the IMF, the Arab Fund for Economic and Social Development, and the Arab Monetary Fund, provided a forum for public officials, private sector representatives, and civil society to share their views about low growth, inequality, and government accountability and corruption. The conference allowed participants to discuss their experiences in overcoming obstacles to faster implementation of inclusive growth policies and how the private sector and civil society can help support this goal.

Government representatives spoke to the changes being made to reorient public resources to social spending and to the urgent need for jobs, especially for young people. They emphasized the importance of the private sector stepping up to provide economic and financial access for youth and women. Conference attendees called for strong action to tackle corruption, not only to improve the business environment for private firms but also to enlarge the envelope of public resources and to foster support for reforms. Attendees heard of the resilience and dynamism of the region’s young entrepreneurs, who have built their own opportunities notwithstanding the difficult environment. The seven-fold increase in fintech start-ups in the MENA region since 2009, the emergence of new e-platforms like *eFawateerCom* in Jordan that have expanded financial access to millions of users, the emergence of new locally grown tech giants like the transport firm *Careem*, and the job-matching site dedicated to women, *Glowork*, speak to the potential of technology and new sectors to drive growth and job creation, while helping to equalize access to opportunities.

The conference found that moving forward to promote higher inclusive growth in the MENA region requires forging a new political consensus that seeks buy-in from people who may stand to lose in the short term as policymakers make difficult trade-offs to ensure greater opportunity for all in the longer term. The policy priorities that emerged from these discussions can be summarized in “ACT NOW” (Graphic 1), a call for reforms across the region to promote the following key elements:

Accountability: increase transparency and strengthen institutions to control corruption and ensure shared responsibility for inclusive policies.

Graphic 1. A call for faster implementation of reforms to promote inclusive growth in MENA.



Competition: promote the private sector through better regulation to build a vibrant economy.

Technology and trade: leverage technology and innovation, nurture trade, and attract foreign investment to diversify and develop new sources of growth and job creation.

No one left behind: build strong safety nets and empower disadvantaged groups, including youth, women, rural populations, and refugees.

Opportunity: create a level playing field for all people through equitable and growth-supporting government spending, fair taxation, and structural reform.

Work: invest in people and equip workers for the new economy through education to foster greater equality and prosperity.

Moving forward on this inclusive growth agenda will be a shared responsibility. International financial institutions must better assist countries, but firms and civil society also need to do their part. This is essential because no one stakeholder has the necessary breadth of insight, expertise, or experience to tackle all aspects of the inclusive growth agenda. Collaboration and partnership will be key to design effective country-tailored policy solutions. Active consultation by governments with civil society and the private sector can contribute to better policy solutions and allow these sectors to support reform efforts by providing feedback on how policies are being implemented on the ground.

To advance this debate and help inform policy implementation, this paper presents analytical work spanning each of the action areas that emerged from the Marrakesh conference. Given that many promising reforms are already underway in the region (Chapter III) and that the intention of the paper is to chart a future course to enhance inclusive growth policies, the paper intentionally emphasizes the key areas where faster and deeper progress is needed to ensure economic opportunity is shared by all.

In Chapter III, we focus on one critical component of the MENA region's economic challenge: how to build a more vibrant private sector that promotes higher growth and job creation. This will entail moving away from a model where the state is the employer of first resort and where women and young people are left behind.

Chapter IV discusses how policymakers can better promote inclusive growth by fostering strong institutions and greater transparency. Expanding access to financial services and ensuring social safety nets adequately protect the poor and vulnerable will also enable the less well off in society to better participate and benefit from growth. The case is also made for targeted interventions to address the obstacles facing youth, women, rural communities, and refugees. The chapter also emphasizes the need to improve the quality of public services provided to rural communities.

Chapter V asks how governments can use fiscal policy to better invest in people and infrastructure. Fiscal policy is a key lever for governments to ensure that the benefits of growth are shared more broadly, but today, social spending in MENA is less than 11 percent of GDP. Infrastructure needs are also large. How can governments increase spending on infrastructure, social, and other inclusive growth priorities when budgets are so tight? A key priority is building broader and more equitable tax bases and reprioritizing government spending toward infrastructure and social priorities such as social safety nets, education, and health services, while improving governments' effectiveness by tackling inefficiencies and corruption.

The gains from reforms that promote inclusive growth are substantial. To give some examples:

- The region's youth hold huge potential to spur growth if given opportunities. If the region could generate an additional 0.5 percentage point of employment growth per year, real GDP growth would accelerate to 5.5 percent per year, and real per capita income would rise annually by 3.8 percent. Without such change, unemployment could reach 14 percent by 2030 and labor force participation would not change.
- Reducing the gender gap in labor force participation to double (rather than triple) the average for emerging market and developing economies would have doubled GDP growth in MENA over the past decade—a gain of US\$1 trillion in cumulative output.
- Business climate reforms that generate a one-point increase on the World Economic Forum's Global Competitiveness Index for MENA countries would raise productivity growth by 1.4 percentage points, turning productivity growth positive relative to the average 1.1 percent decline experienced during 2007–12.
- Raising tax collections to the average level of emerging markets would create resources of more than 9 percent of MENA GDP to fund priority social and infrastructure spending.
- For each 1 percentage point of GDP in spending on energy subsidies in the MENA region that is redirected to infrastructure spending, the region has the potential over six years to increase its real GDP by 2 percentage points and create ½ million new jobs. Alternatively, by eliminating generalized fuel subsidies, governments in the MENA region could afford to fund a 40 percent increase in social protection spending to bring the regional average spending on social protection to 7 percent of GDP.
- Increasing finance available to MENA SMEs to the EM average would provide more than US\$300 billion for additional private sector investment in the region.
- Promoting greater data transparency could reduce sovereign risk premia by about 15 percent for MENA countries—based on countries adhering to IMF data standards.



The Path toward Higher, More Inclusive Growth

Promoting inclusive growth requires bold reforms, and the uptick in global growth provides the best opportunity in years to make progress. To take advantage of these tailwinds, the region needs measures that increase the efficiency of capital investment and improve productivity. This would reverse the drag on growth from low employment, inefficient investment, and low productivity witnessed in the last decade (Figure 2.1).

Fortunately, the region has embarked on many reforms, with governments across the region having placed inclusive growth and job creation at the heart of their development strategies. Governments have started to implement these policies (Box 1). The challenge is how to speed up and scale up implementation, to move the dial on inclusive growth from endorsement to execution and generate tangible improvements in employment prospects and living standards.

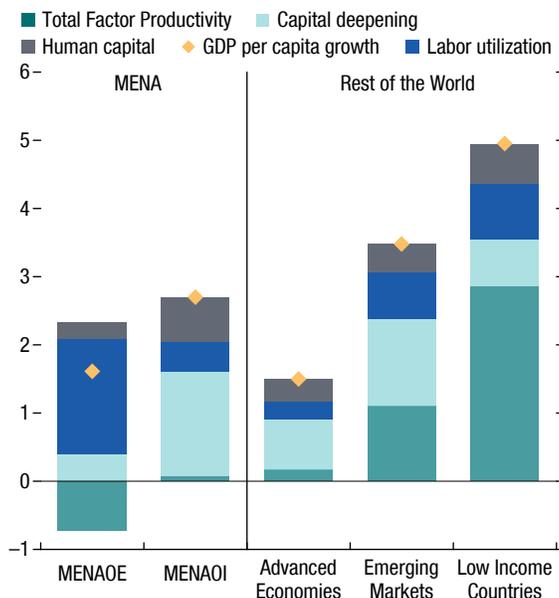
Countries are creating space for higher and more effective social and investment spending. On the fiscal front, efforts are being made to scale up (or preserve where fiscal consolidation is needed) and improve the efficiency of social expenditures, especially in education and health, so they can better target the vulnerable and improve outcomes. Measures are also being implemented to improve the efficiency of public investment. Afghanistan and Morocco are implementing gender budgeting; Egypt has plans to implement it in 2018/19. Still, social spending in the region (11 percent of GDP) remains low relative to peers (Chapter V), so much more progress is needed to improve the quality of public services and broaden access.

Countries are also creating space in their budgets for higher inclusive growth spending through re-orientation within often tight budget

Prepared by Bénédicte Baduel (MCD). Erik Roos provided research assistance.

Figure 2.1. Decomposition of Real GDP Per Capita, 2000–14

(Annual average, percent)



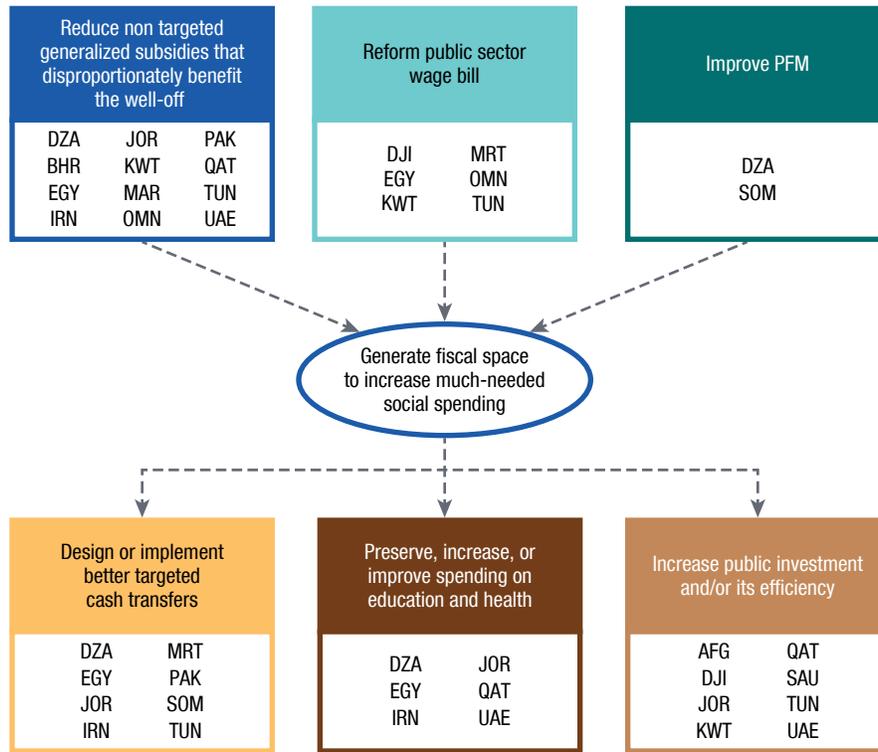
Source: Dabla-Norris et al. 2014.

Note: MENAOE corresponds to DZA, BHR, IRN, IRQ, KWT, LBY, OMN, QAT, SAU, ARE and YEM; MENAOI corresponds to AFG, DJI, EGY, JOR, LBN, MRT, MAR, PAK, SOM, SDN, SYR and TUN.

envelopes (Figure 2.2). Many countries are phasing out generalized fuel subsidies to free up resources and put in place or scale up cash transfer programs that are more effective at protecting and benefiting the poor. They are also increasing other social outlays to better protect the most vulnerable. Twelve countries in the region have started or finalized fuel subsidy reforms, resulting in fuel subsidies being halved to 2.2 percent of GDP in 2016 from their level in 2010. Egypt is raising the coverage of targeted cash transfers to 2 million households (equivalent to an estimated 8 million individuals) in 2017–18 from 160,000 households two years ago.

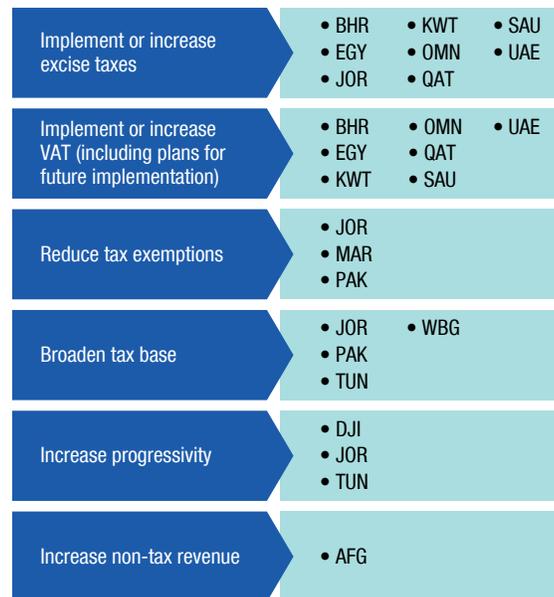
Countries are also taking steps to raise revenues to fund their social and investment needs (Figure 2.3). Egypt, Saudi Arabia, and the UAE have introduced a VAT, joining some 140 countries worldwide that have one. In introducing consumption taxes such as the VAT, countries have sought to protect lower income households by excluding basic food items and setting the registration threshold to exclude smaller businesses. Some countries are also seeking to better tax the wealthy by broadening the capital gains tax on real estate (Djibouti), and to improve the progressivity of income taxes by exempting the lowest income earners from income tax (Tunisia, Djibouti). Still, the region’s tax revenue-to-GDP ratio of under 10 percent remains low (Chapter V), and there is scope to raise more revenues, more equitably, to fund inclusive growth reforms in many countries.

Figure 2.2. Countries Creating Fiscal Space by Reorienting Spending



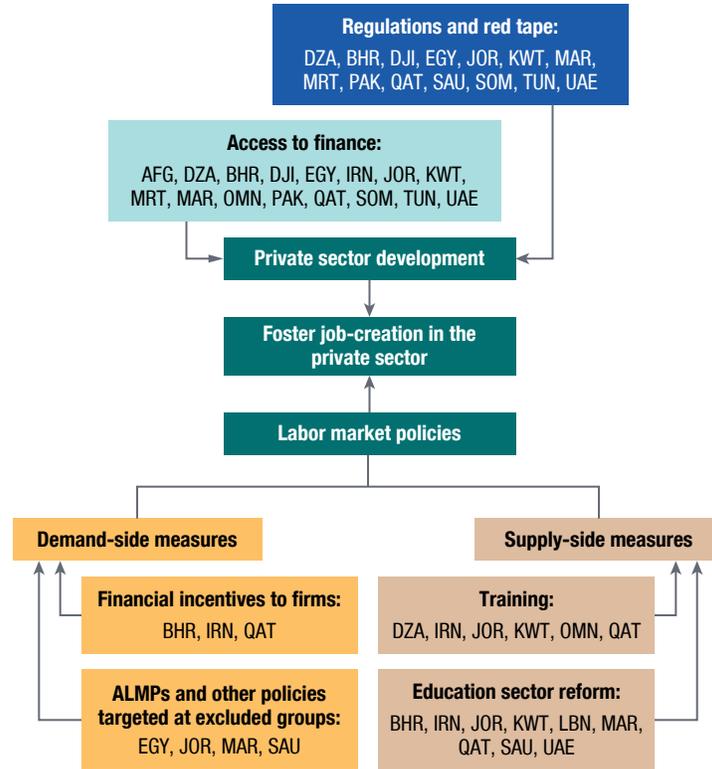
Source: Surveys to IMF MENA staff.

Figure 2.3. Countries Creating Fiscal Space by Increasing Revenues



Source: Surveys of IMF MENA staff.

Figure 2.4. Countries Fostering Private Sector Development and Labor Market Policies for Private Sector Job Creation and Youth and Women Inclusion



Source: Surveys of IMF MENA staff.

Countries are improving the business environment to assist private sector development and ultimately job creation (Figure 2.4). Private sector development—the engine for job creation now that fiscal space is constrained and governments can no longer be the employer of first resort—is a key priority for inclusive growth. Bahrain, Djibouti, Egypt, Jordan, Kuwait, Mauritania, Morocco, Pakistan, Qatar, Saudi Arabia, Tunisia, and the UAE are implementing policies to ease the time and cost of starting a business, introducing one-stop registration, and in some cases using e-government technologies. Morocco, Tunisia, Saudi Arabia, and Sudan have streamlined customs procedures. Several countries have enacted new laws targeting small and medium-sized enterprises, known as SMEs (Algeria); public-private partnership frameworks (Algeria, Kuwait, Qatar); or bankruptcy (UAE). Kuwait and Saudi Arabia have taken measures to facilitate foreign direct investment.

As a result of progress made in countries like Djibouti, Mauritania, Morocco, and the UAE, the region’s average score on the World Bank’s Ease of Doing Business index improved to 47 percent below the level of the best global

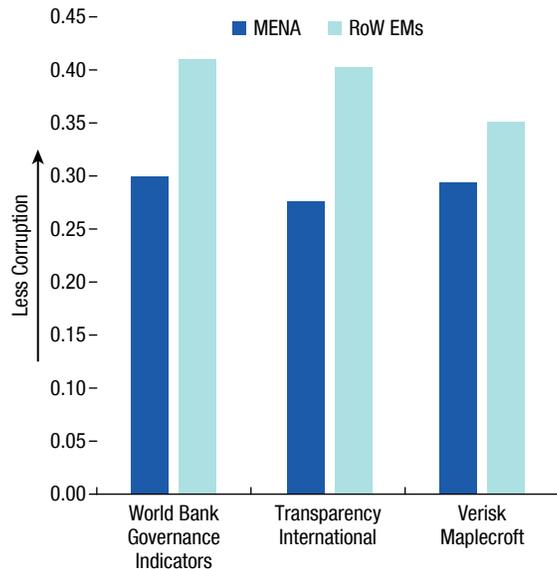
performer in 2018. There is still ample room for improvement, especially as differences in the business environment across the region are large.

Inadequate access to finance remains the region’s top business climate constraint to private sector development (Chapter III). This is a key challenge for SMEs. MENA’s loans-to-SMEs ratio is the lowest in the world (2 percent of GDP), even though SMEs account for 60 percent of employment. Many countries are increasing access to finance for SMEs (Algeria, Djibouti, Egypt, GCC, Jordan, Morocco, Iran, Pakistan) and for women (Jordan, Pakistan, Somalia), expanding mobile banking (Djibouti, Jordan, Morocco, Pakistan, Somalia), and developing Islamic finance (Djibouti, Mauritania, Morocco, Pakistan).

Countries are also implementing measures to improve workers’ skills and boost labor demand in the private sector. Active labor market policies are being pursued to benefit women and youth in Egypt, Jordan, Morocco, and Saudi Arabia. Having ensured relatively high levels of access to schools (about 80 percent for primary education), countries are seeking to improve the quality and efficiency of education as the region performs poorly on international tests.

Finally, several countries implemented policies to tackle corruption and improve accountability in the use of public funds, but much more needs to be done (Figure 2.5). Steps are being taken to strengthen public financial man-

Figure 2.5. Control of Corruption
(Average, normalized standard score)



Sources: World Bank, Transparency International; Verisk Maplecroft; and IMF staff calculations.
Note: All three corruption indicators have been standardized between 0 and 1.

agement (Egypt, Jordan, Morocco, Tunisia, Oman, Qatar), including, in some cases, the governance of state-owned enterprises. Oman, Saudi Arabia, and the UAE have introduced key performance indicators. In many cases, e-government is an important element of such reforms: Bahrain and the UAE have been ranked as top performers on the UN e-government index.

While all of these achievements are notable, much work remains. In subsequent chapters, this paper will explore the main impediments to opportunity for all in the MENA region and what steps countries need to take to overcome them.

Box 1. Inclusive Growth Strategies in MENA countries

Afghanistan	The Afghanistan National Peace and Development Framework, issued in 2016, aims to build broad-based and inclusive growth and to create jobs. It emphasizes policies to improve the rule of law and address corruption.
Algeria	In 2016, the authorities adopted a broad strategy to move toward a private-sector-led growth model and reduce the dependence on hydrocarbons. The action plan of the newly appointed government calls for pursuing reforms to improve economic governance and improve transparency. The government will launch wide-ranging consultations to push forward subsidy reforms and gradually adopt a social transfer policy.
Bahrain	The Bahrain Labor Fund and Development Bank supported SMEs through business management support and subsidized loans. Bahrain's Vision 2030 promotes the role of the private sector and further diversifying the economy.
Djibouti	Vision 2035 is an ambitious plan to make the country a middle-income economy within the next 20 years by raising medium-term growth, making it more inclusive and reducing unemployment.
Egypt	Vision 2030 has inclusive growth objectives including reducing poverty, increasing women's labor force participation, reducing the gender gap, and improving the business environment.
Iran	The Sixth National Development Plan aims to develop the private sector and reduce oil dependency. As part of this plan, the authorities have also set specific goals in terms of better integrating women in the labor force.
Jordan	Vision 2025 is a 10-year framework for economic and social policies, which aims at advancing fiscal consolidation and broad structural reforms to enhance the conditions for more inclusive growth.
Kuwait	The government's 6-pillar reform strategy aims at underpinning gradual fiscal consolidation and at boosting private sector growth and fostering economic diversification, including through PPPs, privatization, and labor market and business climate reforms. The authorities also established an SME financing fund to tackle the SME financing problem.
Mauritania	The first pillar of the "Strategy for Accelerated Growth and Shared Prosperity 2016–30" is to promote higher, sustainable, and more inclusive growth and higher job creation.
Morocco	The authorities have different plans to address IG issues, including the National Strategy for Employment 2015–25, the Vision for Education 2015–30, and the National Anti-Corruption Strategy.
Oman	The 9th five-year development plan (2016–20) targets creation of productive job opportunities for Omani nationals, and improvement of their capabilities and skills through economic diversification, including by investing in infrastructure, enhancing the role of the private sector, and encouraging entrepreneurship and SMEs.
Pakistan	Pakistan Vision 2025, the National Financial Inclusion Strategy 2015, and the National Doing Business Reform Strategy 2016 are targeting different aspects of inclusive growth challenges.

Box 1. Inclusive Growth Strategies in MENA countries (*continued*)

Qatar	The Ministry of Development Planning and Statistics is currently developing its Second National Development Strategy 2017–22, with a focus on improving the quality of education, fiscal management, and the institutional framework for the conduct of fiscal policy to create room for private sector participation in the economy. This complements Qatar’s National Vision 2030, launched in 2008, to “transform Qatar into an advanced economy capable of achieving sustainable development by 2030.”
Saudi Arabia	The Vision 2030 strategy and National Transformation Program (NTP) envisages ambitious economic diversification, and job creation for its young population. It also aims to enable a greater role for the private sector, increase female labor force participation and home ownership, and transform Saudi Arabia into a trade and financial hub.
Somalia	The authorities’ National Development Plan outlines their medium- and long-term development strategy, including reforms to social safety nets, youth and women’s participation, private sector development, and access to finance.
Tunisia	The authorities’ five-year economic vision 2016–2020 aims to promote stronger and more inclusive growth.
UAE	Vision 2021 aims to achieve a more diversified and knowledge-driven economy.
West Bank and Gaza	The 2017–22 National Policy Agenda fosters social justice, education and health care, and building resilient communities.

Source: IMF country teams.

CHAPTER



Creating Jobs for Millions

There is no greater challenge facing the MENA region in its efforts to build a future based on inclusive growth than job creation. Pressures on the region's labor markets are rising. In the past five years, the region's working-age population increased by 50.2 million, and 27.6 million people joined the labor force.¹ Yet employment increased by only 25.4 million. Current population projections suggest that about 5.5 million new workers will join the MENA labor force each year in the next five years—just over 27 million youth (Graphic 2).² Finding jobs for these millions is a key challenge for the region.

Graphic 2. MENA will need to create jobs for millions of new labor market entrants.

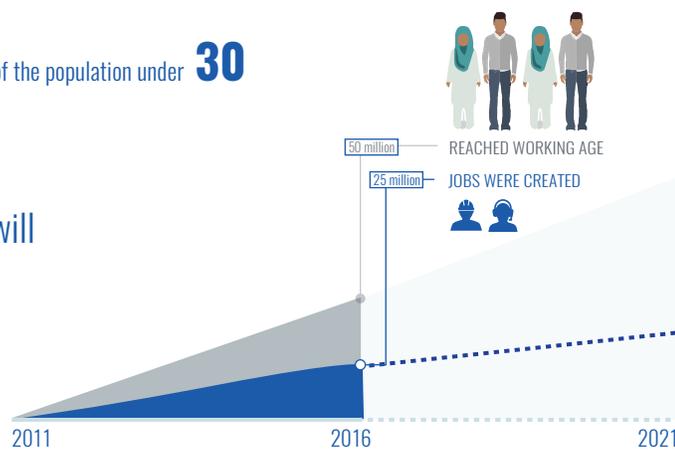
MENA is the world's

2nd youngest region with **60%** of the population under **30**

In the next 5 years

more than **52 million** new people will be of working age...

...over **27 million** will seek jobs¹



¹ILO estimates, with unchanged participation rates.

Prepared by Gaëlle Pierre (MCD), with inputs provided by Carolina Castellanos. Erik Roos provided research assistance.

¹All figures and numbers are based on ILO estimates unless otherwise stated.

²This includes about 0.5 million in MENA AD, 3.8 million in MENA EM, and 1.2 million in MENA LIC. These numbers include Pakistan and Afghanistan; looking at the region without these two countries there will be 3.4 million new entrants.

Opinion surveys illustrate the importance of job creation, with one recently reporting that 35 percent of young people regard unemployment as the biggest obstacle currently facing the Middle East.³

Growth has failed to generate enough jobs. The region faces some of the lowest rates of employment globally. Fewer than one in every two adults works, which is in large part a reflection of the low participation by women, who are three times less likely than men to be in the labor force and nearly twice as likely to be unemployed. Each percentage point of growth in the region has generated a rise in employment of 0.25 percentage point in the region's oil exporters and 0.39 percentage point in its oil importers, in line with other EMs and LICs but far below levels needed to employ a growing young population (Crivelli and others 2012).

However, the region's demographics—particularly its young population and pool of educated women—provide an enormous opportunity. The region is also centrally located and rich in history, advantages that can be leveraged for trade and tourism. Implementing a range of policies that facilitate private-sector-led growth and employment would improve per capita income.

Putting more people to work would foster demand and potentially lead to further growth and job creation. An extra 1.7 percentage points of economic growth per year (from a historical growth rate of 3.8 percent to 5.5 percent) would lead to an extra 0.5 percentage point of employment growth, on average, every year and a decrease in the unemployment rate of 6 percentage points by 2030.⁴

Four Stylized Facts on the Region's Labor Markets

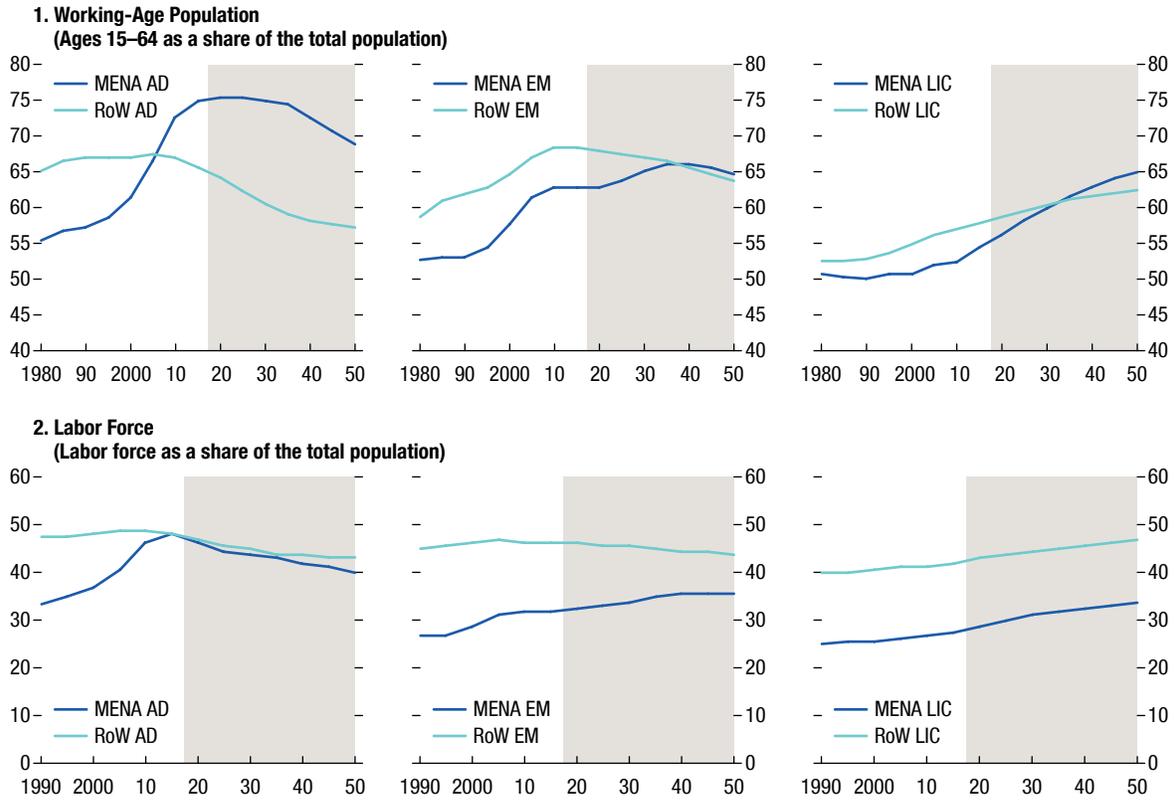
Fact No. 1: The region has a young and fast-growing working-age population that has been left on the sidelines—and that's especially true for women.

With 60 percent of the population under the age of 30, the MENA region is the world's second-youngest after sub-Saharan Africa. In the MENA region's emerging market and low-income countries, large numbers of young people will join the labor force over the next few decades. In the Gulf Cooperation Council (GCC) countries, the working-age share of the population will peak around 2020, after which it will start to decrease (Figure 3.1).

³In several countries, the vast majority of youth are concerned about unemployment: Iraq (69 percent), Algeria (64 percent), Bahrain (60 percent), WBG (57 percent), and Lebanon (55 percent). See ASDA's Burson-Marsteller (2017).

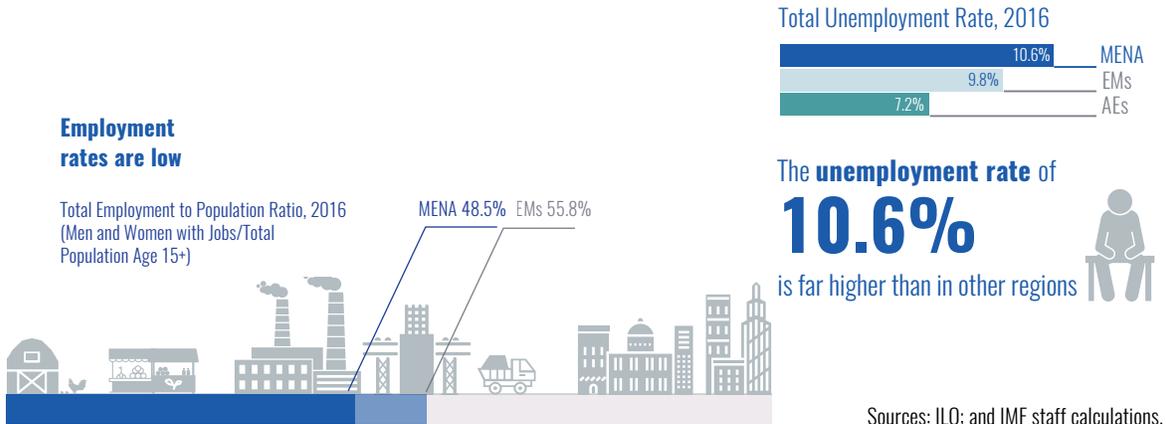
⁴Corresponding to an unemployment rate of 8 percent compared to a projected 14 percent under current conditions.

Figure 3.1. Working-Age Population and Labor Force Projections



Sources: UN Population; ILO estimates; and IMF staff calculations.
Note: Estimates of labor force include nationals and non-nationals.

Graphic 3. Labor market performance is weak.

