Overview

The Middle East and North Africa Region (MENA)[1] is undergoing a remarkable period of high economic growth. In parallel with that growth, job creation has increased and unemployment has declined. In view of the rapid expansion of the labor force—the fastest in the world—this is a remarkable feat. The private sector is becoming the main source of new jobs as the share of domestic and foreign private investment increases. However, outcomes are uneven—not all countries are benefiting during this remarkable period of expansion. Women are participating more in economic life but consistently fare worse than men. Productivity growth, the key to long-term growth in incomes, remains low, and sectors with high value added are not the ones creating the majority of the new jobs. The region faces the dilemma of quality vs. quantity of jobs it produces. The private sector will be operating within the context of greater integration into global markets. This signals the emergence of new engines of job creation that, however powerful, may be volatile. It also points to the need for better education systems to prepare workers for a more competitive environment and safety-net mechanisms to address the needs of those that may be left out. Overall, MENA countries have the opportunity to use the current economic boom to advance their reform agenda.

Economic Developments and Prospects

For the fourth year in a row, the MENA region enjoyed a robust pace of economic growth. Strong oil revenues, along with the ongoing European recovery, a more dynamic private sector, and a shift toward more investment provided the momentum needed for another year of first-rate economic performance. Real GDP increased by 6.3 percent in 2006, up from 4.6 percent during the first four years of the decade. Indeed, the region's growth performance in 2006 was one of its best since the 1970s. Growth in 2006 was driven by the continued strong momentum of the MENA Region's *resource-rich, labor-importing* countries and the improved performance of *resource-poor, labor-abundant* countries, while growth in *resource-rich,*

[1] The region consists of resource-poor, labor-abundant economies (Arab Republic of Egypt, Jordan, Morocco, Tunisia, Lebanon, and Djibouti); resource-rich, labor-abundant economies (Algeria, Islamic Republic of Iran, Iraq, Syrian Arab Republic, and the Republic of Yemen); and resource-rich, labor-importing economies (Saudi Arabia, United Arab Emirates, Kuwait, Libya, Qatar, Oman, and Bahrain).

labor-abundant countries stagnated at about the levels reached in 2005.

On a per capita basis, the region grew at an average of 4.2 percent in 2006, the highest level recorded in at least two decades. Given the rate of population growth in the region, this is a remarkable achievement. While recent poverty data are not yet available, the sustained growth performance is likely to have reduced poverty levels.

The current pace of growth has narrowed the gap in per capita income growth between MENA and other developing regions. Over the second half of the 1990s, growth of real per capita income averaged 1.7 percent in MENA. That level was 61 percent of the growth attained by low- and middle-income developing countries as a whole. By 2006, MENA's real per capita income was growing at nearly 75 percent of the aggregate rate. This change is welcome, but it is not enough to close the income gap with other regions. Prospects for sustaining growth in MENA at current or higher rates over the coming years will depend on advances in the structural reform agenda—where progress has been uneven—and on the growing role of the private sector. In the near term, advancing reforms remains a substantial challenge for policy makers in the region.

In contrast to the strong regional growth performance, industrial production turned from gains of 4.1 percent in 2005 to a decline of 0.4 percent in 2006, largely as output of hydrocarbons faced capacity constraints. Among the *resource-rich, labor-abundant* countries, industrial production declined by 2.3 percent in 2006. For *resource-rich, labor-importing* countries, the decline was moderate, at 1.1 percent during the year. In contrast, industrial production accelerated in *resource-poor, labor-abundant* countries to 3.4 percent.

Despite the downturn in oil production and the turnaround in the world oil price[2] from peaks of more than $70 per barrel in August 2006, revenues for the oil exporters continued to build. Hydrocarbon receipts in 2006 rose by more than $75 billion over the 2005 figure, reaching $510 billion. Surplus funds among the oil exporters and the availability of new investment opportunities across the region (some generated by ongoing reforms) boosted flows of foreign direct investment (FDI) to new highs of more than $24 billion in 2006. FDI in the past year was concentrated in the region's *resource-poor* countries (except Djibouti), where the share of FDI in GDP quadrupled from 2004. FDI also was high in the United Arab Emirates (UAE).