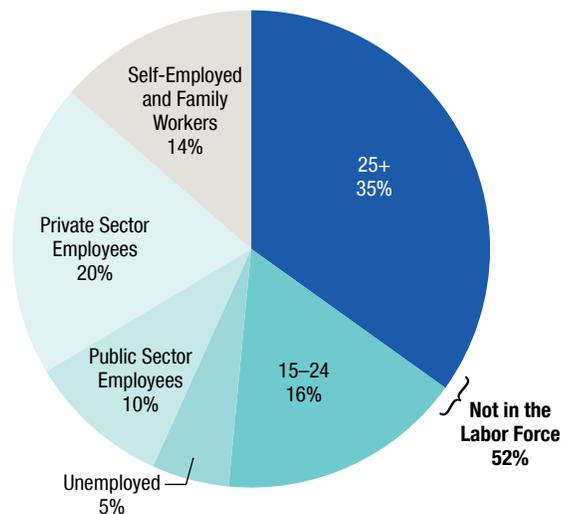


Sources: ILO; and IMF staff calculations.

Labor market outcomes, which have not changed markedly in the past 15 years, leave significant room for improvement (Graphic 3, Figures 3.2–3.5):

- Labor force participation has increased only slightly, from 51.8 percent in 2000 to 53.6 percent in 2016.
- Unemployment rates are high by international standards. After reaching more than 11.5 percent in the early 2000s, unemployment rates averaged 10.6 percent for the region in 2016. This compares with 7.2 percent in Advanced Economies and 9.8 percent in Emerging Market Economies.
- Compared with the other two sub-regions, GCC countries tend to have an increasing and higher labor force participation rate, as well as lower total unemployment rates.⁵ In MENA EMs, less than half the working-age population participates in the labor force (46.5 percent) compared to over 60 percent in other emerging market economies. The average unemployment rate is also higher (13.6 percent). There are some exceptions, with Morocco and Pakistan having relatively better rates of employment, participation, and unemployment. The higher employment rates and lower unemployment rates typically observed in LICs compared to EMs are not evident in MENA. The participation rate in MENA LICs (50.7 percent)

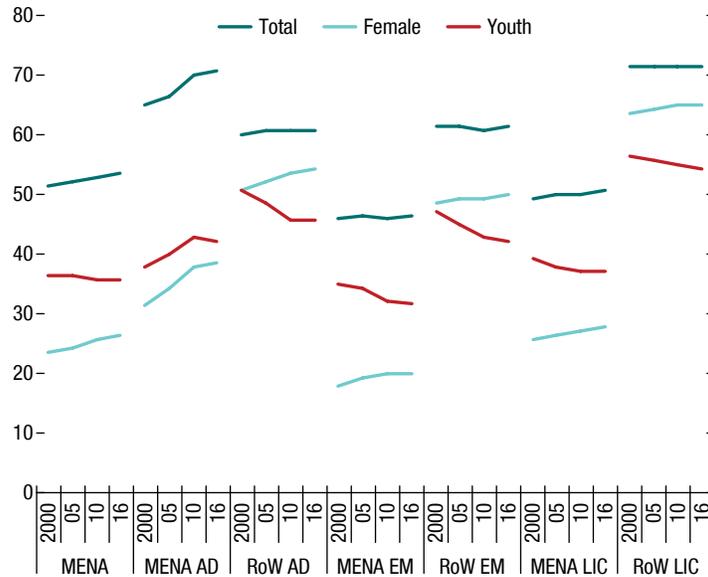
Figure 3.2. Breakdown of Age 15+ Population in Selected MENA Countries, 2016



Sources: ILO; national authorities; and IMF staff estimates.
 Note: Country coverage includes AFG, DJI, DZA, BHR, EGY, IRN, IRQ, JOR, KWT, MRT, MAR, OMN, QAT, SAU, and TUN.

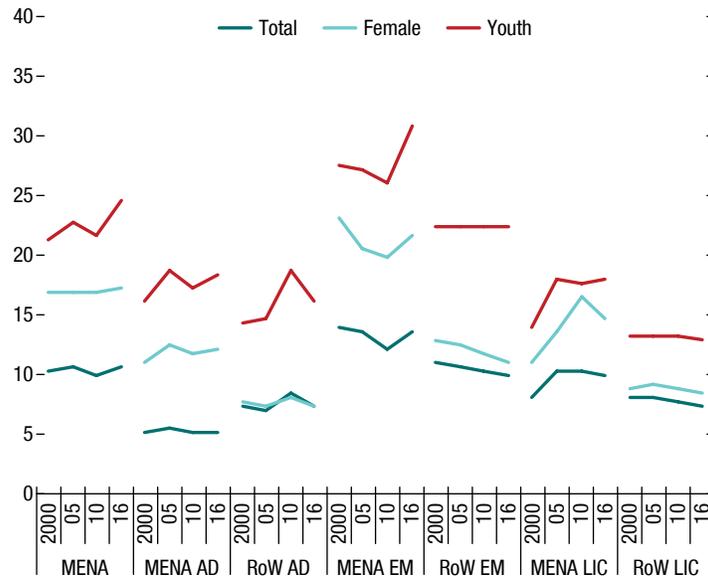
⁵These outcomes refer to total population, but important differences exist in labor outcomes of nationals and expats since the GCC labor markets are highly segmented between these two groups.

Figure 3.3. Labor Force Participation
(Percent of population age 15+)



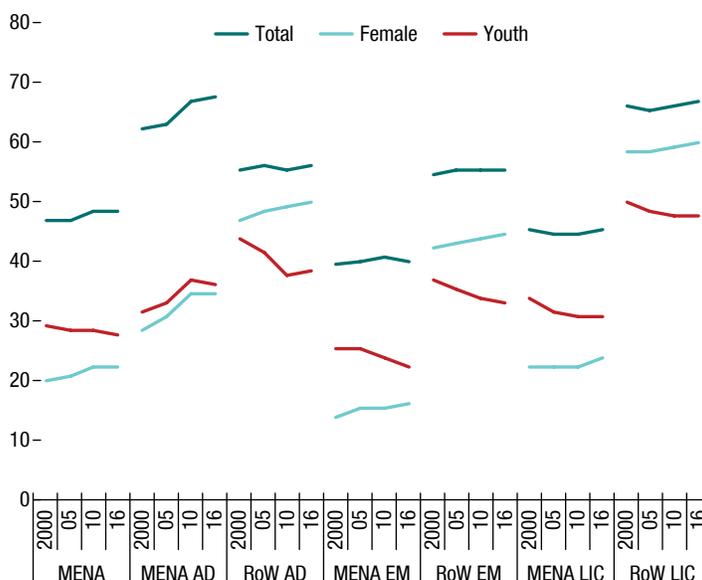
Sources: ILO estimates; and IMF staff calculations.

Figure 3.4. Unemployment Rate
(Percent of labor force)



Sources: ILO estimates; and IMF staff calculations.

Figure 3.5. Employment to Population Ratio
(Percent of population age 15+)



Sources: ILO estimates; and IMF staff calculations.

is more in line with MENA EMs (46.5 percent) than with other LICs (71.9 percent). Employment to population ratios are therefore also much lower in MENA LICs (45.7 percent versus 66.7 percent other LICs).

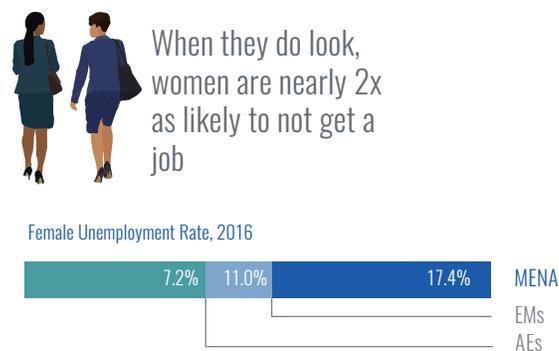
- Conflicts have a significant impact on labor markets. Countries affected directly by conflict have experienced large decreases in their labor force, with death, injury, or displacement or insecurity preventing individuals from traveling to work. Over the medium to long term, individuals may lose their skills and settle for lower paid jobs. Countries hosting large numbers of refugees, such as Lebanon and Jordan, have seen significant increases in the supply of labor, particularly in the informal sector. Since the beginning of the Syrian crisis, and combined with depressed economic activity, Jordan's unemployment rate rose by about 3.1 percentage points, and labor force participation decreased by about 2.0 percentage points.⁶
- Despite improved and generally converging educational attainments (with evidence of girls outperforming boys in standardized tests in several countries), women are disproportionately excluded from economic activity. While female labor force participation has increased gradually since 2000—rising from 23.3 percent at the turn of the century to 26.8 percent in 2016—women are still nearly three times less likely than men to be in

⁶Appendino and others (2017); Tiffin (2017), Rother and others (2016).

the labor force and nearly twice as likely to be unemployed. Since 2011, female unemployment has been about 18 percent, and for young women the rate has hovered near 36 percent (Graphic 4).

- The gender gap is pervasive in all three sub-regions. In the GCC, relatively good outcomes hide large disparities. The unemployment rate for men is relatively low at 3.9 percent even though male labor force participation is high (86.4 percent) compared to Advanced Economies (67.4 percent). But women are three times more likely than GCC men to be unemployed, and female labor force participation (38.7 percent) is lower than Advanced Economies (54.3 percent). This compares favorably to other MENA subgroups, but it is worth noting that female GCC nationals have even lower participation rates (around 30 percent). The low overall participation rate in both MENA EMs and LICs compared with their peers reflects the much lower female labor force participation in these countries.

Graphic 4. Women are at a particular disadvantage.



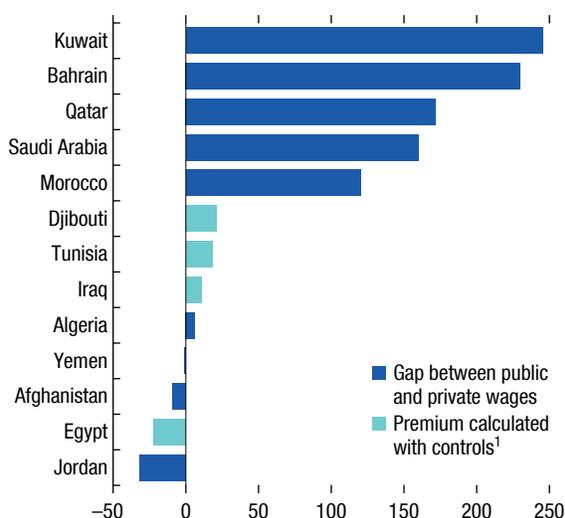
Sources: ILO; and IMF staff calculations.

- Meanwhile, young people (aged 15–24 years old) face difficult school-to-work transitions and are more than three times as likely to be unemployed as adults. Youth unemployment rates have worsened significantly since 2010. The gender gap is also present among young people.

Fact No. 2: MENA is not creating enough high-quality private sector jobs.

The public sector, including state-owned enterprises, is the largest employer in many MENA countries, accounting on average for nearly 8 percent of the working-age population in MENA oil importers and Iraq and Yemen, and 13 percent in GCC and Algeria. This compares to 5 percent of the working-age population employed by the public sector in emerging market and developing economies.

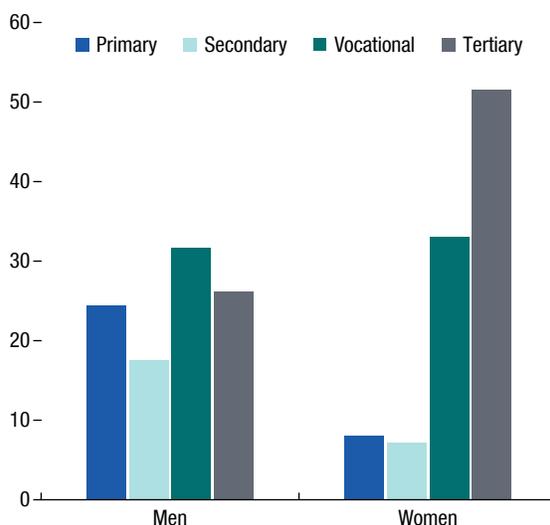
Figure 3.6. Public Private Sector Wage Gaps¹
(In percent, latest available)



Sources: National authorities; national labor surveys, and International Labour Organization. Data for Morocco from World Bank (2011).

¹Numbers represent wage premium estimates obtained after controlling for employee characteristics (IMF 2016a).

Figure 3.7. Level of Education of Unemployed Youth
(Percent)



Source: IMF staff calculations based on ILO School to Work Transitions data. Note: Based on surveys conducted in Egypt, Jordan, Lebanon, Tunisia, and West Bank and Gaza.

In many countries, public sector wages exceed private sector wages and are disconnected from productivity (Figure 3.6). This remains true when comparing wages of workers with similar levels of education.⁷ Countries with especially high gaps between public and private wages—often double or triple that of other emerging market and developing economies—experience higher and longer durations of unemployment. In addition, public sector employment offers benefits and protections that are more generous than the private sector, and in some countries actively attracts talent. This leads to a tendency among job seekers to remain unemployed to wait for a public job (termed “queuing”). This partly explains the high and often longer-term unemployment among highly educated young people (Figure 3.7).⁸

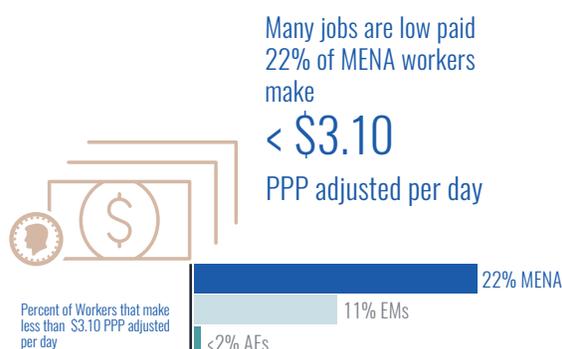
Informal employment is also significant. Small-scale (informal) activities provide most jobs in the region. Businesses with five or fewer employees dominate the private sector in Egypt and West Bank and Gaza, representing almost 60 percent of employment. This phenomenon is much lower, but still substantial in Jordan (40 percent) and Tunisia (37 percent). Moreover, most small-scale activities tend to be in low productivity sectors.⁹ Informal employment, proxied

⁷Public wage premium calculations are likely to be underestimated due to non-inclusion of various non-wage benefits and allowances. While reliable data are scarce, such benefits tend to be substantially higher in the public sector.

⁸IMF (2018), World Bank 2013a.

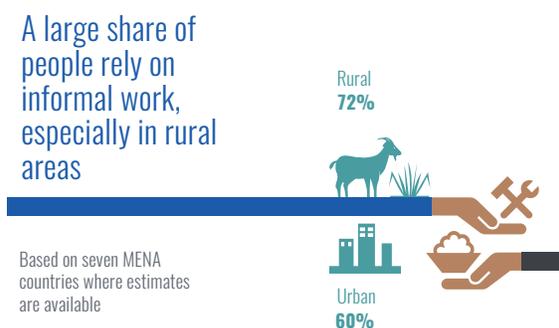
⁹Gatti and others (2014); World Bank (2015a).

Graphic 5. The share of working poor is significant.



Sources: ILO; and IMF staff calculations.

Graphic 6. Informality is prevalent.



Source: Angel-Urdinola and Tanabe (2012).

by the share of self-employed and unpaid workers, represents, on average, around 30 percent of employment in MENA EMs, 50 percent in MENA LICs, and is negligible in the GCC (around 3 percent). The share of workers earning less than \$3.10 per day (PPP) is higher than the average in emerging market economies (11 percent), although it has decreased from 29 percent in 2000 to 22 percent in 2016 (Graphic 5).

Rural areas experience more precarious employment and higher levels of informality, especially in MENA EMs (Graphic 6). Whereas urban areas often experience higher unemployment, rural areas tend to have a high share of informal employment and a large agriculture sector. For instance, rural unemployment in Pakistan stood at 3 percent in 2015 compared to 5 percent in urban areas, while the rural employment to population ratio was 55 percent (versus 42 percent) and rural labor force participation was 56 percent (versus 45 percent).¹⁰ In Algeria, rural employment is more precarious: around 27 percent of jobs are permanent, compared to 40 percent in urban areas.¹¹

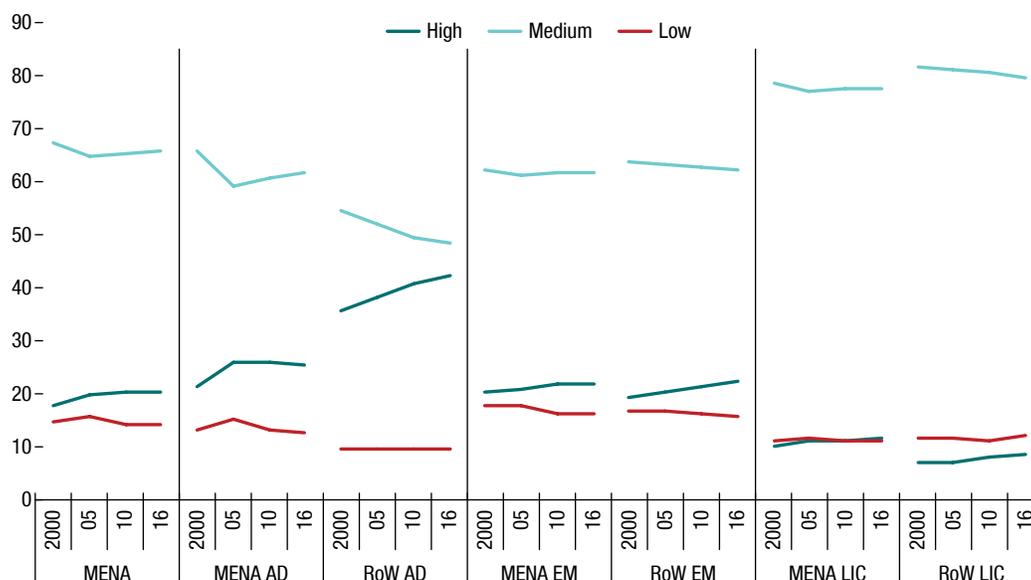
The region is not creating enough skilled jobs, and employment is dominated by medium-skill jobs.¹² While MENA's emerging market and low-income countries are similar to their comparator groups, GCC countries have a higher share of medium-skill employment than Advanced Economies (62 percent versus 48 percent, respectively) and a lower share of skilled workers (Figure 3.8). At the same time, compared with peer groups, a significant share of those who are unemployed have an advanced level of education. This can result from highly educated individuals waiting for jobs that meet their expectations and/or significant skills mismatches, given that education systems do not equip students with the skills relevant to working in the private sector. Another cause of these outcomes is the low demand for educated workers due to a lack of dynamism and innovation in the private sector.

¹⁰ILO.

¹¹Pierre (2014).

¹²Skill levels are defined by the ILO depending on the occupation of workers: high skilled are managers, professionals, and technicians; medium skilled are clerical, service, and sales workers; skilled agricultural and trades workers; and plant and machine operators and assemblers; low skilled are workers in elementary occupations.

Figure 3.8. Breakdown of Workforce by Skill Level
(Percent of total workforce)



Sources: ILO; and IMF staff calculations.

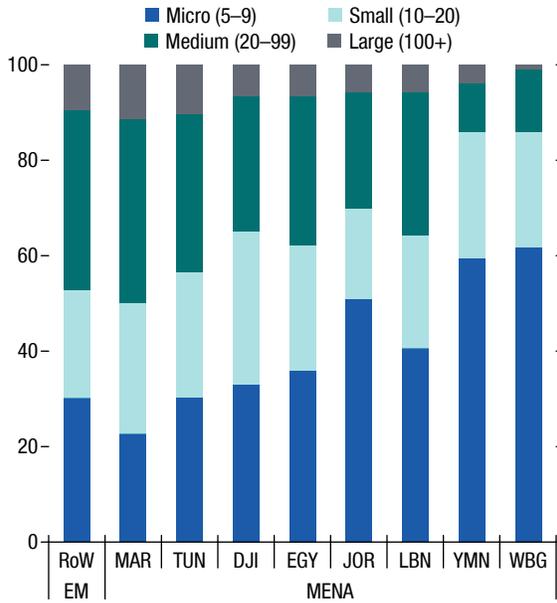
Fact No. 3: Private sector firms are too few and too small.

The entry of new firms into the formal sector is low by international standards. Non-GCC MENA countries have the lowest number of newly registered limited liability firms per 1,000 working-age people of any region. The entry of firms to the formal sector is higher in GCC than in non-GCC MENA countries, but is still relatively low by international comparison. Among non-GCC countries, Tunisia and Morocco had the highest formal sector entry rates. However, their rates pale in comparison to those in fast-growing emerging market countries—such as Serbia, Brazil, Croatia, Chile, and Bulgaria—where the rates of firms entering the formal sector were between two and eight times higher. Firm entry is lowest in Algeria, Iraq, and Egypt, with fewer than 0.5 newly registered limited liability firms per 1,000 working-age people.

Once in the formal sector, most firms tend to remain small and generate few jobs, which indicates a lack of access to finance and weak legal rights (Figures 3.9 and 3.10). Between 2010–13, employment by existing firms with fewer than 20 employees decreased in seven surveyed MENA countries, while it increased in all other regions. Job creation among medium-size firms was also low compared to other regions, while large firms did well. And in many emerging market economies, the share of small and medium-sized enterprises (SMEs), which tend to be the source of most job creation, is low compared to other EMs.

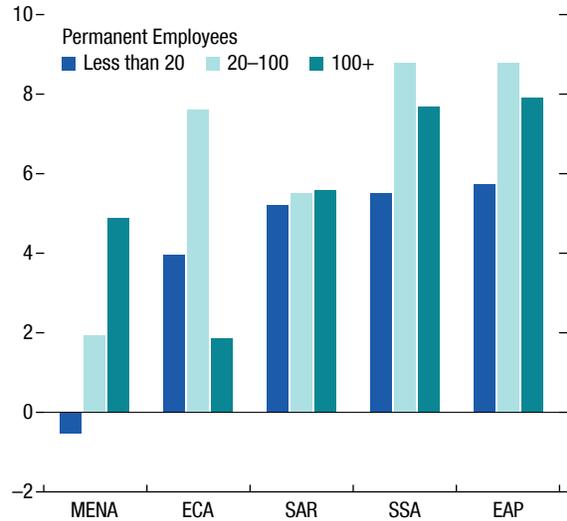
A few fast-growing firms, the so-called gazelles, account for a high share of job creation in the region (Figure 3.11). Gazelles are firms that start with at least five employees and double their employment over a three-year period.

Figure 3.9. Distribution of Formal Private Sector Firms by Size
(Percent of total firms over 5 employees)



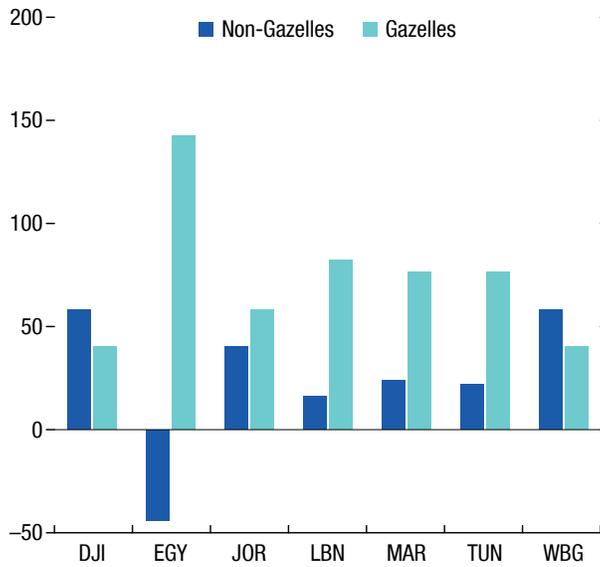
Sources: World Bank Enterprise Surveys; and IMF staff calculations.

Figure 3.10. Annual Employment Growth by Firm Size
(Percent, average 2010-13)



Sources: World Enterprise Surveys; and IMF staff calculations.

Figure 3.11. Share of Total Net Job Creation
(Percent)



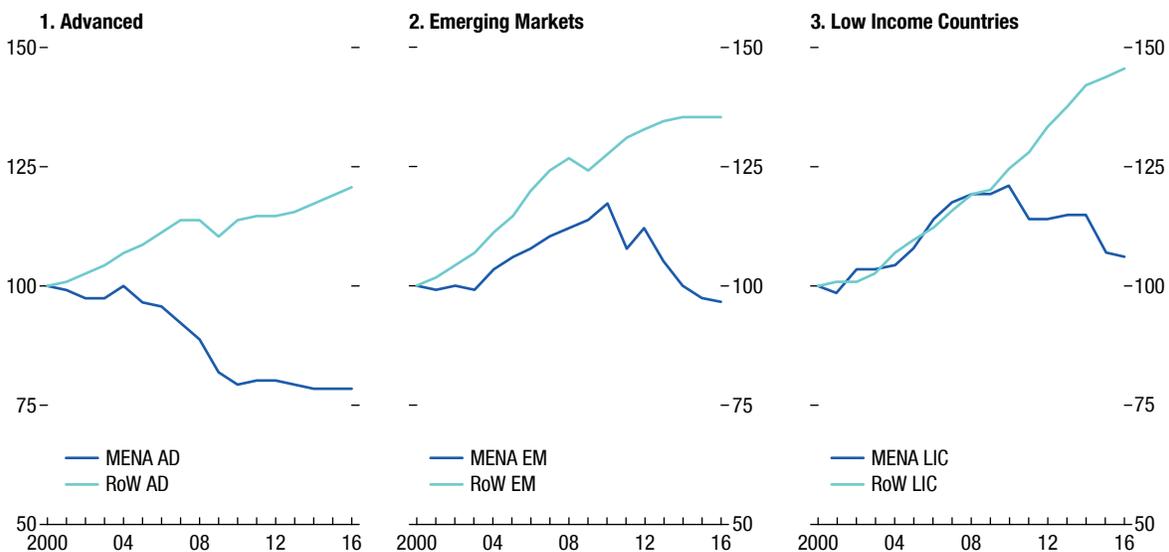
Sources: World Bank Enterprise Surveys; and IMF staff calculations.

While gazelles represent, on average, 3.4 percent of formal sector firms, they account for almost three-quarters of total net job creation in the surveyed countries. In Egypt, gazelles more than compensate for the loss in employment among other firms. Firms with fewer than 20 employees are the most likely to be gazelles, and the vast majority (75 percent) started as small firms. Gazelles are more likely to be young firms and to have innovated their product line than non-gazelles (32 percent of gazelles innovated versus 19 percent among non-gazelles).

Fact No. 4: Private sector firms have limited opportunities.

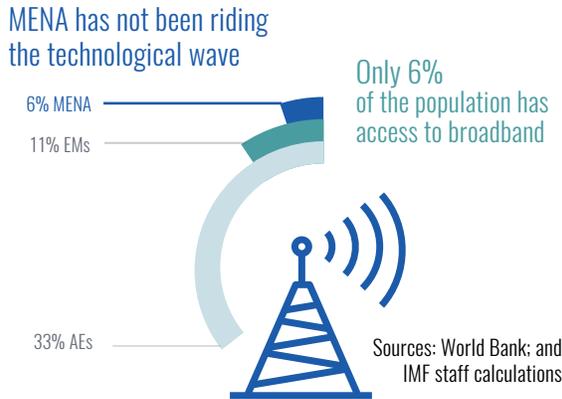
In marked contrast with the rest of the world, labor productivity has been declining since the global financial crisis, and even earlier in the GCC (Figure 3.12). Moreover, higher capital intensity among firms leads to lower total factor productivity (TFP—the effectiveness with which firms use factors of production). Large firms are generally more productive, but they tend to be more capital-intensive. In several countries—Djibouti, Egypt, Lebanon, and Tunisia—the mix of relatively high labor productivity and lower TFP suggests that firms are not using capital and labor in an efficient manner. There are some exceptions. In Jordan, labor tends to be less productive but total productivity is high. By contrast, in Morocco, relatively high labor productivity is associated with relatively high TFP, indicating a comparatively efficient system (EBRD 2016).

Figure 3.12. Labor Productivity
(Index, 2000 output per worker in PPP dollars = 100)



Sources: ILO; and IMF staff calculations.

Graphic 7. The region is largely missing the opportunities afforded by new technologies.



MENA has been staying largely outside the technological wave. This is illustrated by substantially lower broadband access rates, with only 6 percent of the population having access, lower than in other EMs and far below the share in advanced economies (Graphic 7). At the same time, countries of the region lag their peers in research and development (R&D). On average, countries in the GCC only spend 0.5 percent of GDP on R&D, while the average is 2 percent for advanced economies. Outside the GCC, the average for MENA countries for which data are available is 0.4 percent of GDP, compared to

0.5 percent for emerging markets.¹³ MENA countries also lag peers in exporting high-technology products; high technology exports account for an average of 2 percent of manufactured exports from MENA, while in emerging markets they make up nearly 19 percent of exports on average.¹⁴ This is also partly explained by their lack of integration in high-value-added trade.

Economic and political uncertainty in the region has deterred foreign investors, constraining the ability to invest in capital or technology. Unlike other emerging regions, MENA did not experience the post-global financial crisis resumption of foreign direct investment (FDI) flows. For example, during

2010–15, inflows to Latin America and the Caribbean increased by 11 percent and by 76 percent in sub-Saharan Africa. In contrast, FDI inflows to the MENA region declined by 53 percent over the same period (Graphic 8). Consequently, despite upticks in some countries such as Egypt, the region only captured around 5 percent of total FDI inflows to developing economies in 2015, compared to 12 percent in 2008 (Figure 3.13). Raising levels of FDI inflows as a share of GDP to the average of emerging markets would require an influx of \$40 billion (1.25 percent of GDP).

Graphic 8. Foreign investors are staying away.

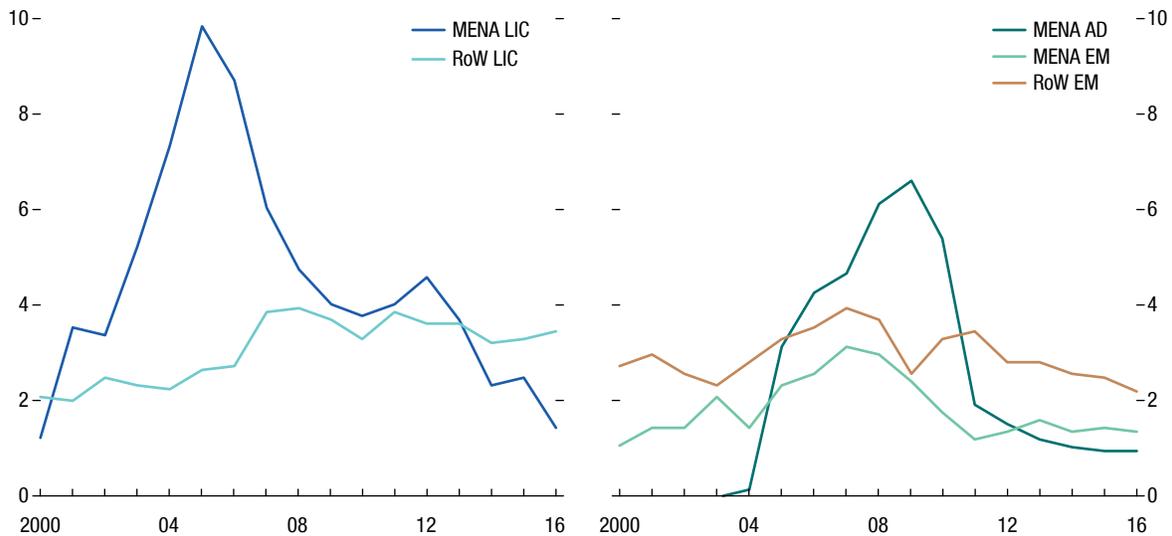


Sources: National authorities; and IMF staff calculations.

¹³Countries include EGY, IRN, IRQ, JOR, PAK, and TUN with R&D spending ranging from 0.04 percent of GDP in Iraq to 0.72 percent in Egypt (World Development Indicators).

¹⁴World Development Indicators.

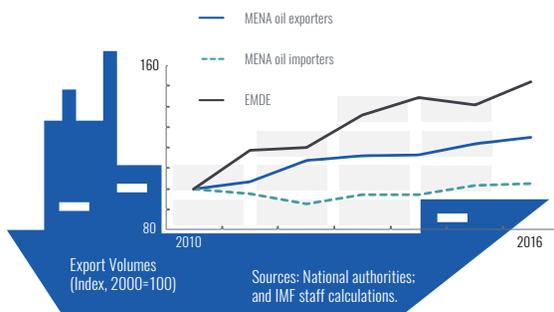
Figure 3.13. Foreign Direct Investment
(Percent of GDP)



Sources: National authorities; and IMF staff calculations.

Graphic 9. MENA is lagging peers in terms of trade openness.

The region could benefit from greater integration into global trade



countries would benefit from deepening access to export markets through trade agreements and by leveraging new integration opportunities, such as China’s Belt and Road Initiative and the Compact with Africa (IMF 2017a).

MENA countries could benefit from greater integration into global trade (Graphic 9). Oil dominates the export sectors of the region’s oil producers, and these countries would benefit from greater diversification. Non-oil MENA countries tend to be more diversified and somewhat better integrated in GVCs, with export penetration similar to other emerging market and developing economies, but their export volumes have been stagnating compared to peers in the past 15 years, and they would benefit from increasing the quality of their exports. Most countries

Designing Comprehensive Job Creation Strategies

Fostering greater private sector activity and job creation necessitates a broad range of economic and social policies (Graphic 10). This policy agenda is relevant for all countries of the region, as oil exporters seek to diversify their economies and others seek to foster private sector job creation to absorb their growing labor forces. But, as always, the policies adopted should be tailored to country-specific circumstances.

Graphic 10. Fostering job creation requires action in several policy areas.

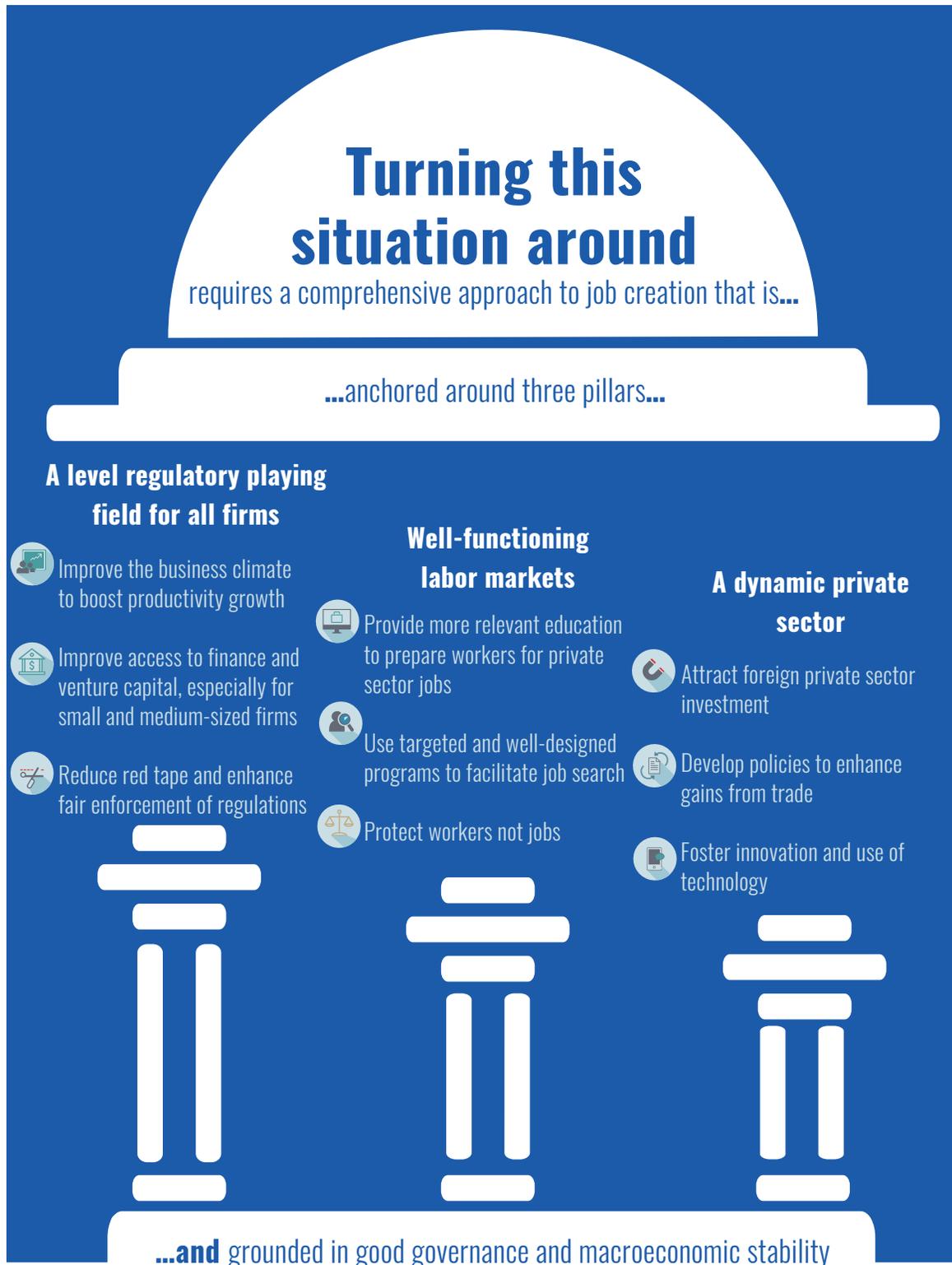
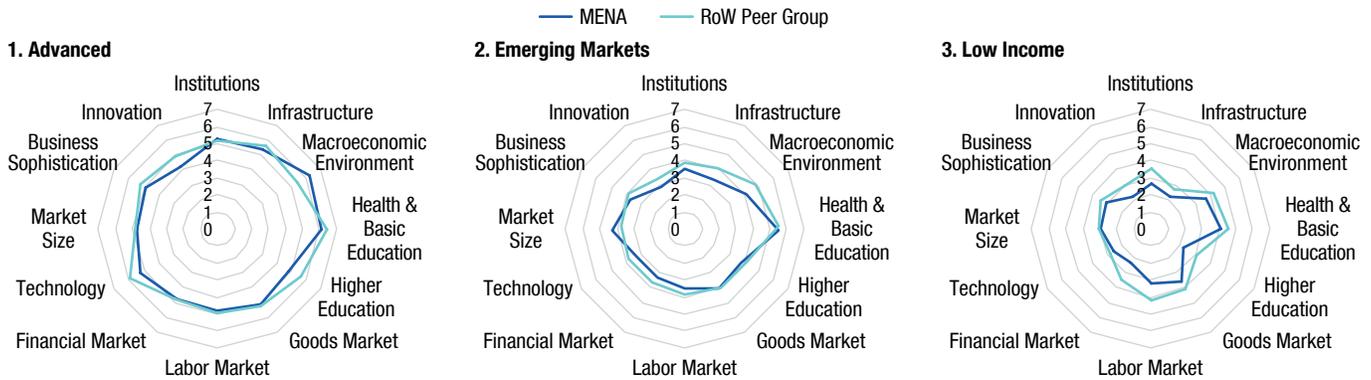


Figure 3.14. Competitiveness Pillars

(Score, 1–7 scale, higher values = greater competitiveness)



Sources: World Economic Forum; and IMF staff rankings.

Note: For MENA Low Income Countries, only Afghanistan and Mauritania are available.

Priority 1: Level the regulatory playing field so private firms become main engines of job creation

Improving the business climate would help boost productivity growth and allow the private sector to expand. Providing more efficient basic services, promoting the rule of law, ensuring fair competition, scaling back the dominance of state-owned firms, reducing corruption, and streamlining business regulations can all significantly benefit productivity. Implementing reforms that would move a country one point up the overall global competitiveness index¹⁵ (where 1 is lowest and 7 is highest (Figure 3.14)) would raise productivity growth by 1.4 percentage points (Graphic 11) (Mitra and others 2016).

Improve access to finance, especially for SMEs. Despite relatively large financial sectors and a reasonable share of private credit in GDP compared with other regions, credit tends to be concentrated on large corporations (EBRD 2016). The MENA region has the lowest concentration of loans to SMEs among all regions (they represent 2 percent of GDP) (Graphic 12). A six-fold increase (or \$311 billion) would bring the region to the EM average. Getting credit is one of the dimensions in which each sub-region lags its comparator group. In addition, informal firms, which are prevalent in the region, have limited access to credit. Large shares of firms are disconnected from the formal financial system and rely instead on their own capital (Figure 3.15). These firms may be missing opportunities to grow.

Governments can support better access to bank financing, especially for SMEs, by improving credit information systems and enhancing collateral

¹⁵This index is compiled annually by the World Economic Forum and published in the Global Competitiveness Report.

Graphic 11. Reducing the gap in competitiveness would help productivity growth.



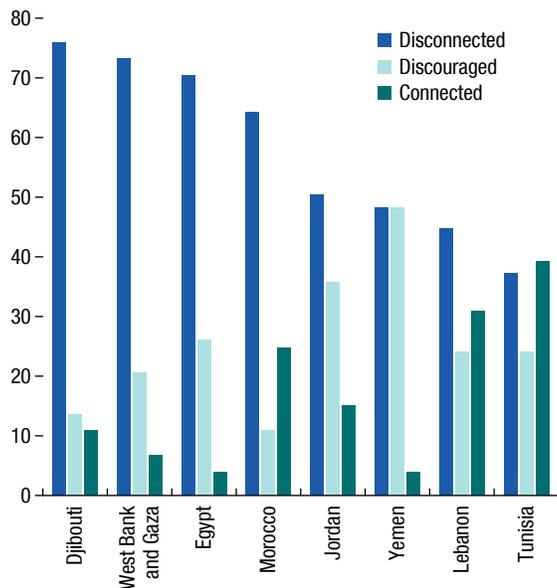
Moving 1 point up on the global competitiveness index would...

increase productivity growth by + 1.4 percentage points



Figure 3.15. Firms' Credit Relationship with the Financial Sector

(Share of firms disconnected, discouraged, or connected to financing)



Sources: EBRD; EIB; and World Bank.

regimes. Some countries in the region have set up schemes to support the development of SMEs, combining financing, technical assistance, and training.¹⁶ Such schemes can help, although others, such as directed credit or subsidized interest rates, may be counterproductive. Moreover, other types of financing may be more appropriate to foster entrepreneurship and risk taking in the region. Some examples include leasing, factoring, asset-backed lending, lending based on credit score of the owner, etc. Regional venture capital has been developing, but remains small.

Graphic 12. Access to finance is a key constraint for SMEs in the region.

Small and medium-sized firms lack access to finance



Loans to SMEs amounted to **2% of GDP**, the lowest concentration in the world

Sources: IMF Financial Access Survey; and IMF staff calculations.

Reducing red tape and ensuring regulations are enforced fairly would provide space to enable the private sector, and especially SMEs, to grow: Dealing with permits, investor rights, and insolvency frameworks are among the areas where the region most lags its peers. These factors may discourage investment and deter entry into the formal sector. Onerous regulations also leave private sector firms and new entrants at a disadvantage compared with well-connected larger or state-owned firms. In MENA EMs, streamlining the process for obtaining construction permits may also help the countries progress (see Box 2 on how to reform the business climate).

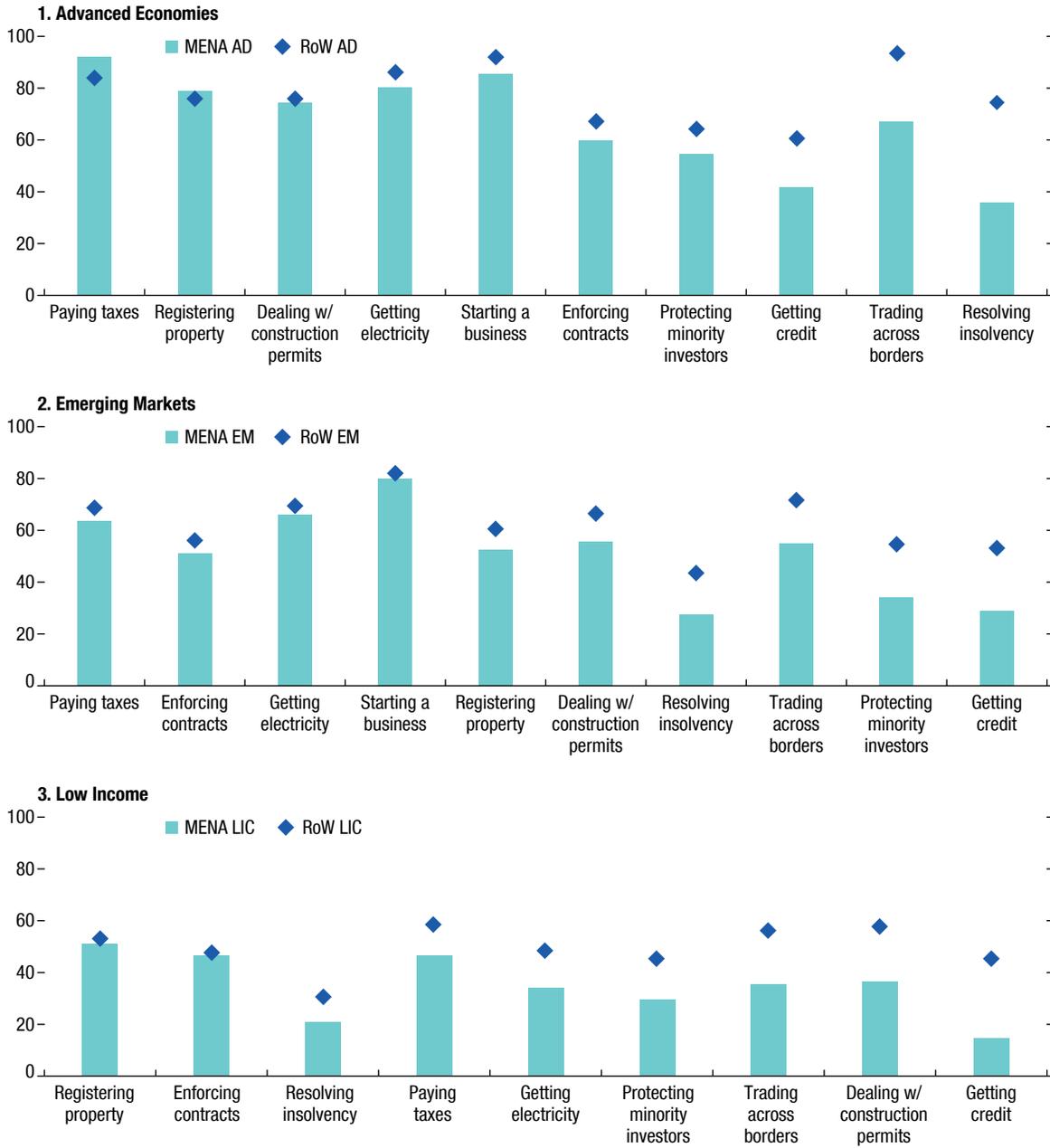
Priority 2: Policies to promote well-functioning labor markets

Protect workers not jobs: Labor regulations are useful in guaranteeing protection of workers, but they should not be unduly strict or loose.¹⁷ Labor market regulations should reflect country-specific considerations, guided by the general principle that workers, rather than jobs, should be protected. This is all the more necessary given the rapid technological progress and the increasing use of use of AI and robots in the workplace. Protecting workers will require less onerous labor regulations that facilitate workers' mobility and social policies that smooth workers' transitions into new jobs, such as unemployment benefits and active labor market policies (ALMPs). In particular, there is scope in several countries of the region to reduce severance payments, which neither effectively nor fairly protect workers,

¹⁶See Rodriguez and Ananthakrishnan (2015) for Kuwait.

¹⁷World Bank (2013b).

Figure 3.16. Constraints to Doing Business, Relative to Comparators
 (0–100 scale, 100 is the best performance)



Sources: World Bank Doing Business Distance to Frontier Indicators; and IMF staff calculations.
 Note: Constraints are ordered by best performance relative to comparators to worst performance.

Box 2. How to Reform the Business Climate

Business environment reform operates on many levels and involves a wide range of stakeholders. Inevitably it is political. Strong communication can aid the process. Building support and engaging with those who wish to protect the status quo can help. The inputs and participation of all stakeholders, including politicians, officials, the formal and informal private sectors, and civil society, can be reflected in the reform process. A consultation mechanism that permits stakeholders to give feedback for reformers to take into consideration is essential, as is enhancement of stakeholder capacity.

In the UAE, discussions with relevant stakeholders were embedded into the drafting of the foreign investment law. Communication was carried government to government (G2G, such as Ministry to Ministry or intra-Ministry Communication); government to business/government to private sector (G2B/ G2P); and government to citizen/resident (G2C). The authorities used several communication tools, including brochures and publications, newspaper articles, periodic meetings with Chambers of Commerce and Industry, newspaper articles, road signs, a telephone hotline to receive complaints from consumers, and TV appearances of key officials.

Reforms should be sequenced and modified to country circumstances. “Quick wins” may build reform momentum, but a long-term perspective is also necessary to ensure sustainability. For example, in 2006/07, the UAE started with relatively easier reforms: several rent ceilings were issued at the Emirate level to deal with the rent increases in the short to medium run; a consumer protection law was passed in late 2006 to reduce prices of some basic commodities; and a National UAE Development Strategy was announced in 2007. The UAE took additional time to change more complex regulations such as the new competition law, which would combat cartels and abuse of dominant position; the foreign investment law, which would further increase private sector competition; and establishing a statistical bureau.

Reformers should understand and manage the implementation gap typically found between the adoption of regulations or principles, and changing practice and enforcing regulations on the ground.

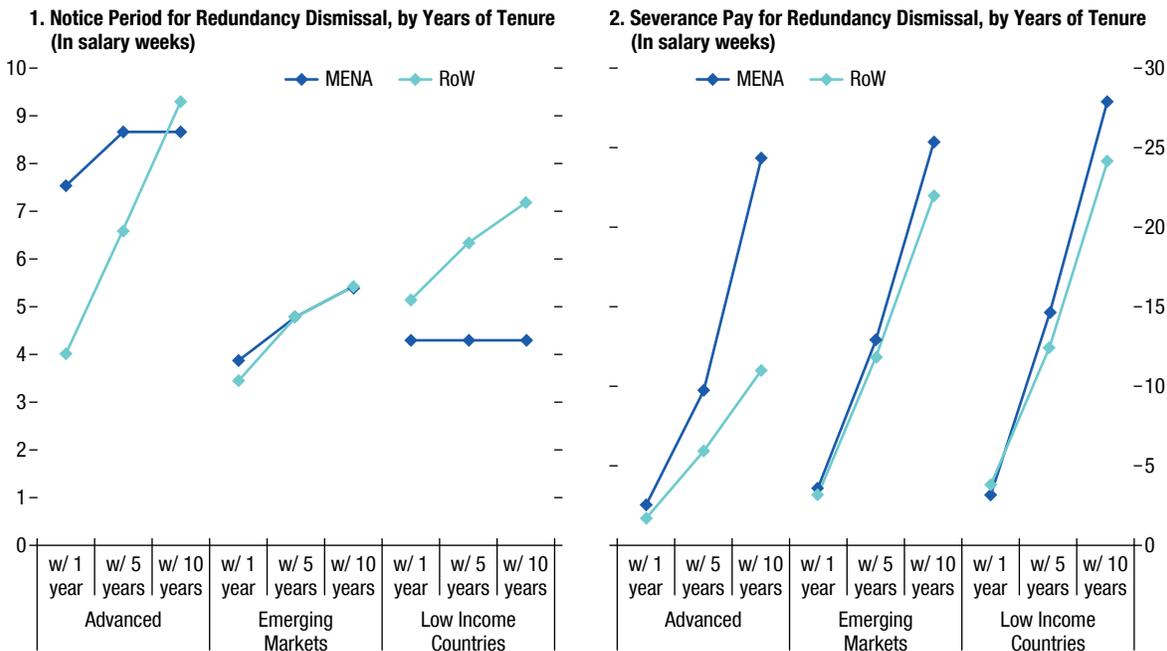
Development agencies should also ensure that systems are in place for donor coordination, and take responsibility for the quality and consistency of the advice and assistance they provide. They should ensure all stakeholders’ participation.

Sources: Al Farra (2007); OECD (2008).

and develop more efficient systems of unemployment protection/insurance (Figure 3.17).

Eliminate regulations that discriminate against women, youth, and refugees: Labor regulations should not lead to certain groups being priced out of the labor market. There are several examples of policies that may have unintended effects on certain groups: imposing a uniform minimum wage may price out unskilled or young workers; restrictions on work hours for women may impede their employment or their ability to become entrepreneurs; and more burdensome regulations applied to workers with short tenures may discourage new hiring. More generally, designing labor regulations that apply to all and are implemented in an equal and fair manner would avoid distortions and market segmentation. In countries where women and youth are hampered by lack of work experience or face other obstacles to their employment, consideration could be given to policies that generate incentives for firms to hire these groups (for example, some countries have experimented with temporarily lowering employer taxes or social security contributions to encourage firms to hire inexperienced workers). Moreover, it would be useful to review social policies that introduce disincentives for women and youth to work; for example, families may lose social assistance if female household members start working. Finally, refugees often face specific difficulties in obtaining legal status that enables them to work formally in host countries.

Figure 3.17. Labor Market Regulations



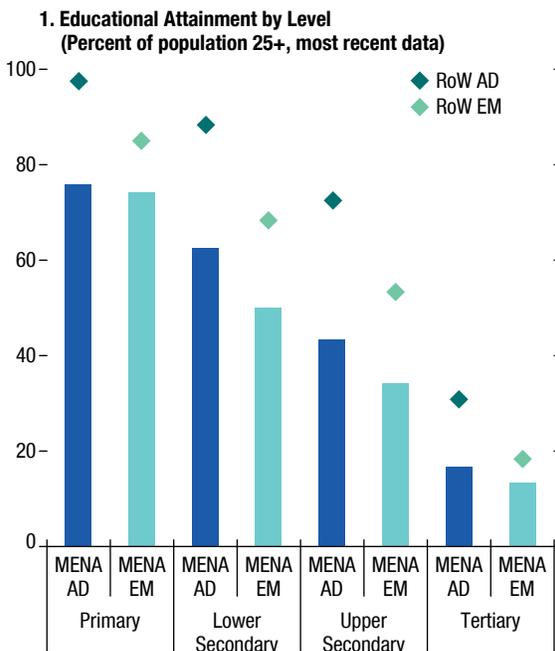
Sources: World Bank Doing Business; and IMF staff calculations.

Finding ways to include them more quickly in the host labor market would enable them to contribute to economic activity, including through streamlining work permits and giving them access to relevant active labor market programs, such as training.

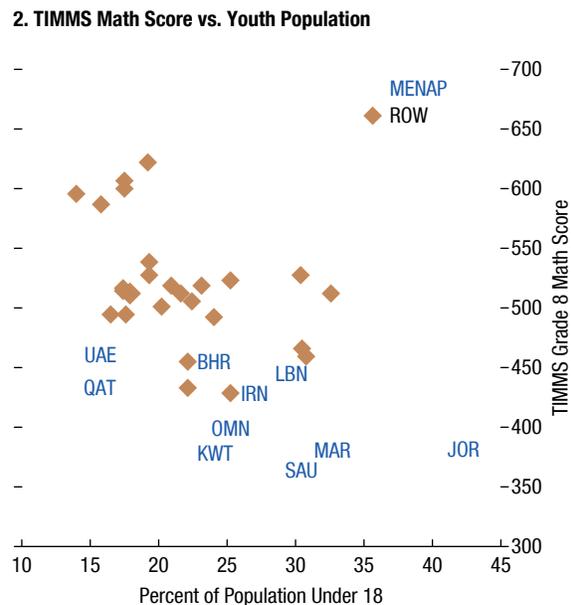
Diminish distortions from high-public-sector employment and wage premiums: Many countries will need to review public wage bill management and refocus on the core goal of delivering higher-quality public services, instead of using public employment and wages to achieve multiple socio-economic goals, such as providing employment or redistributing oil wealth. Structural reforms can help to achieve a modern service-orientated civil service (IMF 2018). This is necessary because ultimately in an age of constrained budgets and rapid technological change the private sector will have to become the main supplier of jobs.

Reform education to better prepare workers for the private sector and to ensure their adaptability in the face of technological change: The goal is to equip workers, particularly future generations, with relevant skills that make them more productive and adaptable. In addition to closing remaining attainment gaps and improving test scores (Figure 3.18), curriculums need to move away from rote learning and include greater emphasis on technological skills, but also soft skills such as problem solving, critical thinking, and

Figure 3.18. Educational Levels and Test Scores



Sources: World Bank; and IMF staff calculations.



Sources: IEA; ILO; and IMF staff calculations.

teamwork. To improve learning and provide students with a better understanding of private sector work and entrepreneurship, education systems must adapt to technological progress and meet its new demands. It must reach out to external actors, including the private sector (World Bank 2017a). In the region, the UAE, which achieves substantially lower education outcomes despite outspending OECD peers, is implementing reforms to make education spending more efficient and to ensure more equitable outcomes across all income groups (Garcia Martinez and Soto 2017). Moreover, creating clusters with links to universities and investing in specific-purpose skills and infrastructure may be a good starting point to spur economic activity as the case of Morocco illustrates (Box 3).

Develop well-targeted ALMPs to facilitate job search:

- ALMPs can improve inclusiveness in the labor market and help groups that face specific difficulties—especially youth, who often lack work experience—in obtaining employment, especially in cases where technology could make some low-skill jobs obsolete. In the short term, public employment services can successfully help job seekers find work, while training programs tend to help beneficiaries in the long run. A recent inventory of youth training and job search initiatives in the region shows that about one-third of reviewed programs had increased youth employment or earnings. Temporary wage subsidies (or reductions in employer taxes or social security contributions) for groups with low productivity or lack of experience, such as youth, may spur labor demand and help these groups get relevant work experience and reach satisfactory levels of productivity. In countries with unemployment insurance, participation in ALMPs complements benefits payment.
- At the aggregate level, higher spending on ALMPs is most often associated with reduced cyclical and long-term unemployment.¹⁸ While the evidence on the size of their impact varies greatly, the *Jovenes* programs in Latin America are good examples. In Colombia, for instance, the program positively impacted wages and employment, in particular with women’s salaried earnings increasing by close to 20 percent (Attanasio and others 2011).
- Program design is crucial. International evidence shows ALMPs work best when integrated with other policies that respond to the different needs of participants. Since ALMPs require significant institutional capacity, scaling down their goals can make programs more manageable. Monitoring and evaluation regimes can help improve and fine-tune ALMPs.

Develop labor market policies targeted at displaced people, refugees, and their host communities: Integrating refugees and economic migrants into local labor markets is the best way to engage them in economic activity.

¹⁸Card and others (2017); Kluge and others (2016); McKenzie (2017).

Box 3. Creating Job Opportunities through Trade: The Case of the Automotive Clusters

The automotive cluster in Morocco provides an example of how the government enabled foreign direct investment to create jobs. It sought the integration of the Moroccan economy into international markets by developing an export industry to lift economic growth and reduce its dependence on agricultural production and the real estate market.

The cluster is mostly based in the Casablanca Industrial Zone and the Tangier/Kenitra free zones, and its main player is Renault, which owns 80 percent of the Casablanca plant and is the only manufacturer in Tangier. However, its operations are diverse, with 30 different activities in agri-food, textiles and leather, metallurgy, mechanical, electronics, chemical, and high technology.

The cluster takes advantage of its geographic proximity to large European consumer markets and the potential to function as a gateway to emerging markets in North Africa and the Middle East. It also benefits from free trade agreements signed by Morocco, notably with the European Union, the United States, Turkey, and some Arab countries.

Despite the challenging global economic environment, the cluster has been able to develop and be profitable, especially because it targets the lower end of the automotive market, which has been less affected by lower demand. It has steadily increased since its inception, and by 2013 it had vehicle production of 167,000, €2.8 billion in exports, 85,000 employees, and over 200 companies. The cluster also had a positive impact on the local economy, with 43 percent of car parts sourced from local suppliers.

The government has taken a lead role in facilitating the clusters. By law, companies enjoy a special regime: goods entering and leaving the Tangier Free Zone are not subject to the national legislation on foreign exchange and commercial and industrial activities. Services for overseas markets by companies in the Tangier Free Zone enjoy total exchange freedom whatever the nationality and residence of the operator. The economic zones where the clusters are located offer fiscal incentives and provided strong infrastructure (a modern road network and state-of-the-art ports).

To overcome the skills gap in the local labor force, educational institutes were put in place to train the workforce with the appropriate automotive skills. The government also provides subsidies for training operators, technicians, and managers. At the same time, institutes for collaboration facilitate the creation and implementation of a common strategy among different actors and diffuse knowledge and best practices in the industry.

Further improvements could be made, especially in terms of increasing the availability of skilled workers; a greater focus on research and development in order to be able to add more value; a decrease in the over-reliance on one car manufacturer; attracting additional suppliers, especially in products not already provided locally; expanding to new export markets; and strengthening the institutes for collaboration.

Sources: Benabdejlil and others (2016) and Maturana and others (2015).

However, the host country circumstances will determine the design and pace of integration, especially where labor markets are weak.¹⁹ Granting working rights would enable refugees to join the formal sector. Providing access to public services, social programs, or ALMPs can facilitate integration into local life and limit human capital degradation. Policies that target both refugees and host communities can help maintain social cohesion. Support from the international community will be crucial in aiding host countries in providing this global public good (Rother and others 2016).

Include all stakeholders through communication and social dialogue: Reviews and reforms of labor market regulations are particularly sensitive, especially in the context of broad economic reform needs and social tensions. To secure and sustain reform momentum, it is important to ensure the buy-in of all stakeholders, including workers' and employers' representatives (the example of Tunisia is discussed in Chapter V). Inclusive consultations do not always guarantee support for sensitive reforms. However, engaging those most directly affected by reforms can, over time, foster trust, especially in commitments made to mitigate the costs of reforms, and eventually increase the sustainability and success of these reforms.

Priority 3: Promote greater trade, investment, innovation, and use of technology

Expand trade: Countries in MENA that can bring their trade openness on par with the best historical year-over-year improvement observed in the region, potentially can add 1 percentage point to their projected 2018–22 GDP growth. Combining greater trade openness with efforts to enhance export diversification, improve export quality, participate more actively in GVCs, and improve the competitiveness of exchange rates could yield growth gains of 2.0–2.5 percentage points. Greater trade is also linked to productivity gains.²⁰ However, there may be substantial transitional costs, including job losses associated with increasing openness (Helpman 2016). Policies can help mitigate these costs by promoting diversification into sectors with high job-creating potential and facilitating labor mobility, developing active labor market policies (ALMPs) for reskilling, and providing unemployment insurance and other social protections (IMF 2017a).

Attract foreign investment: Developing sound policies that improve macro-economic, business, and financing frameworks can help attract FDI, including in infrastructure and green energy.²¹ Reforms to improve the business

¹⁹See for example Tiffin (2017) for the case of Lebanon.

²⁰Ahn and others (2016).