Domestic demand continues to be the main source of growth in the region, but investment has risen markedly. The contribution of gross domestic investment to GDP growth almost doubled in 2006, from 2.6 to 4.1 GDP growth points. In addition, private investment as a share of GDP has been increasing, signaling a shift toward more private-sector led growth.

Several factors are likely to shape the profile for growth in the MENA region over the medium term. The external environment is expected to be fairly conducive during 2007–09. At the same time, domestic conditions will vary decidedly across the region, as will efforts at reform. The flux of political tensions could affect the confidence of global and regional investors as well as oil-market conditions. On the other hand, if conflicts were to subside the peace dividend could be significant, boosting growth prospects, incomes, and development.

Labor Market Outcomes

During 2000–05 the MENA region experienced record levels of economic growth, which had strong effects on labor markets. Job creation accelerated, unemployment declined, and women increased their participation in the labor force. While the overall picture is positive, regional aggregates mask the diversity of results at the country level.

Between 2000 and 2005, the region's aggregate unemployment rate fell from 14.3 to 10.8 percent of the labor force, narrowing the gap between MENA and other developing regions. In view of the massive expansion of the labor force, the decrease in unemployment is a remarkable achievement over a short period. But not all of the news is good. Although unemployment has come down in 8 of the 12 countries for which data are available, it is stagnating in Jordan and rising in Kuwait and UAE, albeit from very low levels. Political instability has pushed up unemployment rates in the West Bank and Gaza, which, with Iraq, has the most severe unemployment problem in the region.

Higher growth has delivered many new jobs. Falling unemployment amid rapid growth of the labor force is evidence of high job creation, which reached 4.5 percent on an annual basis during

[2] The World Bank average oil price is a simple average of Brent, Dubai, and WTI crude prices.

2000–05, the highest among all developing regions. All of the 12 MENA countries for which we have data have enjoyed job growth in recent years—in most the growth has been considerable. *Resource-poor* countries are at the low end of the spectrum of job growth; *resource-rich* countries at the high end. Gender differences in employment rates also have declined, but youth, traditionally underrepresented among the region's employed, are barely keeping up with advances for other age groups. Despite the strong job growth, MENA still employs only a small share of its potential workforce. The region's *employment* rate—the share of the working-age population that is actually employed—is only 47 percent, the lowest in the world.

Perhaps the single most important transformation affecting MENA's labor force in the past few years is the increasing presence of women workers. While not much growth could be reasonably expected among men, given already-high participation rates, female participation rates have continued their rapid acceleration, albeit from low baselines. The *resource-rich, labor-abundant* countries are seeing the clearest changes. In Iran, women's participation in the labor force rose from 33 to 41 percent in five years, a phenomenal leap. In 1990, participation rates for women in Iran were below MENA average; by 2005, they were the third-highest in the region. Participation rates also increased substantially in Algeria and Syria. On net terms, the boost in labor force growth since 2000 was entirely due to the arrival of women in the region's labor markets. Nevertheless, because women are still less successful than men in finding jobs, women's unemployment is growing alongside their employment. Nor is higher education any guarantee of labor market success—especially not for women.

Currently, the region's labor markets are at the extreme of developing countries. The region has the highest levels of labor force growth, the lowest levels of female participation, and, except for Sub-Saharan Africa, the youngest labor force. The age profile of the region's labor force is fast approaching that of South Asia and Latin America, but MENA will continue to face a job creation challenge greater than that of any other region except Sub-Saharan Africa. By the end of the next decade, women's participation rates will have drawn close those of South Asia, but still will be the lowest of all developing regions. MENA's total labor force participation rates will remain the lowest of any developing region.

What are the characteristics of the new jobs in the region? On the one hand, the new momentum in job growth has not touched some of the traditional characteristics of MENA jobs. Employment elasticities remain high, for example, indicating that growth in labor productivity continues to be low. On the other hand, labor demand in the public sector is slowing, and most new jobs are in the private sector, mainly in services. Although the services sector has accounted for most new jobs in MENA, the agricultural sector continues to play an important role. In the Islamic Republic of Iran, for example, agriculture provided half of the new jobs in the recent period, while in the Arab Republic of Egypt and Morocco it provided two-fifths and in Algeria, one-fifth. Rapid expansion of female employment in these countries may be traced to the expansion of employment in the agricultural sector and in low-skills services (in Algeria), meaning that women are not really gaining good jobs.