²¹Estache and others (2013), IMF (2013d, 2016a) and IMF and others (2016).

climate and functioning of the labor market are also essential. Some countries choose to develop special economic zones that act as laboratories to experiment with simplifying business regulations in a controlled way. However, nations that do so would need to focus on how these zones can catalyze lasting improvements in the whole economy (see Box 3 on Morocco).²²

Foster innovation and the use of technology: Leveraging technology can lead to new job creation and improved productivity. It also has the potential to strengthen inclusiveness and social cohesion.²³ However, it will likely require adjustments, especially if it destroys low-skill jobs. Policies that facilitate job search, expand access to inputs and new markets, and aid job creation in new sectors could help mitigate such costs. Moreover, by enabling flexible ways of working, technology can help groups that would otherwise not have been able to work (e.g., women or workers who face long or difficult commutes). Improving innovation and research capabilities and expanding the use of information and communication technologies can yield substantial dividends, both directly and by leveraging other reforms. For example, most countries would benefit from proactive policies to leverage broadband access and improve connectivity to lower business and trade costs. This includes expanding the reach and availability of networks; fostering adoption and promoting more effective usage of networks; and maintaining a competitive environment to sustain growth, drive innovation, and deliver consumer benefits (Gelvanovska and others 2014).

²²UNCTAD (2015).

²³World Bank (2016b); and World Economic Forum (2017).

Too Many Remain Excluded: 7 Key Facts

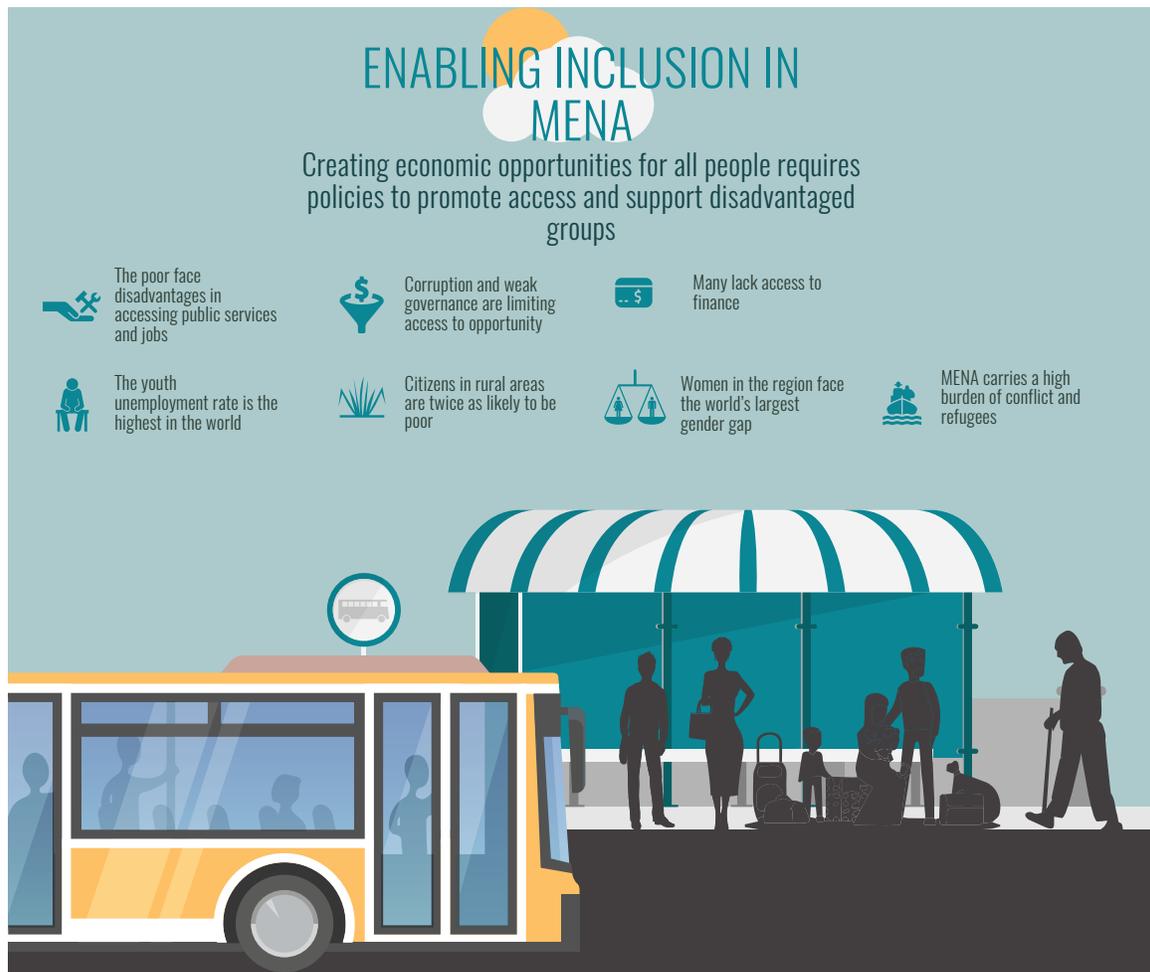
Economic inclusion refers to equality of opportunities. It holds that people should be able to access economic opportunities regardless of factors such as their gender, age, socioeconomic status, or location. Yet poverty, inequality, persistent unemployment, and lack of financial access are significant challenges in the MENA region. These challenges are magnified for the youth, women, rural populations, and people affected by conflict (Graphic 13).

Some MENA countries have made progress in addressing poverty. Poverty has been on a secular declining trend in several countries, and income inequality remains at or below comparator countries (Figures 4.1 and 4.2).

Still, due to structural and development challenges, poverty remains significant in some countries in the region. In the 14 emerging market and low-income MENA countries where data are available, 142 million people (about a quarter of the population) live on less than \$3.10 per day (Figure 4.3). Many people live on incomes just above the poverty line and are vulnerable to falling below it. Moreover, multidimensional poverty—which combines traditional income-based poverty assessments with measures of deprivation across health, education, and standards of living—remains high

Prepared by Carolina Castellanos (WHD, previously MCD) with inputs from Vahram Stepanyan (Boxes 8 and 9, and inputs on fuel subsidies and public wage bills) and Alexei Kireyev (both MCD). Erik Roos provided research assistance.

Graphic 13. Concerted policy efforts are needed to create economic opportunities for disadvantaged groups.



in several countries, ranging from over 20 percent in Djibouti to more than 80 percent in Somalia (Figure 4.4).¹

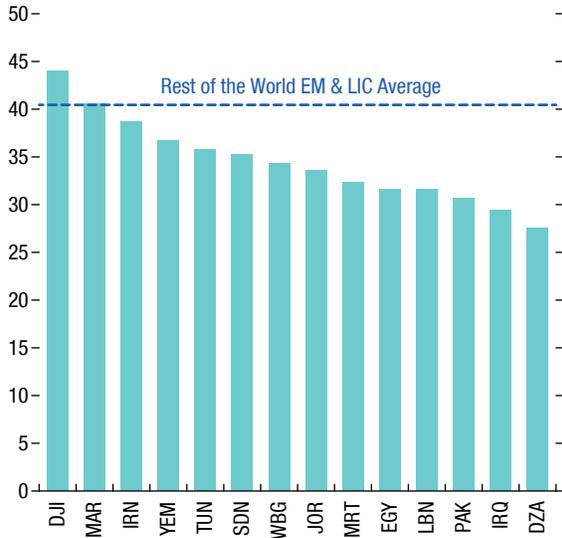
Public acceptance of inequality has declined amid significant pessimism about the future. In surveys conducted in Egypt, Jordan, and Morocco over 2000, 2008, and 2012, people expressed an increasing desire for more equal incomes (Figure 4.5). At the same time, the public perception of prospects for life in the future is notably pessimistic (World Bank 2016c).

Seven salient facts help explain exclusion and lack of access to economic opportunities in the MENA region:

¹The UNDP's multidimensional poverty index measures the number of people who suffer deprivation in 33 percent or more of weighted indicators among life expectancy, education, and per capita income.

Figure 4.1. Income Inequality Has Been Relatively Favorable

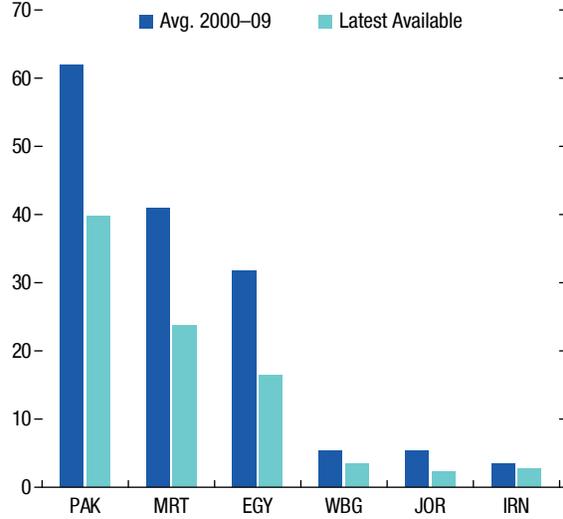
(Gini coefficient, for MENA countries, latest available value)



Sources: World Bank; and IMF staff calculations.

Figure 4.2. Poverty Has Been Declining

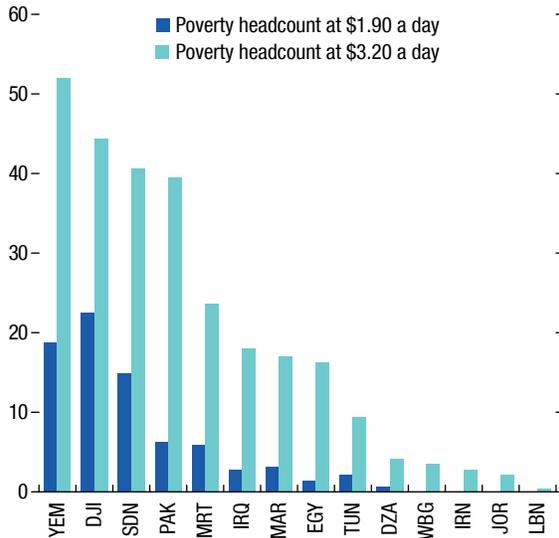
(Poverty headcount ratio at \$3.20 a day; 2011 PPP; % of population)



Sources: World Bank; and IMF staff calculations.

Figure 4.3. Poverty Headcount Is Still Significant

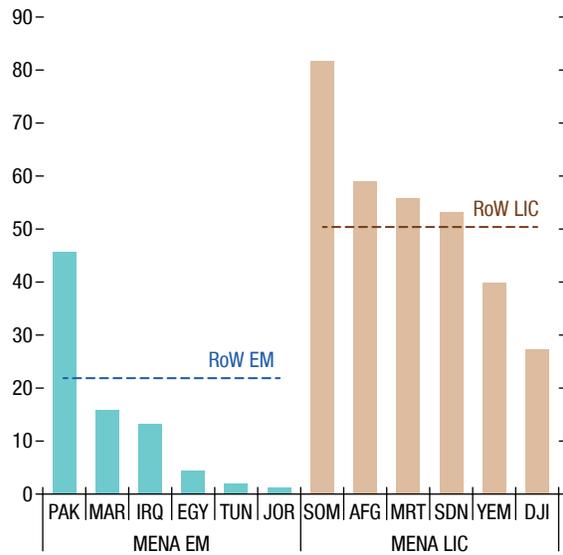
(Percent of the population)



Sources: World Bank; and IMF staff calculations.

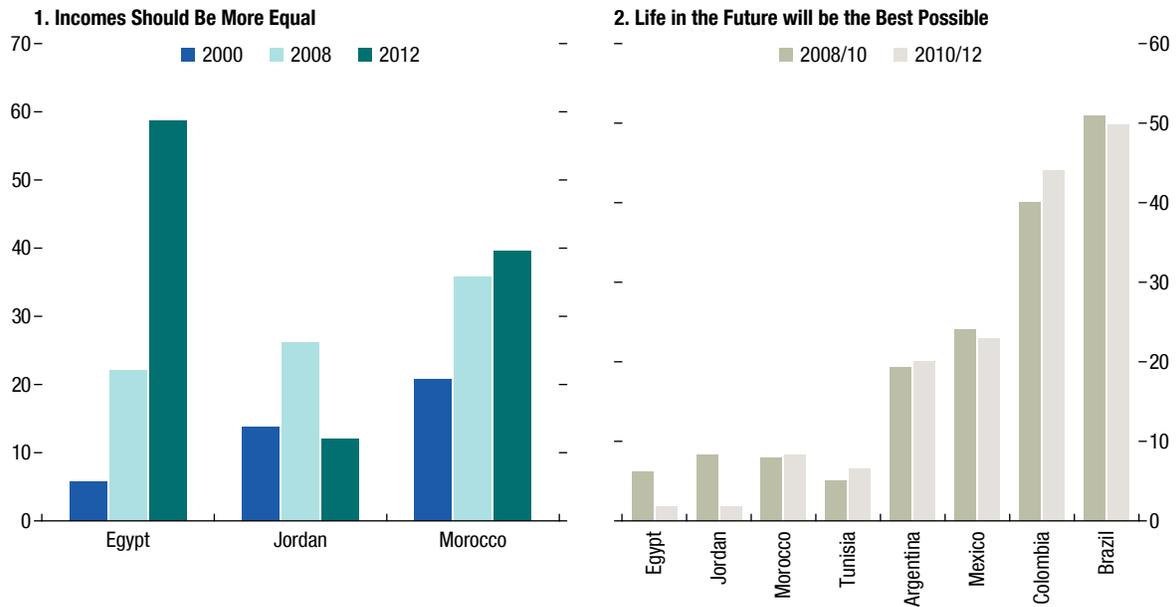
Figure 4.4. Multidimensional Poverty Remains Significant

(Percent of population, latest available)



Sources: UNDP; and IMF staff calculations.

Figure 4.5. Perception of Economic Fairness and Future Prosperity
(Percent agreeing with statement)



Source: World Values Survey.

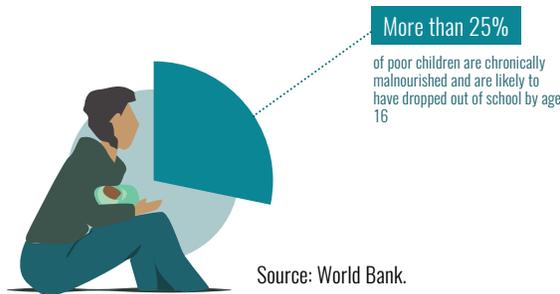
Source: Gallup.

Fact No. 1: In MENA, being poor or having a low income puts many at a significant disadvantage for accessing essential public services and social safety nets (SSNs).

Limited access to essential health, education, and other public services hampers inclusion. Lower access to health and education services limits the ability of the poor to stay healthy and build physical and human capital, ultimately hindering development, productivity, and growth. In Egypt, Jordan, and Pakistan, child mortality is more than twice as high for children born into families in the poorest income quintile relative to the richest quintile. In Egypt, Morocco, Yemen, and Syria, more than 25 percent of children in the bottom income quintile are chronically malnourished. By the time they reach age 16, they are likely to have dropped out of school (World Bank 2016c)(Graphic 14). In Jordan, a 10-year-old girl in the poorest quintile is 40 percent less likely to drink treated water and 50 percent less likely to have a bed than a girl in the richest quintile (World Bank 2016c). Socioeconomic status is still a main determinant of access to education, especially in emerging market and developing economies. Sizable gaps among socioeconomic groups in attending early childhood, secondary, and tertiary education remain in almost the entire developing world (IMF 2017b).

Lack of access to SSNs leaves the vulnerable exposed to shocks and unable to propel themselves to better livelihoods. The importance of efficient SSNs and social protection stems from concerns about inequality and social and

Graphic 14. Poverty has a concatenating effect on well-being and life outcomes.



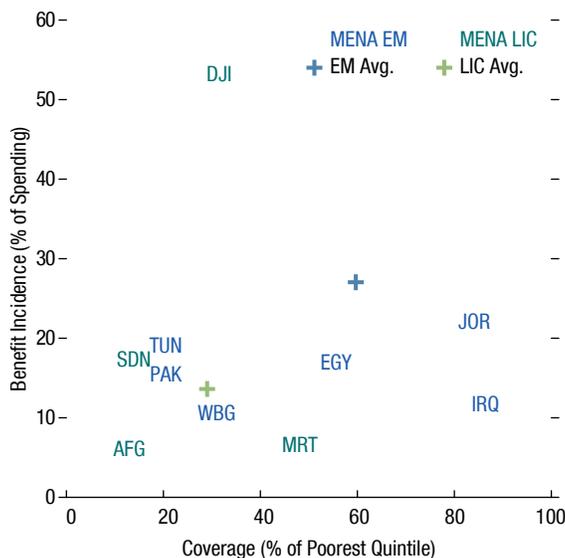
political stability, and is reinforced by apprehensions about the impact of trade, immigration, and new technologies on vulnerable groups (Independent Evaluation Office of the IMF 2017). In MENA, SSNs are small by international comparison. Except for the West Bank and Gaza, which spends over 5 percent of GDP on SSNs, most MENA countries spend less than 1.2 percent of GDP, well below countries at comparable income levels. Moreover, too few among

the vulnerable benefit from these programs. In several MENA countries, only between 7 and 14 percent of SSN spending reaches the poorest income quintile (Figure 4.6). SSN coverage of the population in the lowest income quintile is in some cases limited to 12–20 percent. These trends reflect difficulties of the existing programs in targeting the poor, along with limited awareness of such programs among targeted groups (Graphic 15).

Fact No. 2: Governance issues and control of corruption are limiting equal access to opportunity.

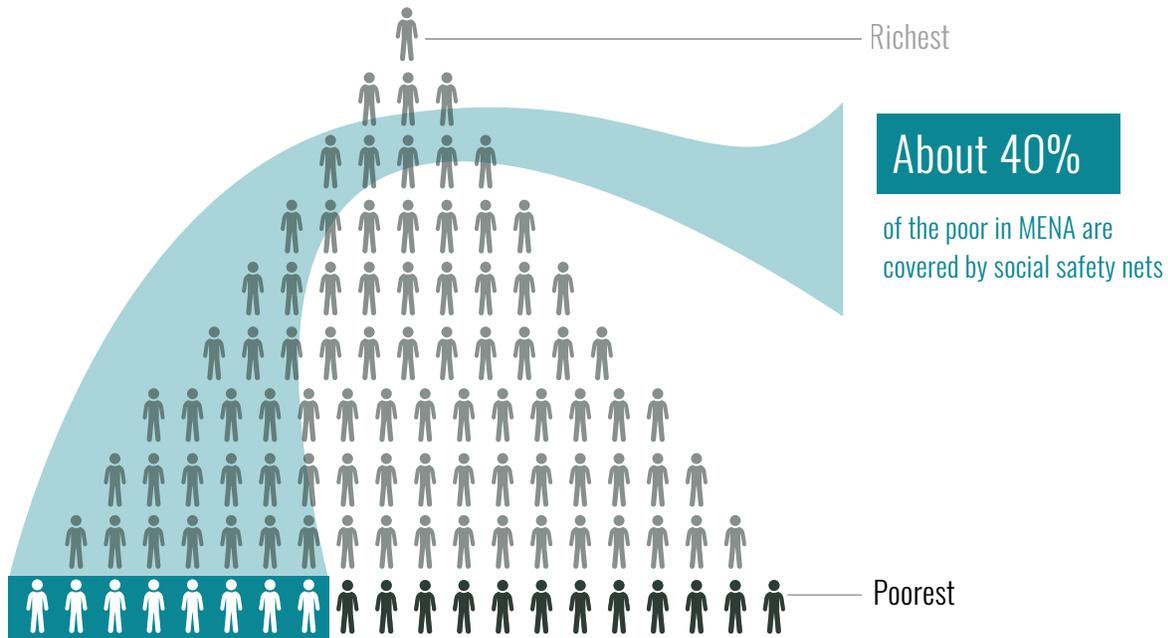
Limited civil service accountability, the importance of connections (*wasta*), and inefficiencies in public spending and lack of voice are among the

Figure 4.6. Benefit Incidence and Coverage for Social Safety Nets (Poorest 20 percent)



Sources: Aspire Database; World Bank; and IMF staff calculations.

Graphic 15. Social safety nets are not targeting the poorest.



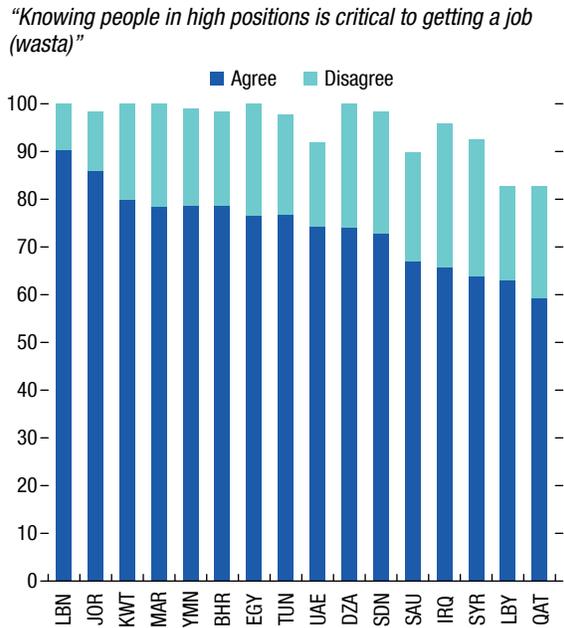
Sources: World Bank; and IMF staff calculations.

dimensions that are hindering inclusion. Nontransparent processes and excessive bureaucratic discretion in granting business licenses, for example, can lead to exclusion of those who lack *wasta*. Indeed, between 60 and 90 percent of respondents to a Gallup survey conducted in 2013 in countries across the region think that knowing people in high positions is critical to getting a job (Figure 4.7).

More broadly, government effectiveness, regulatory quality, the rule of law, and control of corruption are low by international comparison, and have worsened over the last decade (World Bank Worldwide Governance Indicators 2017c). Among the world’s regions, MENA has the second-highest perceived level of corruption (Transparency International 2017) and the highest percentage of firms that identify corruption as a major business constraint (Graphic 16, World Bank Enterprise Surveys 2017d).

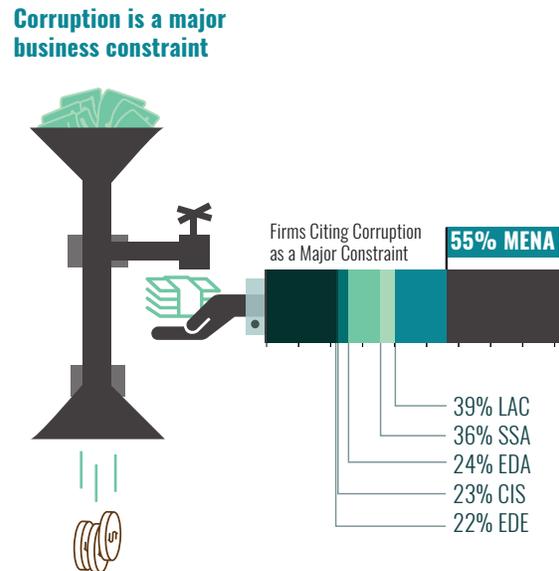
Public sector employment frameworks can be conducive to inefficiencies and governance issues. Access to public sector jobs is often not transparent or competitive, a key concern when, as noted in Chapter III, public sector employment is high. In some cases, public sector jobs are created to reward political supporters or as a social protection mechanism, regardless of need, affordability, or productivity (World Bank 2016e). Public sector staff often tend to be promoted based on seniority rather than merit and performance. In most countries, institutional frameworks do not require accountability on hiring or performance, so dismissing poor performers is unusual (World Bank 2016e).

Figure 4.7. Importance of Connections in Getting Jobs
(Percent agreeing/disagreeing with statement)



Source: 2013 Gallup World Poll Survey.

Graphic 16. Corruption is hindering private sector development.



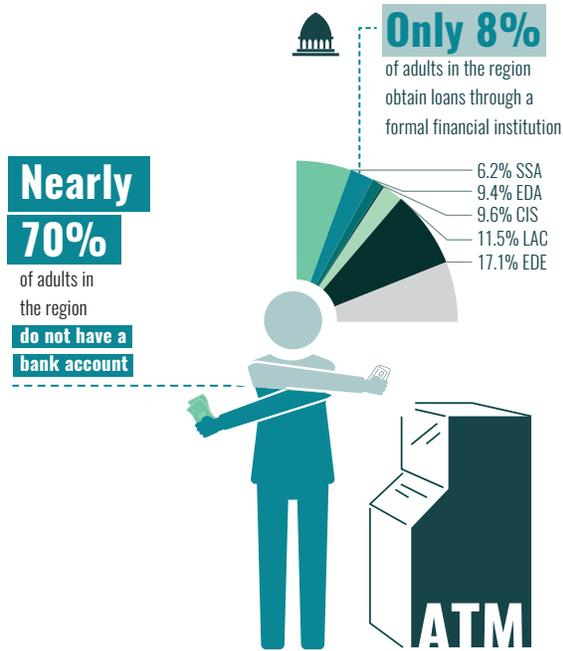
Source: World Bank Enterprise Surveys.

Fact No. 3: The majority in MENA still lack access to formal finance: Nearly 70 percent of adults (about 330 million people) do not have a bank account.

Access to financial services allows individuals and families to budget more effectively and invest in their futures through education, health, or business opportunities. Bank account ownership is significantly below comparator regions, and just 8 percent of adults in the region obtain loans through a formal financial institution (Graphic 17, Figures 4.8–4.9). Insurance service penetration is very limited, particularly in low-income populations (Arab Monetary Fund and others 2017).² Lack of financial access in the region is the result of banking systems that are often strongly oriented toward the public sector and large, established corporates; limited development of non-bank financial institutions; financial infrastructure bottlenecks (lack of credit information and problems enforcing creditor rights); scarce competition among financial providers; and limited financial education among potential clients.

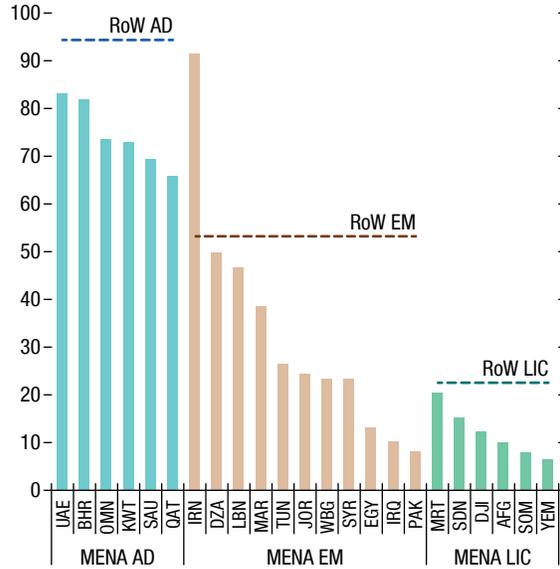
²Insurance companies and mutual funds account for less than 5 percent of GDP on average in the region. (World Bank 2011).

Graphic 17. In MENA, a significant number of people are financially excluded.



Sources: World Bank; and IMF staff calculations.

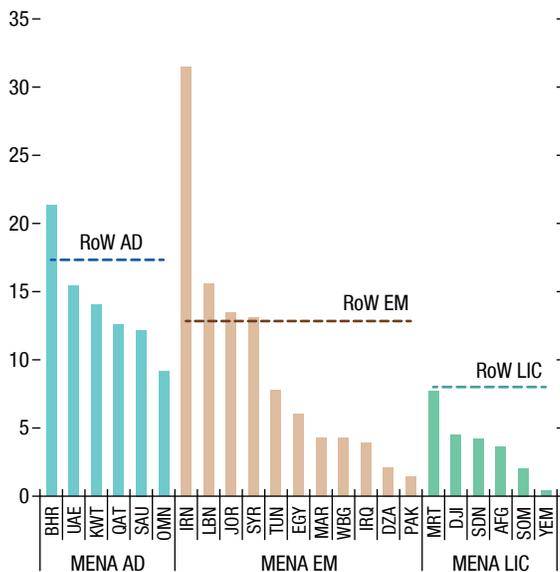
Figure 4.8. Financial Access Is Insufficient
(Percent of age 15+ population with an account at financial institution)



Sources: World Bank; and IMF staff calculations.

Figure 4.9. Borrowing from Financial Institutions Is Low

(Percent of age 15+ population that borrowed from a financial institution)



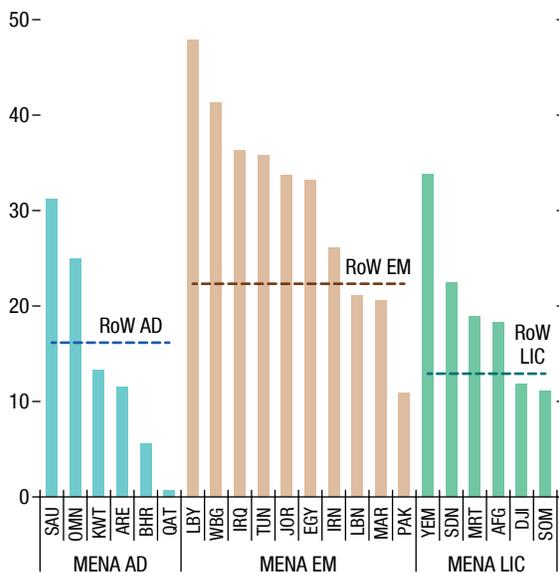
Sources: World Bank; and IMF staff calculations.

Fact No. 4: Despite being tech-savvy and having significant educational attainment, youth in the region are disproportionately excluded from formal jobs.

Youth unemployment is the highest in the world, averaging nearly 25 percent, and reaching over 30 percent in eight regional countries: Saudi Arabia, Libya, West Bank and Gaza, Iraq, Tunisia, Jordan, Egypt, and Yemen (Graphic 18, Figure 4.10). Furthermore, youth in the region are more likely than elsewhere to be neither in education, employment, or training (NEET). On average, NEET in the region accounts for about 30 percent of the youth population.³³ The Moroccan Ministry of Youth and Sports estimated that more than half of all Moroccan youth are NEET. In West Bank and Gaza, 25 percent of young men and 38 percent of young women are considered NEET, and in Egypt, the corresponding shares are 17 and 41 percent.³

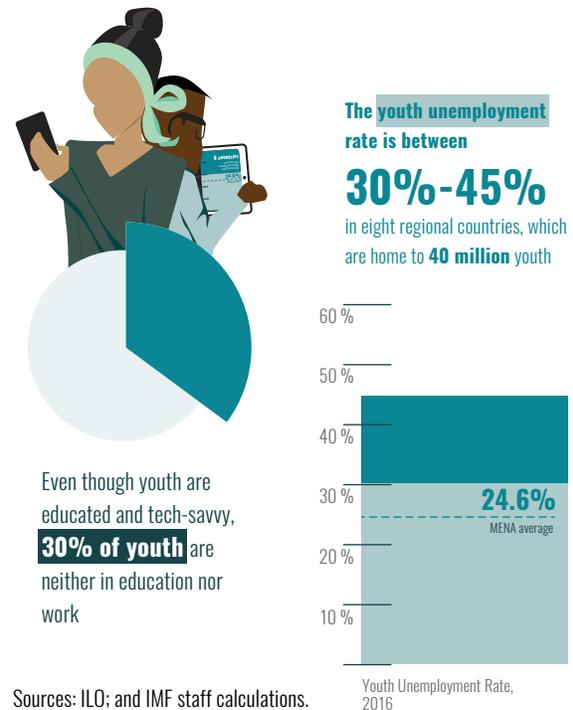
Educational attainment and technology usage are not aligned with the needs of the labor market. The MENA region has nearly universal access at the primary level and about 70 percent enrollment at the secondary level, but many MENA countries fall behind peer economies in the level of educational attainment

Figure 4.10. Youth Unemployment Is Very High
(Youth unemployment rate, 2016, percent)



Sources: ILO estimates; and IMF staff calculations.

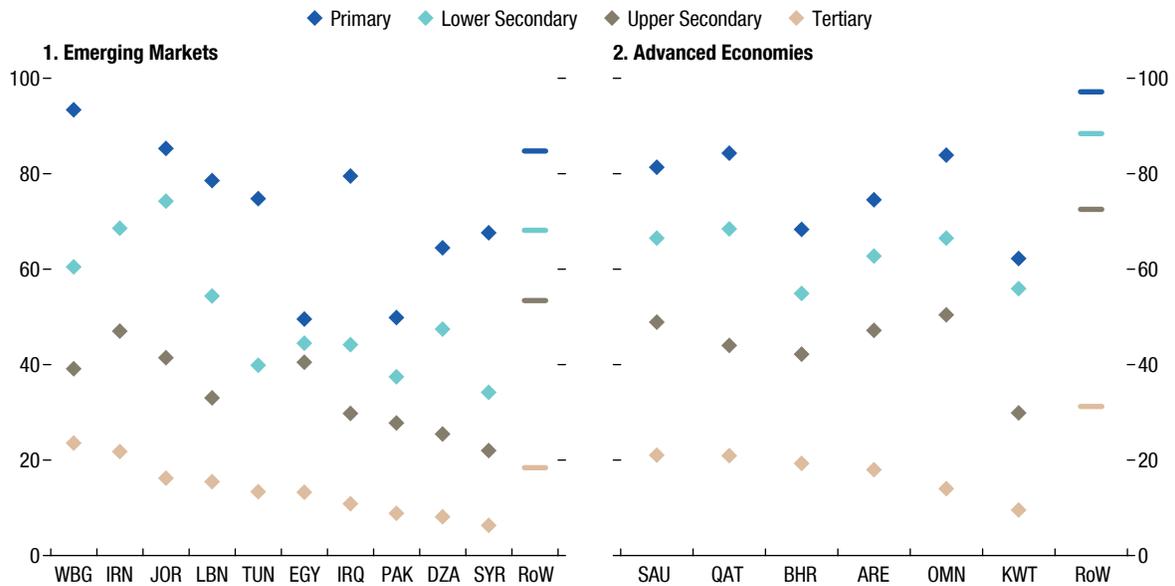
Graphic 18. Large Numbers of Youth are Excluded.



Sources: ILO; and IMF staff calculations.

³³Data obtained from ILOSTAT, database of the International Labour Organization.

Figure 4.11. Educational Attainment
(Percent of the population 25+, most recent data)



Sources: World Bank; and IMF staff calculations.

(Figure 4.11). Youth in the region tend to be tech-savvy and are avid users of mobile technologies. In Jordan, Lebanon, West Bank and Gaza, and Pakistan, 55 percent of 18- to 34-year-olds own a smartphone, compared to 31 percent of adults over 35 years old (Poushter 2016). Despite these figures, youth rate the quality of their own education as poor and believe they lack technical skills for the labor market (Shediac and others 2013).

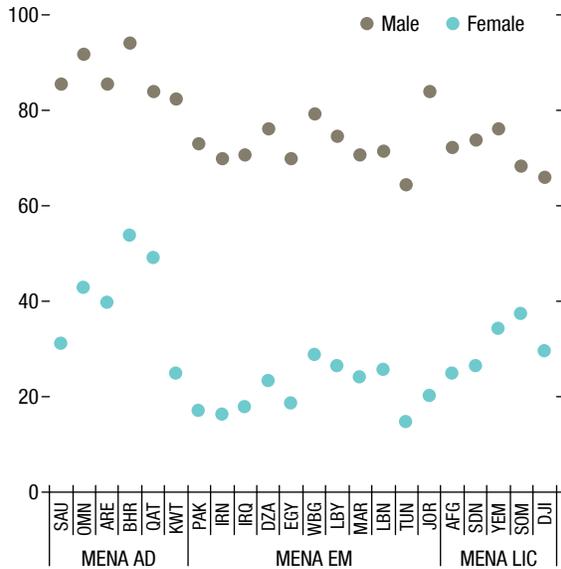
The financial access gap among youth is the widest in the world. In the MENA region, young adults are less than 50 percent as likely as older adults to own a bank account, the widest relative gap among the world's regions (Demirguc-Kunt and others 2015).

Fact No. 5: Women in the region are less likely to have access to opportunities.

The MENA region has the largest gender workforce participation gap in the world. While men's labor force participation is generally comparable to that of developed economies in other regions, only about one in four women participates in the labor force.⁴ There is significant variation across the region, ranging

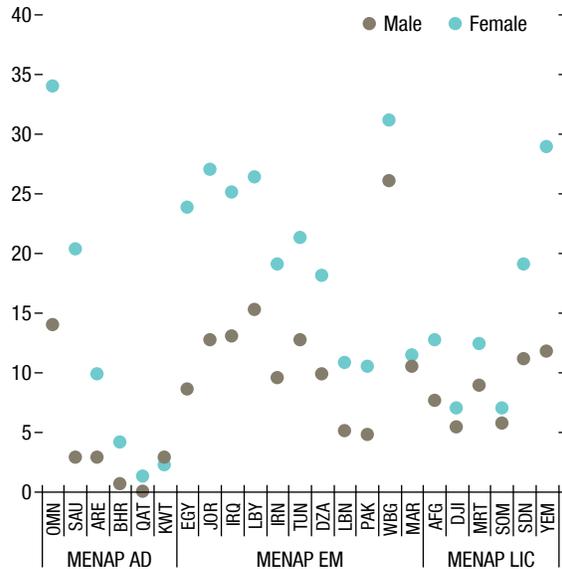
⁴While male labor force participation is high on average, this masks lower participation among male nationals in some GCC countries.

Figure 4.12. Labor Force Participation by Gender
(Percent of age 15+ population)



Sources: ILO estimates; and IMF staff calculations.
Note: ILO estimates include nationals and non-nationals.

Figure 4.13. Unemployment Rate by Gender
(Percent of age 15+ population)



Sources: ILO estimates; and IMF staff calculations.
Note: ILO estimates include nationals and non-nationals.

from fewer than 15 percent in some countries to about 50 percent or more in Kuwait and Qatar (Figure 4.12).⁵ Despite relatively high levels of education, female unemployment is high, exceeding 30 percent in some countries. Female youth unemployment is even higher, reaching 62 percent in Saudi Arabia, 70 percent in Syria, and 65 percent in Libya and Iraq (Figure 4.13).⁶

Inequalities faced by women in MENA are uniquely severe. Legal, institutional, cultural, religious, and discriminatory barriers greatly impede female equality. In some countries, laws do not guarantee equal constitutional, inheritance, and ownership rights for women. Married women face even more constraints, including in traveling, obtaining identification, conferring citizenship to their children, getting a job without spousal permission, and registering a business (World Bank 2016d). In Iraq, Morocco, and Tunisia, tax provisions favor men by granting explicit or implicit tax deductions or credits to the male head of household. Iraq grants tax deductions to widows or divorced women, but if a woman is married, the tax deduction is granted by default to the husband (World Bank 2016d) (Figure 4.14). There are 30 countries in the world that have 10 or more legal differences based on gender; of these, 18 are in MENA (Graphic 19).

⁵Data obtained from ILOSTAT, database of the International Labor Organization.

⁶Ibidem 36.

Figure 4.14. Countries in the Region Where Married Women Cannot Perform an Action Equally as Men
(Differences in Blue)

	AFG	DZA	BHR	DJI	EGY	IRN	IRQ	JOR	KWT	LBN	MAR	MRT	OMN	QAT	PAK	SAU	SDN	SYR	TUN	UAE	WBG	YMN
Apply for a passport	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Be head of household	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Choose where to live	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Confer citizenship to children	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Get a job without permission	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Travel outside the home	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Obtain a national identity card	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Travel outside the country	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Register a business	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■

Sources: World Bank; and IMF staff calculations.

Graphic 19. Women in MENA face severe inequalities.



Sources: ILO; and IMF staff calculations.

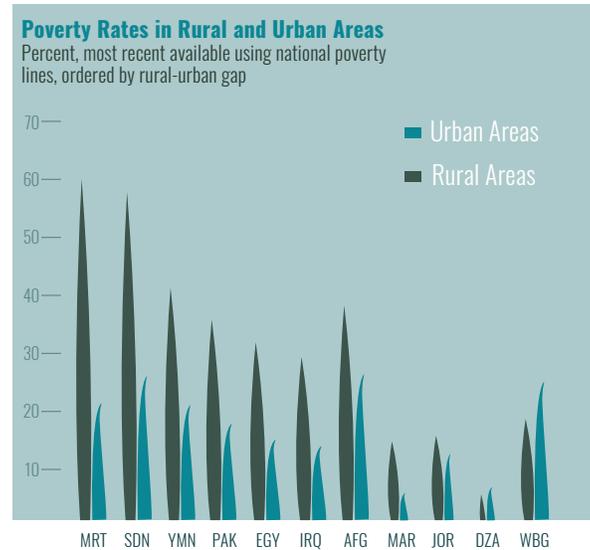
Access to finance is particularly low among women. Women in the region are 50 percent less likely than men to have a bank account. Ninety-three percent of young women (between 15 and 25 years old) lack an account at a formal financial institution—the highest rate of exclusion in the world (World Bank 2016f). Women lack access to formal financial services due to structural barriers, regulatory hurdles, lack of targeted products, and inaccessible delivery channels.

Fact No. 6: Rural communities tend to be twice as likely to be poor.

In most MENA countries, more than 20 percent of the population is rural, and in Afghanistan, Sudan, Yemen, Pakistan, and Somalia, that figure exceeds 60 percent.⁷ In some countries, like Egypt, Iraq, and Yemen, rural poverty is twice as high as urban poverty (Graphic 20). In some rural regions of Morocco, the poverty rate is 40 percent above the national average (Box 4). Rural poverty is often concentrated in distinct geographic areas, where access to healthcare and education is more limited and where human development indicators are below national averages.

⁷Data obtained from the World Bank DataBank and estimates are based on the United Nations Population Division's World Urbanization Prospects.

Graphic 20. Poverty in rural areas is significantly higher.



Source: World Bank.

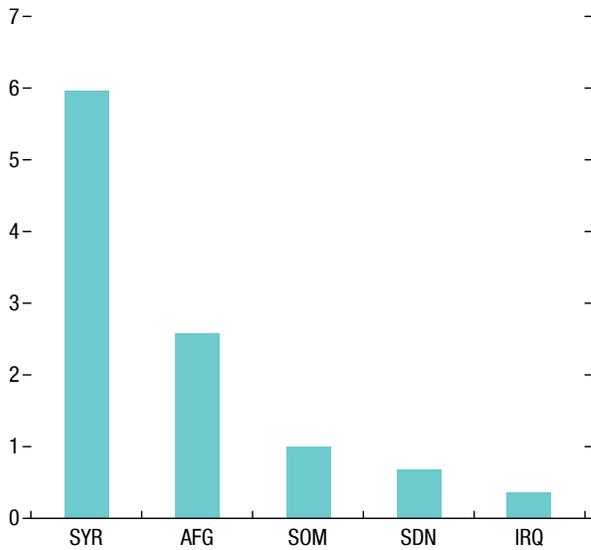
Box 4. Rural Poverty in Morocco

In Morocco, strong growth rates during the last decade helped eradicate extreme poverty. However, poverty and inequality, particularly in rural areas, is still significant. In 2016, of the 14 million people (39 percent of the population) who lived in rural areas, about 3 million (19 percent of the rural population) lived with less than \$3.10 a day (World Bank 2014). In 2011, the poverty rate in three rural regions was 40 percent higher than the national average (World Bank 2015c).

Access to quality education, health, and core infrastructure services in rural Morocco is limited. Illiteracy in rural areas remains significant (about 60 percent), and it is possibly as high as 90 percent for rural women (Project Literacy 2016). Beyond primary education, significant gaps remain between rural and urban, as well as male and female, citizens. The net enrollment rate in secondary education is 79 percent for boys in urban areas, but only 26 percent for girls in rural areas (World Bank 2016c). These disparities can be explained by the scarcity of quality educational institutions outside cities and towns; traditional norms (many families do not allow girls to commute alone to school or live away from home); and underage marriage, which, while illegal, is still commonplace and often results in the termination of girls' school enrollments.

In terms of health, Morocco made commendable progress. In the last 20 years, maternal mortality decreased by about 66 percent, and infant and child mortality decreased from 84 to 30 per 1,000 live births between 1992 and 2011. However, the maternal mortality ratio in rural areas is twice as high as that in urban areas (148 versus 73 deaths per 100,000 live births), and child mortality is 40 percent higher in rural areas. These disparities can be largely attributed to inequalities in access to health care providers and inefficient resource allocation among rural health care providers.

Figure 4.15. MENA Refugees by Country of Origin
(In millions)



Sources: UNHCR; and IMF staff calculations.

Fact No. 7: The MENA region hosts almost half of the world's population displaced by conflict, who tend to be poorer and disproportionately excluded.

The MENA region hosts a staggering number of refugees and internally displaced persons (IDPs). MENA has 44 percent (23.7 million people) of the world's people displaced by conflict: 5.5 million refugees and 18.2 million IDPs (Figure 4.15). The region is also the source of 10.3 million refugees (over 60 percent of the world total; UNHCR 2016d).

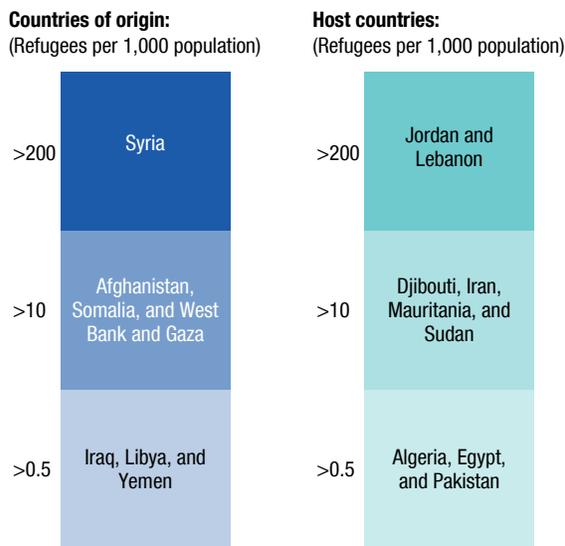
Refugees and IDPs are more likely to be poor and are disproportionately excluded. After six years of civil war, about six out of 10 Syrians live in extreme poverty, and life expectancy has fallen from 74.4 years before the crisis

Graphic 21. The effects of armed conflict in Syria have been severe.



Sources: World Bank; Lewis and Thacker.

Figure 4.16. Number of Refugees by Country of Origin and in Host Countries.



Sources: World Bank; UNHCR; UNRWA; and IMF staff calculations.
 Note: Refugees include Palestinians who were displaced as a result of the 1948 Arab-Israeli conflict and their descendants.

to 69.5 in 2016, the lowest it has been in almost 30 years (World Bank 2017b) (Graphic 21). Yemen's poverty rate has increased from 42 percent of the population in 2009 to 56 percent in 2015 (UNCHR 2016a). In addition, the large flow of refugees presents significant challenges. In some countries, notably Jordan and Lebanon, they constitute a sizable share of the host country population (Figure 4.16). Refugees tend to be excluded from opportunities, including access to education, health care, finance, and the job market. (World Bank 2016d). Armed conflict has forced more than 10 million children out of school in the region (Lewis and Thacker 2016).

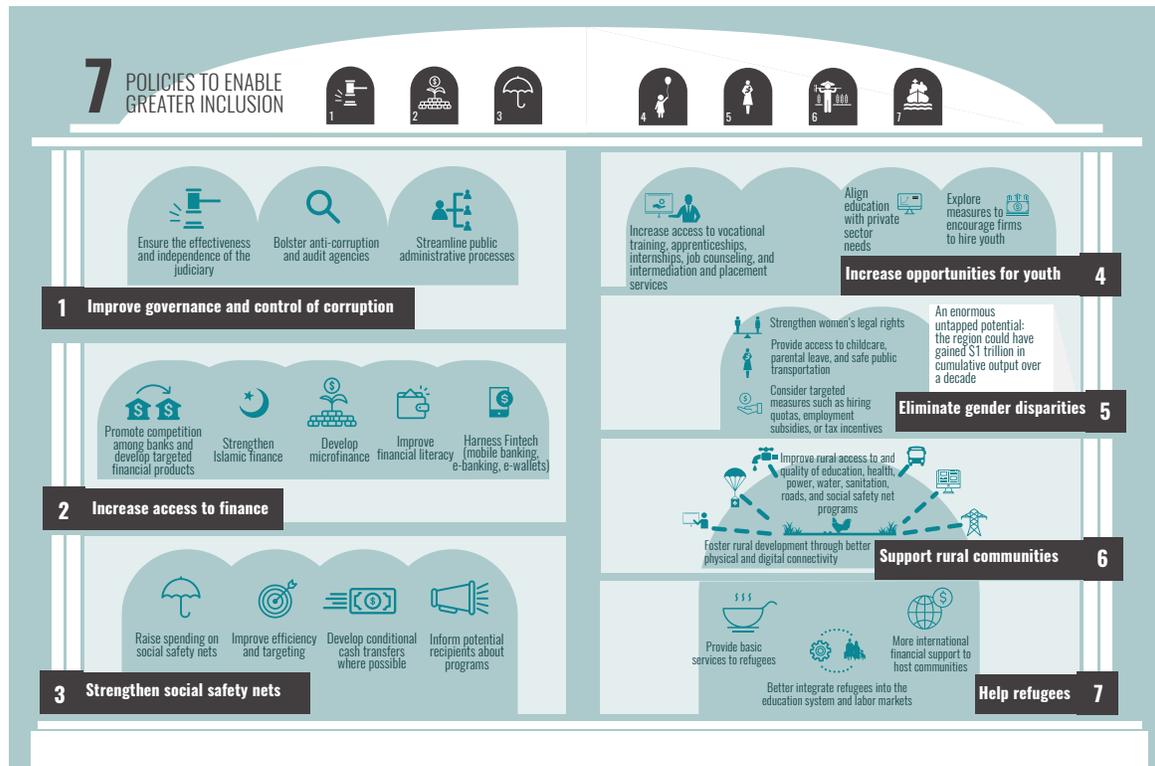
Toward Greater Inclusion

Strategies to strengthen inclusion need to focus on multiple policy areas. Some of these reforms could be implemented relatively quickly and have a short-term impact, but other reforms would require long-term planning, including the development of administrative capacity. Therefore, the authorities need to prioritize reforms and align them with their national objectives and institutional capacity (Graphic 22).

Priority 1: Strengthening Governance

Implementing institutional reform and strengthening accountability will improve governance. Governance can be advanced by strengthening institutional and public employment frameworks, enhancing the efficiency of public spending, reducing opportunities for rent seeking, and allowing resources to be competitively allocated. To this end, some measures that can be taken include adopting modern public financial management, procurement, and fiscal transparency laws (Chapter V); ensuring transparent and streamlined administrative processes; engaging in civil service reform; strengthening checks and balances by bolstering the effectiveness of institutions of accountability and oversight, such as audit institutions and anti-corruption agencies; reinforcing government transparency, including timely dissemination of socioeconomic statistics; and improving the rule of law by ensuring the effectiveness and independence of the judiciary.

Graphic 22. 7 Policies that can be deployed to foster inclusion in economic opportunities.



Countries have started to address these issues, but far more progress is needed. Tunisia approved an anti-corruption strategy that tackles the issue at the national level, grants more participation and freedoms to civil society and the press, and improves access to information (Box 5). The Tunisian Parliament also adopted laws on financial courts and public access to information. Egypt

Box 5. Tunisia Anti-Corruption Law

In Tunisia, corruption is an issue of significant public concern. The Tunisian Association for Public Auditors estimates that at least 450 million dinars (\$230 million) in bribes were given to civil servants in 2013 alone. Most Tunisians consider the judicial system to lack independence and the police to be corrupt, and more than 10 percent of businesses report encountering at least one bribe payment (GAN Business Anti-Corruption Portal, 2017). Against that background, the government made fighting corruption a priority. In February 2017, the Tunisian Parliament approved a new anti-corruption law, which envisions the creation of a “High Authority for Good Governance,” an independent body that oversees any matter related to corruption at the national level. The law also rewards those who help identify corruption practices, criminalizes retaliation against whistleblowers, provides more freedom to the press and civil society, improves public access to information, and establishes a legal framework for financial courts.

has a Public Procurement Law and an Anti-Money Laundering Law, and its Penal Code criminalizes bribery, corruption, gifts to influence, abuse of office, and use of public resources for private gain (GAN Business Anti-Corruption Portal, 2012). There, public officials are subject to regular financial disclosure (Transparency International 2015). The Law on the Regulation of Prohibition of Conflict of Interest bars public officials from holding any interest in areas over which they exercise power (US Department of State 2014). Pakistan's and Afghanistan's corruption perception scores also improved, with Afghanistan's almost doubling between 2013 and 2016 (Transparency International 2017). That said, there remains large scope for improvement for the region to catch up with comparable countries in other regions.

Priority 2: Improving Financial Access and Inclusion

Greater financial inclusion strengthens access to economic opportunity. Besides having an impact on growth and productivity through better allocation of resources, financial inclusion reduces poverty and inequality by raising incomes, reducing vulnerability to shocks, and increasing human capital investment, which also helps reduce the gender gap.

Efforts to improve financial access should be rooted in fostering competition among providers, strengthening the financial infrastructure, and boosting financial literacy. Measures should focus on encouraging financial sector competition and intermediation, as well as fostering the creation of financial products for different segments of the population, while ensuring adequate financial supervision and regulation; developing a well-functioning pension and mortgage market; improving credit information systems such as credit registries and bureaus; enhancing collateral regimes; reforming insolvency frameworks; supporting financial transparency; and instituting financial literacy programs. Some countries in the region have launched successful financial inclusion initiatives (Box 6).

Egypt and Morocco have introduced private credit bureaus, Tunisia has upgraded its public credit registry, and Pakistan has passed legislation enabling out-of-court enforcement of collateral. Pakistan's National Financial Inclusion Strategy aims to promote digital transactions, expand and diversify access points, improve the capacity of financial services providers, and increase the level of financial awareness and capability. Morocco granted a banking license to the postal network, which resulted in 500,000 new accounts during the initial years of operations. Morocco also made it compulsory for commercial banks to offer low-income banking products. The Gulf Cooperation Council (GCC) and Morocco are working to strengthen financial literacy through dedicated programs.

Nongovernmental organizations (NGOs) are also working on financial literacy: For example, INJAZ, a Jordanian NGO operating in Qatar, Egypt,

Box 6. Promoting Financial Inclusion: Regional and Worldwide Country Examples

Egypt: Financial Sector Reform. To improve financial sector soundness, the Egyptian government launched the Financial Sector Reform Program in September 2004. The program included significant reforms in the legal, regulatory, and supervisory framework across bank and non-bank financial institutions. The goal was to enhance competition, improve financial intermediation, mobilize savings, and ensure systemic soundness. The strategy started by upgrading financial institutions' accounting, auditing, and reporting based on international standards. Besides consolidating the banking sector, divesting the state-owned banks' shares in the joint-venture banks, and privatizing state-owned banks, the program also restructured the insurance sector, developed a well-functioning mortgage market, and strengthened supervision and regulation of non-bank and microfinance institution. (World Bank 2015).

Pakistan: National Financial Inclusion Strategy. Pakistan has achieved significant progress in increasing access to financial services. The State Bank of Pakistan (SBP) is actively engaged with the banking sector to reach rural and urban areas through the Financial Literacy Program (FLP) and Financial Inclusion Program (FIP). Branchless banking has transformed the way people manage their assets, with the number of outlets providing branchless banking services reaching 360,000 compared to 14,200 conventional banking branches (IMF 2017c).

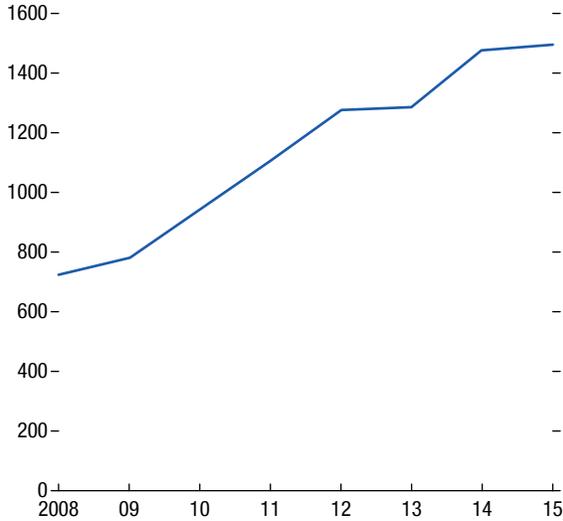
Saudi Arabia, and the United Arab Emirates, offers a popular online youth financial literacy program. Nonetheless, considerable scope for further progress remains. While many countries have established credit registries, their coverage is limited. In addition, credit bureau laws in the region can be improved to comply with international best practices (World Bank 2018).

Developing Islamic banking can foster financial inclusion. Islamic finance assets have grown significantly, from about \$200 billion in 2003 to about \$1.9 trillion in 2016 (Figure 4.17). In several MENA countries, the penetration rate of Islamic banking exceeds 15 percent. Despite this growth, Islamic finance assets are still concentrated in the GCC, Iran, and Malaysia, and they represent less than 1 percent of global financial assets (Krammer and others 2015). Broadening Islamic finance can help financial inclusion, especially among groups that do not participate in conventional banking due to religious reasons.

There remains significant potential to broaden microfinance. The microfinance loan volume in MENA region countries has remained low, at or below 0.7 percent of GDP, with Jordan in the lead (Figure 4.18).⁸ That

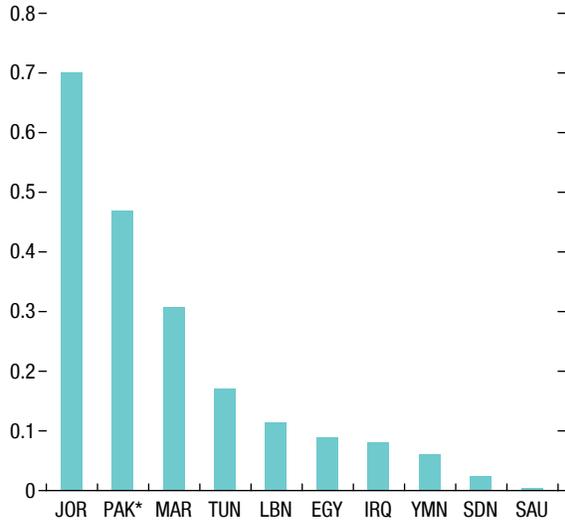
⁸Data obtained from the Sanabel Microfinance Network Financial Statistics Database.

Figure 4.17. Global Islamic Banking Assets
(In billions of US dollars)



Sources: IFSB; national authorities; and IMF staff calculations.

Figure 4.18. Total Microfinance Assets in MENAP Countries
(Percent of GDP, 2012)

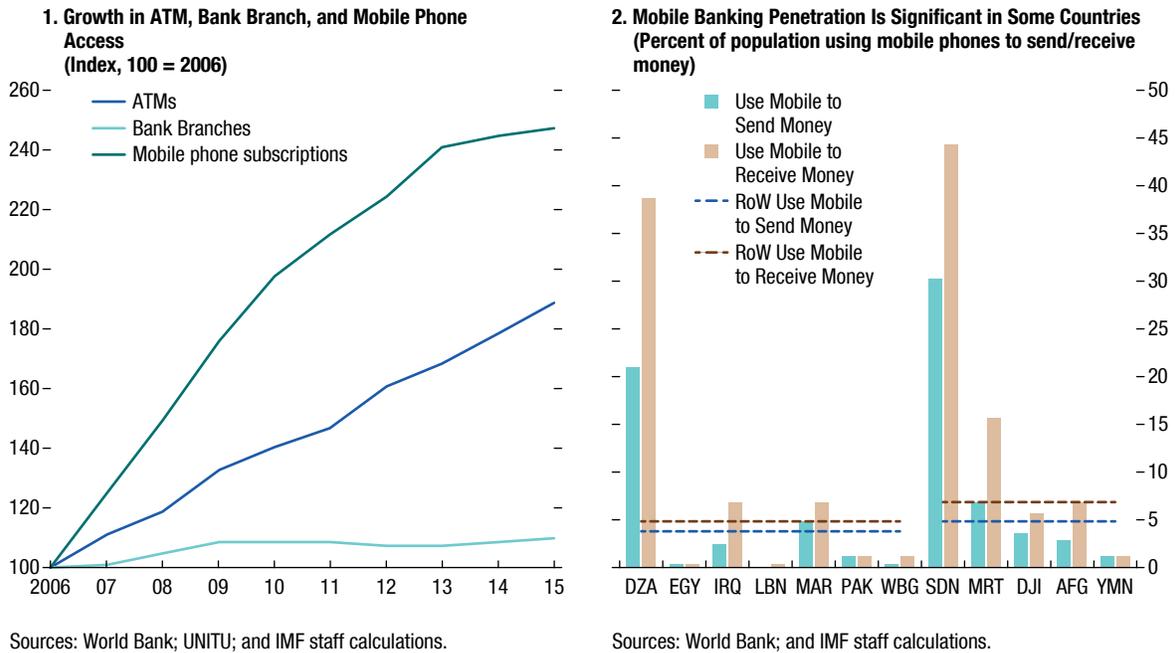


Sources: Sanabel; Financial Access Survey; national authorities; and IMF staff calculations.
Note: Pakistan data are from 2016.

said, the loan volume has already begun to grow at a fast pace in Egypt, Jordan, and West Bank and Gaza. The potential is sizable. For example, for clients of Morocco’s Al Amana microfinance institution, access to credit led to a 52 percent increase in the number of days worked outside the household, and a 10 percent increase in savings and consumption (Duflo and others 2014). Many countries in the region have taken policy initiatives to strengthen microfinance, including Egypt, Jordan, Morocco, Syria, Tunisia, West Bank and Gaza, and Yemen. Morocco updated its Microfinance Associations Law to consolidate smaller microfinance institutions to curb risky loans and financial vulnerabilities; and Jordan is finalizing its Financial Inclusion Strategy, which will expand its microfinance strategy.

Technology is opening new avenues to strengthen financial systems and inclusion (Figure 4.19). Fintech, including mobile banking, e-banking, e-wallets, advanced database technologies, biometrics, and distributed ledger technologies, has become a relatively inexpensive tool that can help excluded participants use banking services and enter the financial market. This is particularly true for people who live in areas with low bank branch and ATM penetration who could be users of mobile or online banking. Fintech can also lower transaction costs of banks and governments by making credit histories and information on customers readily available. At

Figure 4.19. Mobile Phone Access and Mobile Banking



the same time, while improved financial access can boost access by the private sector to credit, it can potentially present challenges to financial supervision.

Progress is underway to harness technology for financial inclusion. The region has experienced a seven-fold increase in fintech start-ups since 2009, concentrated in Egypt, Jordan, Lebanon, and the UAE. Start-ups predominantly focus on payment and funding solutions. Banks are also investing in digital technologies to strengthen their customer focus. In some countries (Djibouti, Egypt, Iraq, Pakistan, Somalia, Sudan), telecommunication companies are increasingly providing mobile payment services (IMF 2017a). In Sudan, close to half of the population uses mobile banking, and in Pakistan, the number of mobile accounts has been rising rapidly. As mentioned in Chapter I, Jordan introduced *eFawateerCom*—an electronic platform that allows people to pay bills online and from ATMs, POS terminals, and kiosks—and *Green Wallet*, an online credit platform that allows users to request and receive a loan within 15 minutes. *Middle East Payment Services*, a fintech solution company with operations in Jordan, Iraq, and the West Bank and Gaza, has grown substantially, providing secure payment processing for mobile payment services, ATM management, and credit and debit card purchases (Coleman 2016). In Egypt, the American University of Cairo and Commercial Bank partnered to create the AUC Venture Lab Fintech Accelerator. The program aims to develop and support fintech start-

ups in areas such as digital and mobile payments, peer-to-peer lending, customer interface, personal financial planning, retail trading, and investing and remittances (Arabnet 2017).