Despite the negative overall relationship between employment and productivity growth in the region, several countries are generating jobs in sectors where productivity is also increasing. The expansion in jobs in the services sectors, and to a limited degree in the industrial sector, has been accompanied by some gains in productivity in most countries. However, there are too many cases of job creation with declining productivity, notably in the countries with the highest job growth. The agricultural sectors in Iran, Egypt, and Algeria all have seen important drops in productivity as employment has increased.

Job creation will remain a priority for MENA countries for the foreseeable future. What will it take to meet the employment challenge? The vast majority of the needed jobs must come from within MENA's economies. Migration provides an important mechanism for risk diversification and income growth, but the sheer size of the job challenge means that labor demand abroad cannot fill the employment gap. Thus, the region must maintain through 2020 the exceptionally high rates of employment growth seen in recent years, while advancing reforms to provoke even greater job creation, particularly by the private sector. At the same time, the employment creation engine must be tuned to provide more of the type of jobs that can raise workers' income. That in turn depends on boosting workers' productivity.

If MENA is to shift to a pattern of high job growth reinforced by rising productivity, economic growth rates will need to remain strong and even increase. Historically the region's high employment elasticity implied strong job creation in times of fast economic growth but, as noted above, most of the new jobs appeared in low-productivity activities. In a sense, MENA faces a dilemma of quantity vs. quality of jobs. Continued high demographic pressures will push for quantity. But if policy makers wish the improved employment picture to survive a fall in oil prices, they must not ignore job quality. Although the reform process has picked up speed in some countries, it is still moving too slowly to deliver sustained growth at levels that could significantly raise productivity while simultaneously creating jobs (as in East Asia). Moreover, to move to a model of high productivity growth, MENA would need to expand reforms to include efficient safety nets to protect those who may be left behind, even if only temporarily, by structural changes. Labor policy must strike a balance between these two fundamental objectives—protecting workers from the risks of unemployment, lost income, and poor working conditions, and encouraging job creation and the allocation of labor to its most productive uses.

Structural Reform

Strong oil revenues and oil-related wealth, along with Europe's ongoing recovery, provide the momentum for continued robust growth in the MENA region over the short term. Over the longer term, however, MENA economies will have to make comprehensive structural changes to deliver the strong growth needed to meet the region's employment challenge. Particularly critical are improving the climate for private investment, opening economies to greater trade, and improving governance mechanisms across the board for greater public sector accountability and inclusiveness, as well as improved public sector efficiency.

MENA countries have moved their structural reform programs forward over the past six years. On the trade front, as regional and bilateral trade agreements proliferate, regional economies have significantly reduced tariffs and nontariff barriers to imports. Overall, the region ranks second among developing regions on tariff reforms carried out since 2000, trailing only Europe and Central Asia. Less progress has been made in improving the business climate, though MENA countries have undertaken various measures, including the liberalization of key services in the economy, across-the-board business and regulatory policy reform, and targeted interventions to promote specific sectors.

But the path to creating an environment conducive to export-oriented businesses and private sector investment remain far from complete. On the trade front, outside the Gulf Cooperation Council, tariff protection remains excessive, especially among the region's *resource-poor* countries, and significant barriers to developing a strong trading sector persist in the form of cumbersome import- and export-clearing processes. The overall business climate remains weak, with significant impediments to conducting business, especially in key areas such as starting a business, protecting investors, and enforcing contracts.

Many of the region's development challenges are traceable to significant deficiencies in governance. Often efforts to overcome those deficiencies have focused on reforming public administration, both to improve efficiency in the delivery of high-quality public services and to generate fiscal savings. But several countries have gone further, taking important steps to open up their political space, allow for greater public accountability, and strengthen inclusiveness in public policy making, all areas in which MENA continues to score poorly in world rankings. Over the past six years the region as a whole has made some progress in reducing this governance gap. Between 2000 and 2006, MENA countries ranked on average in the 63rd percentile on improving the mechanisms for government accountability, higher than all other regions of the world, with particularly strong efforts among *resource-poor* countries and *resource-rich, labor importing* countries.