Priority 3: Expanding and Stepping Up Social Safety Nets (SSNs)

A key challenge facing countries in the region is to improve the coverage, quality, and often, the generosity, of social safety net spending. In the context of significant fiscal pressures, in the short term countries can first aim to strengthen well-targeted programs to further expand the coverage of these social nets to reach more of the poor. To improve beneficiary impact, governments can, in addition, remove duplicate programs and avoid fragmentation by merging programs or benefits. Over the longer term, coverage can be further expanded and funded in a sustainable manner through expenditure reforms that eliminate waste (e.g., energy subsidy reform) and equitable domestic resource mobilization (see Chapter V).

West Bank and Gaza has a successful cash transfer program that could be scaled up. The program allows recipients to purchase food and health insurance. The coverage of the program rose dramatically: an additional 8 percent of households could maintain electricity services and conduct repairs, and adolescents reported feeling more optimistic about the future (UNICEF 2015).

SSNs need to be appropriately tailored to the level of administrative capacity of each country to minimize risks of wasteful spending and corruption (IMF 2017d). Where administrative systems are adequate, some cash transfers can be made conditional to advance development priorities such as attendance to maternal health, child development, education, or professional training. Tailored mechanisms are needed for monitoring and evaluation. This will enhance social accountability and governance and allow programs to be redesigned and redirected as needed. For all types of programs, an accompanying outreach strategy is needed to increase awareness among potential recipients, who often have limited knowledge of the programs.

Some progress has been achieved, though more can be done. Jordan, Pakistan, West Bank and Gaza, and Yemen have introduced SSNs to better benefit the poor, albeit with elements of means testing or proxy means testing, which bases assessments on attributes that correlate with poverty. Prior to its current conflict, Yemen had successfully scaled up its Social Welfare Fund, to reach 1.5 million households in 2012 (Box 7). Pakistan established a

Box 7. Yemen's Social Welfare Fund

Yemen's Social Welfare Fund (SWF) is a cash transfer program that aims to increase the share of poor households among the beneficiaries and contribute to building human capital in selected districts (World Bank 2010). Initially, the cash transfer program had low coverage and limited impact on the incomes of the poor. In 2010, amid a difficult fiscal and socio-economic situation, Yemen decided to take measures to improve the SWF's efficacy. The Yemeni authorities (supported by the World Bank) developed a proxy means testing strategy to better identify the poor and needy, while it also took steps to improve the management of the program and reduce waste. The strategy included conducting door-to-door evaluation surveys, training staff to support beneficiaries and raise awareness about the program, and conducting periodic online and in-person monitoring. By 2012, the SWF reached 1.5 million households.

national registry through objective targeting, and hosts a database of more than 167 million people (World Bank 2015b). In Tunisia, where fiscal space is constrained, to create room to improve coverage of social safety nets for the poor, the current universal energy subsidies are expected to be streamlined into targeted programs to be rolled out in 2018, with World Bank assistance.

Countries should make better use of data and indicators to ensure more of the poor are adequately covered and benefit from social safety nets. "Conditional cash transfer" programs (such as those in Brazil and Mexico), which target the poorest households and condition transfers on accessing education and health services, can be useful tools to help create incentives for the poor to access social programs. A key challenge of such programs is to adequately identify the poor. Although these programs may prove difficult to implement in some MENA countries, where capacity and data is lacking, and are less relevant for the GCC economies, where education and health outcomes are at much higher levels, the case of Pakistan (Box 8) shows the potential to improve the coverage of social safety nets to the poor even in low income countries facing capacity constraints. The effectiveness and coverage of social assistance can also be enhanced by reducing fragmentation and duplication across social assistance programs.

Over the medium term, to further expand the coverage and generosity of social safety nets, countries need to find resources to sustainably fund the expansion and do so in an equitable manner. One option could be to eliminate fuel subsidies to free up some additional fiscal resources for larger social safety net programs, or other priority spending or fiscal needs. For example, if at the extreme all spending on fuel subsidies across the region were fully eliminated, this would generate enough resources for a 2 percent of GDP increase in social protection spending, which would amount to a 40 percent overall boost in social spend-

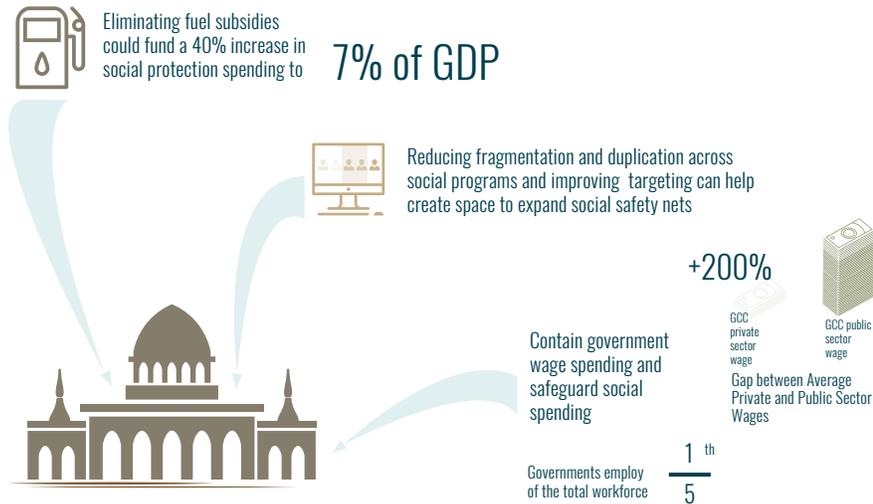
Box 8. Improving Social Safety Nets (SSNs): The Case of Pakistan

Pakistan has strengthened social protection programs to reduce poverty. The government made progress under the most recent IMF-supported program, which reduced the fiscal deficit while at the same time strengthening social safety nets and protecting social safety net funding. The latter was implemented under the program by setting a floor for targeted cash transfer spending under the Benazir Income Support Program (BISP).

BISP, the main SSN program, provides unconditional as well as educational cash transfers to poor households (for families with children ages 5 to 12 to support enrollment, attendance, and completion of primary school). The program uses a targeting mechanism that relies on proxy means testing and a delivery mechanism whereby most of beneficiaries use dedicated debit cards. BISP has helped lift targeted households out of poverty, with the proportion of beneficiaries living below the poverty line declining by about 20 percentage points relative to non-beneficiaries. However, its small size constrains its impact. Broadening BISP coverage, including to ensure adequate coverage of the poor, and stepping up educational transfers is key to strengthening Pakistan’s social safety nets (IMF 2017e).

ing. That is enough, for example, to raise spending in the region to the Latin American and European EM average level of spending on social protection of about 7 percent of GDP (Graphic 23). However, there could also be other social needs that need to be met by such savings, so—as highlighted in Chapter V—space and funding to expand social safety nets could also be created, through wider and more equitable tax bases that expand progressive income, wealth, and property taxes.

Graphic 23. Efficient spending can make more resources available for social safety nets.



There is also a need to address the growing pressure on public sector wage bills in the region to safeguard space for priority social and pro-growth spending, including that available for social safety nets. Whereas wage spending is important for provision of government services such as health care and education, growing wage bills reduce space for other public spending (including social safety nets and infrastructure spending) and/or increase deficits and debt. While across-the-board hiring and wage freezes or reductions in wages can address high and growing public wage bills in the short term, they are not typically efficient or sustainable. Such measures need to be replaced with carefully planned civil service reforms which, among other things, consider the composition of public wage bills and link compensation to employee performance (Box 9). The impact of such reforms on wage inequality also needs to be examined.

Box 9. Tunisia: Containing the Wage Bill to Create Space for Investment

Tunisia's wage bill increased to 14.1 percent of GDP in 2016 (from 10 percent in 2010). The surge resulted from robust hiring during 2011–14, and, more recently, from real wage increases. This left fewer resources available for public investment. The increase in government employment was associated with a decline in productivity and negative spillovers to the private sector. Labor productivity in the civil service (measured as value added per worker) declined by 10 percent between 2010 and 2015. Tunisian graduates tend to still prefer a career in the civil service, and the resulting high reservation wages tend to slow entrepreneurial initiative, dent overall competitiveness, and contribute to the slow pace of job creation in the private sector.

The authorities recently adopted a comprehensive civil service reform strategy that should help contain the wage bill, and this reform is incorporated into Tunisia's IMF program. The strategy focuses on reforming wage setting and compensation, controlling hiring, and reducing employment through voluntary separation and early retirement.

Reforming the civil service is challenging. With high unemployment, slow job creation, and strong social pressure to improve living conditions quickly, many stakeholders question the rationale for reducing the role of the civil service as the country's most stable employer. Unions have opposed previous reform attempts that focused on wage and recruitment freezes. The upcoming civil service reform will require the authorities to build a broad coalition in favor of the reform. For that reason, the reform will emphasize the expected improvements in public service quality and the gains from higher public investment, including in the form of new private sector jobs.

This box draws on IMF (2018).

Priority 4: Providing Access to Opportunity for Youth

Improving the quality of, and access to, education is crucial to expanding opportunity for young people. Educational programs can align better with the needs of the private job market by partnering with the private sector to streamline and reorient the curricula. This can be done by concentrating on enhancing soft skills, independent thinking, and problem solving and increasing the focus on STEM and sector-specific technical skills. Regularly and systematically measuring learning progress and teacher performance and targeting corrective policies to assessed educational gaps can help improve education outcomes. Providing more early childhood education and lowering the cost of schooling (for example, through school-provided meals or targeted cash transfers) can improve enrollment and retention (World Bank 2017a).

ALMPs and targeted incentives can also play a significant role. Vocational training, apprenticeships, paid or unpaid internships, job counseling, intermediation, and placement services can greatly enhance youth's skills and experiences for the demands of the job market. Egypt, Jordan, and Tunisia have government-funded labor market programs, although they have not yet reached many beneficiaries (IMF 2014b). The UAE is actively promoting vocational training (Hamdan 2013). Other policy options could include well-designed wage subsidies, tax benefits, and quotas for employers hiring youth and underserved people. Under its 2016–19 IMF-supported program, Jordan is studying options to temporarily lower payroll taxes for women and youth.

Priority 5: Eliminating Gender Disparities

The economic potential for strengthening gender inclusion is vast. The MENA region could have gained \$1 trillion in cumulative output (doubling the average real GDP growth) over the past decade if female labor force participation had been raised to narrow the gender gap from triple to double the average for other emerging market and developing economies (IMF 2013d).

Strengthening institutional and legal rights is critical to reducing gender disparities. Institutional and legal inequities can depress personal welfare and economic growth and reinforce intergenerational poverty. Inequality manifests itself in many ways, including unfair treatment of women, fewer girls attending school relative to boys, fewer women working or running businesses, and a wider gender wage gap. Countries should strive to remove legal barriers that limit women's rights, including in areas affecting physical movement, inheritance rights, and accepting jobs or registering businesses. Similarly, institutional barriers, such as access to legal recourse, should be removed.

In addition, targeted support for women is needed to reduce the gender gap. Ensuring equal access to education for girls and women is crucial for enhanc-

ing women's role in the economy (Kochhar et al 2016). Carefully designed and targeted hiring quotas and employment subsidies or tax incentives can also be explored. Other measures should include social campaigns to reinforce the importance of girls' education and women's participation in the workforce; providing women with childcare, maternity leave, and opportunities for professional advancement; and adopting measures to increase security for women in public transportation.

Despite the deep gender gap on legal rights, valuable progress has been achieved. Morocco outright forbids gender discrimination in accessing financial services. Jordan passed a law preventing women from waiving their inheritance and requiring any property they inherit to be registered in their name when the will is executed (World Bank 2016d). Egypt's new constitution has a nondiscrimination clause and introduces female quotas for Parliament (10 percent) and local councils (25 percent). Egypt also adopted a law that criminalizes sexual harassment in the workplace, classroom, and public spaces. Under its 2016–19 IMF-supported program, Egypt has spent EGP 250 million to improve the availability of public nurseries and other facilities that can enhance the ability of women to actively seek jobs, and it is working on increasing the safety of public transportation for women. Iran increased paid maternity leave and introduced (albeit limited, thus far) paid paternity leave. Lebanon also increased paid maternity leave and criminalized domestic violence. Algeria, Morocco, Iran, and Djibouti legally mandate equal remuneration for equal work. Pakistan introduced a 22 percent quota for women in local governments and increased the legal age for marriage to 18 years, with sanctions for perpetrators. Saudi Arabia introduced a 20 percent reserved seat quota for women at the Shura council, enacted a law criminalizing domestic violence (World Bank, 2016d), and recently allowed

The National Plan for Advancement of Bahraini Women (2013–22) is the gender strategy plan of Bahrain. It contains five impact outcomes: family stability, equal opportunities, lifelong learning, quality of life, and a house of expertise on gender issues. It aims at empowering, educating, and offering more opportunities to women. The strategy has specific objectives and measurable milestones. To date, the strategy has been able to advance significantly on improving and creating new laws and decrees supporting gender equality, and increasing funding for women's education and health initiatives (National Plan for the Advancement of Bahraini Women 2013).

Tunisia, Iraq, Egypt, and the West Bank and Gaza adopted gender quotas for public positions. These are voluntary party quotas, reserved seats, and legislated gender quotas to increase women’s political representation. Female participation in representative bodies has increased to a regional average of 13 percent, compared to a world average of 23 percent. Eight percent of women participate in cabinets in MENA. Algeria, reached 30 percent of women in Congress. Without quotas, it would take an estimated 70 years for governments to achieve gender parity, as opposed to 20 years with quotas. Other countries, such as Djibouti, Jordan, and Morocco have female quota requirements in Parliament (OECD, CAWTAR 2017).

women to drive starting in June 2018. However, enforcement of some of these laws remains weak, with ample room for enhanced implementation and significant scope for further legal reforms.

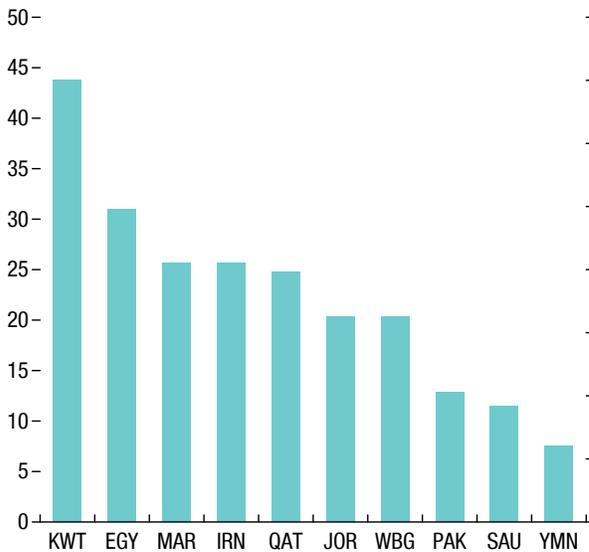
Some countries have developed national gender equality strategies. In Bahrain, Egypt, Jordan, and Morocco, the strategies focus on work-life balance;

in Bahrain, Egypt, Jordan, Lebanon, Morocco, and West Bank and Gaza they focus on enhancing gender diversity. However, there is room for scaling up these strategies as they are often narrowly focused on protecting women’s maternal roles (OECD, CAWTAR 2016).

More women need to be hired for top executive branch positions (Figures 4.20 and 4.21). Here, West Bank and Gaza, Morocco, Algeria, and Jordan have appointed several women ministers; Egypt, Iraq, Jordan, Kuwait, Morocco, Lebanon, Oman, the Palestinian Authority, Syria, Tunisia, and Yemen have female ambassadors overseas; and Egypt, Jordan, Morocco, and the Palestinian Authority have female mayors in several cities. Iran has two female Vice Presidents. Nonetheless, much more progress is needed.

Figure 4.20. Female Share of Public Sector Employment

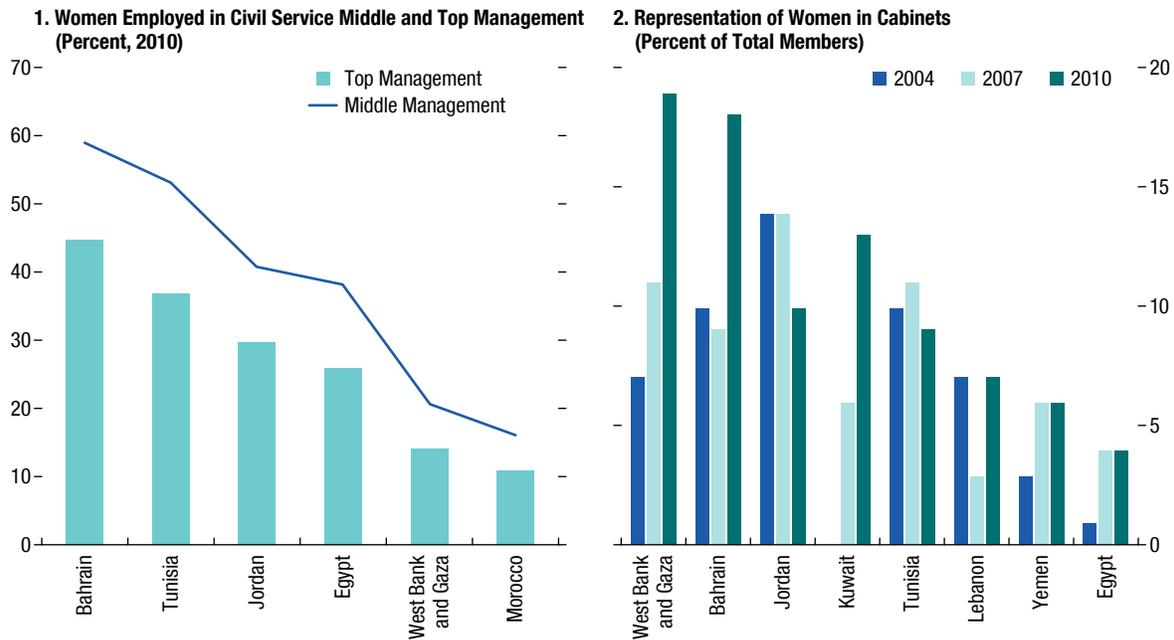
(Percent, latest available data)



Sources: ILO; and IMF staff calculations.

Note: Jordan’s data are from 2004. All other data are 2010 or later.

Figure 4.21. Women’s Representation in Government
(Percent agreeing with statement)



Sources: OECD; and IMF staff calculations.

Priority 6: Supporting Disadvantaged Rural Communities

Targeted policies to strengthen access to jobs and public services are needed to support disadvantaged rural communities. Rural disparities and exclusion can be addressed by focusing on adequate provision (in quantity and quality) of education, health care, power, water, sanitation, and roads, along with ensuring access to targeted SSNs. Tracking the execution of targeted public spending in these areas is key to ensuring the efficient use of public funds. In addition, strengthening physical and digital connectivity would improve access to product and labor markets. Other policy responses could include (1) targeting rural investment; (2) supporting agribusinesses with microfinance and educational programs; (3) improving the business climate by addressing infrastructure problems and supply chain bottlenecks; and (4) involving farmers and the private sector in the provision of services to agriculture, such as research, management, and innovation. In Morocco, the microfinance institution Alkarama has financed several agribusiness projects. In Lebanon, the Makhzoumi Foundation, among others, has vocational programs geared toward rural communities and environmental projects.

Priority 7: Helping and Integrating Refugees

Comprehensive strategies are needed to protect, nurture, and integrate refugees. While refugees present significant fiscal, socio-political, and institutional difficulties to the countries absorbing them, governments worldwide and of MENA, IFIs, and civil society need to work together to strengthen their roles in responding to the displacement crisis. It is particularly important to protect displaced people from further violence, while also supporting, financially and logistically, host communities so they can effectively handle the large numbers of refugees without causing distress to their own populations. After meeting the immediate need of providing basic services, there should be focus, within socio-political constraints, on integrating refugees into the education system and labor market by providing opportunities for training and counseling and by simplifying documentary requirements. Where warranted, employer tax incentives or temporary wage subsidies can be considered. Maintaining adequate labor standards for refugees, as for the national labor force and guest workers, is another important aspect of inclusion.

Creating employment opportunities for refugees can support the economy. In Jordan, for example, an IMF study found that employing refugees could strengthen growth while increasing the refugees' welfare (Aiyar et al 2016). Syrian refugees in Jordan are considered Jordanian residents, and the government has made progress in integrating them into the formal labor market by providing work permits.

CHAPTER

V

How Can Governments Enable Higher Inclusive Growth?

Significant portions of the Arab world say that governments could do more to address growing income inequality (Graphic 24). This is a reflection of the dissatisfaction many feel toward the quality and accessibility of public services—education, health, water, sanitation, and power—that are instrumental for expanding opportunities in the region and ensuring citizens enjoy a high standard of living. Here are a few of the 2014 Arab Barometer survey’s most striking findings (Figure 5.1):

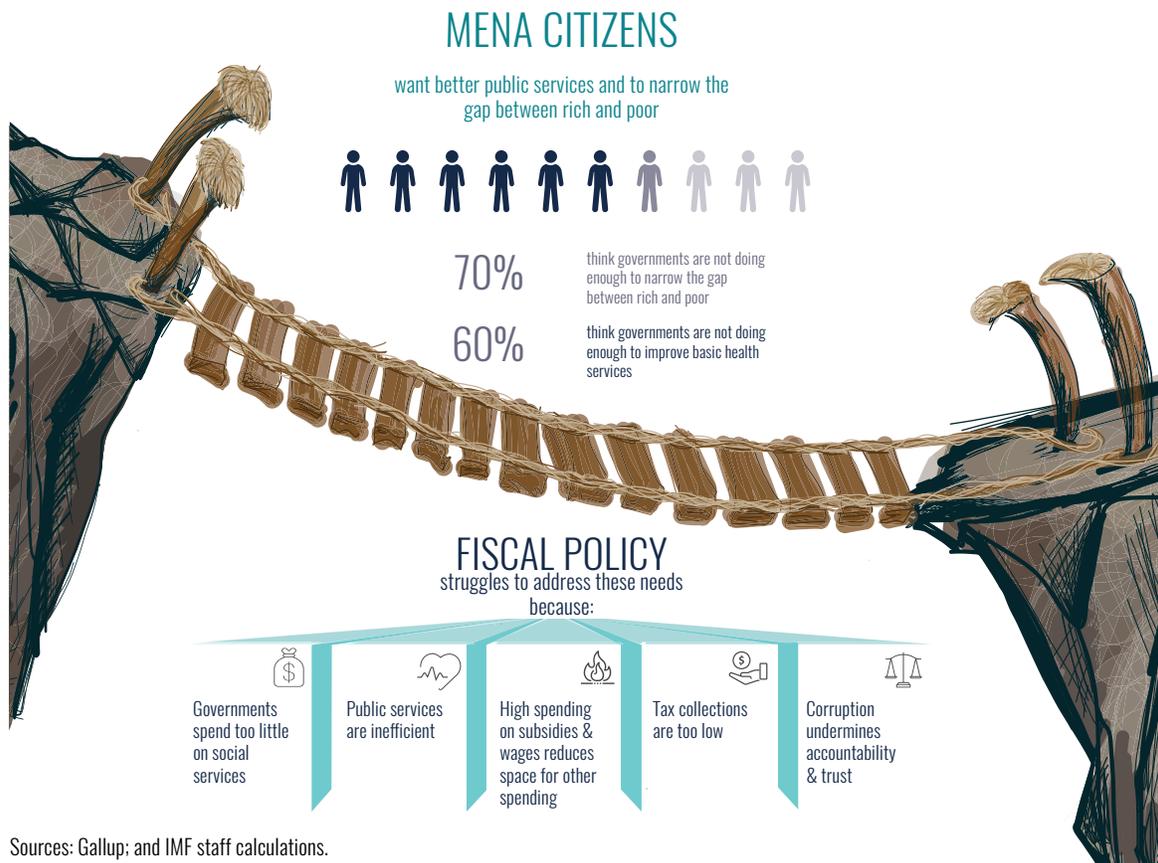
- Seventy percent responded that the government was “doing badly” or “very badly” at narrowing the gap between the rich and the poor. Only Kuwait had a dissatisfaction rate below 50 percent (at 30 percent).
- Sixty percent responded that the government was “doing badly” or “very badly” at improving basic health services. Dissatisfaction ranged from about 30 percent in Algeria, Jordan, and Kuwait to more than 80 percent in Egypt and Lebanon.

Furthermore, the most recent World Values Survey found a large share of MENA citizens (about 40 percent) support greater redistribution from rich to poor (Figure 5.2).

Governments, however, face challenges in their ability to address calls for greater inclusiveness and higher growth through increased spending on social and infrastructure priorities due to rising fiscal deficits and debts (Figure 5.3). MENA LICs and countries in conflict may not be able to accommodate the full cost of inclusive growth policies and may need more support from the international community.

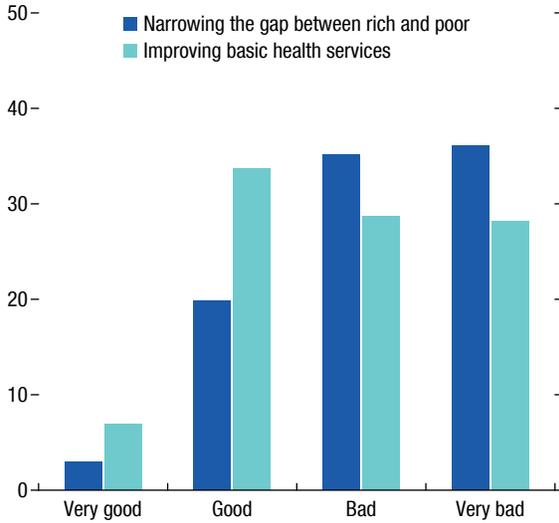
Prepared by Vahram Stepanyan with inputs from Bénédicte Baduel (both MCD). Erik Roos provided research assistance.

Graphic 24. Fiscal policies in MENA struggle to deliver higher and more inclusive growth.



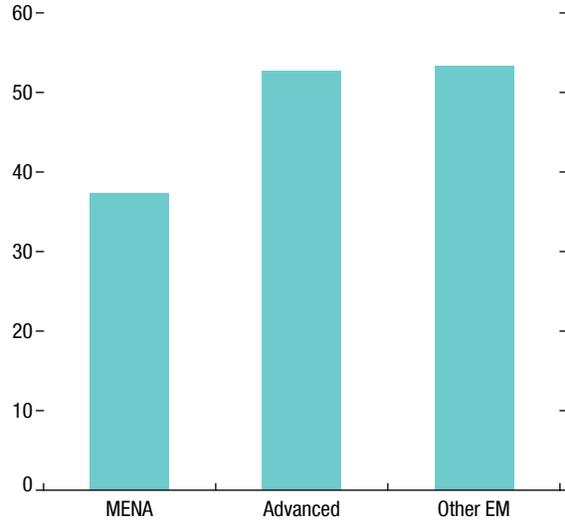
- Deficits and debt have risen sharply in MENA EMs. Increases in spending after 2011 caused deficits and debt to widen to 7 percent of GDP and 73 percent of GDP in 2016 on average, respectively, up from 2 and 58 percent of GDP in 2008. In some countries, such increases have undermined macroeconomic stability—a prerequisite for sustained growth—and have required cuts in spending or higher taxes to reduce risks.
- In MENA LICs, deficits and debt have deteriorated, often reflecting the impact of conflict and reconstruction needs. At an average level of 7 percent of GDP, deficits are more than double their 2008 levels, and debt now exceeds 50 percent of GDP. Moreover, disbursement of official development assistance to the region has been declining (OECD 2017), and borrowing costs are rising with global interest rates.
- In MENA AD, lower oil prices have reduced growth and opened up budget deficits. Between 2008 and 2013, government revenue exceeded outlays by some 10 percent of GDP. During the next three years, those budget surpluses gradually turned into deficits, which in 2016 averaged above 10 percent of GDP. In less than four years, government debt has more than tripled to exceed 35 percent of GDP.

Figure 5.1. Perception of Inclusiveness
(Percent of respondents)



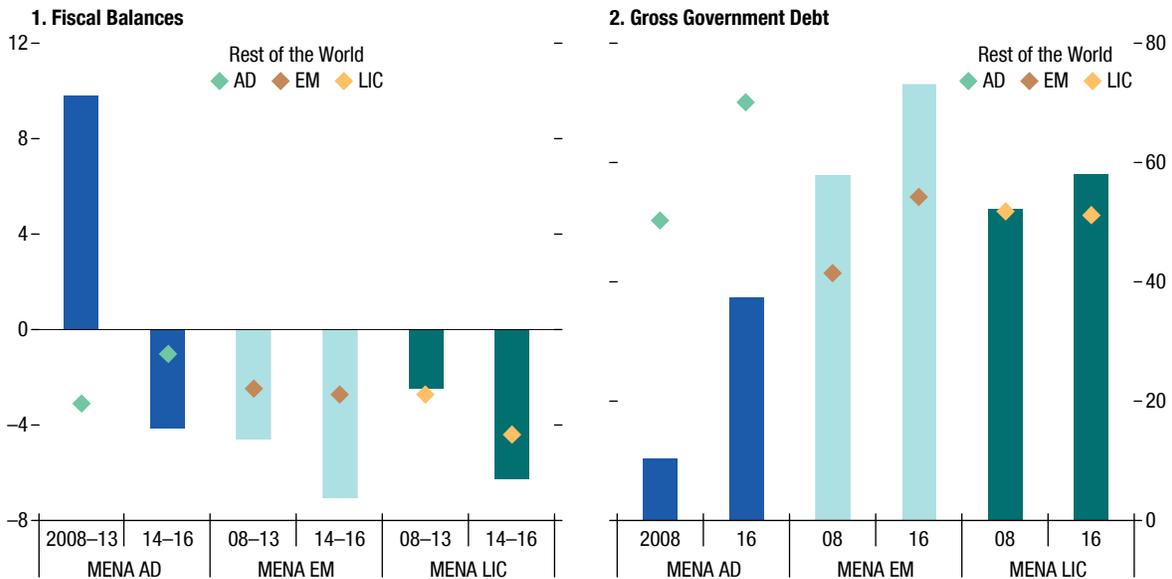
Source: Arab Barometer III. Arab Democracy Barometer was fielded from 2012–14 in 12 countries: DZA, EGY, IRG, JOR, KWT, LBN, LBY, MAR, SAU, SDN, TUN, and WBG.

Figure 5.2. Public Support for Redistribution
(Percent, 2010–14)



Source: World Values Survey. Respondents were asked to respond on a 1–10 scale with 1 meaning that they completely agreed with the statement “Incomes should be more equal” or 10 if completely agreeing with “We need larger income differences as incentives for individual effort.” Answers 1–5 were taken as expressing support for redistribution. MENA includes DZA, WBG, JOR, IRQ, KWT, LBN, LBY, MAR, PAK, TUN, and YMN.

Figure 5.3. Fiscal Balances and Government Debt
(Percent of GDP)



Sources: National authorities; and IMF staff calculations.

Are Fiscal Policies Supportive Enough of Inclusive Growth?

Governments' tax and spending choices impact growth, citizens' incomes, and access to opportunities. In MENA, the evidence suggests that nations could allocate more to fiscal programs that benefit all and spur higher growth. Resources spent need to deliver better outcomes for citizens, and there is ample scope to achieve this by improving the quality of services delivered and reducing inefficiencies. The low levels of tax collection work to constrain governments' ability to spend more on priority social and infrastructure spending without jeopardizing macroeconomic stability.

Fact No. 1: Governments spend too little on social services, and many citizens lack access to these services.

Social spending—defined by government outlays on social protection (which includes social pensions), health, and education services—is low in MENA (Graphics 25 and 26). It averaged just 11 percent of GDP across the region and has not changed significantly in the past decade (Figure 5.4).

Graphic 25. Social spending in MENA is low . . .

MENA spends

11% of GDP

on education, health, and social safety nets

11 %

Social Spending in percent of GDP



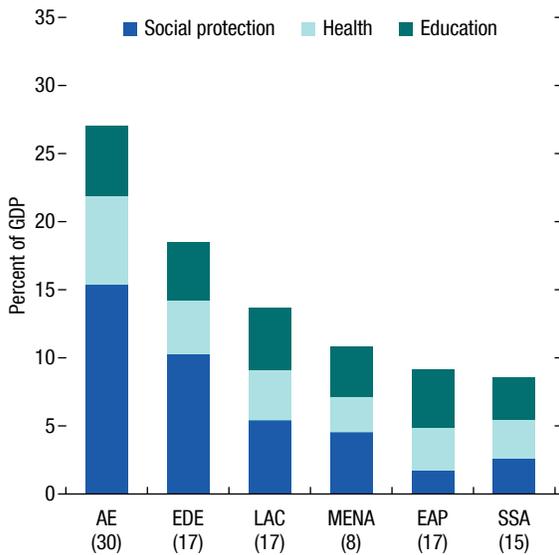
Source: IMF *Fiscal Monitor*, October 2017.

Graphic 26. . . . and not adequately focused on the vulnerable.



Sources: World Bank; and IMF staff calculations.

Figure 5.4. Social Spending by Region (Percent of GDP)



Source: IMF *Fiscal Monitor*, October 2017.
 Note: Number of countries in each group in parentheses. MENA includes BHR, DZA, EGY, IRN, LBN, PAK, TUN, and YMN.
 AE = Advanced Economies, EDE = Emerging and Developing Europe, LAC = Latin America and the Caribbean; MENA = Middle East, North Africa, Afghanistan, and Pakistan, EAP = East Asia and the Pacific, SSA = Sub-Saharan Africa.

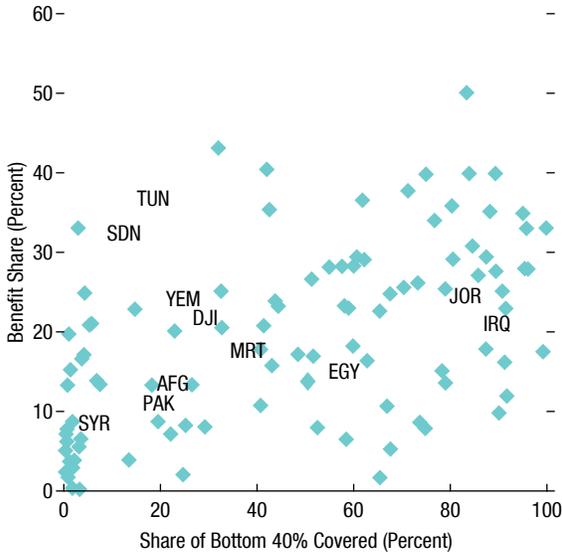
By comparison, in Latin America social spending amounts to 14 percent of GDP, and in Emerging Europe it equals 19 percent. MENA would need to spend an additional US\$70 billion (about 4.5 percent of GDP) to bring social spending broadly in line with the EM average.

For the 11 countries in the region for which data are available, on average, only 21 percent of spending on social protection (encompassing social assistance, social insurance, and labor market programs) goes to the poorest 40 percent, and 41 percent goes to the top 20 percent (Figure 5.5). This suggests the less needy are benefiting more from social protection systems.

The region has higher levels of educational inequality than most emerging markets. Even though access to education has improved significantly in the past two decades (Chapter IV), the poorest still have substantially lower access. For example, for those 20–24-year-olds

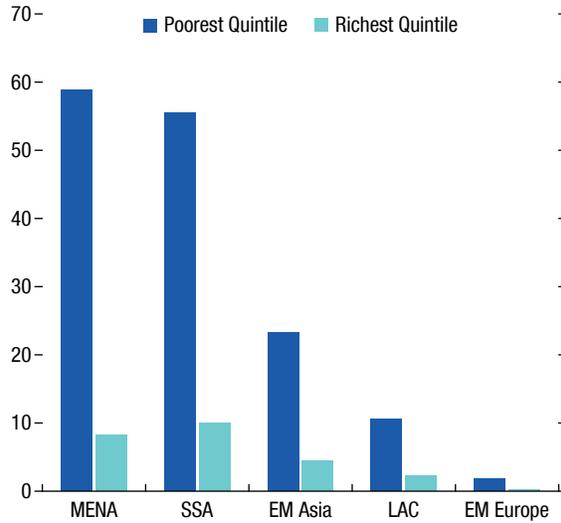
who are among the poorest fifth of the income distribution, about 60 percent—approximately 5 million youth—have fewer than four years of education (Graphic 27). This is six times that of the richest quintile, where fewer than one-tenth have less than four years of education (Figure 5.6). In countries impacted by conflict, the risk of exclusion from education is even higher. Only one in every two refugee children has access to primary

Figure 5.5. Social Protection Spending, Bottom 40 Percent
(Most recent year)



Source: IMF *Fiscal Monitor*, October 2017.

Figure 5.6. Population with Less than Four Years of Education, Ages 20–24
(Average weighted by population, percent, latest available year)



Sources: UNESCO World Inequality Database on Education; and IMF staff calculations.
Note: MENAP includes AFG, EGY, IRQ, JOR, MRT, PAK, SDN, TUN, WBG, YMN.

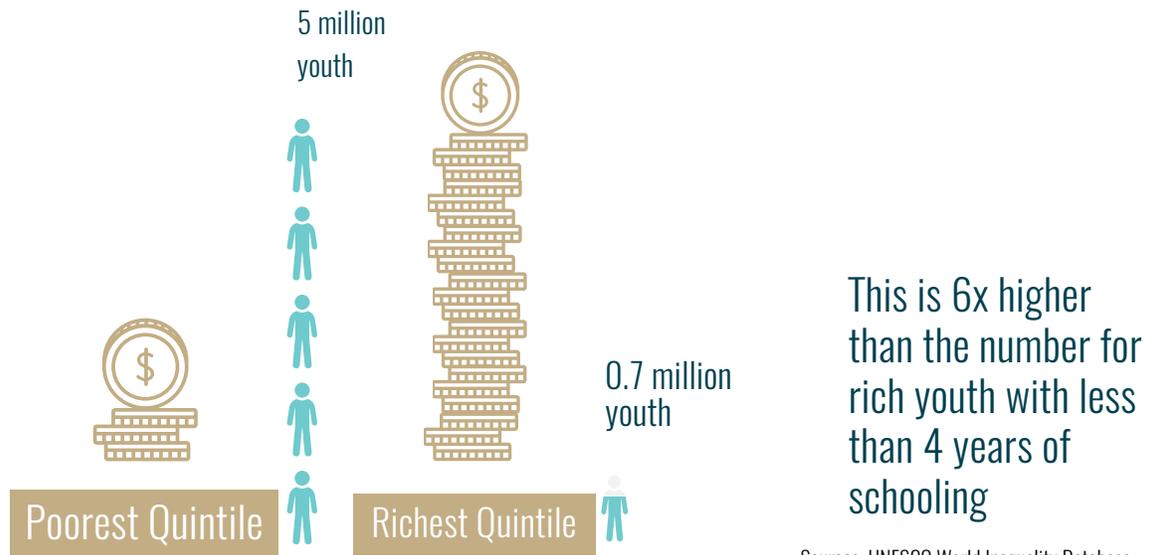
Graphic 27. Level of education inequality is relatively high in MENA.



60% of poor youth have less than 4 years of schooling

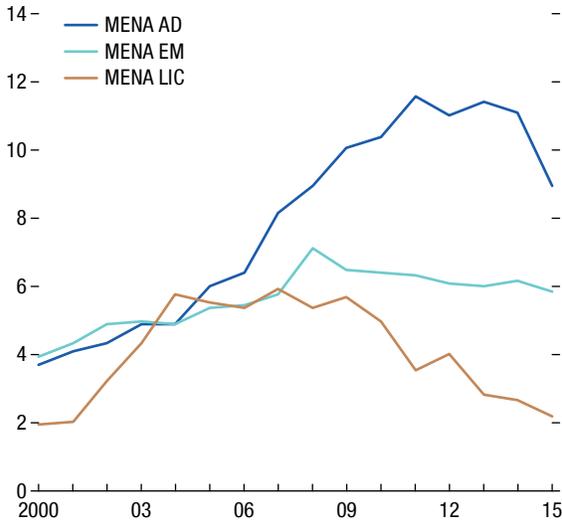


20-24 yrs. old in the poorest quintile with 4 years or less of schooling



Sources: UNESCO World Inequality Database on Education; and IMF staff calculations.

Figure 5.7. Public Investment
(Percent of GDP, weighted by 2011 PPP dollars)



Sources: IMF Investment and Capital Stock database; and IMF staff calculations.

education, and a refugee child is five times more likely than the average child to be out of school (UNHCR 2016a).

Public investment spending is declining across the region. Capital spending in MENA ADs has gone down from its peak of 11.6 percent in 2011, but it was still relatively high at 8.9 percent in 2015 (Figure 5.7). In MENA EMs, capital spending has been on a declining trend since 2008, and at 5.9 percent, it is below the EMs' average of 7.5 percent. The rate of capital spending in MENA LICs (2.2 percent) is well below its peers (5.2 percent LIC average). The Global Infrastructure Outlook¹ shows the extent to which current investment levels are insufficient to support growth and prosperity across the region. In Egypt, Jordan, Morocco, and Pakistan, the estimated

cumulative investment gaps by 2040 are high, ranging from 36 percent of GDP in Morocco to a high of 69 percent in Egypt. The World Bank estimates the damage from conflict in Libya, Syria, and Yemen at about US\$300 billion.

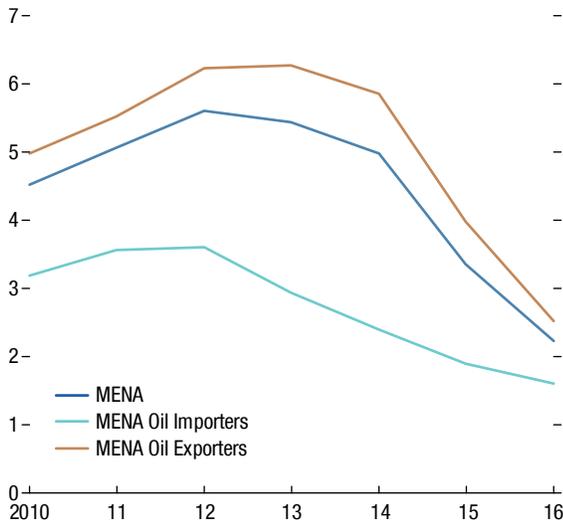
Why is the region not allocating more to programs and services that have the potential to spur higher growth that benefits all? One reason is that the region spends more and devotes a far higher share of total public spending to wages and non-targeted subsidies, which are often regressive. Such spending crowds out social and infrastructure spending.

Fact No. 2: High spending on subsidies and wages reduces space for social and investment spending

In 2016, the region spent US\$74 billion on fuel subsidies, or 2.2 percent of GDP. Although this is half of its 2010 level—the region still accounted for more than a quarter of global spending on fuel and other energy subsidies (Fedelino et al. 2017, Figure 5.8). Large generalized subsidies (mostly on energy) have been the main vehicle for social protection and redistribution in the region. These subsidies tend to benefit the rich more than the poor (Graphic 28). In fact, 43 percent goes to the richest 20 percent of the population because the poor consume less fuel (IMF 2013b). By way of contrast,

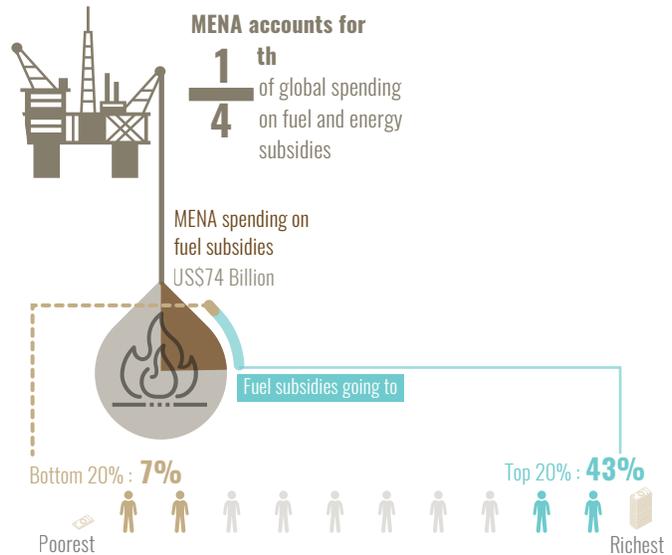
¹Global Infrastructure Outlook: Forecasting Infrastructure Investment Needs and Gaps—A G20 Initiative.

Figure 5.8. Diesel and Gasoline Subsidies
(Percent of GDP)



Sources: IEA; OECD; country authorities; and staff calculations.

Graphic 28. MENA spending on fuel subsidies.



Sources: Fedelino et al. 2017; IMF 2013.

the bottom 20 percent of the income distribution only receive 7 percent of these subsidies. These subsidies have created incentives to invest in capital- and energy-intensive industries to the detriment of job-rich industries.

Spending on wages of government employees in the MENA region accounts for a higher share of government spending than in peers. On average, outlays by governments on wages comprised about 32 percent of total government spending in 2016, compared to 27 percent and 23 percent in emerging market and advanced economies of other regions, respectively (Graphic 29).

Graphic 29. MENA government spending on wages.



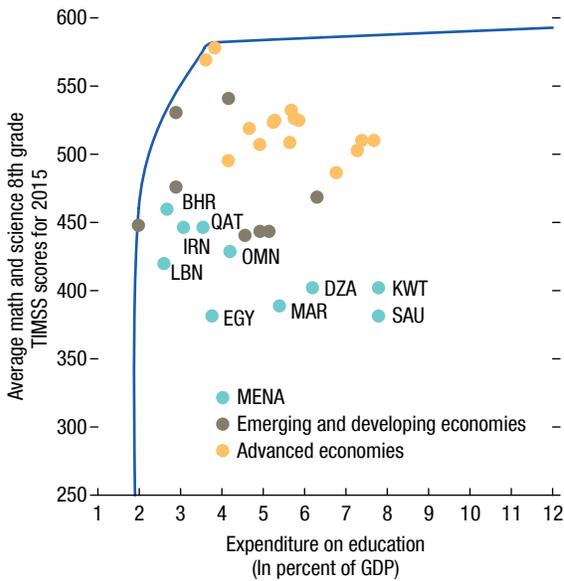
Governments employ **1/5** of the total workforce

Source: IMF 2018.

This spending was also higher, when measured as a percentage of GDP: 11 percent compared to 9 percent and 10 percent in emerging market and advanced economies, respectively. The region also employs a larger share of its workforce in the civil service relative to peers (Chapter III).

Fact No. 3: Public services are inefficient and of poor quality

Figure 5.9. Student Performance Compared to Education Spending



Sources: TIMSS and PISA evaluations; and IMF staff calculations.
 Note: For Algeria and Mexico, PISA scores were mapped into comparable TIMSS scores based on the performance of their peers in both evaluations.
 PISA = Programme for International Student Assessment;
 TIMSS = Trends in International Mathematics and Science Study.

Education and health spending often do not yield the outcomes they are designed to achieve. While levels of educational attainment are relatively high across the region, education outcomes are substantially lower than in comparator peer countries even though MENA nations often outspend them (see Figure 5.9 and Graphic 30). Likewise, in many countries of the region, health spending is substantially below the estimated health efficiency frontier (Figure 5.10). With the same amount of spending, higher health outcomes could have been achieved (even though there can be factors outside the health system that affect the outcomes). The region also lags substantially behind both EMs and ADs in terms of indicators such as infant mortality, hospital beds, and nurses.

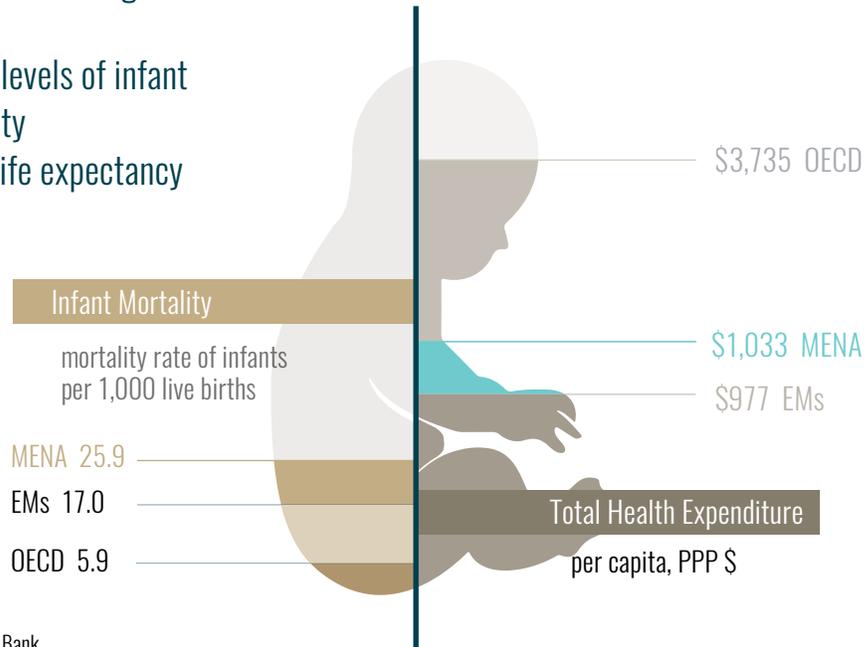
The quality of public investment is often low in MENA countries. For example, Albino-War et al. (2014) find that there is substantial room to improve public investment efficiency in MENA oil exporters,

including in the GCC region. MENA has significant room for improving the appraisal and selection stages of investment projects. The low quality of public investment in many MENA countries is reflected in the quality of their infrastructure (assessed by local businesses’ perception of the quality of road, rail, sea, and air transport and electricity and telecommunication connections) and may partly be the result of corruption in public procurement. According to Transparency International’s 2016 Corruption Perceptions Index, there has not been much progress in fighting corruption in the region: Most Arab countries showed a sharp drop in their Corruption Perception Index, which indicates an increased level of corruption (Transparency International 2017).

Graphic 30. MENA has substantial room to improve health spending efficiency.

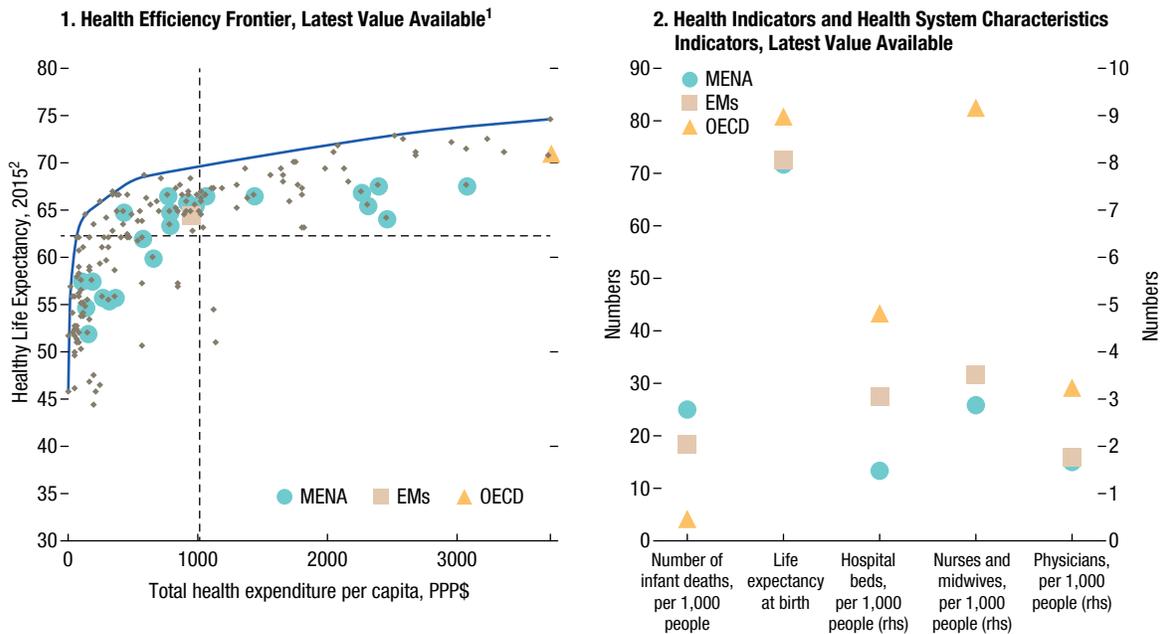
MENA spends more on health than other regions but has

- Higher levels of infant mortality
- Lower life expectancy



Source: World Bank.

Figure 5.10. Health Expenditure



Sources: IMF FAD Expenditure Assessment Tool (EAT); World Bank; and World Health Organization.

¹Dashlines are the average of MENA.

²Healthy life expectancy (HALE) is a measure of health expectancy that applies disability weights to health states to compute the equivalent number of years of life expected to be lived in full health.

Fact No. 4: Tax collections are too low to fund higher inclusive growth spending and point to substantial room for fairer taxation

Tax revenues averaged just 9 percent of GDP in 2016 (albeit with a large variance within MENA country groups) (Graphic 31). In MENA ADs, EMs, and LICs, tax collections amount to 5, 12, and 7 percent of GDP, respectively, compared to an average of 23 percent of GDP in Advanced Economies, 18 percent in emerging markets, and 11 percent in low-income countries (Figure 5.11). Moreover, tax revenues have been broadly stable for the past two decades, while in peer countries they have been rising. Narrow tax bases (which often exclude property and wealth and other assets), low tax rates, numerous and generous exemptions, and weaknesses in tax administration have hampered fiscal revenue mobilization and point to substantial room for more equitable taxation. In MENA AD, where oil revenues boost total government revenue, non-oil revenues are low and personal income taxes and value-added taxes (VATs) are virtually nonexistent (with the exception of a newly introduced

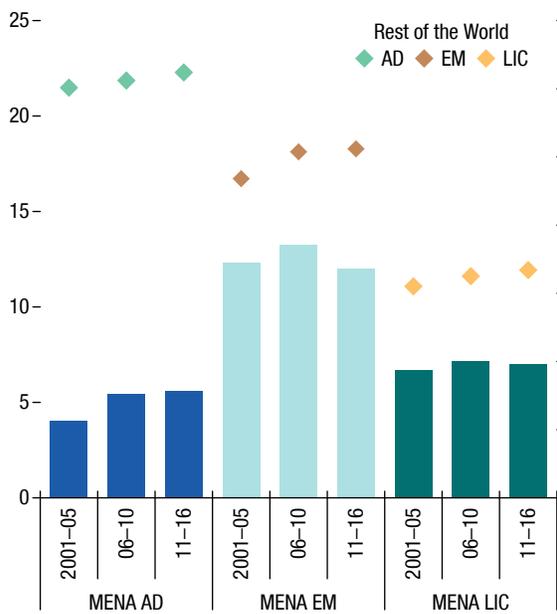
Graphic 31. MENA tax revenues.

MENA tax revenue averaged just **9%** of GDP in 2016



Sources: National authorities; and IMF staff calculations.

Figure 5.11. Tax Revenues
(Regional average, percent of GDP)



Sources: National authorities; and IMF staff calculations.

VAT in Saudi Arabia and UAE). The fall in oil prices and the related decline in growth has caused MENA AD oil revenues to fall from 40 to 27 percent of GDP between 2010 and 2016.

Personal income taxes are not very progressive. Progressivity measures the share of income earned that is paid in taxes by different income groups. The better off in society often pay substantially less in taxes as a share of their income relative to an average citizen or the poor. In some MENA countries, the top tax rates are set at a relatively low level (e.g., in MENA LICs the average top rate is 24 percent vs. an average of 30 percent for all LICs) (Table 5.1). The tax-exempt thresholds (i.e. equivalent of per capita income that is taxed at a zero rate) in MENA LICs apply at much lower income levels (0.5 of average income versus the LIC average of 5 times average income). At the same time, the

average thresholds for the lowest and highest rates (at 2.3 and 9 times average income, respectively) are higher in MENA EMs compared to other EMs (1.9 and 6.2 times of income, respectively), suggesting somewhat less progressivity in MENA EMs. Due to limited availability of data, empirical studies for the region are scarce, but the few that have been conducted suggest there is substantial room to improve progressivity of income taxes. For example, Sarangi et al (2015) find that in Jordan, while higher deciles of income distribution contribute more in taxes, this is not the case for the highest decile—indicating that the rich tend to pay less tax than those in middle-income deciles. In addition, in MENA, nonwage earnings—such as income from interest, capital gains, and dividends—are often excluded from the tax net, and the rich often take advantage of tax planning to minimize their tax burden.

Corporate income taxes in the region suffer from widespread exemptions, often provided nontransparently and with discretion, creating an uneven playing field for businesses (Jewell et al. 2015). In countries with VATs, multiple rates and exemptions have reduced revenue yields, and VATs can be regressive if basic food items and services that comprise a larger share of the consumption baskets of poorer citizens are taxed (Table 5.2).

Taxation of investment income (interest, dividends, and capital gains that largely accrue to the more wealthy) is either inadequate or absent in most

Table 5.1. Personal Income Tax Rates and Progressivity, 2014

	Tax rates (percent)		Tax brackets (times GDP per capita)		
	Lowest	Highest	At zero rate	At lowest rate	At highest rate
Resource countries					
Algeria	20	35	0.3	0.6	3.5
Libya	5	10	0.1	0.5	0.8
Iran	10	20	1.5	6.7	12.0
Iraq	3	15	0.6	0.7	0.9
Yemen	10	20	0.4	0.6	2.9
Non-resource countries					
Mauritania	5	33	0.8	1.6	8.1
Morocco	10	38	1.2	1.6	7.1
Tunisia	15	35	0.2	0.5	7.6
Egypt	10	25	0.3	0.9	12.8
Jordan	7	14	3.5	5.2	6.9
Lebanon	2	20	0.5	0.7	8.7
Syria	5	22	0.1	0.1	0.6

Source: Mansour 2015.

MENA countries. Capital gains on real and financial properties are generally exempt from income tax—registration fees are often used instead. Where investment income is taxed, the main issue is not so much the rate, but the exceptions, rate differentiation, and inconsistencies in the treatment, which creates opportunities for tax planning by high-income individuals (Mansour 2015). Tax evasion and resorting to tax havens are also a concern in terms of lost revenue and fair taxation.

Table 5.2. Value-added Taxes: Rates and Revenue Contributions

	VAT Rates		VAT Revenues			
	Standard rate (%)	Other rates (%)	% of GDP	% of GDP		C-eff. ¹
				% of total taxes	per point of rate	
	2016	2016	Mean 2015–2016			
Resource countries						
Algeria	19	9	4.2	30.3	0.22	n.a.
Iran	9	12; 20	2.7	33.2	0.29	0.45
Yemen (2013)	5	2; 3; 10	2.3	34.2	0.46	n.a.
Non-resource countries						
Mauritania	16	18	6.4	37.3	0.40	n.a.
Morocco	20	7; 10; 14	10.5	48.6	0.53	0.66
Tunisia	18	6; 12	5.8	27.4	0.40	0.40
Jordan	16	0; 4	10.5	64.3	0.66	0.63
Lebanon	10		4.3	30.5	0.43	0.33

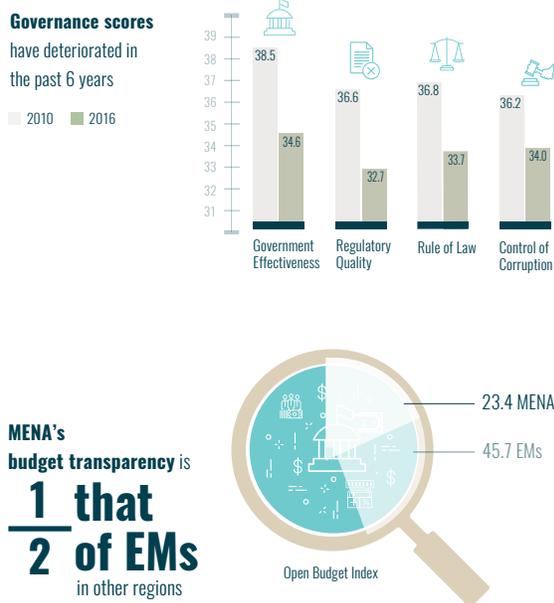
Sources: Mansour 2015; and IMF country team estimates.

¹C-efficiency is the ratio of actual VAT revenues to potential revenues and is estimated using the standard VAT rate.

Fact No. 5: Corruption and lack of transparency on how governments collect and spend money undermine trust and accountability

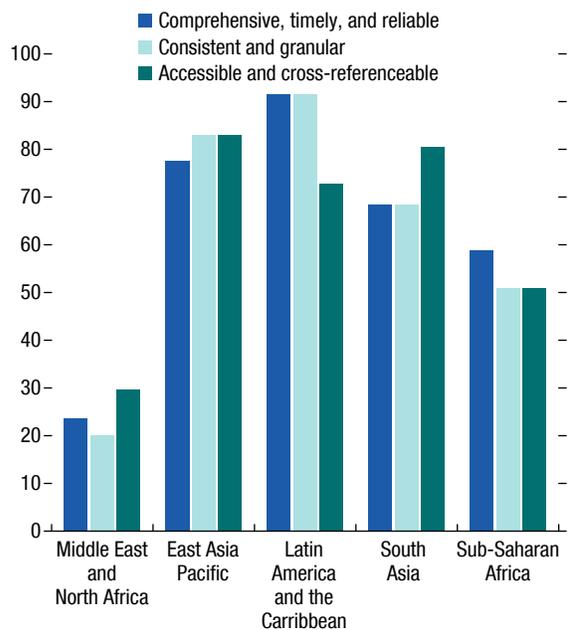
MENA region countries do not fare well on global governance rankings, and these rankings have deteriorated over the past decade. MENA's score on budget transparency of 23 out of a possible 100 is about half that of EMs in other regions (International Budget Partnership data) (Graphic 32). Users of budget data, such as civil society organizations, find fiscal data is often disseminated late and does not cover provinces, local governments, public pension schemes, and sovereign wealth funds (Figure 5.12). The region's score on public participation in the budget process of 9 out of 100 also lags that of EMs in other regions with an average of 26. Tax administrations in many countries of the region are perceived to exercise significant discretion leading to unfair treatment of taxpayers (Jewell et al. 2015). This, as well as lack of trust in the government's ability to efficiently spend resources, could have contributed to tax evasion.

Graphic 32. Governance and budget transparency in MENA.



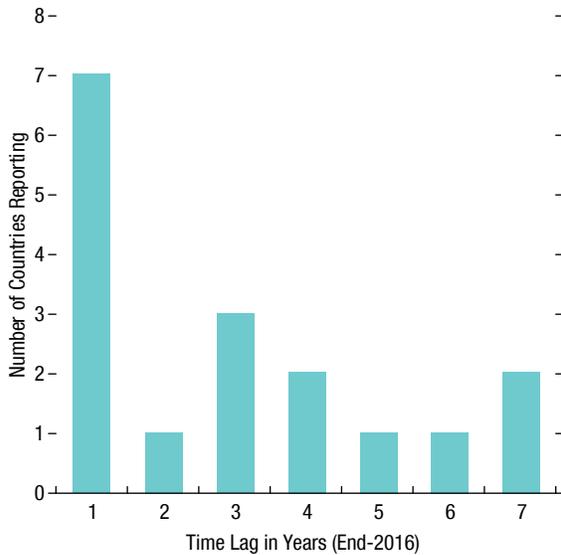
Sources: International Budget Partnership, 2016; and World Bank Governance Indicators, 2010 and 2016.