While the recent oil boom has greatly benefited the oil-producing economies of the region through higher growth and revenues, the potential impact of the oil boom on the ongoing structural reform effort has been an important concern. Though information is scant, there is some indication that the incentives for sweeping improvements in public sector management have faded with rising oil prices. Although *resource-poor* countries have made strong progress in administrative reform, many of the region's oil economies have failed to make significant efforts to improve public sector management.

In the area of enhancing public sector accountability a significant divergence between MENA's

Table 1: Progress with structural reform

Country/region	Trade policy		Business climate*		Governance: quality of public administration		Governance: public sector accountability	
	Current status[a]	Reform progress[b]	Current status[a]	Reform progress[b]	Current status[a]	Reform progress[b]	Current status[a]	Reform progress[b]
Algeria	68	63	36	37	43	16	28	68
Bahrain	—	76	—	—	78	80	27	96
Djibouti	17	47	9	—	—	—	—	—
Egypt, Arab Rep. of	60	100	2	59	34	91	23	73
Iran, Islamic Rep. of	16	67	26	2	17	11	21	6
Iraq	—	—	33	—	—	—	—	—
Jordan	44	94	59	41	71	87	34	62
Kuwait	69	54	77	16	65	64	30	63
Lebanon	50	80	40	46	—	—	—	—
Libya	—	9	—	—	3	13	0	43
Morocco	52	50	38	76	72	91	32	78
Oman	51	43	79	27	66	80	17	89
Qatar	—	—	—		54	69	15	75
Saudi Arabia	64	88	76	75	59	80	6	75
Syrian Arab Rep.	2	32	33	52	14	59	6	54
Tunisia	53	42	55	40	69	76	22	37
United Arab Emirates	75	—	54	20	61	10	20	84
West Bank and Gaza	—	—	22	—	—	—	—	—
Yemen, Republic of	63	82	66	26	27	23	18	48
Regional averages (unweighted)								
MENA	49	62	44	40	49	57	20	63
Resource-poor	46	69	31	54	61	86	28	63
Resource-rich, labor-abundant	37	61	39	29	25	27	18	44
Resource-rich, labor-importing	65	54	71	34	55	57	16	73
East Asia and Pacific	53	40	64	46	45	45	41	44
Europe and Central Asia	50	64	55	59	50	56	52	56
Latin America and Caribbean	64	57	47	54	44	43	57	42
High-Income OECD	84	61	84	49	89	47	91	47
South Asia	28	41	40	24	33	56	37	31
Sub-Saharan Africa	26	22	27	51	33	51	36	52
World	50	50	50	50	50	50	50	50

Source: World Bank staff estimates.

Note: For definitions of MENA country groups, see footnote 1.

a. For each index, the country's current status reflects its 2006 placement in a worldwide ordering based on a variety of relevant indicators, expressed as a cumulative frequency distribution, with 100 reflecting the country with the "best" policies worldwide, and 0 representing the country with the "worst" policies worldwide.

b. Reform progress reflects the improvement in a country's rank between 2000 and 2006 (or between 2003 and 2006 in the case of business and regulatory reform) in a worldwide ordering of countries based on changes in a variety of relevant indicators, expressed as a cumulative frequency distribution, with 100 reflecting the country with the greatest improvement in rank worldwide, and 0 reflecting the country with the greatest deterioration in rank worldwide.

***** The business climate index reported in this year's MENA Economic Developments and Prospects Report has been substantially revised (reflecting both changes in the indicators used and considerable revisions to historical data) and is not comparable with the index that appeared in last year's MENA Economic Developments and Prospects report.

— = not available

labor-abundant oil economies and its *labor-importing* oil economies is notable. Since 2003, many of the *resource-rich, labor-importing* economies of the GCC have begun to exhibit a strong commitment to improving government accountability. In parallel with their efforts toward more prudent management of their oil windfall and stronger economic ties with the world, Oman, Qatar, Saudi Arabia, and the UAE have taken significant steps toward greater inclusiveness and accountability in government. It is a significant and encouraging sign that rising oil prices have not blunted these efforts. MENA's *labor-abundant* oil economies, on the other hand, generally have not moved forward with improvements in public sector accountability since 2003. Creating more inclusive and representative governance structures is influenced by forces other than rising oil prices, but given the importance of this topic in the overall reform agenda, the significant backsliding of a few countries represents a concern for the broader reform agenda, because it casts a shadow over prospects for growth in the long term.