Figure 5.12. Relevant Dimensions of Budget Data for Civil Society (In percent)



Source: International Budget Partnership 2016.

Figure 5.13. Timeliness of Reporting of Government Finance Statistics Data to IMF Statistics Department: MENA Region



Source: IMF Statistics Department.

In terms of transparency, the region is also lagging in implementing the IMF’s data dissemination standards. Only four countries in the region subscribe to the Special Data Dissemination Standard (SDDS), and none have implemented the enhanced General Data Dissemination System (e-GDDS). Only five report budget data in the IMF’s *Government Finance Statistics Yearbook* on an accrual basis, and 11 on a cash basis. As of end-2016, only seven of these countries (Egypt, Jordan, Kuwait, Lebanon, Morocco, United Arab Emirates, Tunisia) publish these data within one year, which limits their usefulness to policymakers (Figure 5.13). No country in the region reports data on Sovereign Wealth Funds (SWFs) in the *Government Finance Statistics Yearbook* or international investment position (IIP).

How Can Governments Better Support Inclusive Growth through Fiscal Policy?

MENA has ample scope to spur higher inclusive growth through more efficient and equitable spending. Furthermore, through broader taxation the region could raise additional revenues in an equitable manner to fund inclusive growth and social and infrastructure programs. The facts presented above suggest some principles to guide policymakers in using their budgets to support higher inclusive growth. These have long been part of policy discussions in the region, and many countries are implementing policies in line with them. While implementation has often been challenging, below we provide some examples of how countries in the region are pursuing policies in line with these principles.

“Fiscal policy is the government’s most powerful tool to achieve distributional objectives. Tax and spending policies must be designed wisely to minimize any adverse effects on incentives to work, save, and invest. On the revenue side, this implies building wider, more reliable tax bases by reducing exemptions, combating tax evasion, and strengthening administration. On the expenditure side, priorities include expanding access to education and health—which will bolster equality of opportunity—and better targeting of social benefits to the poor.”

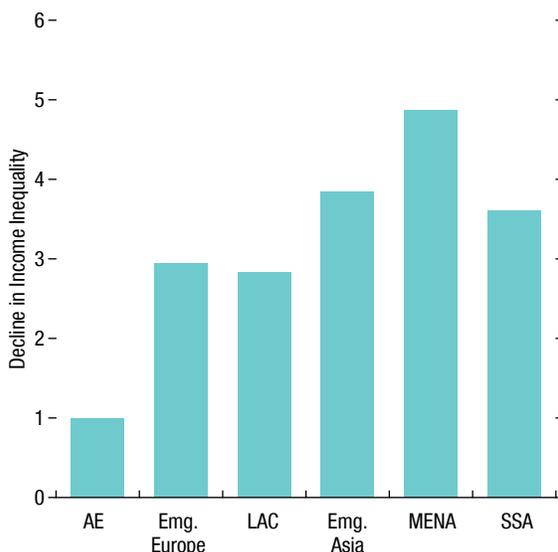
Christine Lagarde, IMF Managing Director

Priority 1. Prioritize spending that generates opportunities for all

Better quality and, where it is low, higher levels of health and education services can reduce inequality and spur long-term growth potential by raising human capital of all citizens. The expansion of education opportunities already contributed to a significant reduction in income inequality in the MENA region. Over the last 15 years, improved access to education reduced the Gini coefficient by almost 5 points, more than in any other region globally (Coady and Dizioli 2017, Figure 5.14). This shows the potential for better access and improved quality of education services to narrow the gap even more going forward. By eliminating inequality in access to health services, the IMF (2017d) shows that average life expectancy in the MENA region could rise by 1.6 years, to 73 years (Figure 5.15). This is the second highest payoff next to sub-Saharan Africa. Thus, efforts should focus on increasing access to higher-quality education and health services and ensuring better outcomes. Box 10 shows how Morocco and Afghanistan are using gender budgeting to ensure policies take into account the impact of fiscal policies on girls and women.

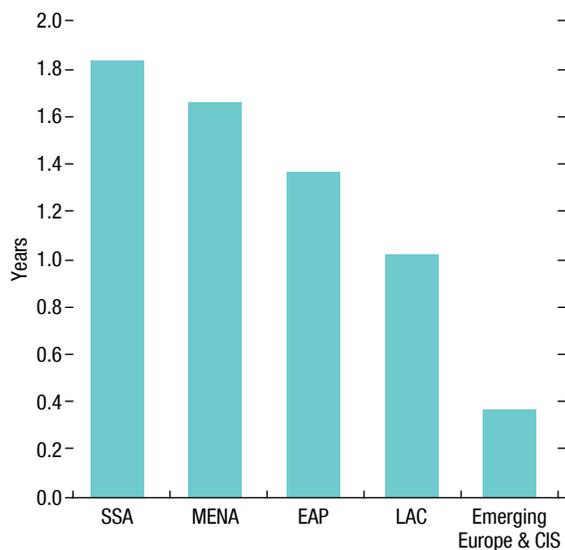
Redirecting public spending toward productive public investment can also help stimulate private sector activity and strengthen long-term growth prospects by raising worker productivity. At a time when private investment rates are also low, higher public investment, including in R&D, could lift overall investment, spur innovation, raise productivity, and ultimately lift growth. The IMF staff estimated that countries that reform their energy

Figure 5.14. Impact of Decline in Education Inequality on Income Inequality, 1990–2005
(Percent)



Source: Coady and Dizioli 2017.

Figure 5.15. Gains in Life Expectancy from Eliminating Health Coverage Inequality
(Based on latest data available)



Source: IMF October 2017 *Fiscal Monitor*.

Notes: Number of countries for SSA (37); MENA (10); EAP (9); LATAM (13); Emg. Europe & CIS (10).

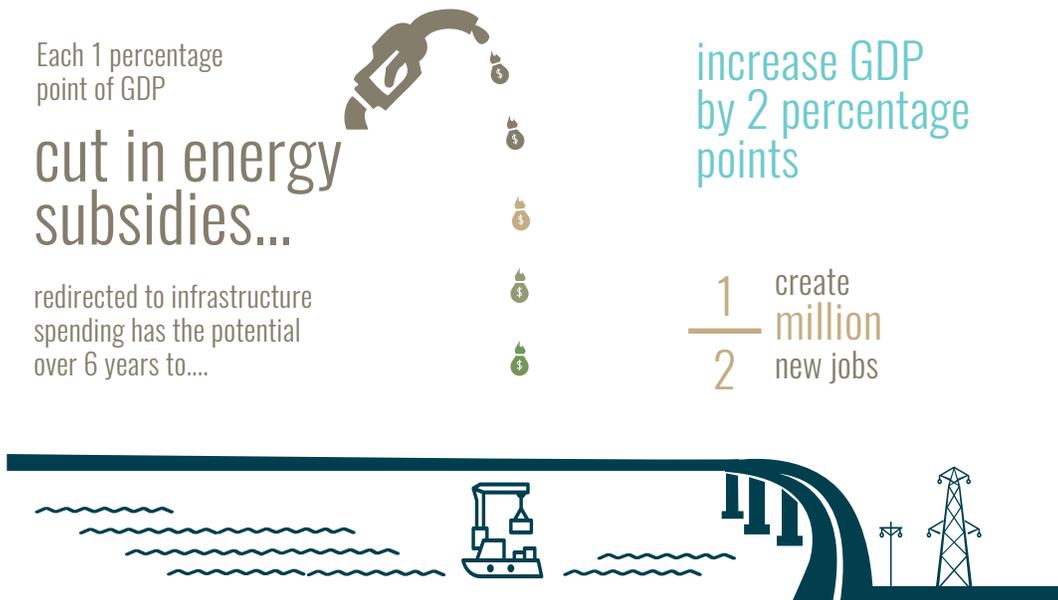
Box 10. Gender Budgeting: Ensuring that Public Spending Benefits Excluded Girls and Women

Despite recent progress, gender inequality remains entrenched in most of the MENA countries. Gender budgeting is an approach that ensures that fiscal policies are related to gender objectives and that public financial management (PFM) practices allow these policies to be operationalized efficiently and effectively (IMF 2017e).

Morocco and Afghanistan are implementing gender budgeting (Kolovich and Shibuya 2016). They prioritize budgetary spending to support national development targets to improve women’s health care and opportunities for education and paid employment. In each country, the Ministry of Finance plays an essential role in ensuring key spending ministries are implementing agreed-upon policies to reduce gender gaps. These countries also collect gender-disaggregated data to inform fiscal decision-making. While Morocco has made progress in key gender equality indicators, it still lags its regional counterparts. Afghanistan made more progress on gender equality and women’s advancement than its international comparators, albeit from a low base given its post-conflict status. Egypt and the UAE are also moving to introduce gender-based budgeting.

subsidies (estimated at around 3 percent of GDP in 2016 on average for the Arab world, including fuel subsidies) could boost output by about 2 percentage points over six years for every percentage point of GDP reduction in subsidies if the resources are redirected into productive investment (Fedelino et al. 2017) (Graphic 33). As an example, if energy subsidies were halved and the savings redirected to infrastructure, economic output could

Graphic 33. Energy subsidy reform can help spur growth and job creation.



be 3 percent higher after six years, which could create nearly 1 million new jobs in the Arab world. These estimates suggest the potential gains from the energy subsidy reform underway in the region (Box 11), though the resources freed up will not be sufficient to fund all priority infrastructure and social spending.

Box 11. How MENA Countries Are Creating Space through Energy Subsidy Reforms

All Arab oil exporters have raised domestic fuel prices, with many committing to further reforms to phase out energy subsidies and replace them with better-targeted programs. In Iran, for example, the government eliminated gasoline subsidies in 2010 and used the revenues raised to implement a universal cash transfer. Each citizen received a cash transfer of US\$45, which for large and poor families doubled incomes and resulted in the Gini coefficient falling from 0.41 to 0.37. The transfer also brought about a sharp drop in inequality in rural areas.

Starting in 2015, GCC countries have adjusted local fuel (petroleum products and natural gas) prices substantially: Gasoline and diesel subsidies have been largely eliminated in the UAE and Oman as their prices were brought close to the international level. While significant price increases have also taken place in Kuwait, Saudi Arabia, Qatar, and Bahrain, fuel prices there remain well below international levels. Algeria increased tax rates on gasoline and diesel in 2016 and 2017. Electricity tariffs were also adjusted upward in the GCC. Algeria increased the VAT for both electricity and gas in 2016, and Iraq increased electricity tariffs in early 2015, though the poorest consumers were excluded from these price increases as part of the IMF program.

Substantial energy price adjustments have also taken place in oil importers, often accompanied by mitigating measures to protect the poor and vulnerable households. Under its IMF-supported program, Egypt has increased fuel prices in line with a multiyear plan to eliminate most fuel subsidies by the end of 2018. It has also adjusted electricity prices since 2014 and plans further tariff increases over the next few years. The energy subsidy reform has been accompanied by a shifting of public expenditures toward targeted social spending to help shield the poor from the impact of the price increases. Notably, after aiding 160,000 households just two years ago, the targeted cash transfer program “Takaful and Karama” will reach 1.7 million households in 2017/18, though there is still room to improve the coverage and scope of these programs to adequately protect poor Egyptian households. Morocco and Jordan have eliminated fuel subsidies altogether using local price adjustments. Sudan and Tunisia have implemented several ad hoc discretionary changes in local prices, but have refrained from allowing full indexation to global prices. Jordan has phased out electricity and natural gas subsidies. Tunisia implemented tariff rate increases in 2012, 2013, and 2017.

Priority 2. Build wider and more equitable tax bases

Better designed tax policy is required to increase tax collections in an equitable manner to fund higher social and infrastructure spending (Jewell et al. 2015). Some options for achieving this include broadening income and consumption tax bases by reducing exemptions and concessions that tend to benefit bigger firms, multinationals, and well-off consumers (Box 12 provides examples of tax reforms underway in MENA) (Graphic 34). A priority should also be placed on raising income tax rates at the upper end. In addition, increasing (and in many countries introducing) property, wealth, and capital gains taxation would also work to improve progressivity of the tax system by capturing the assets of the wealthy in the tax net. It is not solely an issue of higher or more progressive tax rates: closing avenues for tax evasion

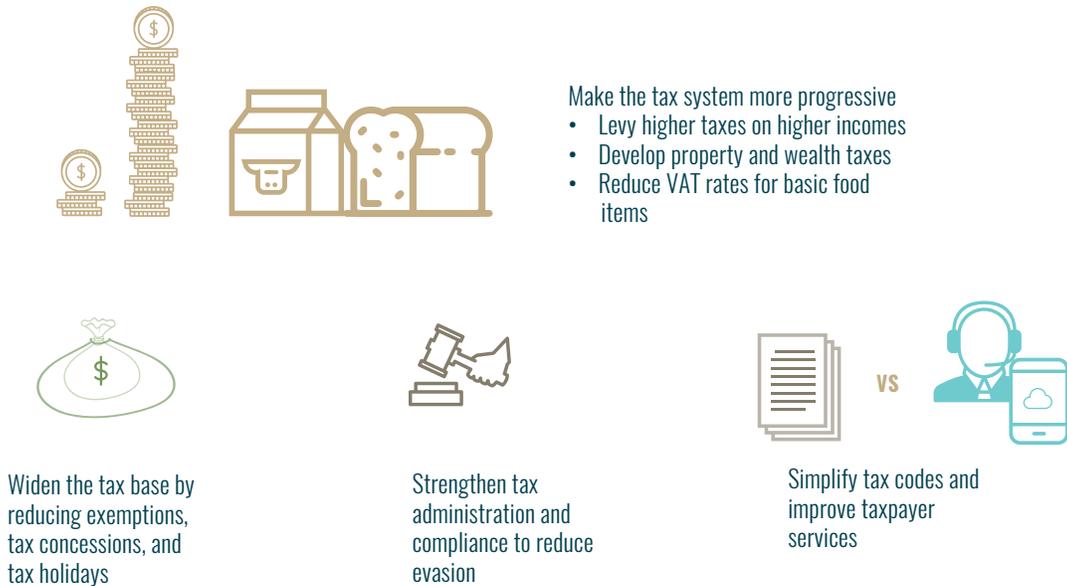
Box 12. Broadening Tax Bases while Protecting Vulnerable Groups

Jordan: The IMF is encouraging amendments to the income tax law to broaden the tax base and make the system more progressive. With about 95 percent of the population not paying income taxes, the amendments to the income tax law seek to (1) reduce the income tax thresholds for individuals and families toward international standards and (2) increase the taxation of other sources of income. The reform, if implemented, will also make the personal income tax rate schedule more progressive, aim at unifying the corporate income tax rates for nonbank corporations, and align this unified rate with the maximum personal income tax rate.

Egypt: In 2017 the authorities raised the income tax threshold and introduced substantial tax breaks for lower-income wage earners. The authorities introduced a VAT to boost government revenues with capacity support from the IMF. The new VAT included exemptions on basic products to protect the most vulnerable households. The proceeds from VAT collections are expected to create space for increased spending on food subsidies and social benefits.

GCC: Here, countries are introducing excises and a VAT to diversify government revenue and reduce budget dependence on hydrocarbon revenues. Excises target tobacco, alcohol, and sugar-based beverages. The VAT, introduced in Saudi Arabia and the UAE in 2018, has a standard rate of 5 percent, and GCC members can zero-rate and exempt basic foodstuffs, medicine, and certain sectors and services. Various government fees have been raised, and Oman has increased its corporate income tax rate from 12 to 15 percent. Additional revenues from these measures are expected to reduce deficits while protecting spending for critical infrastructure projects and finance targeted compensation mechanisms for vulnerable groups impacted by the parallel energy subsidy reform.

Graphic 34. Building wider and more equitable tax bases in MENA



and aggressive tax planning locally and via international channels could create resources and broaden the tax take and could also play an important role in enhancing the legitimacy of tax reform. Regarding consumption taxes, the VAT is one of the least distortionary taxes (IMF 2013c), and its expansion (and adoption in countries that do not have it in place) could provide an important revenue source for many MENA governments, especially if progressive income, wealth, and property taxes prove to be insufficient. Adopting a VAT registration threshold that excludes small traders (IMF 2015) and exempting basic food items essential to the poor from VAT nets in countries where the availability of effective redistributive instruments is limited could help ensure VATs do not unfairly burden SMEs and the poor. For MENA ADs that largely rely on resource revenues, the near-term focus should be on full implementation of the VAT and excises, as well as the establishment of effective tax administrations. Over time, GCC countries could consider introducing or expanding taxation of business profits and property to further reduce reliance on hydrocarbon revenue.

Steps to strengthen tax administration and improve taxpayer compliance can help broaden tax collections in an equitable manner. Stronger tax administration, simplified tax codes, and greater policy certainty would enhance revenue collections by improving incentives for taxpayer compliance and counter tax avoidance and evasion. This would also level the playing field by ensuring firms are treated evenhandedly and help bolster public support for tax and spending reforms. Furthermore, IMF (2017f) shows that both tax policy and

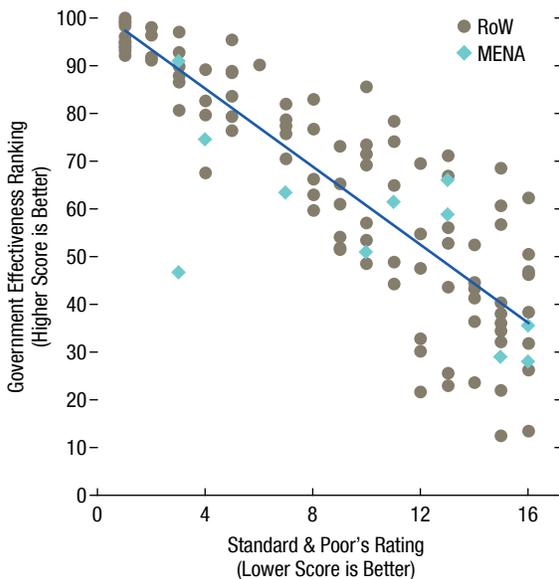
tax administration can create significant distortions in resource allocation and that making the tax system more efficient could boost firm-level productivity. The Platform for Collaboration on Tax launched by the IMF, the Organisation for Economic Co-operation and Development, the United Nations, and the World Bank offers countries in the region guidance and international experience on taxation issues, including handling issues such as cross-border tax evasion and avoidance. MENA countries should actively engage in such platforms and implement measures that, among other things, help them adhere to standards aiming to prevent base erosion and profit shifting.

Priority 3. Tackle corruption and promote transparency

Steps to improve the control of corruption, strengthen and improve the rule of law, and improve the quality and predictability of regulation would help improve governance. This, coupled with improved PFM, in turn would strengthen citizens' confidence in their governments, while also benefiting states (Box 13). Not only do these measures ensure each dollar spent goes to its intended beneficiaries, but they also help identify waste and lower sovereign borrowing costs (Figure 5.16). For example, de Renzio and Wehner (2017) review evidence on how greater citizen participation and budget openness—including evidence from field experiments in Afghanistan—can

improve public resource allocation by ensuring the public programs chosen for implementation address the preferences of the most disadvantaged citizens, and how greater openness can address leakage and tackle corruption. Recent research (Choi and Hashimoto 2017) also shows that greater transparency—promoted through the IMF data standard initiatives—led to a 15 percent reduction in the spreads on emerging market sovereign bonds. The research covered Egypt, Jordan, Iraq, Lebanon, Morocco, Pakistan, and Tunisia, four of which are subscribers to the IMF Special Data Dissemination Standard (Egypt, Jordan, Morocco, Tunisia). Comprehensive budget data allow governments and citizens to see where resources go and assess the impact on the economy and citizens. Fiscal data in the region need to cover activities of public enterprises, social security and pension funds, contingent liabilities, and arrears.

Figure 5.16. Governance Indicators and Sovereign Credit Ratings¹



Sources: Standard & Poor's; and Worldwide Governance Indicators.
¹Countries above the trend line have a better credit rating than is warranted by their government effectiveness ranking.

Box 13. Oman: A Participatory Approach to Policy Design

Oman's *Tanfeedh* (Implementation) was a process designed to seek broad input by the public and stakeholders to develop policies to support Oman's Ninth Five-Year Development Plan (2016–2020). The process was designed in collaboration with the Malaysian government's Performance Management and Delivery Unit. Through a series of workshops, or "Labs," that lasted six weeks, *Tanfeedh* brought together high-ranking public officials and representatives of the private sector, academia, and civil society to discuss the main obstacles, identify solutions, and agree on a timeframe for implementation while setting key performance indicators for each sector. The "Labs" identified 121 initiatives in the five sectors that aim to enable economic diversification and improve government regulations. The initiatives were subsequently presented in a three-day exhibition open to the Omani public. *Tanfeedh* is expected to release its first annual report in April 2018 (www.tanfeedh.gov.om).

Improving data on income distribution, including through timely and comprehensive household surveys, can facilitate fiscal incidence analysis to assess the distributional impact of proposed fiscal and structural reform policies. This can better inform policy choices and the design of mitigating measures to protect the vulnerable and those adversely impacted by reforms.

Greater use of technology can help improve transparency, lower administrative costs, and ensure better targeting. For example, e-cash transfers can lower the cost of providing social assistance and promote financial inclusion. Similarly, open source platforms can improve access to high-quality education at a lower cost (Fiscal Forum 2017). The use of information and communication technologies to collect and disseminate household social and economic survey data can allow policymakers to better assess the redistributive impact and voice of fiscal policy choices. Transparency and accountability and participation in the decision-making process can also strengthen citizens' trust (Box 13).

Priority 4: Increase international support to countries emerging from conflict and managing refugees

As noted in Chapter V, countries in conflict and those hosting refugees face deeper challenges in promoting inclusive growth and opportunity for all. Conflict has undermined macroeconomic stability and created uncertainty throughout the region, which has affected business and household confidence. Nonetheless, countries like Iraq provide an example of how fiscal reforms are helping create space for the costs of reconstruction and for the needs of its vulnerable (Box 14).

Countries coping with large inflows of refugees have faced a number of challenges, including strains on local infrastructure, public services quality, and public finances, as well as intensified domestic labor markets problems. Lebanon, for example has increased the size of its public education system by almost 50 percent since 2011, largely because of the conflict in Syria. In Lebanon, refugees make up almost one-third of the total enrollment in education (World Bank 2017b).

Countries in conflict and those experiencing large inflows of refugees need the support of the international community. The priorities are to address specific challenges associated with conflicts and their cross-border spillovers to protect economic institutions, continue to provide basic public needs, attend to the immediate needs of the affected populations, and fund the related costs, including those related to reconstruction needs (Rother et al. 2016).

Box 14. Iraq: Implementing Fiscal Consolidation while Safeguarding Social Spending

The Iraqi authorities have embarked on a necessary fiscal consolidation that aims to reduce public expenditures to sustainable levels in line with lower oil prices. The government's reforms are being supported by a three-year Stand-by Arrangement (SBA) from the IMF.¹

Mindful of the impact on the poor, these reforms aim to protect social spending. To this end, the SBA includes a floor on social spending (i.e. current health and education spending); food subsidies; and cash transfers to the poorest, internally displaced people and refugees. The government's reforms also aim to contain other spending. This includes reducing the oversized public sector wage bill in the least socially painful way, such as through natural attrition and nominal wage freezes, rather than layoffs. Another objective is to reduce the generosity of the unbalanced public pension system to make it financially sustainable and create incentives for private sector employment.

The authorities are tackling the need to raise non-oil revenues to create fiscal space for investment and reconstruction. This has two main elements: broadening the base for the personal income tax for the higher-paid two-thirds of government employees and taxing goods and services mostly consumed by people who are better-off (mobile phones, internet access, shopping mall sales, restaurant and hotels, cars, alcohol, tobacco, soft drinks). Also, savings that could be redirected to investment are expected through better targeting of social transfers and gradually increasing electricity tariffs for all but the poorest.

¹The SBA in an amount of \$5.3 billion was approved by the IMF's Executive Board in July 2016.

The reconstruction needs of countries affected by conflicts should be addressed more forcefully. The World Bank has estimated the damage from the conflicts in Libya, Syria, and Yemen at about US\$300 billion (World Bank 2017b). Once conditions allow, there will be a need for speedy and well-coordinated reconstruction. Countries' efforts will need to be complemented by sizable support from the international community.

The call of the 2014 Amman conference to generate robust growth, create jobs, provide equal opportunities and protect the poor is more pressing than ever. As described in this paper, more than 27 million young people from the region will join the workforce over the next five years with little certainty of finding a job, and that is particularly true for women.

It was with that sense of urgency that officials and experts from 20 countries gathered in Marrakesh in January 2018 in an effort to build on the progress to date. The work presented in this paper is a reflection of the steps taken since Amman, and expanded upon in Marrakesh, by the IMF and its MENA member countries on the inclusive growth agenda.

Efforts have also been made to deepen policy diagnosis and capacity building in the IMF's core areas of expertise to reflect the key components of this agenda. For example, Article IV consultations covered issues such as women's economic empowerment and inequality in Djibouti, Iran, Jordan, Mauritania, Morocco, Pakistan, and Sudan.

In IMF-supported programs, initiatives to address inclusive growth challenges and better protect the vulnerable from the impact of reforms included social spending floors, higher budget resources for child care services, or support of anti-corruption measures in Afghanistan, Egypt, Iraq, Jordan, Pakistan, and Tunisia.

Meanwhile, the Middle East Technical Assistance Center in Lebanon supported inclusive growth reforms in Algeria, Egypt, Iraq, Jordan, Lebanon, Morocco, and Sudan. The IMF Middle East Center for Economics and Finance (CEF) in Kuwait offers training on inclusive growth theory and policies.

At the IMF, our efforts during the period ahead will focus on helping countries in the region take the ACT NOW principles to the next level—that of implementation. This paper, we hope, will serve as a key milestone for guiding the journey from Amman and Marrakesh to a future of prosperity and inclusion for all people in the region. It has benefited from inputs not only from those who attended the Marrakesh conference but also from consultation with representatives of international, regional, and national civil society organizations (Box 15).

The process of scaling up and speeding up the implementation of the inclusive growth agenda will, however, be a shared responsibility. While international financial institutions must better assist countries, they need to do so in partnership with country governments and others. This would ensure policies are better tailored to country-specific needs. Working in tandem with other stakeholders would better leverage respective expertise and ensure greater scope for synergy and complementarity to improve the design and implementation of reforms. Firms and civil society also need to do their part, not only to spur the development of the private sector and ensure accountability, but also to work collectively with policymakers to propose and design solutions that can drive economic prosperity for all.

Box 15. Views of Civil Society Organizations

The IMF staff consulted with representatives of international, regional, and national civil society organizations (CSOs).¹ The main points raised by CSOs are summarized in this box, and their feedback has been reflected in the paper.

CSOs welcomed the paper and broadly agreed with the main diagnosis that the region needs to foster higher and more inclusive growth and job creation. While CSOs recognize that the region can benefit from giving more space to the private sector, they see corruption, weak rule of law and accountability, excessive spending on the military, and the slow pace of political reforms as the reasons for the lack of tangible progress in achieving inclusive economic reforms. They also affirmed that achieving inclusive growth requires implementing policies that take into consideration economic, social, and environmental rights, and urged the IMF to pay more attention to these issues, including the political economy of the countries in the region.

CSOs pointed out that a large public sector may have been crowding out the private sector, thereby hindering the quality of jobs in the private sector, but they stressed the need for the public sector to ensure equal access to public services of good quality, particularly in education and health. They also cautioned that reforms of the public sector, including the management of the public wage bill, should be done by increasing efficiency and improving the quality of public services rather than focusing on cutting wages and employment. CSOs also emphasized that sequencing would be crucial to the success of the reforms. Public wage bill reforms need to be preceded by reforms to boost the private sector, create jobs, and provide social protection.

They recognized that fostering private sector development will require wide-ranging action. Notably, on promoting SMEs, they stressed that even more than access to finance, SMEs would need support in product development (R&D), logistics, marketing, and soft skills. They cautioned that fostering entrepreneurship through self-employment was not a silver bullet for job creation. They agreed with the need to better leverage technology, but suggested that countries should first and foremost focus on improving educational outcomes and invest in infrastructure. Moreover, they sug-

¹CSOs participated in the regional IMF conference “Opportunity for All: Promoting Growth, Jobs, and Inclusiveness in the Arab World,” where they shared their views on the various issues raised in the paper. The draft paper was then shared with CSOs for their input through a consultation call and written comments. CSOs that commented on the paper are Egyptian Initiative for Personal Rights, Forum Tunisien pour les Droits Economiques et Sociales, Phenix Center for Economic and Informatics Studies in Jordan, Transparency Morocco, Arab NGO Network for Development, Akkad Center for Strategic Affairs and Future Studies in Iraq, Libyan Transparency Association, Oxfam International, L’Espace Associatif in Morocco, Tahrir Institute for Middle East Policy, Shoumo’ for Equality Organization in Morocco, Studies and Economic Media Centre, Transparency International Jordan, General Federation of Jordanian Trade Unions, Bretton Woods Project.

Box 15. Views of Civil Society Organizations (continued)

gested that the paper could cover more the effects of the global economic environment and trade on the economies of the region.

CSOs recommended that the IMF focus more intensively on tax reform, especially the promotion of fair taxation. They suggested that the effort to improve fiscal transparency should be part of a broader strategy to foster sustainable and long-term reforms, rather than small and ad hoc reforms. CSOs stressed the need for countries in the region and the IMF to focus more on progressive direct taxation and less on indirect taxation, such as VAT. They also suggested that the IMF should tackle more rigorously the issue of international taxation and the issue of tax avoidance through offshore centers to minimize increases in tax rates. The IMF could also focus more on developing tools to promote transparency, governance, and anti-corruption.

On the role of women and their participation in the labor market, CSOs identified the lack of decent jobs, regulations that provide disincentives (loss of benefits), transportation, and the high gender wage gap in the private sector as factors that provide disincentives for women to participate. They mentioned that gender budgeting is a useful tool and could be used in IMF programs where relevant.

CSOs underscored that obtaining higher and more inclusive growth may be elusive as long as various conflicts rock the region. They emphasized that achieving durable peace is a necessary prerequisite for improving conditions and called for greater assistance for countries bearing the brunt of the refugee crisis. CSOs believe that it is important to explore further the link between inequality and conflict, both looking at inequality as a driver of conflict and the impact of conflict on increased inequality.

They stressed the need for governments to address issues of rent seeking, corruption, and cronyism, and to move forward with reforms. This would not only contribute to building public trust, which will in turn support reform efforts, but also foster the creation of conditions for greater competitiveness and regional integration. At the same time, they detected a lack of political will to reform, which in their view has been delaying overall reform efforts. In general, they saw it as important to provide voice and consult different stakeholders in the reform process. They also suggested that further analysis could be done on the link between governance and economic growth.

CSOs saw their roles as partners in the effort to foster inclusive growth in the countries of the region, including on topics such as tax reforms. The marginalization of civil society was therefore regrettable, as it would risk exacerbating frustration among the young population. CSOs saw their role as contributing to enhanced accountability and transparency, for example through holding public hearings, tracking public spending and its uses, or pushing for participatory budgeting. They could also support the collection of micro-level data that help in decision-making. They called on the IMF to use its convening power to foster dialogue between the different stakeholders, including CSOs.

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